Turnarounds & Workouts

DECEMBER 2023

VOLUME 37, NUMBER 12*

News for People Tracking Distressed Businesses

www.TurnaroundsWorkouts.com

In This Issue:

The Year in Review

By Christopher Patalinghug

Our Year in Review piece last year stated, "[t]otal commercial bankruptcy filings continue to remain low [in 2022] and are on track to be the fewest in the past 11 years." Notwithstanding, restructuring experts surveyed at that time by *Turnarounds & Workouts* predicted a busy 2023 compared to 2022 and 2021, and expected more in court Chapter 11 filings. Were they right!

According to American Bankruptcy Institute, citing data from Epiq Bankruptcy Analytics, total commercial bankruptcy filings for the first nine months of 2023 have already surpassed by 9% the total for calendar year 2022 and the 2021 total by 3%. About 23,308 commercial bankruptcy cases, which include commercial business Chapter 11, 7, 13 and 15 cases, were filed through November. This compares to 21,396 total commercial bankruptcy cases filed for the entire 2022 and 22,561 for 2021. About 32,517 cases were commenced in 2020 and 39,050

Continue on page 2 →

The Rise of Special Situations

By Doug Mintz and Adam Harris

The restructuring world has seen massive landscape shifts since 2008. These have necessitated significant changes in how lawyers and law firms approach the restructuring practice in the last decade — mandating ever-closer coordination and collaboration between bankruptcy experts, finance partners, litigators and the capital markets team. This enables lawyers to bring their clients a broad-based approach to resolving problems where the solutions are not as simple as they once were.

Factors Driving Change

The United States enacted the U.S. Bankruptcy Code in 1978. Subsequently, bankruptcy filings rose virtually every year through their peak in 2005; they then

Continue on page 12 →

Review, *from page 1*

cases in 2019.

Data from Epiq also showed that around 6,040 commercial Chapter 11 filings were commenced in the first nine months of 2023, already a 58% increase from the year 2022 total and a 62% increase from 2021. About 3,816 commercial Chapter 11 cases were initiated in 2022 and 3,726 in 2021. Around 7,129 commercial Chapter 11s were filed in 2020 and 5,519 in 2019. The 517 bankruptcy petitions filed by WeWork, Inc. and its affiliated debtors propelled the 2023 total, according to ABI.

"The rebound in filings seen this year is a reflection of the challenging economic environment resulting from the evaporation of pandemic responses, including government stimulus, low interest rates and looser lending terms," ABI Executive Director Amy Quackenboss said.

Beyond the numbers, we asked seven experts from six restructuring firms to looked back on how the industry shaped out in the past year and share their views to T&W readers: **Michael J. Cohen**, partner at Gibson, Dunn & Crutcher LLP's Business Restructuring & Reorganization practice in New York; **Shana Elberg** and **Evan Hill**, Corporate Restructuring partners at Skadden, Arps, Slate, Meagher & Flom LLP; Hopkins & Carley Shareholder and Financial Institutions and Creditors Rights Practice Chair **Monique Jewett-Brewster**; **Randy Klein**, principal at Goldberg Kohn and Co-Chair of the firm's Bankruptcy & Creditors' Rights Group; **Jonathan Lazarow**, founding member and co-chair of the Corporate Group at Ambrose, Mills & Lazarow, a boutique law firm in Virginia; and **Doug Mintz**, partner and co-chair of Schulte Roth & Zabel LLP's Business Reorganization Group and Special Situations Group.

In September, Cornerstone Research released its mid-year report on large corporate bankruptcy filings, indicating a significant increase in filings by public and private companies with over $100 million in assets over the first half of 2023 — already surpassing the bankruptcy filings in 2022 — with the trend continuing in the second half of the year. Describe how the restructuring activity looked like this year for you and your firm.

Michael Cohen, Gibson Dunn: We certainly were involved with a sizable number of filings and distressed situations — whether resolved out of court or subject to ongoing negotiations — that fit that description.

Shana Elberg and **Evan Hill**, Skadden: 2023 was a busy year for Skadden's restructuring group, both domestically and internationally. A prolonged period of elevated interest rates, combined with inflationary pressures, mass tort liabilities, and lingering supply chain issues, presented companies with a variety of liquidity challenges. Such challenges included significant funded debt obligations without the ability to refinance cheaply (as has been the case in recent years).

