

# OUT OF THE ABYSS:

## *Bankruptcy and Restructuring After the COVID-19 Pandemic*



*Live Presentation For:*

Media Finance

**FOCUS**

MFM bcca 2022

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# ***Where Have All The Bankruptcies Gone?***

**A discussion about the severe inflation plaguing the U.S. economy, the macroeconomic factors that have kept distressed companies alive during and after the most abrupt economic downturn in history, the current economic shift that is likely to drive a new wave of chapter 11 filings – and why things are likely to be much worse when distressed companies finally go off the cliff**



Economic Report

## Inflation rate slows to 8.3% after gas prices fall, but consumers still face rapidly rising costs

Last Updated: May 11, 2022 at 9:34 a.m. ET

First Published: May 11, 2022 at 8:38 a.m. ET

By [Jeffrey Bartash](#) [Follow](#)

**Core CPI rate of inflation preferred by Fed rises by higher than expected 0.6%**

<https://www.marketwatch.com/story/u-s-inflation-rate-slows-to-8-3-cpi-finds-after-hitting-40-year-high-11652272713>

# US Producer Prices Rise More Than Forecast in Sign of Persistent Inflation

- PPI rose 11% in April from a year ago, 0.5% from prior month
- Goods inflation led the increase, including cars, diesel, eggs

<https://www.bloomberg.com/news/articles/2022-05-12/us-producer-prices-rose-by-more-than-forecast-in-april>



# Supply Costs Continue Rising

FRED — Producer Price Index by Commodity: All Commodities



Prices of **just about every commodity** are rising, some **doubling or more** year over year.

Overall Producer Price Index (PPI) **rose 11%** over the twelve months ending April 30, 0.5% month-over-month

Despite energy volatility due to the Russian war on Ukraine, energy prices actually softened somewhat in April.

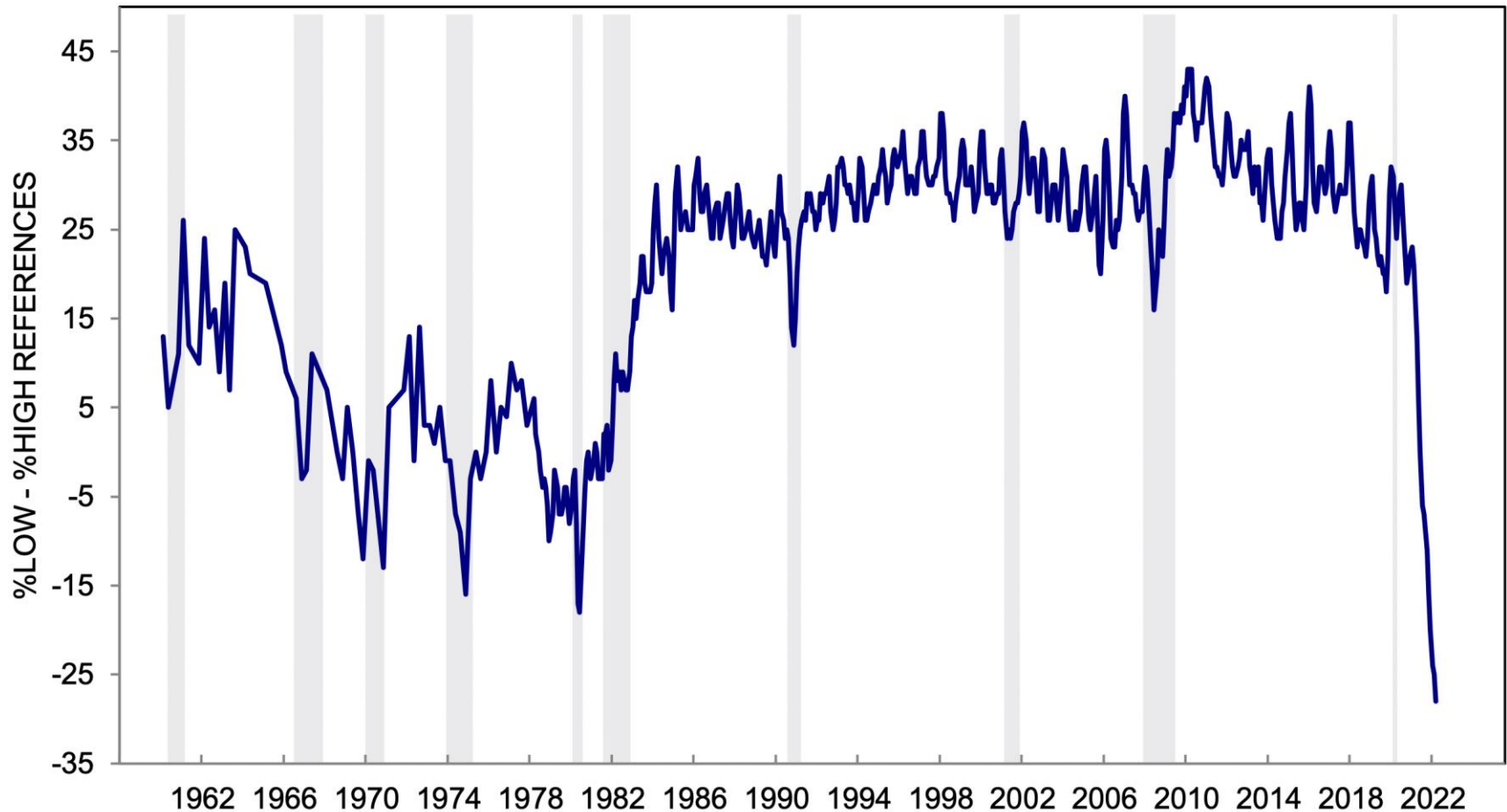
The Russia-Ukraine conflict has also caused significant volatility in some agricultural commodities.

