

Key bankruptcy trends in the first half of 2021

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I. Overview

The COVID-19 pandemic contributed to the year 2020 being one of the busiest years for restructuring professionals since the end of the Great Recession. In 2020, commercial chapter 11 filings increased 29 percent over 2019, and the total of 7,128 filings was the highest since 2012.

As the American economy shut down in the second quarter of 2020, industries as diverse as retail, oil and gas, leisure, and real estate experienced significant restructuring activity as global demand for oil fell by tens of millions of barrels per day, and foot traffic to shopping centers and domestic and international travel decreased significantly due to COVID-19.

The year's largest case was The Hertz Corporation, with almost \$20 billion in funded debt. The filing was precipitated by the massive pandemic-induced decrease in travel, with the company experiencing a 73% decline in global revenue in April 2020, shortly after the pandemic began, compared to April 2019.

Other major bankruptcy filings in 2020 included Chesapeake Energy Corporation, Neiman Marcus Group, J.C. Penney Company, Inc., and LATAM Airlines Group, SA.

In sharp contrast to the busy 2020 and expectations during a continuing global pandemic, the first half of 2021 has seen a sharp decline in bankruptcy and restructuring activity.

During the first six months of 2021, commercial chapter 11 bankruptcy filings decreased by 40 percent, with some of the largest filings including Seadrill Limited, Frontera Holdings, Brazos Electric Power Cooperative, and Washington Prime Group.

The enormous fiscal and monetary support provided by governments around the world is widely credited with preventing an economic catastrophe and providing sufficient liquidity for many businesses to survive the pandemic.

In the United States alone, COVID-19 relief measures exceeding \$5 trillion have been enacted into law since the onset of the pandemic, including the extension of almost \$800 billion in Paycheck Protection Program loans to various businesses.

The Federal Reserve, for its part, also has taken extraordinary action in response to the pandemic. It deployed both conventional monetary policy measures (such as lowering the target federal funds rate to a range of zero to 0.25%) to support the economy

as well as less conventional measures (i.e., purchasing corporate bonds and loans).

Over the course of the pandemic, lenders also have proven amenable to granting covenant relief, extending maturities, and providing additional liquidity to borrowers, rather than demanding more significant restructurings in the midst of an unfavorable or uncertain environment. This too has contributed to a lower level of restructuring activity in 2021 than many initially anticipated.

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For restructuring professionals, the first half of 2021 has presented multiple trends of note in spite of the overall decrease in activity, and several sectors bear watching for signs of distress during the remainder of the year.

II. Key trend: Pushback on 'extraordinary' bankruptcy court relief

At the beginning of the COVID-19 pandemic and with a sudden rush of bankruptcy filings, bankruptcy courts were receptive to providing "extraordinary" relief to chapter 11 debtors utilizing their broad, general bankruptcy powers.

For example, several courts originally granted so-called "mothball" orders allowing debtors to cease their operations and avoid paying post-petition rent, even beyond the periods permitted under the Bankruptcy Code.

Section 365(d)(3) provides that debtors must "timely perform" their obligations under a commercial property lease until the lease is assumed or rejected.¹ However, a bankruptcy court may "extend, for cause, the time for performance of any [rent] obligation that arises within 60 days after" the date the bankruptcy case was commenced although the "time for performance shall not be extended beyond such 60-day period."²

Pier 1 Imports filed for bankruptcy on February 17, 2020. Following the widespread closures in March 2020 stemming from the

COVID-19 pandemic, the debtors sought to temporarily close their stores and defer the payment of rent for periods beyond the 60-day period cited in section 365(d)(3).

The bankruptcy court authorized relief from rent obligations through May 31, 2020 (103 days from the bankruptcy filing), citing COVID-19 as a “temporary, unforeseen, and unforeseeable glitch in the administration of the Debtors’ Bankruptcy Cases” and found that rent could be deferred until the effective date of the plan.³

However, as the pandemic raged on and bankruptcy filings waned, bankruptcy courts began pushing back on non-traditional relief. By late 2020 and early 2021, courts were unwilling to bend the rules.