In 2023, Skadden's most significant Chapter 11 matter was its ongoing representation of Endo International plc and its affiliated debtors. Endo's Chapter 11 cases were precipitated by a combination of factors, including substantial and unsustainable mass tort liability overhang, a significant funded debt burden, and decreased financial performance as a result of losing patent exclusivity for a key product.

Monique Jewett-Brewster, Hopkins & Carley: Our firm's restructuring activity soared in 2023, particularly with respect to commercial real estate secured loans. Many of our lender clients were forced to postpone their nonjudicial foreclosure sales due to real estate developer or shopping center borrowers filing for bankruptcy on the eve of their sales. Unsurprisingly, many of these debtors filing "free-fall" Chapter 11 cases (or those with little to no bankruptcy pre-planning) had no plan for reorganizing their debts in bankruptcy. As such, our lender clients often sought to dismiss their borrowers' bankruptcy cases or have them converted to Chapter 7 liquidation cases. Alternatively, our clients often moved for relief from the automatic stay to continue their foreclosure proceedings, on the grounds that the subject properties held no equity for the bankruptcy estate and were not necessary for any reorganization that the debtor could

Review, *from page 2*

argue might be reasonably in prospect.

Randy Klein, Goldberg Kohn: Many of the larger corporate reorgs were driven by liability management transactions and forum shopping to resolve related litigation. For the middle market, more of the Chapter 11 cases were a result of an overleveraged balance sheet, shrinking enterprise value and the need to convert debt to equity in an in-court process, or as a part of an attempt to find a going concern purchaser under section 363 of the Bankruptcy Code. Our restructuring activity is up significantly over 2022 levels, in large part due to out-of-court restructuring and deleveraging activities, as refinancing (at higher interest rates) is no longer the solution for middle-market borrowers.

Jonathan Lazarow, Ambrose Mills: We had several workout engagements this year. The collapse of Silicon Valley Bank tightened up the credit markets. Even though a variety of lenders, from the regional banks to national commercial banks tightened their lending requirements, we found that good businesses could still negotiate favorable terms with lenders. Yet these same restructuring lenders have sent more companies to workout. For example, relatively strong but lower middle market businesses which have been long term clients of national banks were still being sent to workout. As a result, our firm has seen an increase in restructuring. I think the increase in interest rates has also played a role. Growth was easy when the cost of capital was low, but these higher rates have somewhat challenged business plans.

Doug Mintz, Schulte: Our team had a very busy year. Despite an increase in large company filings, I would only call it significant when compared year-over-year to 2021 and 2022 — the two slowest years for filings in at least 30 years. Over the long-term bankruptcies are way below long-running trends. That is true for all filings but also true for larger filings. Why is that? Because so much "restructuring" has moved much earlier in the cycle over the last decade. Credit the rise of private capital and its focus on efficiency for this trend.

Broadly, there was an uptick in restructuring activity this year, with more of the activity concentrated in the first few quarters. In the fall and winter, it has been clear liquidity is returning to the markets more broadly and rates appear to have halted their climb. This has lifted many sectors of investment.

Which sectors saw the most restructuring activity in the past year?

Jewett-Brewster: According to Cornerstone Research, in the first half of 2023, bankruptcy filings increased most notably in the retail trade, services, and manufacturing industries. Our experience comports with this conclusion, given the challenges some (but not all) retailers continued to face post-COVID. For instance, retail debtors like Bed Bath & Beyond had many locations across the country where its leases were over-market but its stores were underperforming. In addition, retailers such as Party City continued to face supply chain issues, high inflation and stiff competition, all of which contributed to its ultimate bankruptcy filing. Our clients include financial institutions that provide credit to such borrowers, as well as commercial landlords who have had their tenants file for bankruptcy.

Cohen: While the current cycle is not purely sector-driven, it seems healthcare/pharmaceuticals and TMT (telecom, media and technology) feature largely in the recent cycle of distressed deal flow (completed, ongoing and anticipated).

Klein: Retail and, in particular, consumer discretionary spending businesses that saw an unsustainable bump during COVID. Restaurant

Review, from page 3

restructuring continued post-COVID to provide a significant amount of workflow, as well as leveraged roll-ups in the healthcare space that created unsustainable capital structures.