Labor shortages, rising labor costs, and recurring COVID waves in the US and China have **disrupted entire supply chains**, causing shortages of input goods, transportation delays, and manufacturing slowdowns, all with **ripple effects** throughout the rest of the manufacturing and distribution processes, **all the way to retail store shelves..**

There is **not a lone root cause** for price spikes. The issue is systemic and will take time to resolve – stimulus cash and extended unemployment have crowded out private employers, many workers fear returning, and many continue battling over vaccine mandates.

# Inflation is drastically impacting consumer sentiment and purchasing plans.

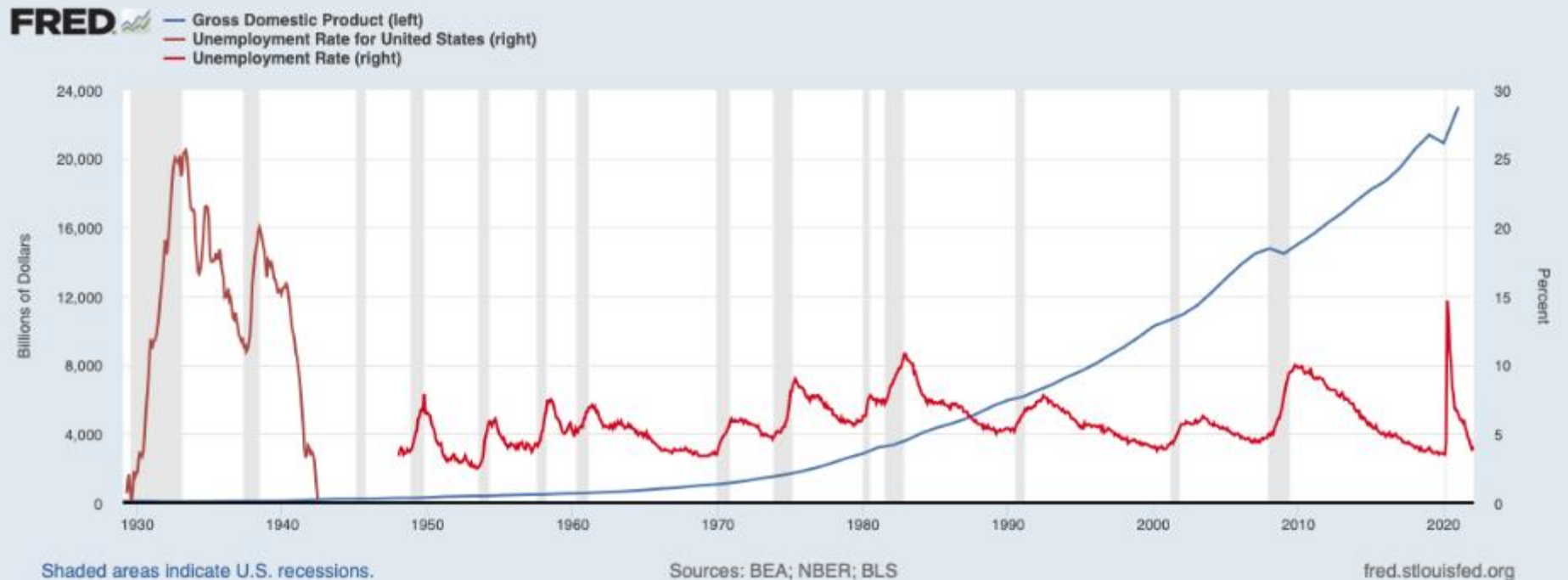
**CHART 36A: PRICE REASONS FOR LARGE HOUSEHOLD DURABLES  
(%LOW PRICES - %HIGH PRICES)**



***HOW DID  
WE GET  
HERE?***



# The 2020 downturn was the most abrupt in U.S. history



Measured by GDP, the impact of the broad economic shutdown triggered by the COVID-19 pandemic in 2020 was **much more abrupt** than the 1929 and 2008 economic crashes.

The shutdown **erased the prior three years** of GDP growth virtually overnight.

Measured by unemployment rate, the Great Depression was much **longer** and had a **far more devastating, prolonged impact** on household incomes and livelihoods.