In the Chuck E. Cheese case, Judge Marvin Isgur of the ever-popular U.S. Bankruptcy Court for the Southern District of Texas denied motions to extend rent obligations beyond the 60-day period, finding that section 365(d)(3) of the Bankruptcy Code unambiguously required timely performance under leases and that the bankruptcy court could not use its equitable powers under section 105(a) of the Bankruptcy Code to alter the debtors’ rent obligations.⁴

Similarly, in the Cinemex case, the debtors, who operated movie theaters in a number of states, argued that their obligation to pay rent should be fully excused, delayed, or commensurately reduced while Florida’s COVID-19 orders limited theater capacity to fifty percent occupancy based on the legal doctrines of impossibility or impracticability of performance.⁵ Relying on Florida law, the court rejected Cinemex’s argument, emphasizing that “courts are reluctant to excuse performance that is not impossible but merely inconvenient, profitless, and expensive[.]”⁶

III. Key trend: Lofty valuations put equity holders in the money

The stock and bond market took significant losses during 2020 but have rebounded and even exceeded pre-pandemic levels. As unprecedented levels of capital have noted into the market, valuations have soared, making recoveries for equity holders in bankruptcy curers — previously unheard of — now almost commonplace.

Hertz filed for bankruptcy on May 22, 2020, as a result of the “abrupt decline” in the car rental business caused by COVID-19. While unsecured bonds issued by Hertz traded as low as ten cents on the dollar around the time of the bankruptcy filing, in March 2021 Hertz proposed a chapter 11 plan with Knighthood Capital and Certares Management acting as plan sponsors that would pay general unsecured creditors 70 cents on the dollar.

Bondholders deemed the initial plan insufficient and teamed up with Centerbridge Partners, Warburg Pincus and Dundon Capital Partners to propose their own plan.

After each group continued to submit topping bids, with both plans ultimately providing 100% recoveries for general unsecured creditors, the debtors held an auction pitting the two groups of sponsors against each other for who could provide the highest recoveries for the existing equity holders.

The Knighthood/Certares-sponsored plan won out, paying existing equity holders \$1.53 per share in cash plus upside in the reorganized company upon Hertz’ emergence from bankruptcy on July 1, 2021.

Shareholders have attempted to exert greater influence in other pending cases as well. In the Garret Motion case, the official committee of equity holders sought to terminate the debtors’ exclusive plan filing period in order to propose a competing chapter 11 plan under which existing shareholders would hold a significantly higher percentage of the reorganized common stock.⁷

The dispute ultimately was resolved and a consensual plan was confirmed in April that provided existing shareholders a greater share of the post-reorganization common stock than the debtors initially proposed.⁸

The first half of 2021 has seen progress toward resolving major issues in the high-profile mass tort cases of Purdue Pharma L.P. and the Boy Scouts of America.

In March 2021 in the LATAM Airlines case, a pro se shareholder filed a motion requesting appointment of an official committee of equity holders, pointing to the fact that the common shares had a \$1 billion market capitalization.⁹ The motion ultimately was withdrawn when Judge James Garrity called the motion “premature.”

Most recently, the United States trustee appointed an official committee of equity security holders in the chapter 11 cases of shopping mall owner Washington Prime Group, which filed for chapter 11 protection in mid-June. Under the current version of the debtor’s chapter 11 plan, recoveries for preferred and common stockholders would vary depending on whether their respective classes vote to accept or reject the plan and whether the court approves the plan’s “death trap” voting mechanics.

The enthusiasm in the markets has also provided relief to distressed companies who have avoided bankruptcy by taking advantage of investors’ demand for investment opportunities. AMC Entertainment, the movie theater owner and operator, warned in December 2020 that it might have to file for bankruptcy.

However, at the beginning of 2021, it was able to tap into the capital markets, raising over \$917 million in new equity and debt and declared that “any talk of an imminent bankruptcy ... is completely off the table.” In June 2021, the company raised an additional \$587 million via equity issuance, further strengthening its balance sheets, despite missing earnings expectations for Q1 2021 and increased competition from streaming services.

