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The Days Of 'Eerie' Bankruptcy Silence Are Numbered

By **Vince Sullivan**

Law360 (August 30, 2021, 12:02 PM EDT) -- Instead of the surge in bankruptcy activity expected in 2021, the number of new cases dropped by a third in the midst of an "eerie" restructuring silence, with experts saying trillions of dollars in federal aid programs are holding things together in a way that isn't likely to last indefinitely.

As the pandemic spread in the spring of 2020, bankruptcy courts sustained a fire-hose-like stream of corporate bankruptcies and many predicted that rate of filings would continue into this year as the trailing effects of business closures and consumer preference shifts — as well as widespread unemployment — rippled across the national economy.

But in the first half of 2021, that restructuring wave hasn't materialized and experts believe the federal government assistance programs adopted in response to the spread of the coronavirus has provided the cushion necessary for many businesses to avoid bankruptcy.

"It's been eerily quiet," James Silver, a partner with Kelley Kronenberg, told Law360. "When the pandemic first hit, we thought it was going to be an economic earthquake and there was going to be a tsunami of bankruptcy filings. That was the expectation."

According to statistics released by the Administrative Office of the U.S. Courts earlier this month, the number of total bankruptcy cases filed in the fiscal year ending June 30, 2021, represented a 32.2% drop over the previous 12-month period, which included the opening months of the pandemic.

Those numbers represent the lowest 12-month total for bankruptcy filings since 1985, a far cry from the rush of cases anticipated by restructuring professionals.

Federal dollars are "lubricating" the economy, Silver said, but once those funds dry up the lull in bankruptcies may end with a crash.

The federal government responded quickly to the pandemic by adopting the $2.2 trillion Coronavirus Aid, Relief and Economic Security Act in March 2020, which, among other things, called for economic stimulus payments sent directly to consumers and hundreds of billions of dollars in relief directed toward small businesses. Follow-up relief packages included the $1.9 trillion American Rescue Plan passed in March 2021 that built upon the assistance programs included in the earlier CARES Act.

These packages also included expanded unemployment benefits and rental assistance, which, paired with eviction moratoria in place until recently, helped keep struggling individuals out of insolvency court.

"Why we haven't seen some of the companies that rely on discretionary funding be hit as hard as they might otherwise be in other recessions is because the government is still pumping in money and helping people continue to spend," Lucy Kweskin, partner at Mayer Brown, told Law360.

With money in their hands and, in some cases, extra money in their hands, consumers were free to spend as before and prop up smaller businesses that otherwise would have suffered catastrophic losses during the pandemic, Silver said.

"Putting more government cash into the hands of the consumer I think helps to delay the onset of bankruptcy filings," he said.

The Paycheck Protection Program that was created under the CARES Act provided nearly $700 billion in low- or no-interest loans to small businesses over the last 18 months, and kept many of them afloat at a time when their revenue streams dried up.

John J. Sparacino, a principal with McKool Smith, said the PPP helped some of his small business clients ride out the pandemic, especially retail or restaurant chains with only a handful of locations. The assistance provided by the program has been a significant driver in keeping those types of enterprises out of bankruptcy, he said.

"That business gets a couple of million dollars from the government and that provides a very, very nice runway to survival and getting to the other side of this worldwide problem," Sparacino said. "It's been a very important assistance boost to these businesses."

An ancillary effect of the stimulus and relief packages adopted by the feds is that the market is also flush with cheap cash at the moment, with refinancing and repricing transactions becoming a more attractive option for struggling companies than a bankruptcy filing would be.

The availability of these options along with a red-hot equity market have created situations where corporations are able to complete out-of-court transactions and avoid the high costs of a bankruptcy filing.

"What we're seeing in the market continues to be companies being able to access capital and avoid having to do a formal in-court restructuring process," Kweskin said.

She pointed to movie theater chain AMC Entertainment, which was able to raise nearly $1 billion through stock issues and new borrowing in early 2021 and another $230 million in June, avoiding a bankruptcy filing that industry experts foresaw as a near certainty just weeks before the company announced the first capital raise.

Corporations are also able to take advantage of competition among lenders to gain favorable terms that are pushing out debt maturity dates through refinancing transactions that result in lower interest rates, she said.

While the economy is filled with government cash, Silver said there is no guarantee that will continue and there are unknown consequences still to be realized after the glut of aid.

"In terms of the economy and what future bankruptcies are going to look like, it's hard to say," he said.

The rise of new variants of COVID-19 have led to an increase in cases of the virus at the same time that the proliferation of vaccines gave many hope for a return to normalcy, and local and state governments are imposing new rules and restrictions on public gatherings. Some places, like New York City, have instituted requirements for customers to prove they are vaccinated before patronizing restaurants and other businesses, while mask mandates are returning in many states.

Sparacino said the bankruptcy world will likely see small peaks and valleys in the trend line for case filings over the next year or two, but that industry-specific increases in the hospitality, travel and commercial real estate sectors are probable.

There may be some reluctance for customers to return to certain travel modes or destinations at this point in the pandemic, he said, and it remains to be seen whether the struggles in those areas are over.

"A part of me thinks that is still to come," Sparacino said of the surge in those types of cases.

Silver said that the flow of government funds will have to be cut off at some point, and then we may see that the money was hiding more foundational flaws in the economy that will need to be addressed or simply weathered.

"You have the government doing a lot of things to mask deeper problems and stave off the consequences of those problems," Silver said. "In my view, you have to take the pain in a real economy and let it work through the system. You deal with it, work through it and get stronger because of it."

--Editing by Emily Kokoll.
