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COVID-19, Courts and Recovery Through Alternatives to Bankruptcy

Unprecedented mass business shutdowns have detonated a chain reaction of unparalleled mass breaches of contract and lease defaults throughout the economy, dwarfing those of the Great Recession.



By Jonathan W. Hugg | April 29, 2020 at 01:34 PM

The legal aftermath of the epidemic is a threat to our recovery. “Business as usual” will likely prove impossible, considering the volume of litigation and the limited budgetary resources expected for courts during the recovery period. Meanwhile, unprecedented mass business shutdowns have detonated a chain reaction of unparalleled mass breaches of contract and lease defaults throughout the economy, dwarfing those of the Great Recession.

In normal times (which of course these are not), it would take years for lawyers to litigate and for courts to adjudicate who ultimately must bear the burden of these colossal losses. The prolonged uncertainty and expense would in turn risk destroying the business operations we need to restart the economy. Despite the availability of aid, especially if closures continue deep into this spring and if consumer confidence remains low, the depletion of cash reserves and strain on credit lines will push to the brink companies that just months ago had sound or even robust balance sheets.

Under these circumstances, many otherwise strong and viable companies may consider looking to bankruptcy for protection. The likely outcome could be wasteful and painful liquidation or reorganization, ruinous personal liability for their guarantors and owners, and minimal or no payment for their creditors.

There must be a better way to handle the needs of financially stressed businesses during the upcoming recovery. Commerce-oriented court programs could help avoid this quagmire. By facilitating the speedy and fair settlement of commercial claims arising from the epidemic, courts could help businesses preserve value, avoid bankruptcy, save jobs and foster a return to near normalcy. The key is for courts to impose new case management procedures that allow for early and aggressive mediation of coronavirus-related contract and lease claims and similar disputes. The time to begin discussion about the efficacy and scope of this approach is now, before courts return fully to operational status and must address not only the backlog of pre-pandemic cases, but also the inevitable flood of new claims caused by COVID-19.

State courts and federal district courts could help save these companies, maintain employment, and assure debt repayment to creditors by offering special case protocols that help businesses quickly negotiate agreements and restructure their coronavirus-related debts outside of

bankruptcy. These programs will also make court dockets more manageable. The Residential Mortgage Foreclosure Diversion Program established by Philadelphia's Court of Common Pleas during the Great Recession could offer a model. Beginning in 2008, under the leadership of former Judge Annette Rizzo, the court mandated face-to-face settlement meetings between lenders' attorneys and distressed homeowners facing sheriff's sale. The point was to put the parties into a structured setting, force them to discuss a good faith resolution, and maximize the likelihood of a settlement whereby the homeowner maintained possession but also restarted mortgage payments. The program has saved thousands of homes and courts across the country have copied it.

Similar COVID-19 commercial conciliation programs could save thousands of businesses. A plaintiff creditor or defendant debtor (or both) could designate its case as coronavirus related by alleging that, but for the financial impact of the epidemic, the case would not exist. A judge could triage these matters, decide eligibility, schedule the case for prompt, face-to-face mediation and address any requests for interim relief. A volunteer lawyer or financial professional conversant with commercial debt workout issues would referee negotiations. The objective would be to push the parties toward an early, enforceable resolution consistent with their contract, whereby the plaintiff creditor would receive prompt payment and avoid years of litigation, and the defendant debtor would remain in business and have an opportunity to recover. The normal litigation process will remain for those cases that do not settle. In Philadelphia, the widely emulated Commerce Court would be the natural administrator of this program.

The abnormal damage caused by COVID-19 to our business community is the definition of "arbitrary and capricious." Our legal response to this unforeseeable, universal trauma must be thoughtful and fair if we are fully and rapidly to recover. Early, court-mandated business mediation is the most efficient and just device for swiftly adjusting COVID-19-related claims and putting the pandemic behind us so that prosperity may return.

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