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Eight Predictions Regarding the Impact of the Coronavirus in the Bankruptcy World – A Retrospective

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On April 9, 2020, the Bankruptcy Law Section of the State Bar of Nevada[1] presented a webinar opining upon the likely legal impacts of the COVID-19 pandemic. Joining the authors of this article were Thomas J. Salerno, Esq., of Stinson, LLP, and G. Neil Elsey of Avion Holdings LLC, who had recently published similar predictions in an article entitled "*The Coronavirus and Its Likely Impact on the Bankruptcy World*."[2]

The panel offered eight predictions as to what would occur in the insolvency field in the months following the initial outbreak of novel coronavirus cases. This article summarizes those predictions and comments on how, in retrospect, each of those predictions faired. Constrained by the space afforded to this article, as well as the continually shifting state of the world, this article is limited to general talking points.

PREDICTION NUMBER ONE:

A new wave of bankruptcy filings in the energy, hospitality, transportation, manufacturing and retail industry spaces.

The only upside will be the pharmaceutical companies and healthcare industries as they kick into overdrive to deal with the pandemic, certainly in the short term. The bankruptcy filings and issues will hit all sides of any business relationship: companies, their customers, banks/secured lenders, vendors, landlords, insurance companies and employees (not to mention the impact on the equity value of these newly distressed enterprises).

In Retrospect: *Spot on.*

The number of high-profile bankruptcy filings in the aforementioned sectors as of the submission of the article include names that can be found on shopping mall directories, in our closets and on our dinner tables, including: Hertz Car Rental, J.C. Penney, Neiman Marcus, Tuesday Morning, Cirque du Soleil, J. Crew, Lucky Brand Dungarees, Ann Taylor, Brooks Brothers, California Pizza Kitchen and LSC Holdings.[3]

By the time this article goes to print, that number will have certainly increased. Roughly 3,600 companies filed for bankruptcy in the first half of 2020. While not all filings were driven by COVID-related issues, the pandemic served as the tipping point for many.

On the retail front, U.S. retailers are on track to close as many as 25,000 stores this year: more than twice as many as closed in all of 2019. State-mandated closures of bars and restaurants have

also forced many to seek bankruptcy protection.

It is not surprising that mall owners, especially those with "Class B" malls (which previously boasted steady foot traffic as well as high-end tenants and concomitant higher-than-average rents) are also feeling the economic pinch of shrinking tenancies, forcing the owners to negotiate consensual restricting agreements. In response, some mall owners have chosen to team up with reputable tenants to supply financing to help carry debtor/tenants through the bankruptcy process. Such was the case when Simon Property Group provided financing to Brooks Brothers, the clothing retailer and shopping mall mainstay.

PREDICTION NUMBER TWO:

In a reflexive reaction, credit will tighten, thereby further impacting already-tenuous cash flows and the ability to access financing. There will be recessions in several countries, and these countries will need credit help.

Downstream vendors, manufacturers and suppliers will be especially strained by reduced cash flow and the credit vacuum, making reductions in the workforce inevitable. Accordingly, transferred pressure on the consumer will lower consumption and spending. The big banks have risk, but not as much as private-equity firms, which have done most of the major highly leveraged transactions in the last 10 years. Banks will tighten credit and private equity, in an effort to unload, and will have many discounted asset sales and bankruptcies. Pension plans that are already underfunded and under pressure will find their assets (and returns on those assets) increasingly inadequate to fund their obligations.

In Retrospect: *On the money.*

Credit has been remarkably elastic. This elasticity is a second-level consequence of both the federal government's Paycheck Protection Program (colloquially referred to as PPP)[4] and a loosening of federal guidelines regarding the monetary amounts banks are allowed to provide as accommodations without impacting the credit ratings of their loans. To this point, many lenders have agreed to simply defer payments to the end of the otherwise scheduled loan maturity. Anticipating what is on the horizon, however, large banks have set aside equally large reserves for the anticipated wave of yet-to-be-triggered loan defaults. JPMorgan Chase, Citigroup and Wells Fargo have put aside $25 billion to cover potential losses on loans.[5]

CONTINUED ON PAGE 27

CONTINUED FROM PAGE 23

Eight Predictions Regarding the Impact of the Coronavirus in the Bankruptcy World – A Retrospective

PREDICTION NUMBER THREE:

Distressed companies can be expected to invoke "force majeure" clauses to argue that they are not really in "default" as they defend collection actions and ultimately access bankruptcy proceedings.

While this is a nice parlor game for lawyers, this sideshow will do little to address the larger economic issues of declining cash flows and asset valuations (discussed in Prediction Number Seven, below), which will persist and put pressure on continued operations and reorganizations (in or out of bankruptcy).

In Retrospect: *Oui.*

A growing number of attorneys suddenly speak French, as parties attempt to invoke force majeure or "superior force" clauses in their agreements. These disputes seem to only now be making their way into the courts after informal attorney-to-attorney letter-writing campaigns. As such, and because each dispute will ultimately turn upon the precise language used in each agreement's particular force majeure provision, it is too early to tell how courts will come down on this issue on balance. But, either way, it is not anticipated that force majeure litigation will significantly affect the macroeconomic issues at hand.

