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Restructuring Pros Reflect on 2022

By Christopher Patalinghug

Total commercial bankruptcy filings continue to remain low this year and are on track to be the fewest in the past 11 years. About 19,384 commercial bankruptcy cases — which include commercial business Chapter 11, 7, 13 and 15 cases — were filed through November this year, according to American Bankruptcy Institute, citing data from Epiq Bankruptcy Analytics. A total of 22,339 cases were commenced in 2021, including 20,673 through the first 11 months last year. A total of 32,517 cases were filed in 2020 and 39,050 cases were filed in 2019.

About 3,522 of the commercial cases filed through November this year were under Chapter 11. A total of 3,724 commercial Chapter 11 cases were filed in 2021, 7,129 such cases in 2020 and 5,519 in 2019, Epiq's data shows.

Data refined by *Troubled Company Reporter* editors, to exclude contemporaneously filed cases being jointly administered, show that about 1,487

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Looking Ahead

By Christopher Patalinghug

"Sleep and exercise," M3 Partners, LP's Colin Adams tells *Turnarounds & Workouts* when asked what his greatest challenge will be in 2023. "We are all going to be very busy."

Other restructuring professionals polled by *T&W* offer similar sentiments. "I expect us to be much busier in 2023 than we were in 2021 and 2022," says Chad Husnick, a partner in Kirkland & Ellis' Restructuring Practice Group.

Jason Zachary Goldstein, a partner in the New York office of Gibson, Dunn & Crutcher and member of the firm's Business Restructuring and Reorganization Practice Group, notes the year 2022 was a busy one for his firm and expects more to come in 2023. "Expect more in court chapter 11 filings in 2023," he says.

While commercial bankruptcy filings this year continue to drop from 2021 levels, an uptick in restructuring activity is widely expected in 2023. Fitch Ratings report default rates are rising across U.S. and European high-yield and institutional

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of the corporate Chapter 11s filed this year through Dec. 26, 2022, involved debtors with more than $1 million in assets. In 2021, 1,429 such cases were filed by corporate debtors with more than $1 million in assets. In 2020, there were 1,764 such cases and 1,914 in 2019.

Year	Total Commercial Chapter 11 Filings
2022 (Thru Nov.)	3,522
2021	3,724
2020	7,129
2019	5,519
2018	5,484
2017	5,771
2016	5,450
2015	5,318
2014	5,189
2013	6,601
2012	7,789

Source: Epiq

Year	Total Commercial Filings (Chapters 11, 7, 13 and 15)
2022 (Thru Nov.)	19,384
2021	22,339
2020	32,517
2019	39,050
2018	38,044
2017	38,536
2016	38,283
2015	30,190
2014	34,818
2013	44,356
2012	58,058

Source: Epiq

Experts from ten different restructuring firms looked back on how the industry shaped out this year and shared their views with *Turnarounds & Workouts*: **Colin Adams**, Senior Managing Director, M3 Partners, LP; **Christopher Carty**, partner in the Restructuring & Finance Litigation Department at Herrick, Feinstein LLP; **Shana Elberg** (New York) and **Nicole Stephansen** (London), Corporate Restructuring partners at Skadden, Arps, Slate, Meagher & Flom LLP; **Andrew K. Glenn, Kurt A. Mayr** and **Shai Schmidt** at Glenn Agre Bergman & Fuentes LLP; **Jason Zachary** Goldstein, partner in the New York office of Gibson, Dunn & Crutcher and member of the firm's Business Restructuring and Reorganization Practice Group; **Liz Green**, partner with BakerHostetler and leader of the firm's national Bankruptcy and Restructuring team and co-leader of the Business Restructuring Response team; **Chad Husnick**, partner in Kirkland & Ellis' Restructuring Practice Group; **Jeff Marwil**, partner at Proskauer and co-head of the Firm's Business Solutions, Governance, Restructuring & Bankruptcy Group; **Andrew Parlen**, restructuring partner at Paul, Weiss, Rifkind, Wharton & Garrison; and **J.R. Smith** and **Brian M. Clarke**, partners at Hunton Andrews Kurth LLP.