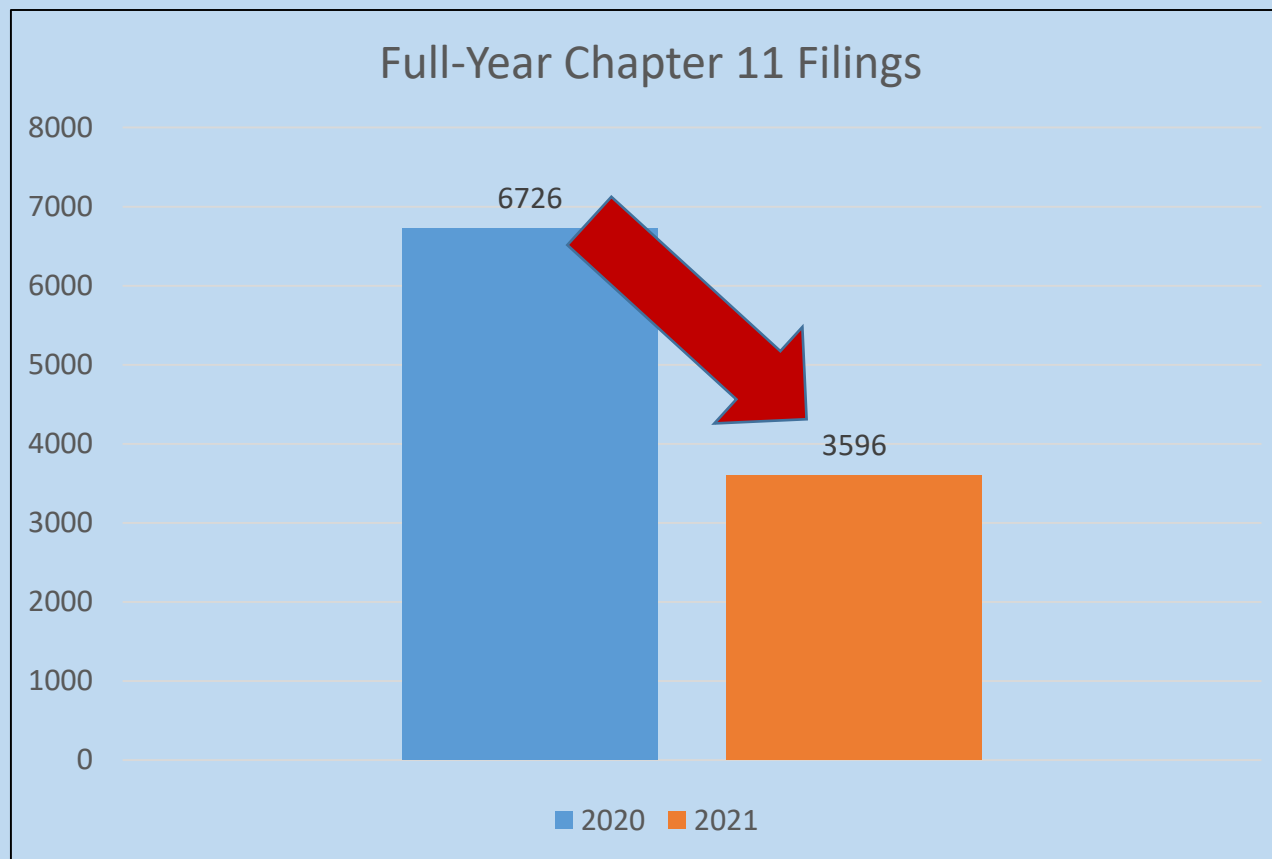
# ... and record-high business bankruptcy filings followed

Cumulative Chapter 11 Filings - January-October



**Business chapter 11 filings** in 2020 surged to the highest level since 2009  
**Through the first nine months of the year**, highest level since 2012  
**Retailers and energy companies** drove the filing volume.  
**Case volume started tapering off** in October 2020 and has continued to decline.

... but then the cases **just disappeared**.



After declining significantly from October 2020 onward, business chapter 11 case **volume plummeted** throughout 2021 and into early 2022.

Some **pockets of restructuring activity** – small retailers, oil and gas, mass tort – but otherwise, activity **virtually idled** vs. the furious pace of Q2-Q3 2020.

# The downward trend in business bankruptcies continues today

02/04/2021

January 2021 Bankruptcy Filings Continue Historic Slide

03/03/2021

February 2021 Bankruptcy Filings Down 3 Percent

08/03/2021

July 2021 Bankruptcy Filings Down 6%

09/07/2021

August 2021 New Bankruptcy Filings Level Flat

12/03/2021

November 2021 New Bankruptcy Filings Decline

01/04/2022

Overall December 2021 New Bankruptcy Filings Continue Decline

**Business**

## Big Bankruptcies Disappear, Posting Slowest Month Since 2008

By Jeremy Hill

February 1, 2022, 9:00 AM EST

Chapter 11 cases, which encompass larger commercial bankruptcies, were up 38% in March over February, but down 43% for the first quarter of 2022 compared with the same period in 2021.

## Total April Bankruptcy Filings Decrease 21 Percent Over the Same Period Last Year

Commercial Filings Fall 16 Percent

May 04, 2022 09:00 ET | Source: [Epiq](#)

