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Cheap Financing Will Keep Bankruptcies Down In 2014

By **Maria Chutchian**

Law360, New York (January 01, 2014, 10:08 AM ET) -- As interest rates remain low, bankruptcy filings in the U.S. won't increase in 2014, but experts say the Affordable Care Act implementation could spark some action in the health care industry, while struggling municipalities will seriously consider Chapter 9 thanks to a recent ruling in Detroit.

With the Federal Reserve unlikely to raise interest rates in 2014, insolvency professionals say cheap financing will be accessible to most companies, which will mean corporate bankruptcy filings will either remain where they are now or continue to decline.

"We've had this type of economy for several years now, so a lot of the firms that were going to go under have gone under already," Matthew J. Gold of Kleinberg Kaplan Wolff & Cohen PC said.

Still, a healthy capital market doesn't mean everyone is out of the woods. As was the case in the past few years, experts predict that retailers — especially big-box stores — are going to hit hard times in 2014 thanks to the ever-growing popularity of online shopping.

And the ruling that found Detroit eligible for Chapter 9 protection and said pension obligations might be reduced under federal bankruptcy law will have an impact on financially-strapped cities and towns nationwide, experts say.

Here is the breakdown of what lies ahead in 2014.

Municipalities to Ponder Pensions Following Detroit

In December, a Michigan bankruptcy judge ruled that Detroit is eligible for bankruptcy relief, despite the protests of retirees and unions. But his decision also caught the attention of many restructuring professionals for a different reason — that being his thoughts on pension obligations.

U.S. Bankruptcy Judge Steven W. Rhodes said in his ruling that public pensions in Detroit are not immune from cuts, as the retirees argued they were under the Michigan Constitution. The finding is widely expected to be appealed, which will force higher courts to take a stand on where the matter falls with respect to the Tenth Amendment.

Several attorneys say that ruling, if affirmed on appeal, could prompt other cities and towns bogged down under massive pension debt to more seriously consider Chapter 9 bankruptcy in the coming year as a solution to their problems.

“If that ruling gets upheld, you will get a slew of Chapter 9s,” Paul J. Labov of Edwards Wildman Palmer LLP said. “If it doesn’t, then we’re probably back to the status quo.”

Others, however, say municipalities won’t necessarily start filing more rapidly, but will instead use the threat of bankruptcy to scare pensioners into negotiating reductions to what they are owed.

Threatening to file is far less expensive than actually entering bankruptcy, Sherri Dahl of Squire Sanders LLP said. Plus, the official ruling was on eligibility issues, and a passing mention by the judge on pension matters doesn’t necessarily mean municipalities can rely on that in their own bankruptcies.

But even if municipal filings don’t go up as a result of Detroit, local governments and players in the bond markets are paying attention to the case anyway, she said. If anything, Detroit has made it clear that bondholders aren’t guaranteed their money either, and that knowledge will make potential bondholders much more cautious in the coming year, she said.

“Before Chapter 9 bankruptcy was talked about in the press a lot, I think there was a lot of incorrect assumptions in the bond market that bonds got paid all the time and were really safe,” Dahl said. “I think the trend in the future is everyone in the bond market is going to be more educated on what can happen if a bankruptcy is filed and how they are not necessarily as protected by the full faith and credit clause [as they thought.]”

Retailers Still in Rough Shape

Brick-and-mortar stores appear to be losing the battle against online retailers such as Amazon, which is going to result in Chapter 11 filings, experts say. Large chains, known as big-box stores, are especially vulnerable as consumers find that the items they seek are more easily accessible online, according to Daniel Y. Gielchinsky of Higer Lichter & Givner LLP.

Large chains are also burdened with expensive leases, causing several to close individual stores that are underperforming, Labov said. An amendment to the Bankruptcy Code in 2005 restricting the time debtors have to resume or reject leases has made it difficult for retailers to restructure.

“I think you’re going to see J.C. Penney or Sears file in late 2014. Both are having liquidity issues,” Gielchinsky said.

Big-box bankruptcies could have a ripple effect too, Gielchinksy said. When they go under, their vendors lose crucial business and shopping plaza owners lose their anchors, potentially causing another wave of bankruptcies.

Despite the annual shopping bonanza of Black Friday, retailers did not make out as well as expected in November, according to various reports. If that trend continues through the holiday season, the industry could start flailing in early 2014, Robbin L. Itkin of Steptoe & Johnson LLP said.