The ongoing Russia-Ukraine War, inflation and the crypto industry meltdown are among the top headlines for 2022. Describe how these events impact the restructuring activity this year.

Shana Elberg and **Nicole Stephansen**, Skadden: The Russia-Ukraine war has fueled an energy crisis already brewing post-pandemic and put extreme stress on the global energy market. The demand in the market and supply shortages have caused energy prices to soar, which has slowed restructuring activity in the oil and gas space — one that was extremely active in the last few years. There is still instability in the oil market however so it remains to be seen how companies in the oil and gas space will fare. Although not necessarily filtering through the restructuring space in large numbers this year (governments have been stepping in to manage the energy crisis in some places) it does feel like this will come to a head over the next year or so.

The crypto meltdown has caused a number of large crypto platforms to turn to bankruptcy regimes across the globe to salvage their insolvent businesses. These U.S. bankruptcy filings have notably included Voyager Digital Ltd. that filed for Chapter 11 protection on July 1, 2022, Celsius Network LLC on July 13, FTX Trading Ltd. on Nov. 11, and BlockFi on Nov. 28. These cases raise novel issues still being briefed and we expect a flurry of bankruptcy activity next year to work through these issues. In light of the lower trading valuations across the industry and analysis of the productive and cash-positive assets

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many of these businesses possess, the expectation is that a number of sales processes will continue or begin in 2023 as distressed businesses in this sector seek to sell off lucrative assets and subsidiaries.

Colin Adams, M3 Partners: Russia-Ukraine war and inflation have led to rising prices for producers and consumers across the industrialized world. The policy response has been to raise rates to cool inflation. Without question, an increasing cost of money and rising input and labor costs have driven firms and their creditors to reconsider challenged business models and over-leveraged balance sheets. With respect to crypto, the near total collapse of confidence in the asset class and industry and crypto lending itself have created a fertile environment for operational and balance sheet restructurings of much of the crypto ecosystem.

Without question, an increasing cost of money and rising input and labor costs have driven firms and their creditors to reconsider challenged business models and over-leveraged balance sheets.

Andrew Parlen, Paul, Weiss: The ongoing Russia-Ukraine War, along with China's COVID-19 lockdown policies throughout most of 2022, really disrupted supply chains. This combination of external forces beyond management control put a lot of downward pressure on company EBITDA, especially in mid-market companies who were already less able to absorb their exit from the Russian markets. I think I saw otherwise well-managed businesses with good products struggle and a number of out-of-court or prepackaged restructurings came about as a result.

People have a lot of views on the crypto industry meltdown, as it's now called. From a legal and restructuring perspective, one of the more interesting aspects of the crypto filings is the coordination (or not) of their global insolvency proceedings. Because of the nature of the businesses and interplay with the financial markets, the crypto-related filings are reminiscent of *Lehman* and the 2008 financial crisis as it relates to the multitude of proceedings at play and attempts to ring fence and control the assets. Also novel to the crypto filings is the rapid need to develop and refine (or some might say expand) the legal definition of property of the estate, assets and their ownership to accommodate these digital currencies. It is a very fascinating topic and may well inform legal treatment of similar and, as of yet, perhaps not even invented digital assets.

Christopher Carty, Herrick Feinstein: The impact of inflation on restructurings will be felt through rising interest rates. Throughout 2022, the Fed repeatedly hiked interest rates to stem the rise of inflation. While commercial bankruptcy filings remain low, as they have since the federal government enacted pandemic-related measures to aid the economy, rising interest rates should lead to an uptick in filings. Once borrowers are unable to refinance their debt on economically advantageous terms, they may need to turn to chapter 11 to address looming maturities.

