PARSONS BEHLE & LATIMER

MONDAY, SEPTEMBER 7, 2020 UPDATE

BANKRUPTCY TRENDS IN A PANDEMIC

1. August's bankruptcy trends headlines.
2. Abstract.
3. The pandemic's effect on the economy.
4. Its effect on bankruptcy filings nationally.
5. Its effect on bankruptcy filings in the mountain west.
6. How big is the backlog?
7. Factors delaying the inevitable.
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1. <u>August Headlines:</u>

- Despite a deep recession that began in March 2020, relatively few businesses had filed bankruptcy through July 2020.

- In August, monthly business bankruptcy filings of all types declined further, by 11%, with chapter 11s leading the way, declining 18%.

- Fewer chapter 11 cases were filed in August than in any month this year. In bellwether Delaware, chapter 11 filings declined 43%.

- As of August 31, 2002 only six states have had more filings year-to-date in 2020 than they did in 2019. In Utah, there have been 40% fewer business bankruptcy filings this year than last.

- A backlog of bankruptcy cases is building.

2. Abstract—A Tale of Two Recessions:

- Business bankruptcy filings in the pandemic are not trending like they did in the Great Recession, which accelerated the rate of filings.

- So far, the pandemic has *decelerated* the rate of bankruptcy filings. Now there’s a backlog of perhaps 7,000 cases, a pent-up demand for bankruptcy relief.

- When the logjam breaks there will be a wave of business bankruptcies and business failures. That wave will reduce wages and corporate income, disrupt supply chains, and result in a glut of assets for sale.

- The longer it takes for filings to begin to rise, the larger the backlog and resulting tsunami will be, and the greater both the collateral damage and the opportunities to buy cheap.

Trends during the Great Recession

- In March 2009, a subprime mortgage debt seize-up triggered a correction (off 10%) on Wall Street.

- Two months later, in May 2009, GDP bottomed out and chapter 11 bankruptcy filings peaked.

- About a year later, in April 2010, the ensuing wave of active pending chapter 11 cases crested.

- The number of active pending chapter 11 cases did not return to pre-recession levels for ten years.

Trends during the Pandemic

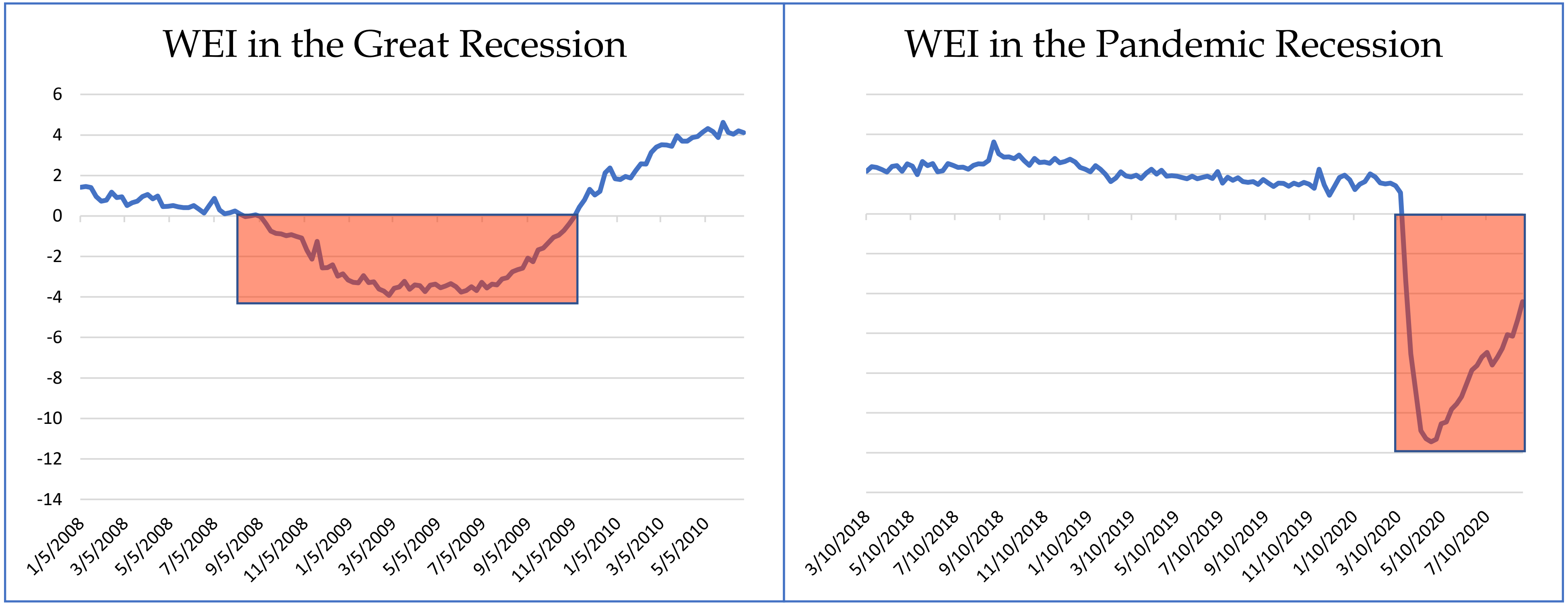
- The stock market suffered a correction in late February 2020, and it bottomed out in mid-March.

- A month later, in April 2020, business bankruptcy filings fell dramatically (instead of peaking, as they did in the Great Recession), and filings have remained below 2017-2019 levels since then.

- The pandemic has most certainly caused bankruptcies, but not *nearly* as many as the data indicates we should expect and prepare for.

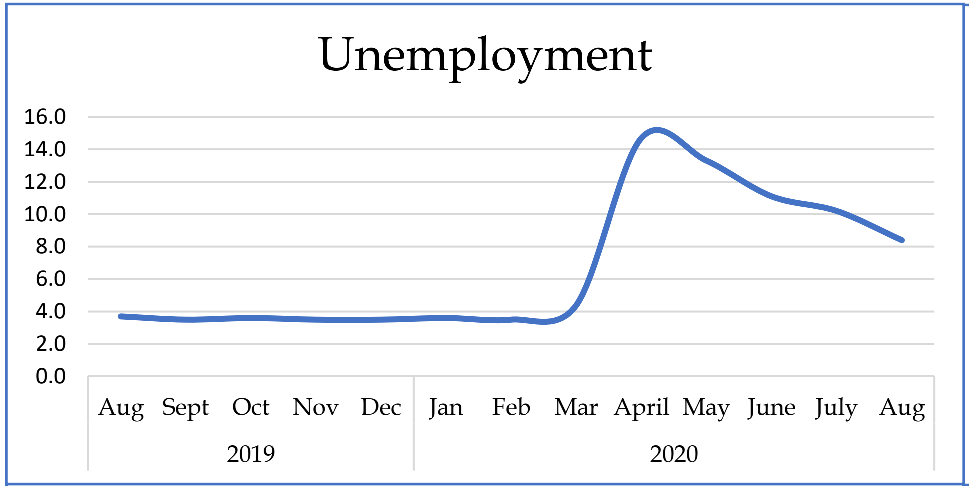
3. The Pandemic's Effect on the Economy:

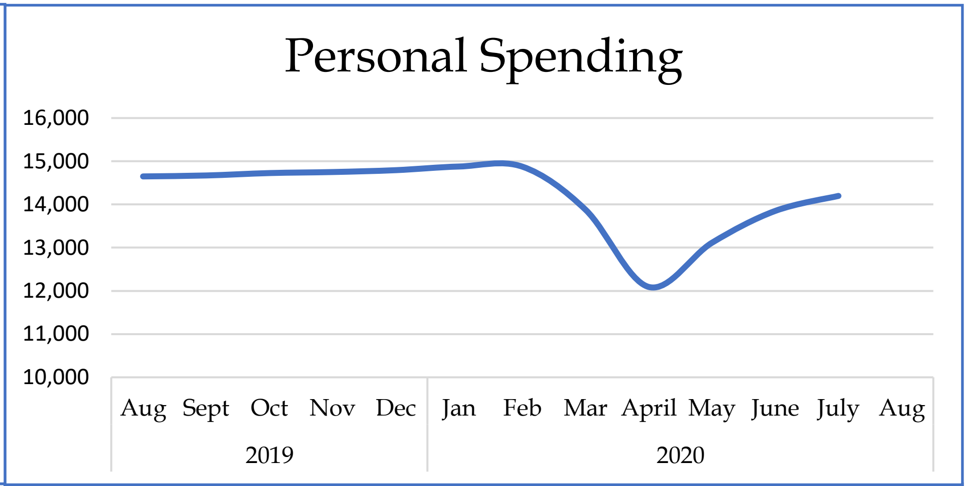
The Weekly Economic Index shows the economic shock of the pandemic as sharper and deeper than that of the Great Recession.