Retailers could also be indirectly hit by seemingly unrelated causes like the ACA and interest rates, according to Jan M. Hayden of Baker Donelson Bearman Caldwell & Berkowitz PC. If medical practices fold under the law or the Fed does raise interest rates, businesses will be affected and forced to lay off workers, which will result in consumers buying fewer goods, she said.

"Everything is obviously very volatile," Itkin said.

ACA Not So Affordable For All

For-profit and non-profit healthcare companies and providers, which have both been in a tight situation for some time, could be in even more trouble in 2014 as the ACA kicks into gear, experts say. Some, especially the smaller providers, may not be able to handle the added costs of meeting the ACA's requirements, attorneys say.

Under the ACA, hospitals will now be held by the Centers for Medicare & Medicaid Services to higher standards for the quality of care they provide and fined if they don't meet those requirements.

"Obamacare will exacerbate the problems in healthcare industry," Irving Walker of Cole Schotz Meisel Forman & Leonard PA said. "There's a national issue of overextending traditional hospitals with heavy debt."

Like healthcare providers, oil and gas companies are likely going to be hit hard in 2014, especially as global changes in price and supply continue, according to Hayden. The industry will also have to find other financial options as government subsidies run out, Christopher A. Ward of Polsinelli PC said.

Global energy consumption grew by 1.4 percent in 2013, below the average annual growth rate of 2.3 percent, according to research provided by Enerdata. Additionally, the U.S. Energy Information Administration says it expects crude oil prices to decline slightly in 2014.

Moreover, the coal mining industry is likely to take a hit thanks to increased regulations, Walker said. "I would expect continued activity in the energy field," he added.

U.S. Bankruptcy Goes Global

Chapter 15 cases, under which foreign debtors seek U.S. recognition of their home-state insolvency proceedings, will become more prevalent in the U.S. in 2014 as other economies worsen, Itkin said.

Discrepancies have popped up among countries' insolvency laws as businesses have increasingly branched out or sought financing from a vast range of countries, attorneys said. With certain foreign economies still flailing, Chapter 15 has become a popular tool for addressing those conflicting laws with respect to U.S.-based assets and lenders.

"As companies become more and more global, there's a need that that restructuring is being respected in other places where they operate," Evan C. Hollander of Arnold & Porter LLP said.

Chapter 15, which was enacted in 2005, is still relatively new, but case law is beginning to take shape. In December, the Second Circuit held that foreign companies must comply with a provision that requires a debtor to have either a business or property in the U.S. in order to obtain Chapter 15 relief.

In 2013 alone, Brazilian bank Banco Pontual SA, Canadian energy company Lone Pine Resources Inc. and Canadian information technology Xchange Technology Group LLC in just the past couple of months brought Chapter 15 cases in the U.S.

But not everyone even needs Chapter 15 right now, with some foreign companies also coming to the U.S. to take advantage of its Chapter 11 laws to conduct their main proceedings here, due in part to the system's debtor-friendly policies. Entities based outside the U.S. but that have a substantial portion of their assets or lenders in the U.S. will often use those to establish jurisdiction for themselves in a U.S. bankruptcy court, and attorneys expect more of the same in 2014.

Out-of-Court Restructurings Gain Steam

Bankruptcy attorneys are likely going to find themselves conducting less of their work within the courts in 2014 as lengthy, drawn-out reorganizations become less appealing to distressed entities, experts say. Though out-of-court restructurings were already popular, they will become even more common in the coming year as companies seek to avoid the costs associated with a traditional Chapter 11 reorganization and negotiate their debts with greater flexibility.

"I do continue to expect that a significant part of my practice and that of my colleagues will be in out-of-court restructurings in numbers that will far exceed the clients we represent in Chapter 11," Walker said.

Similarly, asset sales under Section 363 of the Bankruptcy Code have helped traditional reorganizations become largely obsolete, experts say. Those 363 sales, which usually result in Chapter 11 cases that last no longer than three or four months, will continue to gain traction in 2014 as businesses seek to avoid messy court cases.

The trend of companies restructuring their debt outside of court has undoubtedly contributed to the decline in filings over the past couple of years, attorneys say. However, much of that reorganized debt is set to mature in late 2014 or 2015, making it plausible that companies will run out of options at that time.

"We're at least a year away from the true restructurings from the bankruptcies we were seeing — filings with some meat on the bone," Ward said.

--Editing by Chris Yates.