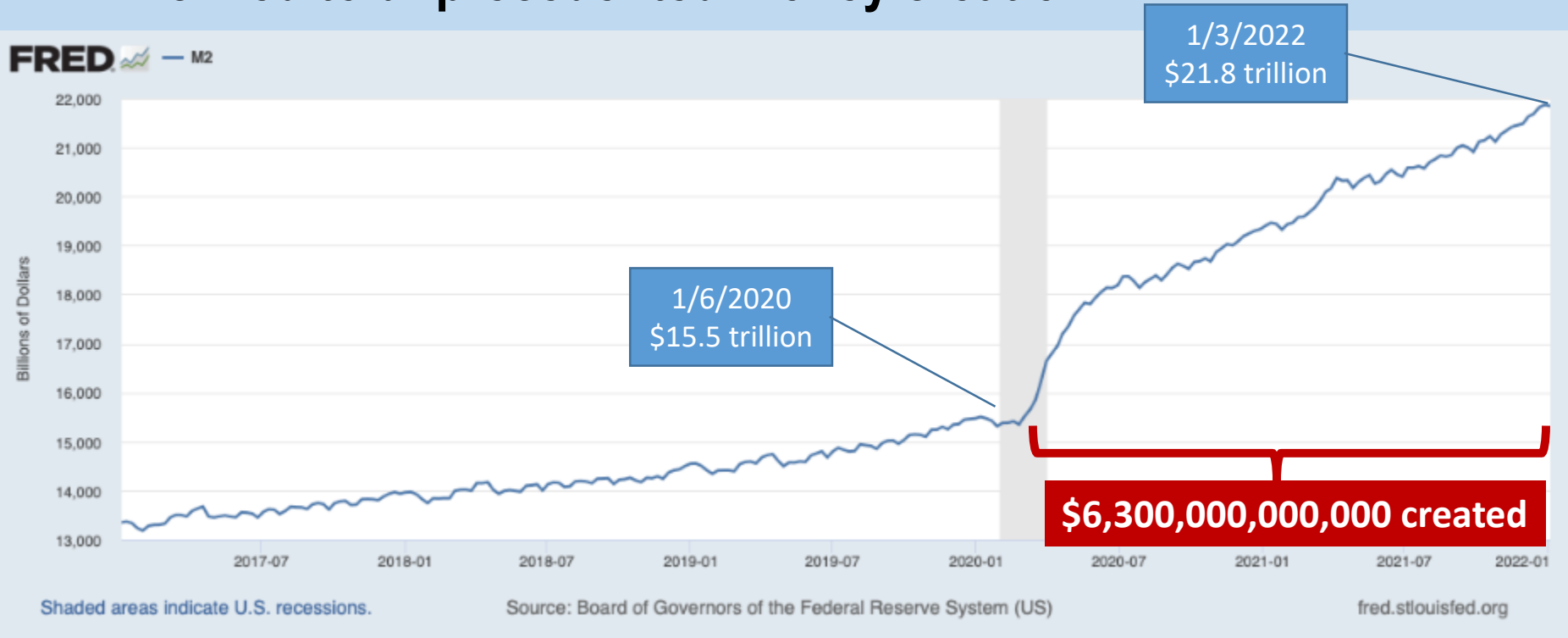
Sources

<https://bankruptcy.epiqglobal.com/blog/tag/press-release>

<https://www.reuters.com/legal/transactional/bankruptcy-filings-are-creeping-back-up-early-2022-2022-04-05/>

<https://www.globenewswire.com/news-release/2022/05/04/2435771/10374/en/Total-April-Bankruptcy-Filings-Decrease-21-Percent-Over-the-Same-Period-Last-Year.html>

# Unprecedented shock led to unprecedented stimulus efforts... ...which led to unprecedented money creation

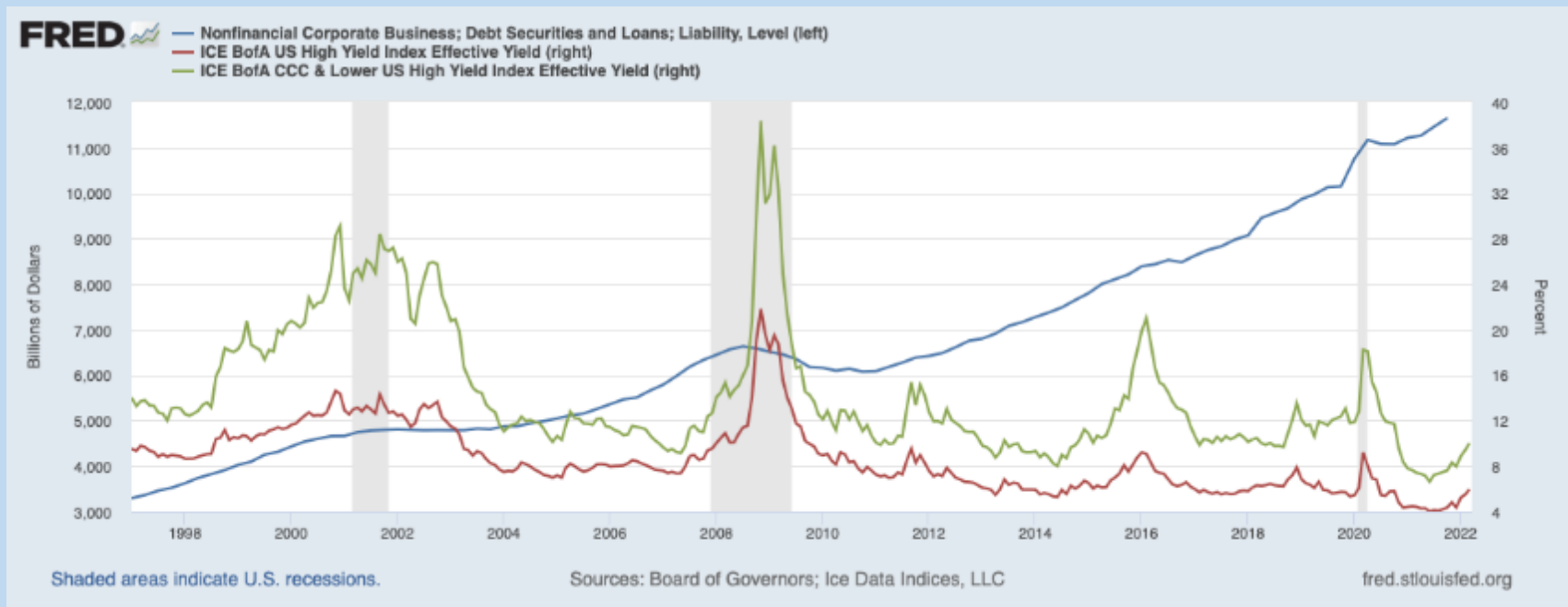


A significant element of the quick, sharp economic recovery in 2020 was the **creation of new money** to fund the broadest economic stimulus program in history.