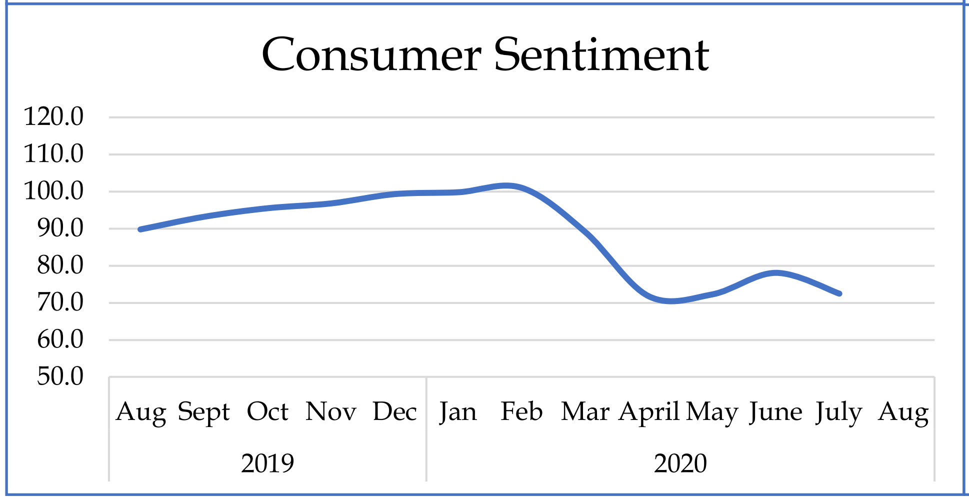


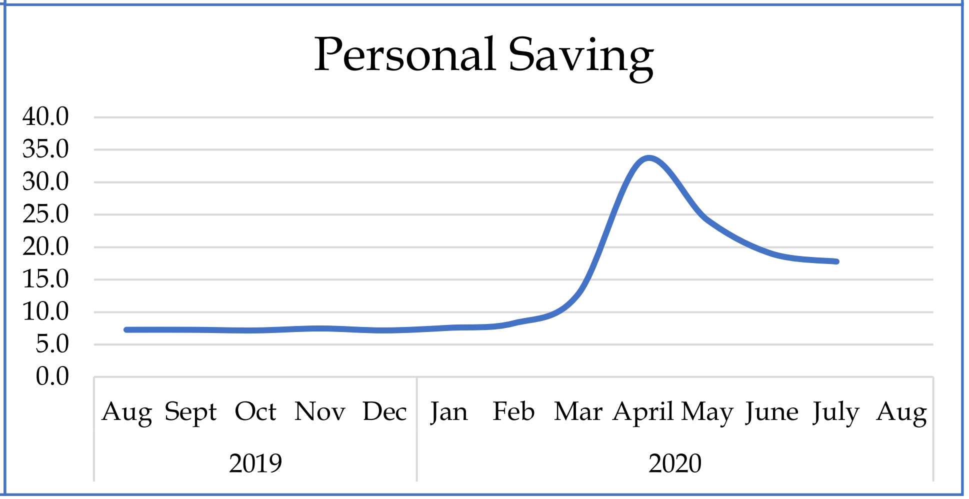
Lewis, Daniel J., Mertens, Karel, and Stock, James H.

Unemployment has fallen steadily since April, but consumer sentiment remains historically low. Consumer confidence is key to economic recovery, as consumer spending comprises two-thirds of GDP.

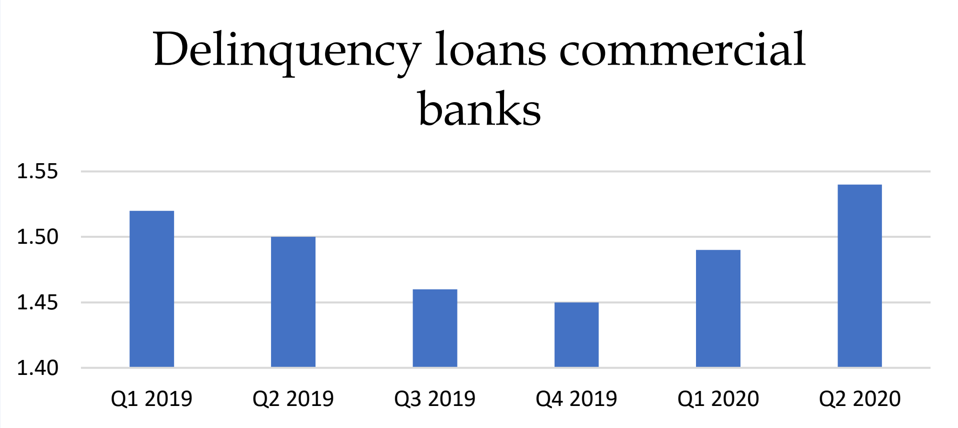


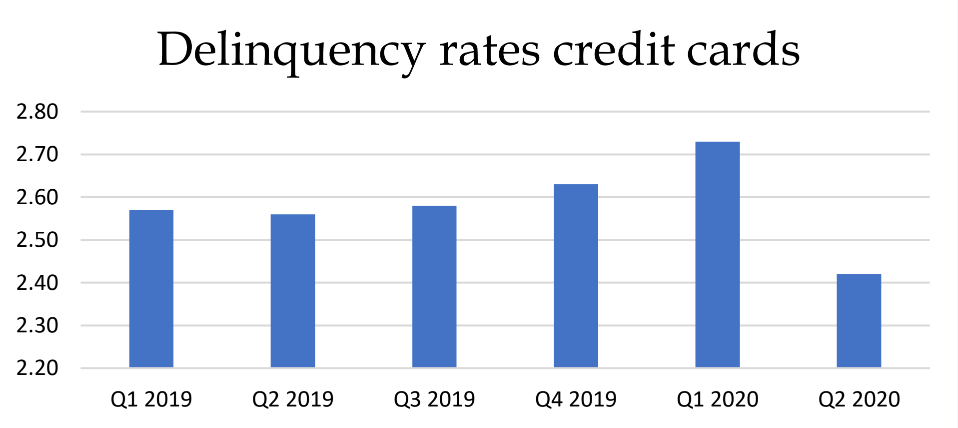


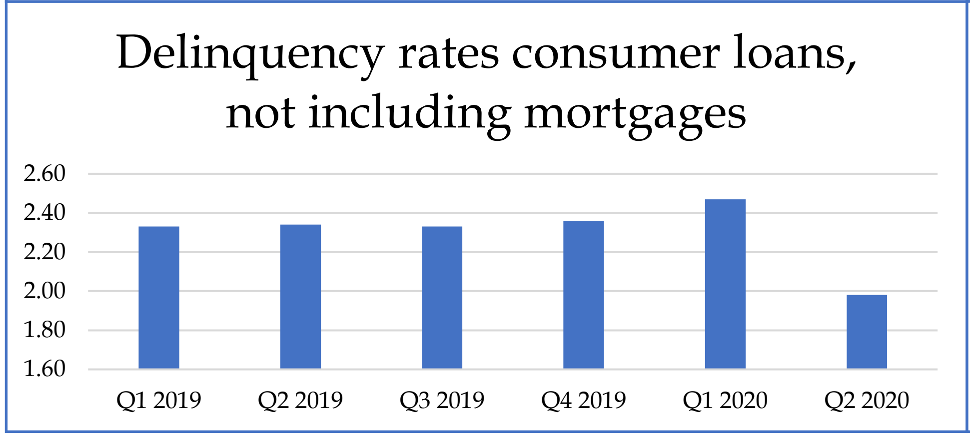


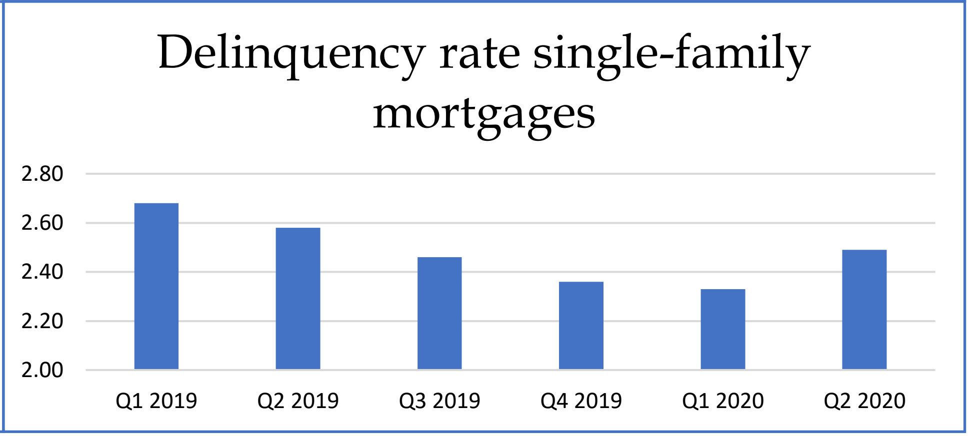


Loan delinquency rates rising is a signal of financial distress. But credit card delinquency rates are way down because consumers and small businesses are spending less and receiving support from the US treasury, and card companies are giving forbearances, which are not booked as delinquencies. Consumer loan delinquency rates are also way down because of the credit card effect and student loan forbearances. However, mortgage delinquency rates rising is alarming given the forbearances given in the CARES act and by lenders.