Andrew K. Glenn, **Kurt A. Mayr** and **Shai Schmidt**, Glenn Agre: The persistence of inflation has led central banks around the world to continue to raise interest rates, which in turn has tightened credit markets and made servicing existing debt more expensive. This has forced some companies to negotiate debt restructurings and other "liability management" maneuvers with their lenders. We expect this trend to continue and increase in 2023.

The crypto industry meltdown has resulted in four major Chapter 11 filings in 2022: Voyager, Celsius, FTX, and BlockFi. The FTX bankruptcy in particular is notable for its sheer size and the fact that millions of creditors may end up losing fiat currency and crypto assets they thought were safely held in their accounts. The crypto bankruptcy cases will continue to unfold amid much regulatory uncertainty concerning the rules governing those companies' businesses and whether various crypto assets should be regulated as securities or commodities. Some of those questions, and the positions taken by federal and state regulators in connection therewith, can play

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a major role in those cases moving forward.

Liz Green, BakerHostetler: Inflation has impacted every sector of the economy. In my experience, lenders are adopting a wait and see approach particularly as it relates to commercial real estate. Lenders are not seeking receivers but are holding on to cash, so it makes the operation of certain commercial real estate untenable for the clients.

Jeff Marwil, Proskauer: Inflation has skyrocketed, resulting in increased interest rates with lenders more reluctant to extend credit. The easy credit and free money era has ended.

The easy credit and free money era has ended.

Any other major stories this year?

J.R. Smith and **Brian M. Clarke**, Hunton Andrews: The primary drivers of both in and out of court distressed situations continue to be persistently high inflation and increases in interest rates. Inflation began to increase dramatically in spring 2021. In January 2022, the Federal Reserve began a series of successive increases in the federal funds effective rate, bringing such rate from just over 0.00% to 4.50%. The Federal Reserve may continue to increase interest rates in early 2023 (perhaps at a slower pace than in the summer and fall of 2022) and currently projects to keep interest rates at their present levels elevated for the foreseeable future.

Poor economic trends and persistent inflation, on the one hand, and rapidly increasing interest rates, on the other hand, have all but closed equity and debt capital markets for primary issuances and refinancing transactions. This has left issuers with floating rate debt — in particular, those which obtained financing in the leveraged loan market during the long period of low interest rates that ended in early 2022 — with ever increasing interest obligations at a time when revenues and profits are in decline and supply chain issues persist in many sectors of the economy. As a result, lenders and analysts are now predicting significantly higher default rates on leveraged loans in 2023 and 2024, as issuers are unable to refinance maturing loans or maintain compliance with covenant levels that were established during periods of low interest rates and more favorable economic conditions. Higher default rates in the leveraged loan market are already driving restructuring activity in late 2022, and will likely continue to be a primary driver of in and out of court restructuring activity in 2023 and 2024.

In addition to the leveraged loan market, increased interest rates had a dramatic impact on the residential mortgage market in 2022. The average thirty year fixed mortgage rate settled as high as approximately 7.0% in November, 2022, more than double the 52-week low of approximately 3.0%. As a result, new home sales in the United States declined dramatically in 2022 from elevated levels that persisted from mid-2020 through the end of 2021.

Glenn, Mayr and **Schmidt**: We have seen the continued utilization of divisional mergers — also known as the "Texas two-step" — by Johnson & Johnson and other companies as a way to shield themselves from mass tort liabilities by confining those liabilities to a separate, newly created subsidiary that later files for Chapter 11. This strategy, where the tort claims are typically estimated and channeled to a trust as part of a subsidiary's bankruptcy case, is highly controversial because it allows companies to avoid jury trials in federal and state courts without subjecting themselves to the requirements of the Bankruptcy Code. Numerous lawmakers have criticized the Texas two-step as an improper maneuver to limit tort claims that should be adjudicated in the general court system — not in bankruptcy court. The prospects of legislative action, however, are unclear.