Unprecedented stimulus efforts prevented a protracted recession, **but at what cost?**

***How do you create that much new money out of thin air without causing inflation?***

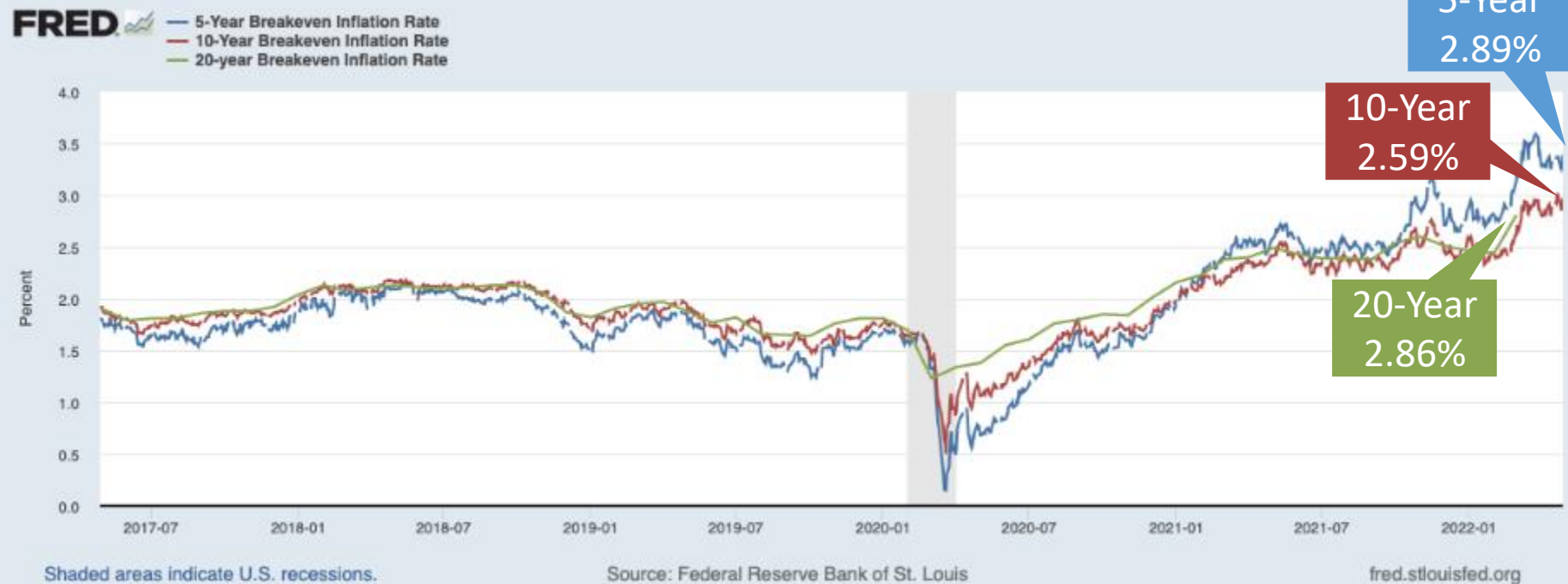
# We found the missing chapter 11 debtors!



Corporate debt was **already at an all-time high** before the pandemic (\$10.2T in Q1 2019). Aggregate corporate debt ballooned to \$11.2 trillion in 2020, **now \$11.7 trillion+ (Q4 2021)**. **Record low interest rates:** Yields on high-yield debt briefly spiked, then **plummeted to all-time lows** in 2020-2021 – single-digit yields even on < CCC-rated “junk” debt. An abundance of essentially free cash resulted in **record levels of speculative lending** to businesses that **otherwise would’ve gone off the cliff in 2020-2021**. Banks held off on calling defaults through 2020 and 2021, but that may be changing. **THIS WAS NOT SUSTAINABLE.** Sustaining this level of high-yield lending would entail pouring all the sidelined cash into the system, with a massive inflationary impact.



# Bond markets expect inflation to persist for a while



TIPS: Treasury Inflation-Protected Securities

*Federal government bonds that pay higher yields as a hedge against inflation*

TIPS Spread: TIPS yield less equivalent-dated Treasury Note or Bond yield

*Bond market proxy for expected future inflation over the term of the security*

**Takeaway:**

**Bond markets expect inflation to remain elevated in the near term, but not forever.**

# Is the worst yet to come?



An **inverted yield curve** (negative spread of the 10-year Treasury yield minus the 3-month Treasury yield) is a **traditional leading indicator** of an upcoming recession.