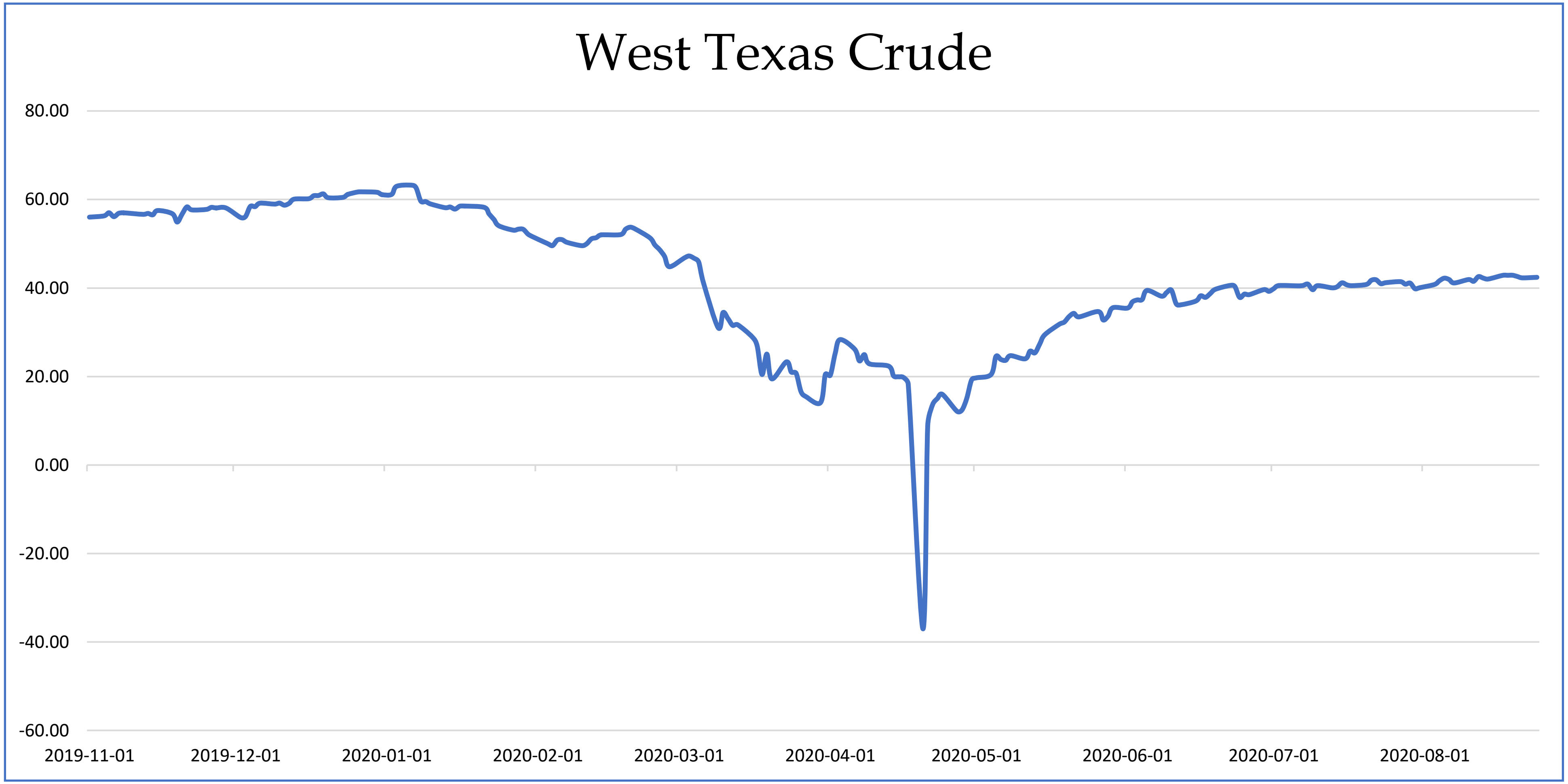






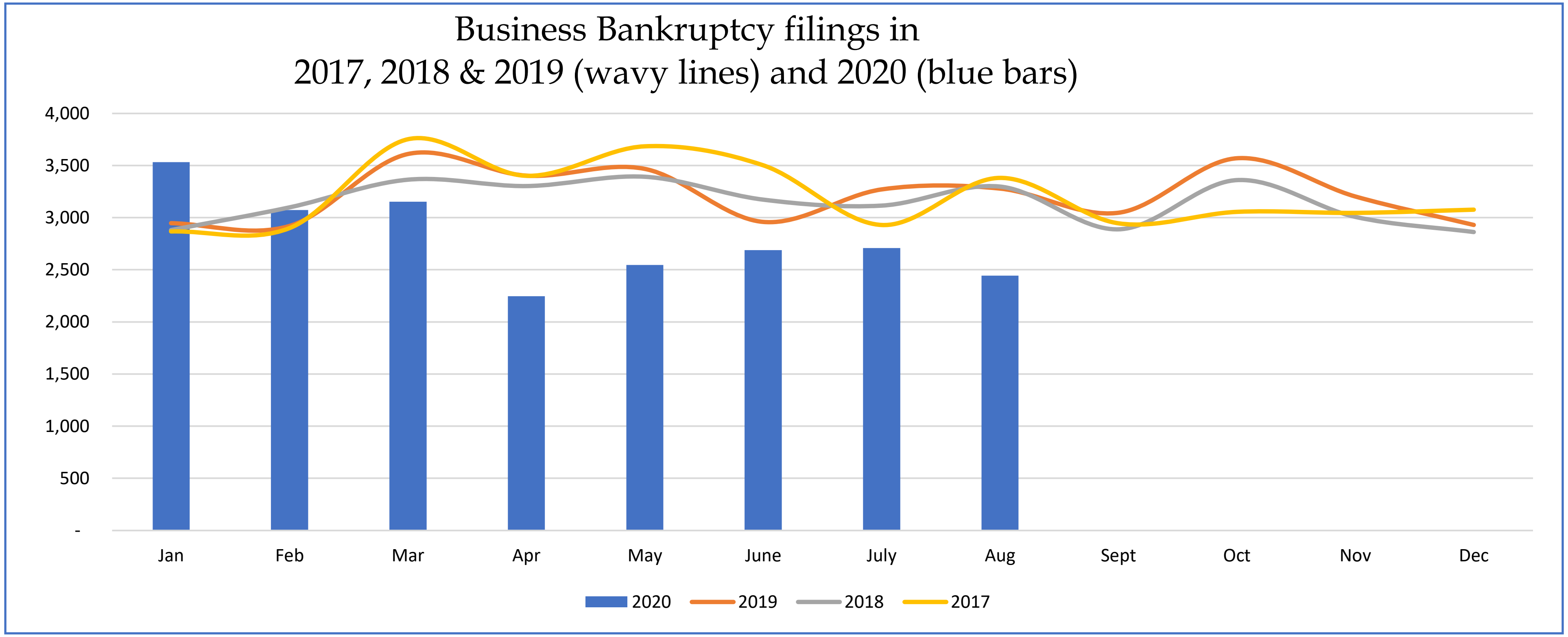


Oil prices were steady at $60 / barrel; after a shock, they've steadied again, but down 33%, which will further stress the energy-sensitive sectors.