Elberg and **Hill**: While in recent years restructuring activity has been more concentrated in certain sectors, for instance retail or crypto, our experience has been that the most existential threats faced by struggling companies in 2023 stemmed from higher borrowing (and refinancing) costs. Such rates-based pressures are largely industry agnostic, felt by companies universally (and are particularly problematic for those companies with significant funded debt obligations maturing in the short term). Commercial real estate is one example of a specific sector that has experienced unique pressure, with increased interest rates having a direct impact on asset values.

Any sectors caught you by surprise?

Lazarow: Brick and mortar retail has seen the most restructuring activity. Many smaller traditional retailers are trying to adapt to new market dynamics. What has been really surprising though is how new, web-based retailers have struggled. Companies such as FARFETCH, a global platform for the luxury fashion industry, have struggled.

We have been most surprised to see several U.S. military contractors struggle because of uneven cash flow and traditional lenders refusing to help smooth out their lumpy cash flow operations.

Mintz: The single biggest surprise remains the lack of activity in the commercial real estate market. We all know first-hand the major changes that have hit professional offices-pace over the last four years. To think that this has had little impact on the commercial real estate market is hard to fathom. Yet, very few commercial real estate deals have even entered into significant restructuring discussions — much less headed for workout or bankruptcy.

What trends emerged in the second half of 2023?

Mintz: The biggest trend of the second half is the resurgence of liquidity across the market — as well as the phoenix-like rise of crypto which has had major implications on value in various crypto bankruptcies. The best evidence of this is the significant rally in the value of FTX claims which has already flowed through to the proposed plan filed in December.

Klein: Increased floating interest rates put significant strain on over-leveraged middle market companies. Real estate continues to be a problem without a solution. It's not a question of grabbing a falling knife. No one seems to want to pick the knife up off the floor either.

Lazarow: We have seen an adjustment to the new normal — higher interest rates and tighter lending requirements. Sponsors are more cautious, and mezzanine lenders are taking advantage of the turmoil with access to private credit markets.

Jewett-Brewster: Small business filings under Subchapter V of Chapter 11 of the Bankruptcy Code — a more streamlined reorganization alternative — have continued to rise, much more quickly than traditional Chapter 11 cases. This trend is likely due in part to Congress' increase of the Subchapter V debt limit from \$2.7 million, as originally enacted, to its current limit of \$7.5 million, to provide small businesses with greater access to bankruptcy during COVID and beyond.

Cohen: The continuing use and evolution of liability management exercises as an initial step in many restructurings as well as rising debt service as a common catalyst both were trends that continued into the second half of the year but were firmly

Review, from page 4

on the horizon beforehand.

What deals, cases or issues stood out in the second half of 2023?

Elberg and **Hill**: From Skadden's perspective, Endo's Chapter 11 cases represented a stand-out case in the second half of 2023, as that was the period in which the Endo debtors negotiated and ultimately announced an intent to pivot from their previously contemplated section 363 sale of the company to pursue emergence through confirmation of a Chapter 11 plan instead. This pivot required extensive negotiations with numerous constituencies in order to properly implement all previously announced settlements in principle that had been reached with major stakeholders in the sale context.

Mintz: The *Purdue* Supreme Court hearing in December stands out as potentially the most important bankruptcy development of the year. We won't know until June probably the outcome, but that ruling has the potential to shape how, and even if, Debtors are able to confirm plans (and thus file for bankruptcy) for the long-term. Fewer releases could hamper deal-making — though as Justice Jackson noted, sponsors could well negotiate deals for releases with all willing parties and that would still have value.

The hearing reflected a potentially divided court — and so we expect any ruling to focus on the propriety of the releases specific to the *Purdue* bankruptcy — rather than a broader statement on third-party releases. We'll be watching this one closely.

Klein: Forum shopping and liability management transactions came together in the *Serta* case filed in Houston (former Judge Jones). For bankruptcy practitioners not involved in the case itself, it was a stunning display to see a bankruptcy judge take litigation away from a federal district court judge. The other big issue is obviously the much-needed clarity on the power of the bankruptcy court to grant third-party releases under a plan. This is not just the *Purdue* case, or the equally divisive *Boy Scouts* case, but is an issue that pervades all of Chapter 11 practice. Many Chapter 11 parties want the releases to bring "closure" and certainty going forward, but many bankruptcy lawyers have quietly (and in some cases not so quietly) questioned the validity of this practice of obtaining plan releases that has developed over the past 20 years.