Spread is **+1.88%** and has turned downward. Rising short-term rates are likely to narrow the spread somewhat in coming months as the Fed tries to get inflation under control.

Takeaway: Probably not an immediate-term recession risk, but in light of the fragility of the U.S. economy (and really the global economy), any sudden shock could change the landscape very quickly. Note: 10Y – 2Y is around 0.28% and has inverted once this year.

# So what's next?

UNSUSTAINABLE LEVERAGE  
PERSISTENT INFLATION  
LABOR SHORTAGES  
RISING LABOR COSTS  
SUPPLY CHAIN DISRUPTION  
INPUT COST INFLATION  
RUSSIA/UKRAINE CONFLICT  
RISING INTEREST RATES  
FED BALANCE SHEET SELLDOWN  
INFLATION EXPECTATION LOOP  
GROWING RECESSION RISK

## S.S. Distress

### FINANCIALLY STRESSED AND DISTRESSED BUSINESSES

The Fed has begun – by all accounts, too late and too slowly – taking steps to try to curb persistent and worsening inflation. With the free-money binge coming to an end and overleveraged businesses facing refinancing difficulty and operational pressures, another surge in business bankruptcies is inevitable. But when?

RENT INFLATION  
EXPIRATION OF STIMULUS PROGRAMS  
LOSS OF LENDER COOPERATION  
DEBT MATURITIES / REFINANCING RISK



# ***Bankruptcy and Restructuring After the COVID-19 Pandemic***

**Trends (old and new), statutory developments, and other changes to the landscape of bankruptcy and restructuring as the world emerges from the pandemic environment**





# ■ Bankruptcy Express: Trends in Speedier Chapter 11s

## ■ Chapter 11 Has **Radically Changed** in 20 (Even 10) Years

- True restructuring – fix operational issues *and* deleverage the balance sheet – is **now the exception**, not the norm
- Faster process is now the norm:
  - Prepackaged Plans
  - Prearranged Plans
  - **Asset Sales** are no longer just a fallback

## ■ Why?

- Prevalence of private equity and hedge fund ownership
- Lack of lender patience: **get paid and run**
- Increase in **loan-to-own** distressed lending
- Chapter 11 administrative costs have ballooned



# Prepackaged vs. Pre-Negotiated Chapter 11 Plans

## Prepackaged (“Prepack”)

Plan has been **solicited in advance** and **accepted by voting classes**

Confirmation occurs very quickly – sometimes 60-90 days post-filing

*Belk*: Drive-through chapter 11 (in and out of bankruptcy in 24 hours!)

Trade claims **typically paid in full** after confirmation or per their terms

Pre-filing vote solicitation provides (near) certainty that impaired, objecting classes will be crammed down

Typically no creditors’ committee

Minimal risk of administrative insolvency

Preference claims *usually* waived

Minimal operational disruption

## Prenegotiated

Plan Support Agreement (PSA) has been **negotiated with certain classes**

Plan still needs to be filed and votes solicited – may take months or years

*Caesars*: Took *nearly two years*

No certainty as to treatment of trade claims – **typically impaired**, sometimes severely. Critical vendors may be treated better.

No certainty as to how any creditors besides the PSA parties will vote – objecting creditors may hijack process

Almost always a creditors’ committee

Risk of administrative insolvency

No certainty re: preference waiver

Risk of significant operational disruption

# Section 363 Sales

- Debtor Uses Bankruptcy Code Section 363 to Sell Assets
  - Entire business, specific assets / business lines, GOB sales
- Sales Under Section 363 Allow the Buyer to Obtain Court Approval To Purchase a Set of Specific Assets Free and Clear of Liens, Claims and Encumbrances Faster Than Through A Reorganization Plan
  - Bankruptcy sale process is public, benefitting debtor and creditors, and the sale is subject to higher and better offers, auction, court approval
  - “Higher and better” contemplates not only the purchase price, but other factors: form and terms of APA, form of consideration, ability to close, continued employment (preserving jobs) vs. liquidation
- Credit Bid: Ability of a secured lender to bid with its secured claim instead of new cash – up to 100% of the par amount of its debt (!)
  - Often part of a loan-to-own strategy
  - Can deter competitive bidding
- Creditors’ Committee May Be Only Check on Process

# Increased Frequency Of Structured Dismissal Of Chapter 11 Cases

## ■ Chapter 11 Exit Options

- Approval of a Chapter 11 plan
- Conversion to Chapter 7
- Dismissal of case

## ■ Structured Dismissal

- A hybrid not provided for in the Bankruptcy Code
- Chapter 11 case is dismissed
- Usually done in conjunction with settlement with secured lender
  - Usually creates claims reconciliation procedure
  - Provides for distributions to creditors
    - Sometimes, settlement proceeds distributed to lower priority general unsecured creditor classes, despite nothing paid to higher priority creditors
  - Third party releases may be granted

# Increased Frequency Of Structured Dismissal Of Chapter 11 Cases

- U.S. Supreme Court Addressed Permissibility Of Structured Dismissal in *Jevic* (2017):
  - Can a bankruptcy court approve a structured dismissal of a Chapter 11 case that provides for distributions deviating from the Bankruptcy Code's priority rules?
  - Answer: NO; strict adherence to Bankruptcy Code's priority rules
- Recent U.S. Bankruptcy Southern District Of New York Decision: Decision Approving a Structured Dismissal – *In Re KG Winddown*
  - Chapter 11 sale did not generate sufficient proceeds to pay all administrative expense claims: estate administratively insolvent
  - Court granted motion to dismiss chapter 11 case
    - *Jevic* left door open for structured dismissals that do not violate claims priority rules
    - Other alternatives, such as conversion to chapter 7 or appointment of trustee would impose costs that would further erode value of already administratively insolvent estate with no benefit to creditors or estate

# ■ Court Operations During COVID-19

- Federal Courts Throughout the Country Have Remained Open For Business
- State Courts have Varied As to the Amount of “Openness”
- Changes Took Place In All Courts
- Bankruptcy Courts Also Changed
  - Section 105 of the Bankruptcy Code grants the Court Broad Discretion to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions” of the Bankruptcy Code.