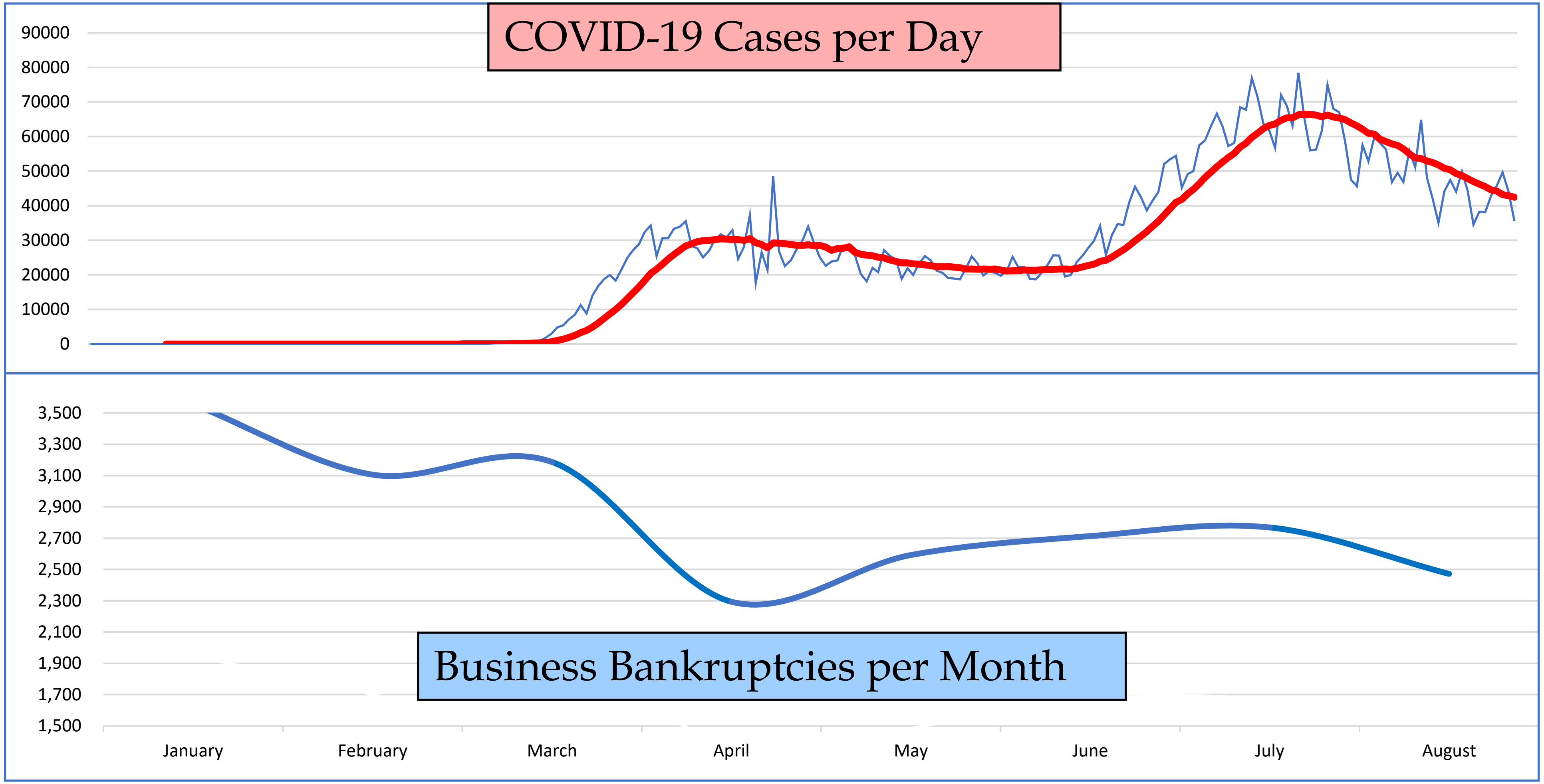


4. The Pandemic's Effect on Bankruptcy Filings :

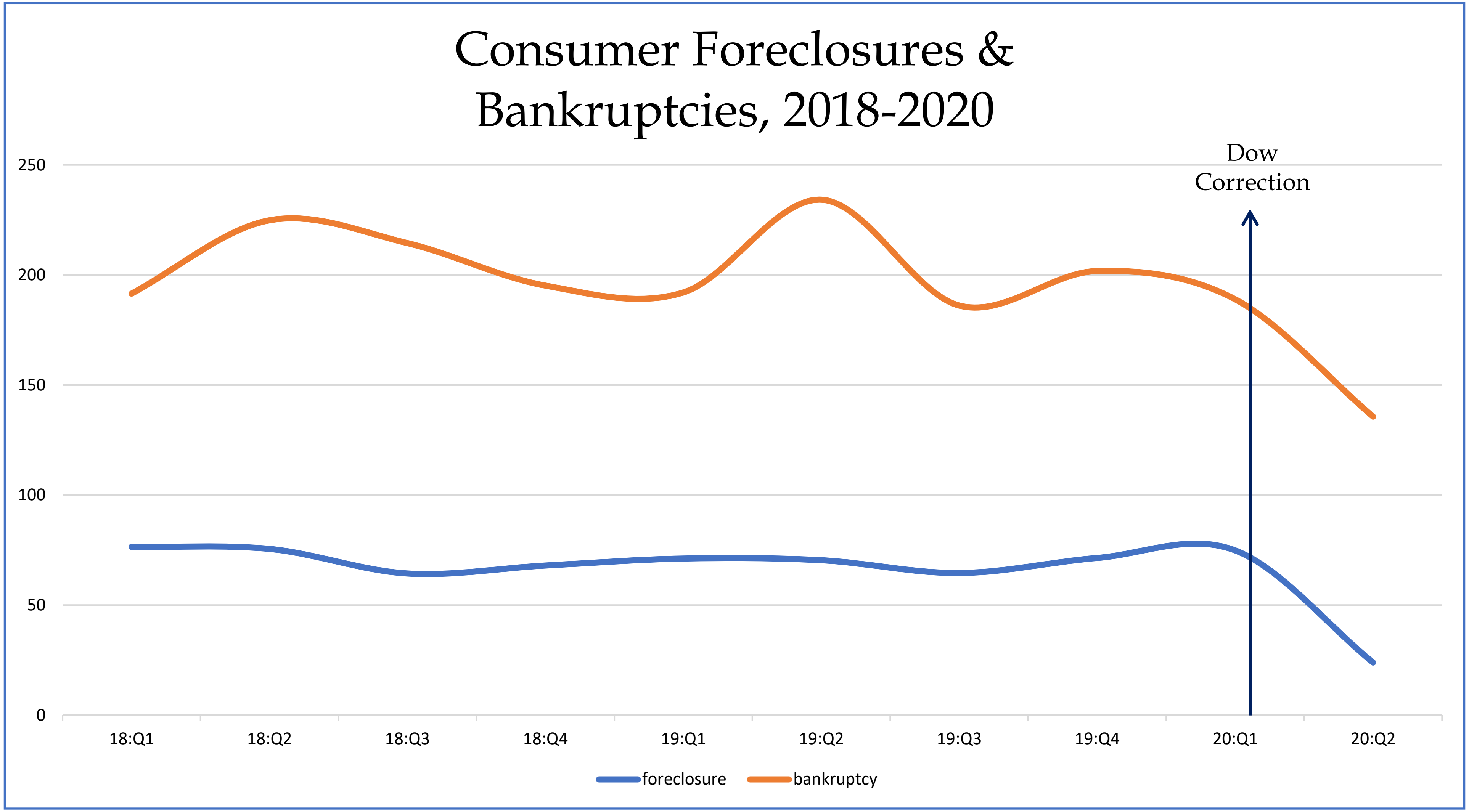
Despite enormous economic stress, business bankruptcy filings year to date in 2020 are below the normal levels of the last three years. Before the pandemic took hold, filings in 2020 were high in January and normal in February. After it took hold, filings fell nearly 30% from March to April and have remained below normal since then.



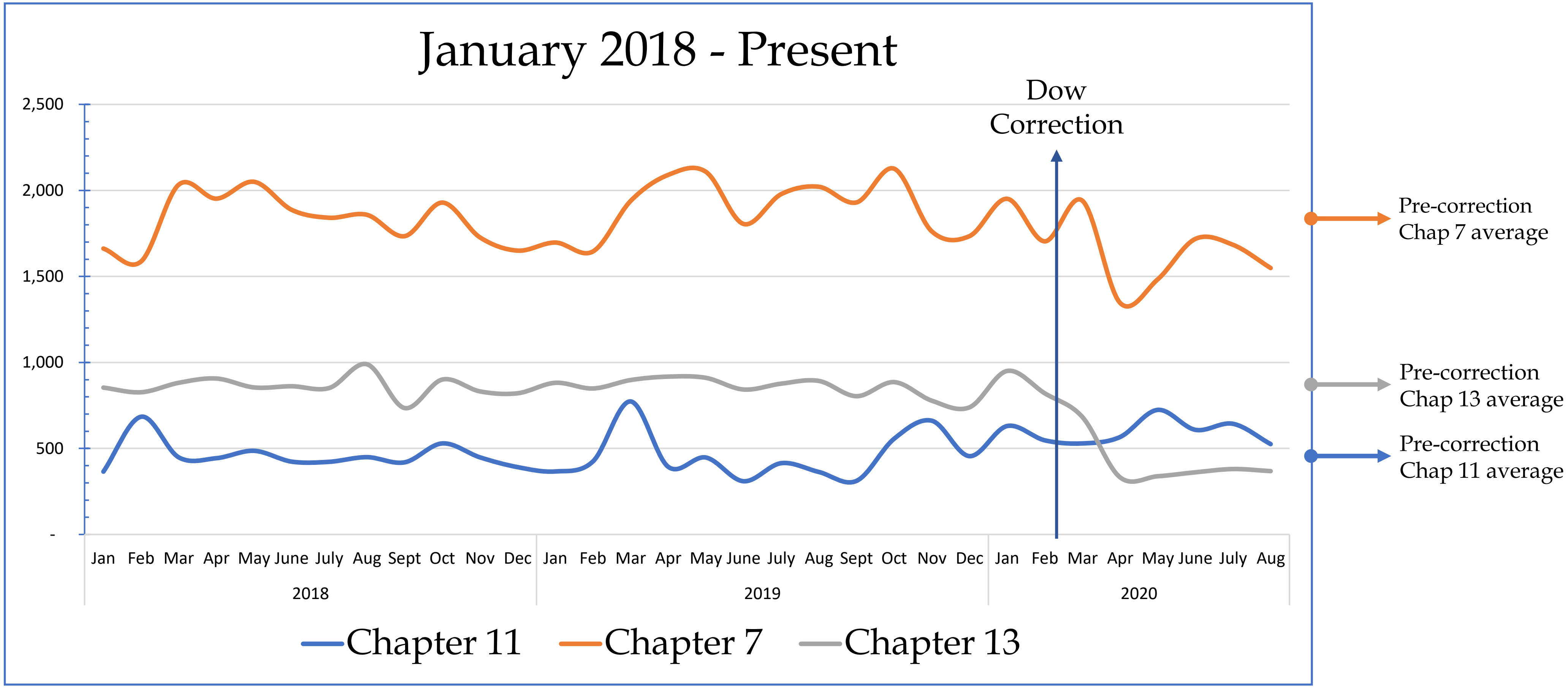
In March, April, and May 2020, there was an inverse relationship between COVID cases and business bankruptcy filings – as cases rose, filings fell. Then in August, cases fell and so did filings.



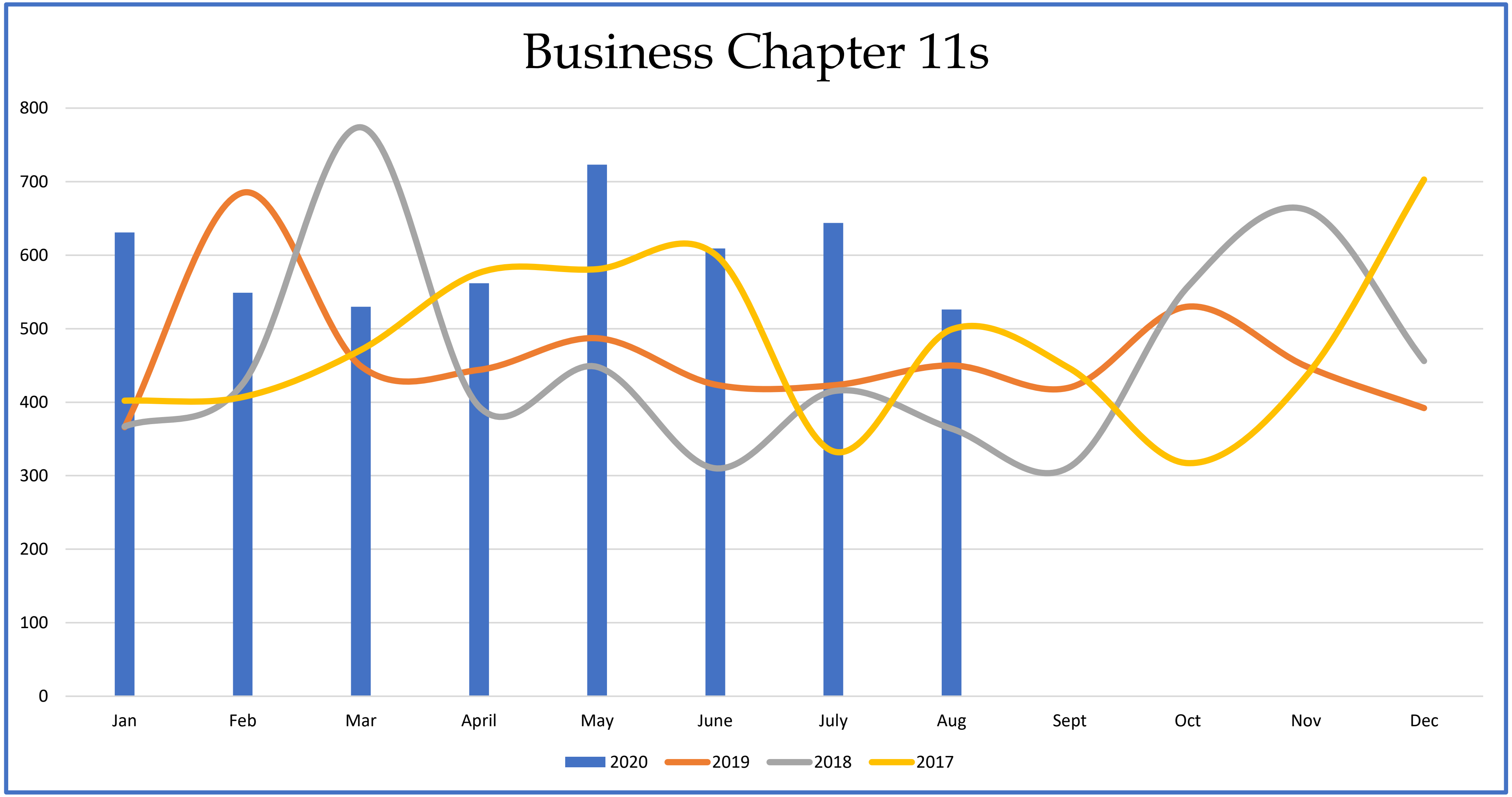
Consumer bankruptcy filing and foreclosure rates also plunged with the pandemic:



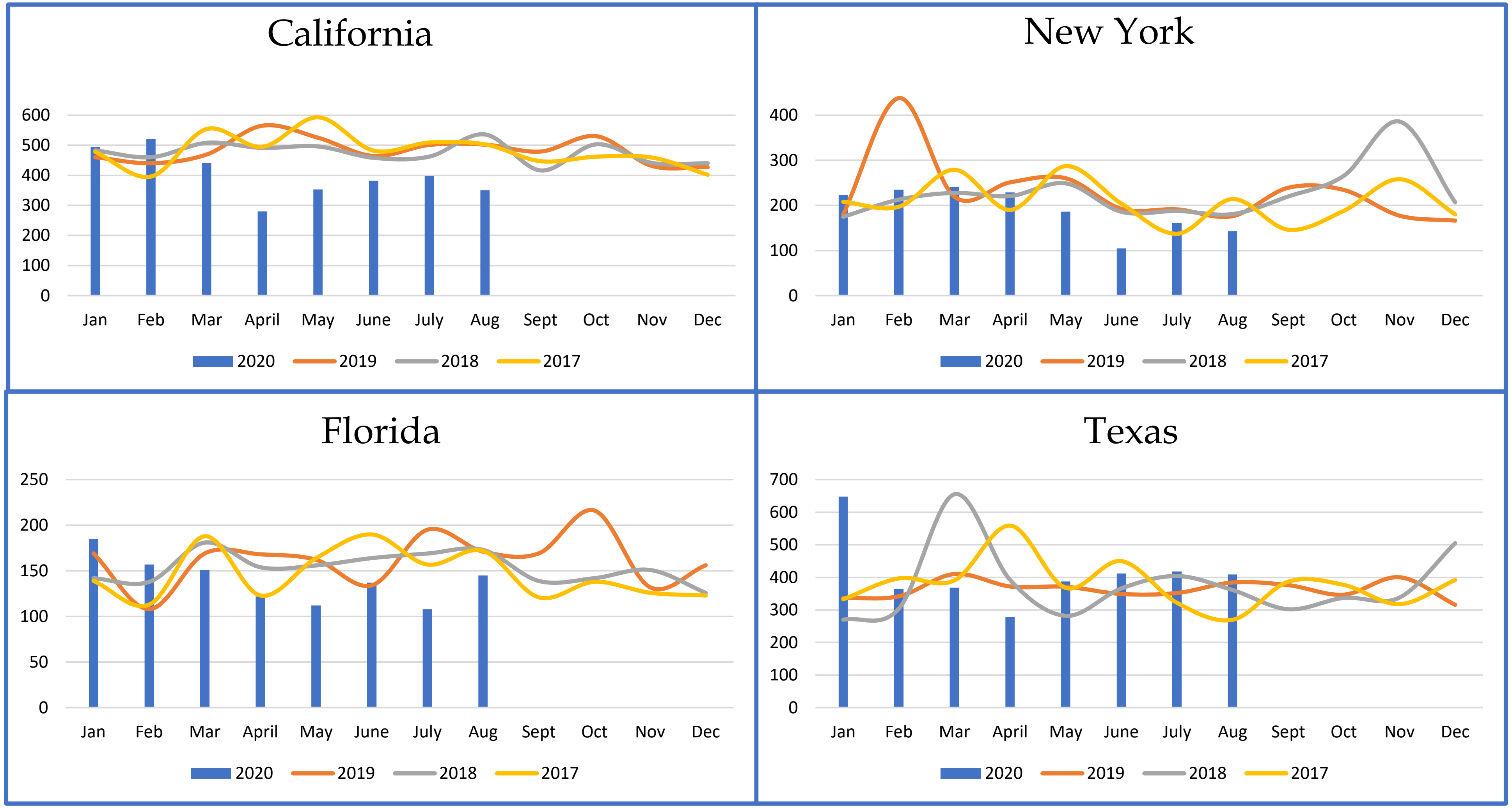
Since the Dow's correction, chapter 7s and 13s are down significantly from their pre-correction averages. Chapter 11s had been rising slowly above their average since last September but fell in August.



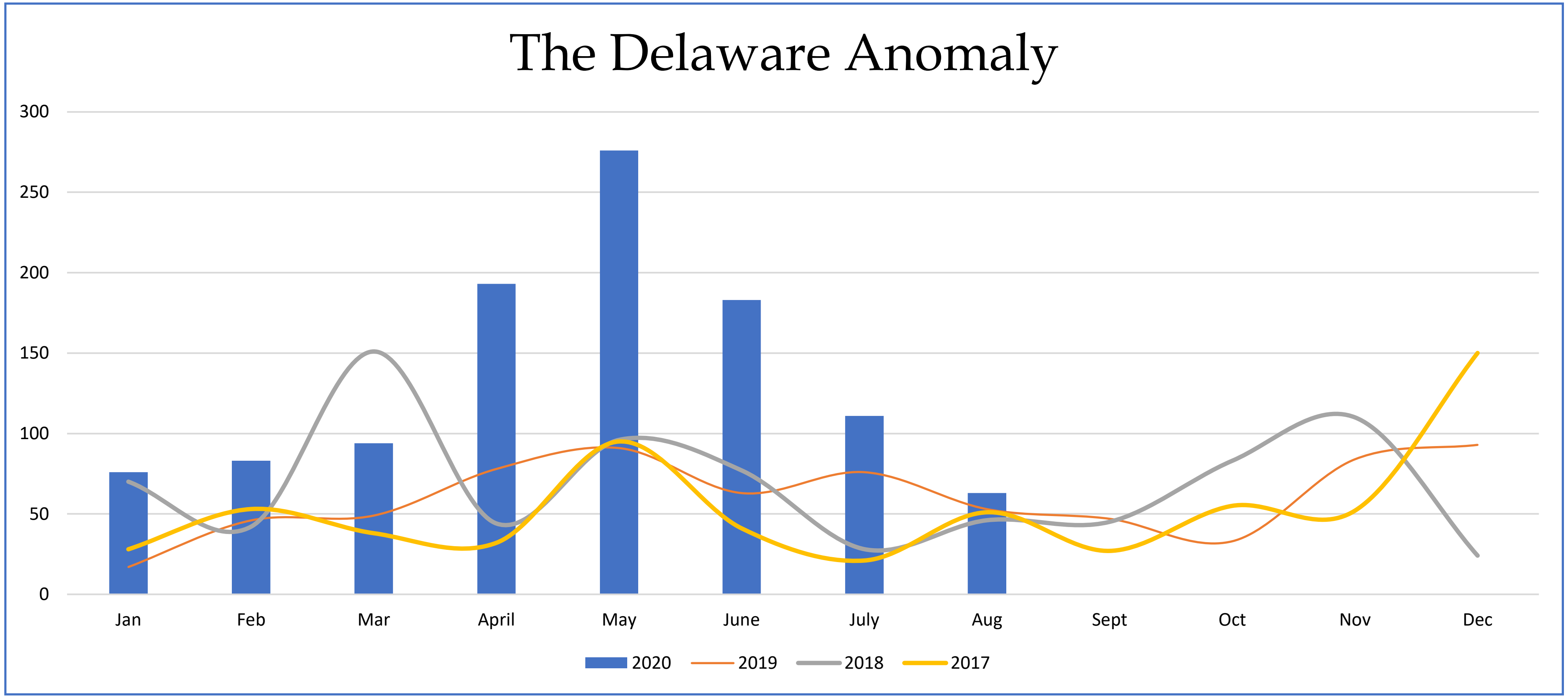
Chapter 11 filings in 2020 were higher than normal only in January, May, and July. No clear trend for business chapter 11s has emerged.