Lazarow: With our clients we have found that we could finally get some movement from lenders. It took time but eventually the markets stabilized.

Cohen: One development — and it is not new — is that many (but by no means all) of the most challenging issues and disputes that we are seeing — although they are usually material enough to litigate — more often than not still result in compromise and sometimes more efficiently than one would expect. Part of the reason is that avoidance of delay likely looms large in any investor's calculus of whether to litigate or settle a given dispute.

Are there restructuring-related events or issues in the past year that, in your opinion, should be talked about more?

Klein: Too few courts have grappled with the doctrine of "good faith" in connection with amendments to loan documents. There is no way to anticipate and draft all potential future constructs into a loan agreement. The suggestion made by many that the majority is unconstrained to amend documents (unless expressly prohibited) will prove in the long run to be bad for lenders generally. There has always been an overriding doctrine of good faith, it is just that the courts have found it easier to put the burden on the lawyers to draft better documents.

What was your biggest challenge this year?

Review, *from page 5*

Elberg and **Hill**: Orchestrating the pivot to a plan of reorganization — from the previously contemplated sale-based approach — in the Chapter 11 proceedings of Endo International plc and its affiliated debtors was our biggest challenge of the year.

Following a highly complex mediation process involving more than a dozen parties, including the official committee of opioid claimants, the unsecured creditors committee, the future claims representative appointed by the bankruptcy court, and an ad hoc group of first lien lenders, among others, Skadden was able to negotiate, draft, reach consensus on, and ultimately file a Chapter 11 plan of reorganization on a highly compressed timeframe and in spite of entering Chapter 11 with an RSA that contemplated a 363 sale. This plan pivot, we believe, will clear the way for Endo's ultimate re-emergence and successful reorganization.

Given the sheer number of constituencies that possessed divergent — and often competing — interests during this process, reaching resolution with such parties was a monumental challenge, and we believe represents our most significant restructuring milestone to have occurred in 2023.

Lazarow: We did not expect the credit markets to tighten as fast as they did. Overnight it seemed the markets determined that the only investments worth doing are those straight down the middle. This resulted in less strong businesses having to restructure.

Jewett-Brewster: I would say striving to persuade some bankruptcy courts that some debtor-borrowers truly have no reorganization prospects in sight. Bankruptcy courts strive to balance the rights of the debtor and its creditors in bankruptcy; and often, the courts will provide debtors with as much opportunity as possible to confirm a Chapter 11 plan of reorganization. Still, when the debtor has negative net cash flow postpetition and no means of financially performing under a plan, that debtor very likely does not belong in chapter 11. We've therefore had a challenging year striving to persuade some bankruptcy courts of when it's time to "pull the plug" on a debtor's reorganization efforts.

What changed in your outlook on the restructuring industry since early January 2023?

Elberg and **Hill**: Businesses around the globe faced a unique set of circumstances in 2023, including wide swings in economic sentiment and high interest rates, along with geopolitical unrest. Many such events could not have been predicted in early 2023, and precisely how they will ultimately impact the restructuring industry in 2024 remains to be seen. That said, Skadden had a busy 2023, and we anticipate we'll generally remain busy through 2024. Just how busy may depend on what the Fed decides to do with rates (and how soon any rate cuts may be forthcoming).

Mintz: Early last year, the market faced rising interest rates and tightening credit. Today rates seem to have stabilized — even if elevated — and liquidity is far greater. This is a much more favorable environment for borrowers than 12 months ago.

Klein: I did not expect the continuation of the private debt investment dollars to continue pouring into the senior loan asset class, creating the continuation of too much supply. With too many dollars chasing deals, the borrowers and their counsel continue to have the leverage to drive loose and faulty documentation (from the lender perspective). ¤

About This Publication:

Turnarounds & Workouts is a newsletter for people tracking distressed businesses in the United States and Canada. *Turnarounds & Workouts* is published by Beard Group, Inc., Telephone: (240) 629-3300. ISSN 0889-1699. Editor: Christopher Patalinghug (tope@beardgroup.com). Assistant Editors: Psyche Maricon Castillon, and Peter A. Chapman. Subscription Rate: $447 per year per firm for one recipient plus $25 per year for each additional recipient. Contact tope@beardgroup.com for comments and coverage suggestions.