A similar hot-button issue that came to the forefront in 2022 is non-consensual third-party releases, where non-debtors receive a release from legal claims held by third parties as part of a bankruptcy proceeding of a separate entity. In the *Purdue* case, the U.S. District Court for the Southern District of New York held the bankruptcy court lacked authority to approve third-party releases granted

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to members of the Sackler family as part of Purdue's Chapter 11 case. That decision is currently on appeal and, given the inconsistent law on this point in different jurisdictions, may soon reach the Supreme Court.

Parlen: The high-yield and Term B debt market is dead. Very few deals are coming to market, and any new commitments being underwritten are subject to very wide market flex. Both uncertainty about rates and, in the case of LBOs, lack of confidence about appropriate asset values in an uncertain economic environment have led to a highly limited calendar of new deals in the high-yield and syndicated Term B debt markets.

What does this mean? Well, there are a lot of negative market pressures out there affecting companies. We've heard about them before: the Russia-Ukraine war, supply chain issues, fundamental industry shifts (e.g., from cable to digital, brick and mortar to online shopping, the e-economy, etc.). Inflation and rising rates mean increasing debt and capital costs. This squeezes existing liquidity and, with the death of the High Yield/Term B debt market, companies have less flexibility with which to respond. Companies with high capital costs and that are locked into business models that limit their ability to increase prices, in particular, may well struggle.

Creditor-on-creditor violence continues, but is it reaching the outer limits of its own effectiveness? During 2020 and 2021, the COVID era, we saw a lot of these non-*pro rata* uptier transactions outside of bankruptcy court. But now state courts in non-bankruptcy litigations are starting to deny motions to dismiss. This introduces new levels of legal uncertainty and overhang. Do these transactions stay in vogue? Some creditor groups may still proceed with non-pro rata uptier transactions where the underlying document provisions are especially favorable. However, given the general apparent hostility of state courts, there is no such thing as a 'risk-free' non-*pro rata* uptier transaction. Combined with the fact that companies find themselves with more acute needs, in many cases due to global pressures beyond their control, and in a rising interest rate environment, does the old school DIP loan and Chapter 11 filing present a more attractive option for priming and enhancing seniority? Time will tell.

Lastly, I would be remiss not to mention the circuit level decisions around post-petition interest and make-whole payments. These are interesting matters on which the Ninth (*PG&E*), Fifth (*Ultra*) and Second (*LATAM Airlines*) circuits have opined, and on which the Third Circuit (*Hertz*) will do so soon. Notably, the circuits are mostly aligned on the issues. The solvent-debtor exception survived codification of the Bankruptcy Code; creditors are entitled to postpetition interest at the contract rate in a solvent debtor case; make-whole premiums are the economic equivalent of interest and accordingly, disallowed under section 502(b) of the Code; and unimpairment for purposes of treatment and voting under a Chapter 11 plan means plan unimpairment, not the Bankruptcy Code's effect on a creditors' legal rights. These cases provide clarity, but with each answer provided, new ones crop up. What is a solvent debtor, exactly? And how and when is that measured? If make-whole premiums constitute disallowed postpetition interest, then how will investors get compensated for the costs of being unable to place their funds elsewhere? How are such costs or damages determined? What is certain is that each new decision will open new battlegrounds around these issues.

Marwil: Crypto. The staggering losses and emerging discovery of fraud has deeply impaired the safety and credibility of crypto. The lack of government regulation and oversight is part of the root cause.

Carty: Another major story is if, and when, the bankruptcy industry will return to in-person bankruptcy court appearances being the norm. While more and more courts have reopened their doors during 2022, most bankruptcy court hearings continue to be remote, and I'm not sure that should change. Over the past nearly-three years, the courts and practitioners have become quite skilled at conducting these hearings remotely, and remote hearings offer time efficiencies that can help keep

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costs down.

Were there events or issues that should have taken center stage but did not?