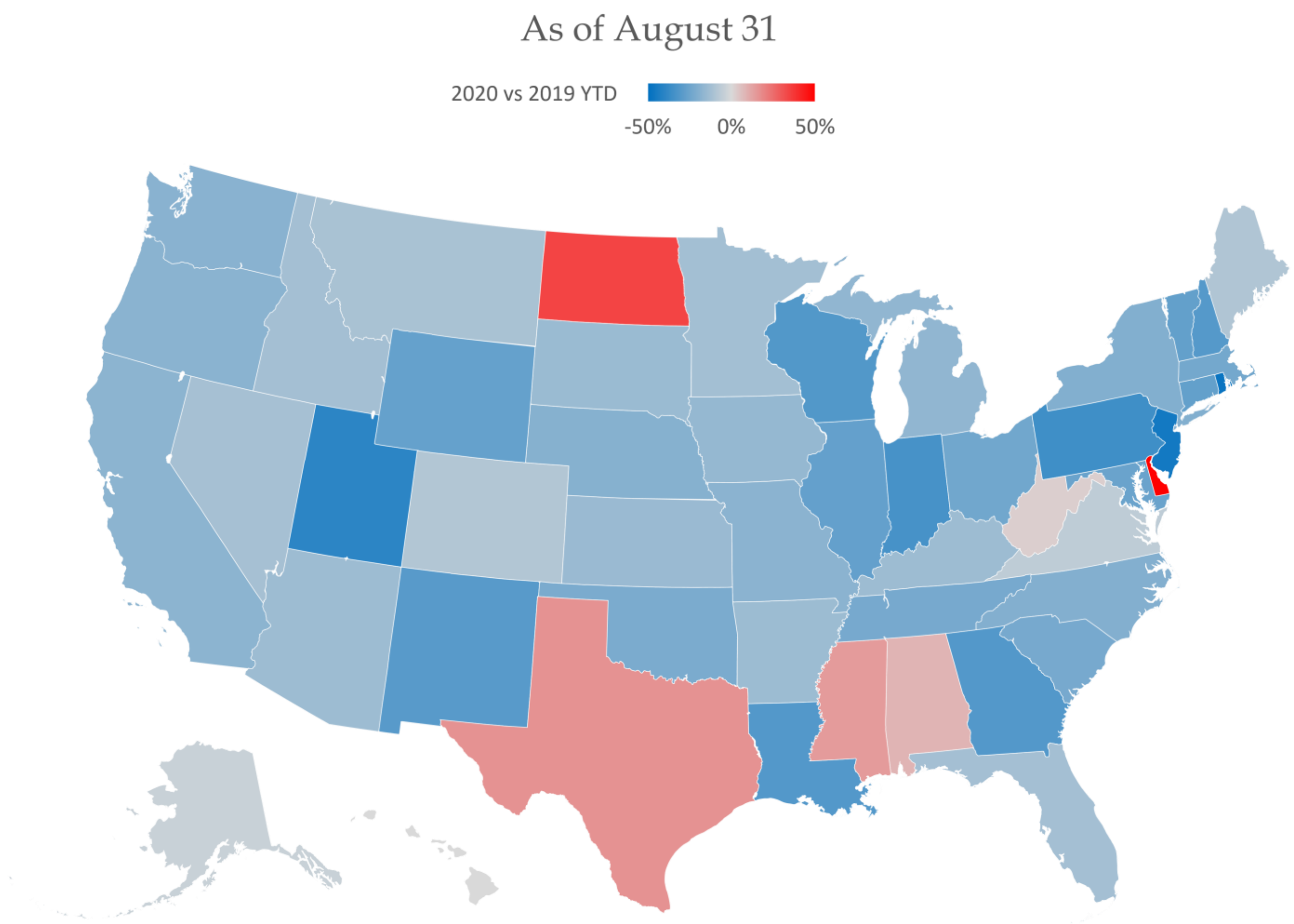
Business bankruptcy filings in our most populous states mirror the national trend. Even Texas, which has been one of the most bankruptcy-active states in 2020, is showing no spike.



Only Delaware has defied national trends. The state of incorporation for many public companies, it alone has had more bankruptcies in 2020 than in 2017-2019, but only in April through July. Many of these were high-profile bankruptcies in energy and brick and mortar sectors, several of which were destined to fail regardless. In August, Delaware returned to normal and is not showing signs of any impending wave.



Remarkably, as of August 31, <u>only six states</u> have had more filings year-to-date in 2020 than in 2019.



Only states with bankruptcy increases:

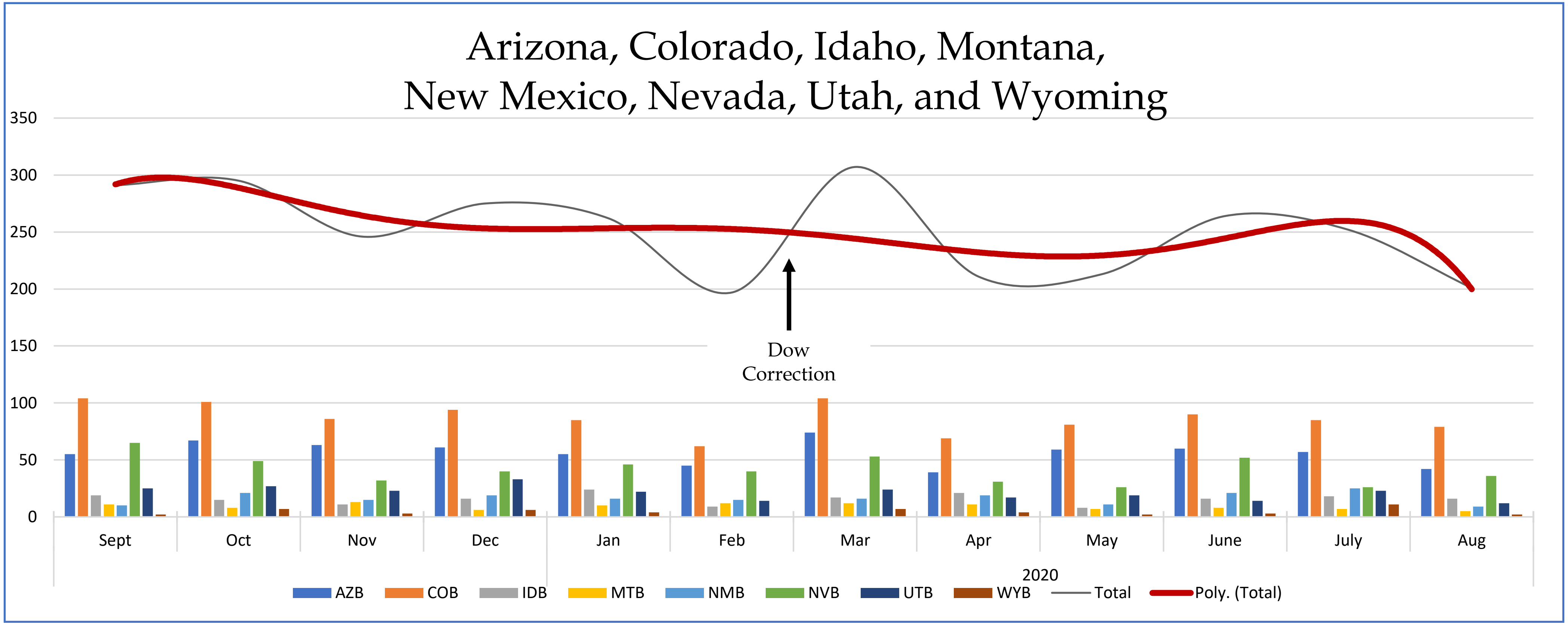
Delaware	128%
North Dakota	34%
Texas	16%
Mississippi	14%
Alabama	9%
West Virginia	2%

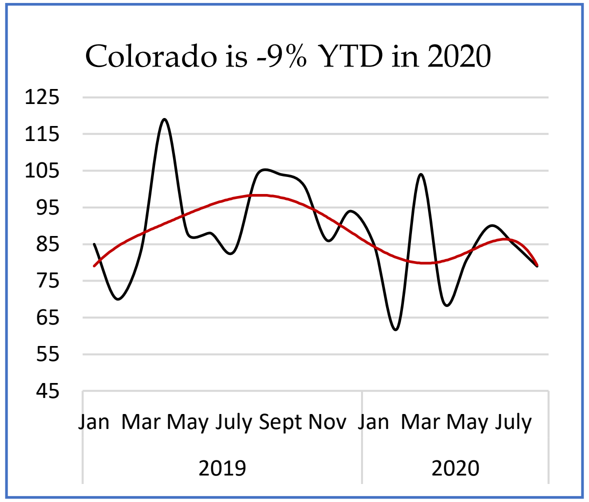
States with largest bankruptcy decreases:

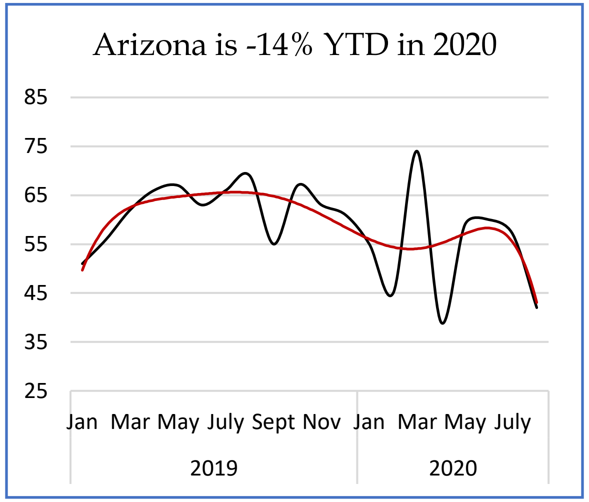
Rhode Island	-48%
New Jersey	-46%
Utah	-40%
Pennsylvania	-35%
Indiana	-34%
Wisconsin	-31%
Georgia	-31%
Louisiana	-31%
New Hampshire	-30%
New Mexico	-30%