# ■ Bankruptcy Court Operation During COVID-19

- General Orders Entered in Most Jurisdictions Posted on Court Websites Outlining Temporary Operating Procedures – Each Jurisdiction Has Different Rules and Procedures
  - No in person appearances without court approval
  - Hearings, conferences and trials held by telephone or video conference
  - Evidentiary hearings held by video conference in discretion of presiding judge. Court determination of method of submitting evidence on a case-by-case basis
  - Limited in-person access to the clerk's office. Shortened hours and for some courts, access only by appointment. Clerk's office is available by phone, e-mail and drop boxes. ECF for electronic filing

# ■ Bankruptcy Court Operation During COVID-19

- Virtual Hearings Have Made Court Operations Run More Expeditiously and Cost-effectively
  - Dispensing with travel time and the cost of attorney's travel has generated significant savings
- Due to the Efficiency and Relative Seamlessness of the Virtual Process, We Expect This Trend to Continue, to Some Extent, in the Post-pandemic World
- Anticipated Hybrid Approach
  - Matters, such as case conferences, remain virtual
  - Other matters, such as trials and hearings, would return to the courtroom

# Changes In Creditor Committee Formation

- Pre-Pandemic Practice in Certain Jurisdictions: In Person Committee Formation Meetings Requiring Creditors Seeking Appointment to the Committee to Travel to the Meeting Location and Incur the Expense of doing so
- As a Result of the Pandemic in Jurisdictions Where In Person Organizational Meetings Were Held, the United States Trustees Have Switched to Gathering Information, Selecting Committee Members, and Organizing Creditors' Committees Entirely Remotely
  - Working well
  - Encourages creditor participation
  - Fewer proxies



## ■ Subchapter V Small Business Cases

- Enacted as Part of Small Business Reorganization Act of 2019 (SBRA)
  - Purpose is to reduce costs and increase efficiency
  - Permitted any business with maximum aggregate debt of \$2,725,625 to file as a small business Chapter 11; increased to \$3,024,725 on April 1, 2022
- Per CARES Act, the Maximum Aggregate Debt Limit for Small Businesses (Excluding Affiliates/Insiders) Increased to \$7,500,000, Not Less Than 50% From the Debtor's Commercial or Business Activities
  - Expired March 27, 2022; lapsed back to \$3,024,725 as of April 1, 2022.
  - Senate passed bipartisan bill preserving \$7.5 million eligibility threshold with 2 year sunset

## ■ How is Subchapter V Faring?

- Total Subchapter V cases filed through February 15, 2022: 2,963
  - Number of filings in 2020: 1,360
  - Total filings in 2021: 1,426
  - Total filings in 2022 through February 15: 177
- Largest number of Subchapter V filings in Eighth, Ninth, and Eleventh circuits (in descending order)
- One year in, Subchapter V cases represented:
  - Sixth Circuit – approximately 42% of all chapter 11 filings
  - Seventh Circuit – approximately 55% of all chapter 11 filings
  - Eighth Circuit – approximately 43.5% of all chapter 11 filings
    - Increases to approximately 45% in 18 months



## ■ How is Subchapter V Faring?

- Approximately 80% of Eligible Debtors Elected Subchapter V
- Industries where Subchapter V has been more widely utilized:
  - Retail
  - Construction
  - Health care
  - Hotel/Lodging
  - Restaurants/Bars
  - Trucking/Transportation

# ■ More Subchapter V Cases By the Numbers

- Dataset: Subchapter V Cases Filed Between February 19, 2020 and December 31, 2020 With Data Collected Ending on June 30, 2021
- 438 Subchapter V Cases Analyzed
  - As of June 30, 2021:
    - Plans confirmed in 221 cases
    - Plans filed but not yet confirmed in 105 cases
    - No plan filed in 30 cases
    - 82 cases dismissed

# Subchapter V Cases By the Numbers Per October 2021 ABI Journal Article

- In the 221 Cases With Confirmed Plans:
  - 130 (59%) involve consensual plans
  - Debtors achieve conformation within 6 months of case filing
- Conclusion
  - Subchapter V cases working as intended
  - Subchapter V debtors confirming plans at relatively high rate in relatively short period of time
  - Excellent success rate, at least so far

# ■ Preference Avoidance Litigation

- Although business bankruptcy filings are (way) down in 2021, trade creditors **aren't necessarily out of the woods**.
- The surge of cases in 2020 has led, and will continue to lead until mid-late 2022, to an **uptick in preference avoidance litigation**.
- Congress provided a **new safe harbor** (sort of) in the Consolidated Appropriations Act of 2021 and **procedural protections** in the Small Business Reorganization Act of 2019
  - Trustee due diligence requirement
  - “Covered payment” exception
  - Who has the burden of proof?
  - The real-world benefit of these provisions remains to be seen

