Here We Go Again:
What the Latest COVID-19 Surge Means for Bankruptcy Filings in 2022

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The late great Yogi Berra said it best: "Its déjà vu all over again." Just as we thought the pandemic was coming to an end, we now are seeing a spike in cases similar to the beginning of the pandemic. The spike is causing businesses to shut down again and the fear of uncertainty that was subsiding seems to be returning to many. Insolvency professionals will forever remember March 2020. With the world shutting down (quite literally in some respects), we envisioned a tsunami of bankruptcy filings that had not been seen since the Great Recession. And there was an increase in filings. However, the level did not rise to the point we expected. The increase in filings was largely attributed to specific industries—retail and restaurants—and even then the filings were concentrated to larger companies in those sectors.

As 2020 came to a close and we entered 2021, many observers predicted the tsunami of filings was still on its way, but only later than once thought, so 2021 would be a record year for filings. Of course, that was not the case. As the American Bankruptcy Institute recently reported, total bankruptcy filings for 2021 decreased 24% from 2020 with total filings in 2021 being 401,291 compared to 529,106 in 2020.[1] Such a low number in filings had not been seen in nearly forty years.[2] Breaking these numbers down a bit more, consumer filings were at 378,952 in 2021 compared to the 496,589 filed in 2020. Commercial filings dropped to 22,339 in 2021 compared to 32,517 the year before.

But the soothsayers have polished their crystal balls and while that tsunami still remains out at sea, many of them are saying it is time to move to higher ground as the wave of filings will

[1] https://www.abi.org/newsroom/press-releases/total-bankruptcy-filings-drop-24-percent-in-calendar-year-2021-commercial.
[2] Id.

hit in 2022. This article explores why filings were low in 2021 and why the predictions for 2022 may be accurate.

Where Did All of the Bankruptcies Go in 2021?

It is an understatement to say that money was abundant in 2021. The recent inflation numbers prove that reality.[3] Government programs that started in 2020 carried over into 2021, but with a significant difference. While consumers were receiving checks in 2020, shutdowns and concerns over personal health limited the ability for many to spend that money. As shutdown restrictions were loosened in 2021 and business slowly reopened, consumers hit the streets with spending that pumped billions into the economy. In addition, the Federal Reserve kept interest rates low. This resulted in consumers taking advantage of "cheap money" that they in turn deployed back into the economy. Anyone who has tried to hire a contractor for a home renovation project or buy a new house knows just how hot the residential housing market was last year. But the deployment of money was not limited to only consumers. Businesses did their part as well. Business travel resumed to some degree and expansion plans that may have been put on hold in 2020 were implemented in 2021. Cloaking all of this was a renewed sense of confidence that the pandemic was finally coming to an end and we were returning to "normal". Little did we know.

But other factors were at play as well. Not only were lenders making loans at low rates, lenders (particularly traditional lenders) maintained the same hesitancy they had in 2020 to enforce rights and remedies upon default. Part of this can be attributed to reputational and public relation concerns. Part of this was business driven. For example, if a movie theatre or hotel owner aren't seeing revenues that allow them to service debt, there is little reason to think the lender can foreclose and either rehabilitate the property on its own or sell it to a third party at pre-pandemic value. Thus, the lender may decide it best to leave the collateral in the hands of the borrower for the time being.

Private equity also played a key role in the low number of bankruptcy filings in 2021. First, private equity was willing to step in and buy a struggling business (particularly in the middle markets) that would otherwise have filed bankruptcy. Similarly, private equity firms were more willing to refinance debt businesses had with traditional lenders that allowed the lender to avoid the difficult decision of whether or not to commence foreclosure or exercise other remedies.

What Does 2022 Hold in Store?

The pandemic has given us many lessons one of which is that no one can predict the future. Thus, any "predictions" given about 2022 should be taken with a grain of salt. Inflation should be expected to remain steady (if not increase a bit) in the first two quarters of 2022. And while it may begin to return to normal levels later in the year, it will create pressure on businesses many of which already are on the verge of insolvency. To battle inflation, interest rates can be expected to increase. In fact, JPMorgan Chase & Co. CEO Jamie Diamond says he will not be surprised to see the Federal Reserve raise rates more than four times in 2022.[4] Investors appear to agree as the

[3] Inflation hit 7% in December 2021, the largest 12-month increase in the U.S. since June 1982. https://www.bls.gov/news.release/cpi.nr0.htm.

[4] https://www.reuters.com/business/jpmorgan-ceo-says-2022-could-bring-more-than-four-rate-hikes-2022-01-10/.

10-year U.S. Treasury yield has had an upward trend in recent weeks. While this may help the economy in the long run, it will create stress on leveraged businesses who have grown accustomed to low rates.

A leading cause of the inflation increase—supply chain disruptions—also is not going anywhere in the short term. While businesses are doing what they can to battle this disruption, they can only do so much. Exactly where the tipping point is will vary from business to business, but the supply chain disruptions can be expected to force bankruptcies for some.

And then there is the question of what lenders will do with loans that are in default or on the verge of default. Though not a universal statement, lenders have, in large part, been slow to exercise rights and remedies, but that patience cannot last forever. Assuming there are no new government programs aimed at relieving financial stress, lenders can be expected to be aggressive in exercising rights and remedies.

What Should We Be Doing Now?

Unlike the initial surge in filings in 2020 that may have caught many by surprise, we have had more time to prepare for the expected increase in bankruptcy activity in 2022. So what should we be doing now? Unfortunately, there are likely no new or novel answers to this question. For companies that see 2022 as the year for reorganization, engaging insolvency professionals sooner than later is critically important. This audience knows this, but even a relatively small chapter 11 bankruptcy case can take months to properly prepare. Companies also need to communicate with their lenders, key vendors, and customers. Of course, there is a lot to be considered before having these conversations, but no one likes surprises. The more information this core group has about a company's situation, the more likely members of this group will be allies in a bankruptcy case. For officers and directors of these companies, it is important to understand where your duties lie once the company enters the nebulous known as the "zone of insolvency."

For creditors, it goes back to basic blocking and tackling. Never assume all of your documents are as you think they are. Many a creditor has learned too late that a guaranty was overlooked and never signed or that a financing statement was filed in the wrong state. A thorough review of your documents now will avoid learning of those surprises later. Creditors should keep a close eye on their accounts receivable. Even just a few days' delay in payment from a customer who has a good payment history can be a sign that all may not be well. Communication is important on the creditor side as well, particularly for lenders. If a lender has agreed to a forbearance that has been extended multiple times over the past two years, the lender should consider giving its borrower advanced notice that it does not intend to enter into another extension when the current forbearance agreement expires. No, the lender is probably not obligated to give this type of notice, but it can go a long way in managing expectations and minimizing the threat of claims by the borrower even if those claims are without merit.

Conclusion

One thing is for certain: we all hope to see COVID-19 (including all of its variants) to run its course soon. The impact of the pandemic will be with us long after the illness subsides. Exactly what we will see in the way of bankruptcy filings remains to be seen. However, conditions strongly suggest that we will return to "normal" filing rates and then some.