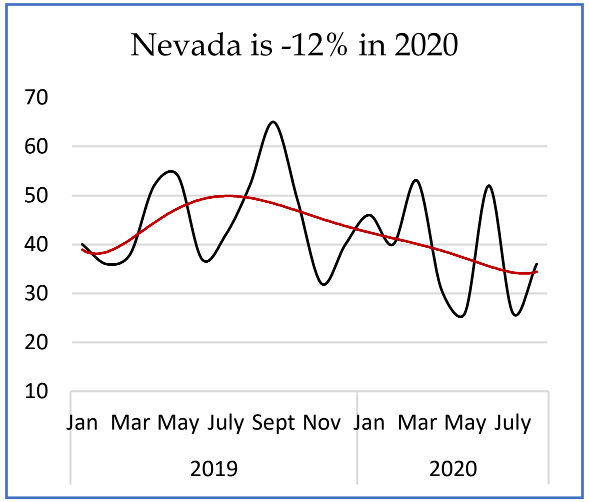
5. The Pandemic's Effect in the Mountain West:

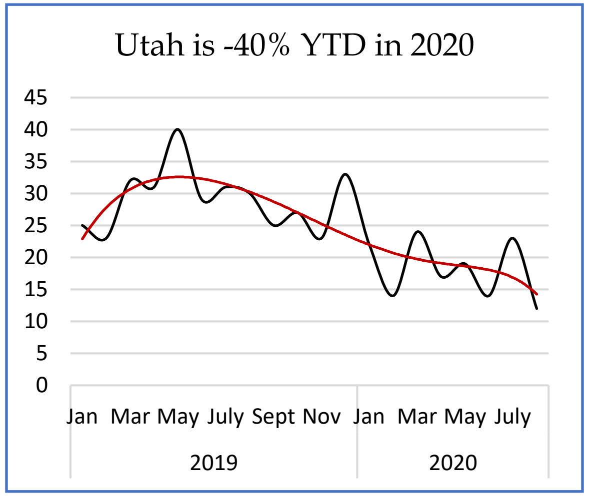
Over the past 12 months the mountain west states are consistent with national trends that indicate a deceleration of business bankruptcy filings. The surge here in March is mostly attributable to chapter 13 filers wanting to protect their tax refunds. Certainly, no spike:

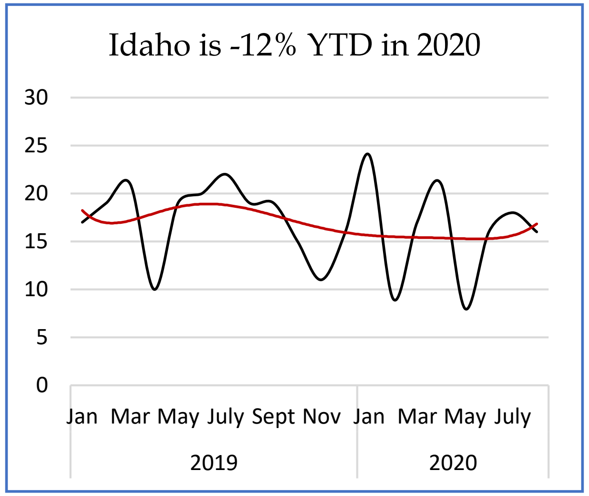


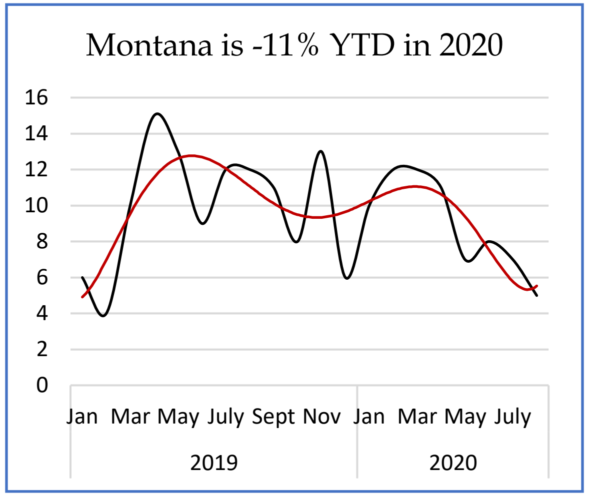

Colorado is -9% YTD in 2020
125
115
105
95
85
75
65
55
45
Jan Mar May July Sept Nov Jan Mar May July
2019
2020


Arizona is -14% YTD in 2020
85
75
65
55
45
35
25
Jan Mar May July Sept Nov Jan Mar May July
2019
2020


Nevada is -12% in 2020
70
60
50
40
30
20
10
Jan Mar May July Sept Nov Jan Mar May July
2019
2020


Utah is -40% YTD in 2020
45
40
35
30
25
20
15
10
5
0
Jan Mar May July Sept Nov Jan Mar May July
2019
2020


Idaho is -12% YTD in 2020
30
25
20
15
10
5
0
Jan Mar May July Sept Nov Jan Mar May July
2019
2020

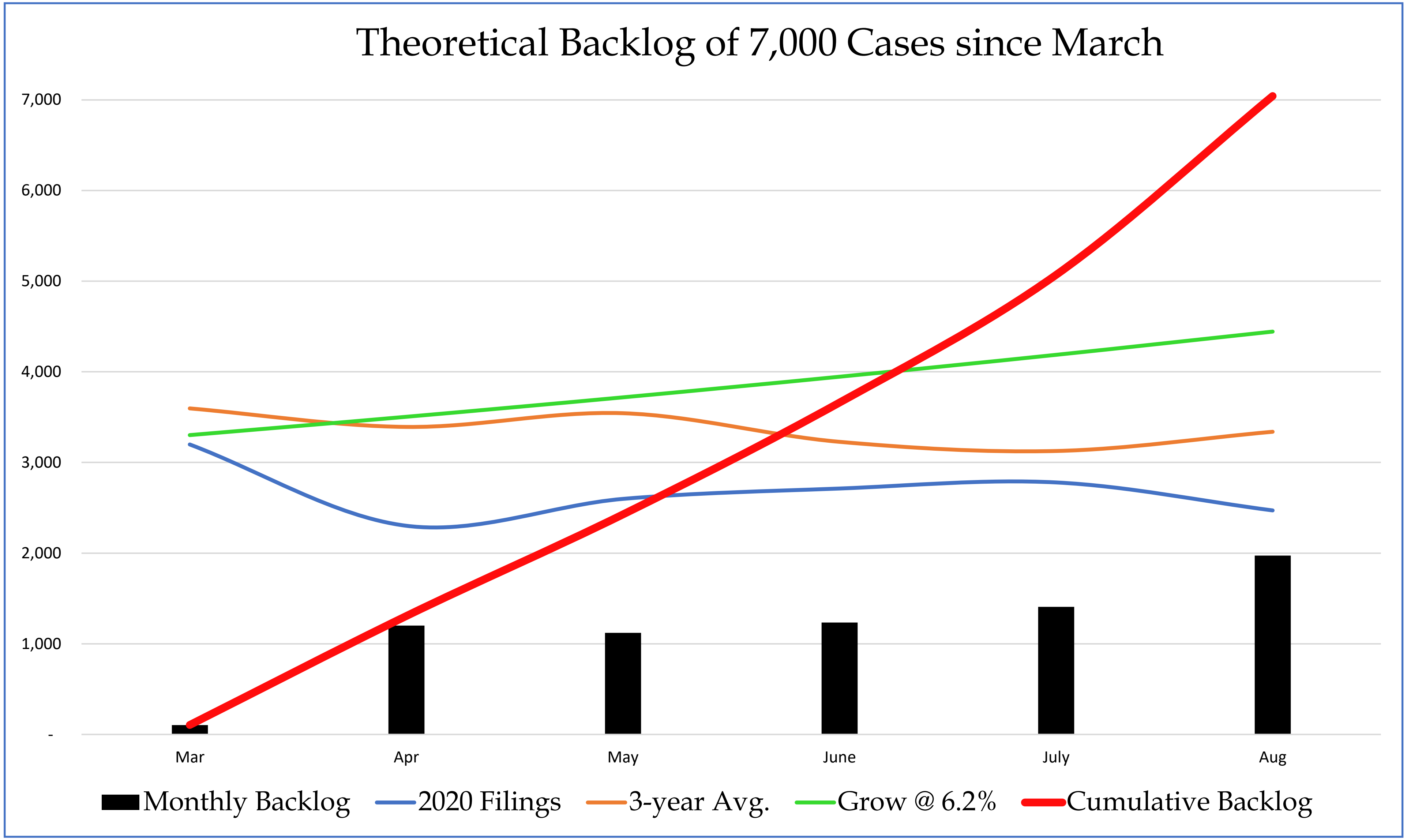

Montana is -11% YTD in 2020
16
14
12
10
8
6
4
2
0
Jan Mar May July Sept Nov Jan Mar May July
2019
2020

6. How Big is the Backlog?

- The pandemic has decelerated business bankruptcy filings. In March through August 2020, those filings were below the average of the previous three years by a total of 4,200 cases. These are not cases that will never be filed. This is the backlog caused by the Pandemic having decelerated the rate of filings.

- The Great Recession accelerated filings. Filings increased around 6.2% per month from March 2008 through May 2009. Had filings grown since the beginning of the pandemic (in March 2020) at 6.2% per month, an additional 2,800 cases would have been filed between then and the end of August.

- These observations predict a total backlog of approximately 7,000 business bankruptcy cases as of August 31, 2020. That's more than two typical months of filings.


Theoretical Backlog of 7,000 Cases since March
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
Mar
Apr
May
June
July
Aug
Monthly Backlog
2020 Filings
3-year Avg.
Grow @ 6.2%
Cumulative Backlog

7. Factors Delaying Bankruptcy Filings:

- **CARES Act.** The Treasury has poured up to $2 trillion into the economy through the CARES Act. This kept marginal businesses afloat.