# ■ Non-Bankruptcy Alternatives

- Assignment For the Benefit of Creditors
  - State liquidation
  - Arises by contract – assignor/debtor designates assignee/fiduciary
  - Varies by state, including availability of court supervision
  - Sale process not favorable for sale of business vs. bankruptcy
  - Executory contracts/leases containing anti-assignment provisions not assignable
- Receiverships
  - Federal or state
  - Commenced by court proceeding
  - Receiver is fiduciary; court order approving receiver fleshes out process

# Secured Party Foreclosure Of Collateral

- Recovery and Sale of Collateral Following Debtor's Default
- Governed by Article 9 of Uniform Commercial Code
- Friendly vs. Unfriendly Foreclosure
- Foreclosure Sale
  - Public or private, must be commercially reasonable
  - Sale free and clear of foreclosing security interest and most junior security interests and liens
  - Net sale proceeds reduce secured claim; deficiency unsecured unless strict foreclosure
  - Scrutiny of sales to insiders or at low sale price
  - Absent surplus, unsecured creditors get nothing
  - Lack of transparency for unsecured creditors
- Response
  - Involuntary bankruptcy petition
  - Transparency about the liquidation process as the price for not filing involuntary petition
  - Formation of out of court creditors' committee

# ■ Liquidation

- Debtor Announces it is Closing its Doors and Liquidating
- Distribution Tendered?
  - In full settlement of claim?
- Response
  - Threat of involuntary bankruptcy petition
  - Attempt to obtain transparency about the liquidation process as the price for not filing involuntary petition
  - Formation of out of court creditors' committee



# ■ QUESTIONS?

Q&A

# Bruce S. Nathan

## Partner, Bankruptcy & Restructuring Department

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With more than 35 years of experience in the bankruptcy and insolvency field, Bruce is a recognized leader nationwide in trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. He has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed. Bruce also handles letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements and legal credit issues for the credit departments of institutional clients.

Among his various legal recognitions, Bruce received the Top Hat Award in 2011, a prestigious annual award honoring extraordinary executives and professionals in the credit industry. He was co-chair of the Avoiding Powers Committee that worked with the American Bankruptcy Institute's (ABI) Commission to Study the Reform of Chapter 11, participated in ABI's Great Debates at their 2010 Annual Spring Meeting—arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors—and was a panelist for a session sponsored by ABI. He is a frequent presenter at industry conferences throughout the country, as well as a prolific author regarding bankruptcy and creditors' rights topics in various legal and trade publications.

Bruce is a co-author of "Trade Creditor's Risk-Mitigation Tools and Remedies Manual," published by ABI in 2019. He has also contributed to **ABI Journal** and is a former member of ABI's Board of Directors and former co-chair of ABI's Unsecured Trade Creditors Committee.



### Education

- University of Pennsylvania Law School (J.D. 1980)
- Wharton School of Finance and Business (M.B.A. 1980)
- University of Rochester (B.A. 1976), Phi Beta Kappa

### Bar Admissions

- New York

# Andrew Behlmann

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Andrew leverages his background in corporate finance and management to approach restructuring problems, both in and out of court, from a practical, results-oriented perspective. With a focus on building consensus among multiple parties that have competing priorities, Andrew is equally at home both in and out of the courtroom, and he has a track record of turning financial distress into positive business outcomes. Clients value his counsel in complex Chapter 11 cases, where he represents debtors, creditors' committees, purchasers, and investors.

Andrew writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsize, privately held company.



### Education

- Seton Hall University School of Law (J.D. 2009), magna cum laude; Order of the Coif
- University of Missouri-Saint Louis (B.S. 2005), Business Administration-Finance and Accounting; *Beta Gamma Sigma*

### Bar Admissions

- New Jersey

# Recent Publications

- May 2022  
[What's in a Name? UCC Financing Statement Mistakes Can Be Fatal](#), *Business Credit*  
Bruce S. Nathan, Michael Papandrea
- April 1, 2022  
[The Subjective Ordinary Course of Business Preference Defense: Tie Goes to the Plaintiff](#), *Business Credit*  
Bruce S. Nathan, Michael Papandrea
- March 2022  
[State Law Preferences Are Alive and Well](#), *Business Credit*  
Bruce S. Nathan, Michael Papandrea
- March 3, 2022  
[Lowenstein Secures Removal of Third Party Releases from Ann Taylor Ch. 11 Plan](#)  
Michael S. Etkin, Andrew Behlmann, Michael Papandrea
- February 2022  
[You Can't Judge a Guaranty by Its Title: A 'Conditional Guaranty' May Be an Unconditional Guaranty of Payment](#), *Business Credit*  
Bruce S. Nathan, Michael Papandrea
- January 2022  
[LC Beneficiaries Beware: Failing to Comply Strictly with Documentary Requirements May Leave You Empty Handed](#), *Business Credit*  
Bruce S. Nathan, Michael Papandrea
- December 23, 2021  
Video - "[Breaking Down the Latest Decision in the Purdue Pharma Case](#)"  
Andrew Behlmann
- November/December 2021  
[Does Guarantor's Bankruptcy Discharge Extinguish Future Guarantor Liability?](#), *Business Credit*  
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