IV. Key trend: High profile mass tort cases progress

The bankruptcy system has long been a vehicle for addressing mass tort liabilities, particularly liabilities arising from exposure to asbestos. Over the years, debtors have turned to bankruptcy to consolidate and resolve an even wider array of mass tort liabilities,

including recently, liabilities relating to the opioid crisis and sexual abuse claims.

The first half of 2021 has seen progress toward resolving major issues in the high-profile mass tort cases of Purdue Pharma L.P. and the Boy Scouts of America, which filed for bankruptcy to address a wave of opioid and sexual abuse claims, respectively.

A. Purdue Pharma

Purdue Pharma and various affiliates filed chapter 11 petitions in September 2019 in the U.S. Bankruptcy Court for the Southern District of New York.

At the time of filing, various of the debtors and related parties were named as defendants in more than 2,600 lawsuits in federal and state courts across the country alleging that Purdue's manufacturing, marketing, and selling of opioid medications greatly contributed to the opioid epidemic in the United States.

The aviation industry (and particularly business travel) remains one to watch for potential distress in the coming months.

At the outset of the case, Purdue Pharma sought a preliminary injunction to pause for 270 days the active cases brought against the debtors by various governmental entities, as well to stay active claims against the current and former owners (including any trusts and their respective trustees and beneficiaries, i.e., the Sackler family), officers, directors, employees, and associated entities.

The debtors argued that the "tidal wave" of litigation would frustrate a successful reorganization, and that it was a "paradigmatic case" for the court to issue an injunction under section 105(a) of the Bankruptcy Code, which empowers a bankruptcy court to issue orders "necessary or appropriate" to carry out the provisions of the Bankruptcy Code.¹⁰

In support, the debtors pointed to the fact that their main operating entity was spending an average of over \$2 million per week in legal and professional costs directly related to the pending lawsuits against the debtors.

Judge Drain granted the preliminary injunction for a shorter period than the debtors initially requested, but it has since been extended numerous times, most recently through August 30, 2021, to allow the debtors and their various creditor constituencies time to negotiate settlements of the massive volume of opioid-related claims against the debtors.

Recently, the case has achieved several significant milestones as the debtors have put forth a chapter 11 plan that they seek to confirm by the end of August.

The plan contemplates that Purdue Pharma's shareholders will contribute \$4.325 billion over nine years, which will be distributed to creditors, and Purdue Pharma's ongoing businesses will be contributed to a newly created private company that will be required to deploy its assets to abate the opioid crisis.¹¹

In exchange for their settlement payments, Purdue Pharma's shareholders (including the Sackler family) would receive broad releases of claims against them based on the debtors' development, manufacturing, and promotion of opioid products.

The current version of the plan was filed with the support of most of the debtors' creditor constituencies. However, the United States Trustee has objected to confirmation of the plan, calling the proposed releases of the Sackler family and related parties "extraordinarily broad" and arguing that they constitute involuntary third-party releases that are barred under the Bankruptcy Code and U.S. Constitution.¹²

Various states have similarly objected to the proposed releases of the Sackler family. The plan confirmation hearing is scheduled to begin on August 12.

B. Boy Scouts

On February 18, 2020, the Boy Scouts of America filed a chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware to confront approximately 275 then-pending lawsuits in state and federal courts across the United States that asserted sexual abuse-related claims against the youth organization.

The increase in abuse claims in recent years placed severe financial pressure on the organization, with the national organization having spent more than \$150 million on settlements and legal and professional costs from 2017 to 2019. The Boy Scouts entered bankruptcy proposing to establish a victims compensation trust that would be the sole source of recovery for holders of abuse claims.

Since the filing, the debtors have engaged in extensive negotiations with their major creditor constituencies, culminating in a proposed settlement with abuse claimants under which the Boy Scouts and its local councils (who are not debtors) would contribute \$850 million to a settlement trust to compensate victims.¹³

The hearing on the debtors' motion to approve entry into the restructuring support agreement and the disclosure statement for the chapter 11 plan, each of which incorporated the settlement, is scheduled to be heard by the bankruptcy court in the next month.