- **Federal Reserve / lower borrowing rates**. By spending $1 trillion to buy bonds, and doing other things, the Fed has maintained credit markets assuring some availability of debt financing at historically low rates.

- **State and Federal moratoria on evictions and foreclosures**. The moratoria on foreclosures on most loans backed by the federal government have been extended to year end. For the time being, most banks are deferring to those moratoria with respect to *non*-federally backed residential loans. When one of them breaks rank, foreclosures and bankruptcies will surge

- **HEROES Act**. Although the Senate has not taken it up, the House's $3 trillion HEROES Act may have led to an assumption that there will be a second substantial stimulus package.

- **Home values**. In the Great Recession most home values were under water. But, so far, residential home values have held during the pandemic, which means that some distressed homeowners have had equity to borrow against for current expenses.

- **Delinquent is not delinquent until it's three months delinquent**. That's when the lawsuits are filed, after moratoria are lifted. Sometime later, when those lawsuits ripen, the defendants may seek bankruptcy protection. Current court backlogs, with criminal matters prioritized, will likely stretch three months to six months or longer.

- **Secured creditor / debtor reticence**. Secured lenders to movie-theater chains, sea-cruise lines, and rental-car companies, for example, may be reticent to foreclose on their collateral. Likewise, debtors—who would love to sell their theaters, ships, and used cars, etc. in order to restructure their balance sheets—may have the same reticence. This is not a sellers' market. A glut of assets for sale will be with us for years.

- **Uncertainty**. The decision to file bankruptcy requires some certainty about what the future holds. Either there's no chance of surviving or a plan to thrive can be formulated and executed. Many businesses may have delayed filing because they simply don't know what the future holds. Increasingly, uncertainty about the next election may play a role.

Conclusion

- The pandemic has caused a recession more damaging than the Great Recession. But while the Great Recession accelerated a wave of business bankruptcy filings, the pandemic has decelerated such filings.

- There’s now a backlog of bankruptcy filings, a pent-up demand for bankruptcy relief. When the logjam breaks there will be a wave of bankruptcy filings and business failures.

- The longer the logjam holds, the worse the collateral damage will be.

- Right now, it looks like it’s building into a tsunami.

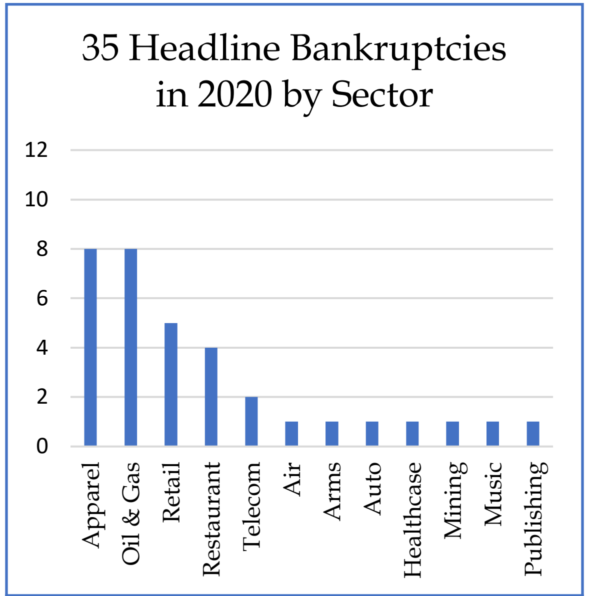
8. Appendices

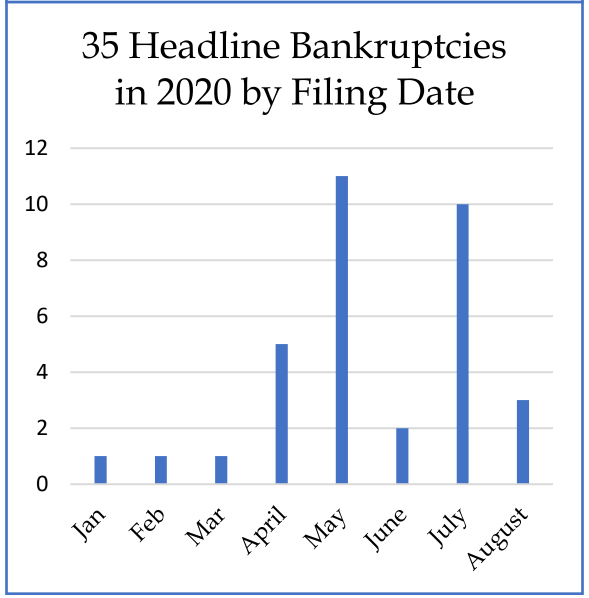
- Bankruptcies making headlines in 2020.
- Data sources.
- Parsons Behle & Latimer's Financial Distress Response Team.

Some 35 bankruptcies have made headlines in 2020, including:

- J. Crew,
- Brooks Brothers,
- Ann Taylor,
- Mens Warehouse,
- Lord & Taylor,
- Hertz,
- Chuck E. Cheese,
- California Kitchen,
- Neiman Marcus,
- JC Penny,
- Stein Mart, etc.

Most of them were in energy and brick and mortar sectors, especially susceptible to the pandemic recession. Many of them were likely to fail in 2020, even without a pandemic. These filings spiked in April, May and July. They do not show a trend or suggest an impending wave.





Principal Data Sources:

COVID-19 statistics:
https://rt.live/
https://ourworldindata.org/coronavirus-data-explorer?zoomToSelection=true&year=latest&time=2020-02-01..latest&country=USA~KOR~DEU~URY~IND~BRA~ITA~IDN~ZAF~MEX~NZL~TWN~NOR&region=World&casesMetric=true&interval=smoothed&aligned=true&smoothing=7&pickerMetric=location&pickerSort=asc

Economics statistics:
https://fred.stlouisfed.org/
https://www.newyorkfed.org/

Bankruptcy filing statistics:
https://www.epiqglobal.com/en-us/experience/restructuring-bankruptcy/aacer-court-data-and-process-automation/services/bankruptcy-statistics-trends

Court statistics:
https://www.uscourts.gov/statistics-reports/caseload-statistics-data-tables?tn=&pn=32&t=All&m%5Bvalue%5D%5Bmonth%5D=&y%5Bvalue%5D%5Byear%5D=

Special thanks to the Hon. Kevin R. Anderson, US Bankruptcy Judge for his guidance.

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FINANCIAL DISTRESS RESPONSE TEAM

- **Tom Beckett (Salt Lake City)**: JD / MBA, N.Y.U.; he formerly practiced in the bankruptcy group at Milbank Tweed in New York.
    - Tom has 30+ years' experience in large chapter 11 bankruptcies, including in the steel, coal, entertainment, and recreation industries. He has litigated force majeure cases and is certified as a business dispute mediator by the Program on Negotiation at Harvard Law School.
- **Bruce White (Salt Lake City)**: Member, Parsons Behle's Board of Directors, and member, advisory board of the Rocky Mountain chapter of the American Bankruptcy Institute. He formerly practiced in the bankruptcy group as a principal shareholder at the international firm of Greenburg Traurig (2200 lawyers) in Texas.
    - Bruce has 30+ years' experience in corporate restructuring, management, acquisition, and divestiture transactions in and out of bankruptcy. He represents secured and unsecured creditors, debtors, and committees in Chapter 11 bankruptcy cases across the county.
- **Rew Goodenow (Reno)**: Past president, Nevada Bar; he is the principal author of Nevada's Limited Liability Company Act and the chapter on receiverships in Nevada's civil practice manual; he chaired the ABA Journal editorial board for three years.
    - Rew has 30+ years' experience representing commercial and investment banks, trustees, receivers, and financial institutions in workouts and creditor litigation.
- **Bryan Elwood (Lehi)**: Lead Note and Comment Editor, B.Y.U. Law Review; former bankruptcy court law clerk; he previously practiced in the bankruptcy group at Greenberg Traurig in Texas.
    - Bryan has 20+ years' experience providing corporate governance, business transaction and corporate reorganization advice, especially in the healthcare industry.

- **Tammy Georgelas (Salt Lake City)**: A former bankruptcy court law clerk, Tammy is recognized as one of the "Top 50 Women" lawyers in the mountain states.
    - Tammy has 15+ years' experience in corporate crisis management, cyber-security, and complex litigation. She currently serves as a federal court appointed SEC receiver.
- **Brian Rothschild (Salt Lake City)**: Former law clerk to the Chief Justice of the Utah Supreme Court; he formerly practiced in the bankruptcy group at Aiken Gump in California.
    - Brian has 10+ years' experience in large business restructuring and is currently a Subchapter V small business reorganization trustee. He is a member of the board of directors of the Utah chapter.
- **Darren Nelson (Salt Lake City and St George)**: Former intern to the Honorable Barry Russell, United States Bankruptcy Judge for the Central District of California; formerly practiced in the bankruptcy group at Brutzkus Gubner, a bankruptcy boutique in Los Angeles California, as well as Kirton McConkie in Salt Lake.
    - Darren has 8+ years' experience in large business restructuring on both the debtor and creditor side. He represents secured and unsecured creditors, debtors, and committees in Chapter 11 bankruptcy cases in Utah and California. Darren obtained his law degree from Loyola Law School in Los Angeles as well as a master's degree in dispute resolution from Pepperdine University.

Parsons Behle's Financial Distress Team also includes **Mike Brown**, **Grace Pusavat**, and **Zachary Shea**, associates who have clerked for bankruptcy judges and/or have represented debtors and/or creditors in significant bankruptcy cases. And we have liaison members with all of the firm's other practice groups and offices.