Jason Zachary Goldstein, Gibson Dunn: Consumer behavior was downplayed but was a major driver of performance in certain sectors as life returned to normal post-COVID. Specifically, certain sectors saw a return to normal levels (airlines, fitness, etc.) while others are dealing with a fundamentally changed consumer environment (movie industry). Over 2021 and the first half of this year, a lot of this was masked by so much cheap money being available in the market. But given tightening credit conditions and fundamental operational issues, we are in store for some real challenges in these sectors.

Elberg and **Stephansen**: SPACs rose and fell over the last two years. It is still to be seen if there will be major fall-out (streaming into the restructuring world) from now-public de-SPACs that are unable to either operate as a going concern or were over-ambitious in their projections and money raises.

Marwil: Government regulation and oversight of crypto; financial restraint on the massive spending bills passed by Congress and signed by the President; and Federal Reserve acting sooner to stem inflation.

What sectors saw the most restructuring activity? Why?

Chad Husnick, Kirkland & Ellis: There were two focal points for restructuring activity over the last twelve months — crypto and mass torts. Crypto-related bankruptcies have dominated the last few months of headlines beginning with the chapter 11 filings for *Voyager* and *Celsius*, then *FTX*, and then *BlockFi*. There are no signs of this activity slowing given the massive uncertainty surrounding these bankruptcies and cryptocurrency generally. Companies facing mass tort liabilities have also been paying very close attention to the chapter 11 cases of *Purdue*, *LTL Management*, and *Aearo Technologies*. Each of these companies faced significant pre-filing liabilities for tort claims. While similar cases have been pending in North Carolina for some time (see, e.g., *Aldrich, Bestwall*, and *DBMP*), Judge Michael B. Kaplan's decision denying the motion to dismiss the *LTL Management* case caused many large companies facing significant tort liabilities to view chapter 11 as a potential alternative to years (perhaps decades) of mass tort litigation in a non-bankruptcy forum. In contrast, the U.S. District Court for the Southern District of New York's decision reversing the *Purdue* confirmation order called into question a bankruptcy court's jurisdiction to approve non-consensual third-party releases and sent a conflicting message about the viability of the bankruptcy alternative. Both of these decisions are on appeal to the United States Circuit Courts of Appeals.

Smith and **Clarke**: Declining origination volumes and rising interest rates in 2022 caused significant financial distress among mortgage originators. Nearly all mortgage originators borrow funds from warehouse lenders to use in the origination and purchase of mortgage loans. Newly originated loans are sold to the warehouse lender until such time as the mortgage loan is to be repurchased by the originator prior to its final sale by the originator to Fannie Mae, Freddie Mac, Ginnie Mae, or another secondary market participant. Often times, mortgages that will be sold to or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae are financed by the warehouse lender at 100%. Mortgages that are to be sold to other secondary market participants (so-called non-agency loans or non-qualified mortgage loans) are financed with a mix of cash advanced by the warehouse lender and with the mortgage originator's working capital. Because the purchase and sale of mortgage loans under warehouse facilities are structured as true-sales and fall within the automatic-stay safe harbors available for repurchase agreements, they are subject to immediate termination on a bankruptcy filing. On any such termination, the warehouse lender can immediately liquidate all mortgage loans then held by such warehouse lender to satisfy outstanding claims

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under the terminated warehouse facility, leaving the mortgage originator with no asset to repurchase from its former warehouse lender and no ongoing source of liquidity to fund committed mortgages. Mortgage originators are therefor often unable to restructure in chapter 11 without agreements from existing or replacement warehouse lenders that enable the originator to fund mortgage commitments after the beginning of a chapter 11 case.

Distress in the mortgage industry combined with potential termination of warehouse facilities on any bankruptcy filing served as a primary driver of out-of-court restructuring activity in 2022, as mortgage lenders sought to stave off bankruptcy by renegotiating warehouse and repurchase facilities, raising cash through sales of equity or ancillary revenue streams (such as mortgage servicing rights), and reducing general and administrative costs. It is likely these out-of-court transactions will continue into 2023 as interest rates remain high and home sales remain low relative to 2020 and 2021 levels. Many mortgage lenders were forced to close their doors in 2022 after out-of-court restructurings and existing warehouse lenders terminated repurchase facilities.