V. Sectors to watch

Despite the relative slowness of the restructuring market in the first half of 2021, several industries and sectors bear watching for potential signs of distress in the coming months.

A. Real estate

As Americans begin navigating the post-pandemic world, the potential lasting effects on the commercial real estate market will become apparent and potentially reveal areas of weakness. Unsurprisingly, the hotel, office, and shopping center segments of the real estate market were hard-hit during the pandemic.

Going forward, the longer-term adoption of work-from-home arrangements has contributed to a reduction in the use of office space that may be a sign of future distress, while the longer-standing consumer shifts away from brick-and-mortar retail appear set to continue.

B. Aviation

The most recent comprehensive COVID-19 relief legislation enacted in the United States included an additional \$14 billion in payroll support for the airline industry through September 30, 2021.

Despite the continued government support and a rebound in air travel, the International Air Transport Association has projected net global airline industry losses of more than \$47 billion in 2021.

Depending on the ability and willingness of governments to provide continued support for the industry, and the possibility of a resurgence of the COVID-19 pandemic due to the spread of variants, the aviation industry (and particularly business travel) remains one to watch for potential distress in the coming months.

C. Leisure and hospitality

The leisure and hospitality sectors continue to bear monitoring in the coming months for pockets of distress, notwithstanding the recent increase in travel, restaurant, and hotel demand as business restrictions have been lifted and people have become vaccinated for COVID-19.

For instance, a new report released by the American Hotel & Lodging Association shows that 21 of the top 25 U.S. hotel markets remain in a depression or recession, in large measure because business travel is not expected to return to pre-pandemic levels for another two or more years. Similarly, major event and convention activity has been slower to rebound than general leisure travel.

Particularly in the event that restrictions on business activity or travel are re-imposed in coming months due to the spread of COVID-19 variants (as has already happened in some regions of the

world), the leisure and hospitality sectors may continue to present opportunities for restructuring professionals through the rest of 2021 and beyond.

Notes

¹ 11 U.S.C. § 365(d)(3).

² 11 U.S.C. § 365(d)(3).

³ In re Pier 1 Imports, Inc., 615 B.R. 196, 202-03 (Bankr. E.D. Va. 2020).

⁴ In re CEC Entertainment, Inc., 625 B.R. 344, 353 (Bankr. S.D. Tex. 2020).

⁵ In re Cinemex USA Real Estate Holdings, Inc., 627 B.R. 693, 696 (Bankr. S.D. Fla. 2021).

⁶ Id. at 699.

⁷ Motion of the Official Committee of Equity Securities Holders for Entry of an Order Terminating the Debtors' Exclusive Periods to File a Chapter 11 Plan and Solicit Acceptances [D.I. 794].

⁸ Debtors' Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code [D.I. 1018].

⁹ Emergency Motion for an Order Appointing an Official Committee of Equity Holders Pursuant to Section 1102 of the Bankruptcy Code [D.I. 2053]; Declaration of Lorie R. Beers in Support of the Motion of the Official Committee of Equity Securities Holders for Entry of an Order Terminating the Debtors' Exclusive Periods to File a Chapter 11 Plan and Solicit Acceptances [D.I. 795].

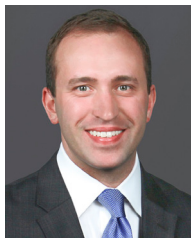
¹⁰ 11 U.S.C. § 105(a).

¹¹ See Sixth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors [D.I. 3185].

¹² See Objection of United States Trustee to Sixth Amended Joint Chapter 11 Plan of Purdue Pharma L.P. and Its Affiliated Debtors [D.I. 3256].

¹³ See Debtors' Motion for Entry of an Order, Pursuant to Sections 363(b) and 105(a) of the Bankruptcy Code, (I) Authorizing the Debtors to Enter Into and Perform Under the Restructuring Support Agreement, and (II) Granting Related Relief [D.I. 5466]; Fourth Amended Chapter 11 Plan of Reorganization for Boy Scouts of America and Delaware BSA, LLC [D.I. 5484].

About the authors



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