PREDICTION NUMBER FOUR:

Bankruptcy courts will be more lenient with debtors due to these unforeseen worldwide phenomena (much like the 9/11 response), which will translate into more delays in the bankruptcy process for creditors, landlords and others.

Courts are likely to give debtors the benefit of the doubt, given the economic forces out of their control, for a little longer than in traditional cases. That said, this will only last so long and will do little to address the overall economic issues. In fact, it will continue to highlight an additional hurdle to the free flow of commerce, inject added costs, and promise a long slog out of the quagmire. It will also increase the professional and related fee burdens on bankruptcy estates.

In Retrospect: *Too early to tell.*

The largest wave of anticipated COVID-related bankruptcies has not yet crashed upon the shore. While the larger bankruptcy cases referenced in Prediction One have commenced, many more businesses and individuals are waiting for a precipitating event to

CONTINUED 0N PAGE 28

CONTINUED FROM PAGE 27

Eight Predictions Regarding the Impact of the Coronavirus in the Bankruptcy World – A Retrospective

trigger their respective bankruptcy filings, which often occur as a last resort. Absent a precipitating event, most would-be debtors simply wait and eventually file as a defensive strategy (if at all). As of this article's deadline for submission, foreclosures and evictions were still frozen in time by governmental moratoriums. Many lenders deferred payment deadlines, PPP monies were not yet depleted and borrowers had access to elastic credit.

Shortly before COVID began to expeditiously spread throughout the U.S., Subchapter V to Chapter 11 of the Bankruptcy Code — which provides relief to debtors with a debt limit of $2,725,625 — was introduced. Notably, the CARES Act adjusted that limit upward for one year, increasing the debt limit to $7,500,000.[6] That shift would serve to help unburden the dockets of bankruptcy courts and make the process cheaper and quicker. The most recent data available indicates that more than 500 filers have opted for Subchapter V relief.

PREDICTION NUMBER FIVE:

On a purely administrative front, court administration will likely change as well.

Bankruptcy courts will allow for more telephonic appearances in matters in order to attempt to minimize community coronavirus transmission, which will have the double-edged potential impact of further distressing the airline/hotel/restaurant sectors while at the same time cutting some costs for clients in the bankruptcy process.

In Retrospect: *We can hear you smiling.*

Appearances in most bankruptcy courts throughout the country have been made telephonically, except for in those matters that are conducted via Zoom or other virtual means. On the plus side, with everyone being forced to appear remotely, dialing in to a hearing to participate does not seem to hold the same disadvantage as it once did.

PREDICTION NUMBER SIX:

In adversity, there is opportunity—hence, as in the 9/11 and 2008 financial market meltdowns, there will be more opportunistic acquirers of assets/companies circling (sometimes called "vulture investors"). Bankruptcy creates a unique vehicle to acquire assets free and clear of liens and adverse interests as well.

In Retrospect: *The Magic 8-Ball says, "Seems Likely."*

One example of this trend is shadow lenders — fast-growing and largely unregulated nonbank financial firms that filled the void created when institutional investors began rapidly withdrawing from prime money market funds and began hoarding cash instead. Shadow lenders' loans often have potential weaknesses, most notably, excessive leverage. To counter a collapse of those facilities, the fed started rolling out emergency lending facilities as a substitute.

PREDICTION NUMBER SEVEN:

Given further restrictions on cash flows and liquidity, there will be (certainly in the near term) a depressing of values (based on discounted cash flow valuations).

This will impact loan-to-value ratio and trigger other covenant defaults, certainly for the short term.

In Retrospect: *Hold that thought.*

Lenders and federal regulators seem content to delay valuations, ostensibly to see if the proverbial ship will right itself.

PREDICTION NUMBER EIGHT:

Watch for law firms, financial advisors, accounting firms and other restructuring professionals to establish multi-disciplinary "task forces" in order to have coordinated and rapid responses to clients and potential clients in a proactive move to deal with the myriad legal and economic issues attendant to the pandemic.

Once again, in adversity there is opportunity.

In Retrospect: *If your spam folder isn't full of legal alerts and law firm announcements, you may have lost internet connection.*

Early in the post-COVID world, firms began marketing task forces. Some have continued with vigor, while some have flagged.

ENDNOTES:

1. https://www.nvbar.org/member-services-3895/sections/bankruptcy-law-section/
2. A copy of the article is available upon written request.
3. The other filings rounding out the top 20 can be found at: https://fortune.com/2020/06/29/companies-filing-bankruptcy-2020-during-coronavirus-pandemic-covid-19-economy-industries
4. https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program
5. https://www.abi.org/newsroom/bankruptcy-headlines/banks-stockpile-billions-as-they-prepare-for-things-to-get-worsePREDICTION
6. The advantages to Subchapter V and other salient information can be more fully found at abi.org/sbra

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