One mortgage originator able to secure debtor-in-possession warehouse financing and confirm a chapter 11 plan in 2022 was First Guaranty Mortgage Corporation ("FGMC"). With post-petition debtor-in-possession warehouse financing from Barclays Bank and a working capital facility from an affiliate of pre-petition equity sponsor PIMCO, FGMC was able to fund and close a backlog of pre-petition mortgage loan commitments after its chapter 11 filing. Hunton Andrews Kurth LLP served as counsel to Barclays Bank in connection with the FGMC debtor in possession warehouse financing.

Elberg and **Stephansen**: Crypto is a web of interconnected companies, a crack in one market player led to numerous other cracks, plus an uncovering of fraudulent activity, which has seen an increased number of insolvency filings around the world. These companies need to pause to determine what assets they are actually holding, how to value those and what good assets remain to be restructured or sold. In healthcare, various sector offshoots continue to see distress and restructuring activity (including, notably, in pharma cases and managed care companies). Retail, which has been a troubled sector for some time now. Inflation plus rising energy has only put a further strain. Many of these companies (at least in the U.K.) are selling their name and online presence and otherwise packing up their brick and mortar stores. Airlines and aircraft leasing continue to see increased activity, due to demands coming out of the pandemic and increased energy costs.

Goldstein: We saw a lot of healthcare related deals this year driven at least in part by home care vs. in person care.

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In recent weeks, tech companies announced major layoffs and hiring freezes. According to a Crunchbase estimate, more than 85,000 workers lost their jobs this year. What is going on in the tech industry?

Elberg and **Stephansen**: It is likely a combination of right-sizing previous bloat and tech companies taking a realistic look at their near-term futures. Over the last few years, tech stocks benefited from large stock increases (creating larger "valuations"). But the market cap for tech stocks fell precipitously in the last year (with trillions of dollars of loss) and now tech companies are facing a new reality.

Adams: Rising interest rates have pressured capital spending projects. The higher cost of money means that projects and ideas must pay off bigger and sooner than has been the case for more than a decade.

Marwil: Consumer demand is

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decreasing and interest rates are increasing. There will be fallout and financial distress for the smaller trading partners with big tech.

Meme stocks started in late 2020 during the pandemic and saw the share price of ailing companies like AMC and Bed, Bath and Beyond benefiting from the trend. Your thoughts on meme stocks?

Adams: While an interesting experiment in the power of crowds and the internet to organize and target crowd sourced energy, it seems that shares of meme stocks can be parked in the cupboard next to your Chia Pet or Pet Rock; financial discipline and positive cash flow will become increasingly important themes throughout 2023.

Goldstein: Indicative of market exuberance in a rather perverse way — no focus on fundamentals of these businesses or coherent investment theories, but rather name recognition and some type of group think mentality.

What do you consider as your biggest challenge in the past year?

Glenn, Mayr and **Schmidt**: The high concentration of large bankruptcy cases in the crypto and opioid and mass tort contexts have presented capital structures that do not provide the typical entry points for creditor representations. For example, crypto structures often do not have term loans or public bond debt, which often organize *ad hoc* groups that we represent. These niche bankruptcies are more challenging to crack.

Green: Restructuring CMBS loans and other single asset real estate loans were our biggest challenge.

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Elberg and **Stephansen**: As a group, the full return to office was both a challenge and a huge success. We work better as a team when we are face to face and having everyone in the office together at least three days a week is not an easy task but it has proven its worth in a short period of time.

Husnick: Staying busy, up to speed, and engaged with colleagues presented the largest challenge (and opportunity) this year. As the effects of the pandemic waned, many restructuring professionals returned to the office, restarted regular in-person attendance at industry conferences, and traveled for business development and client meetings. It felt weird at first, but the benefits of person-to-person interaction and deal-making are as clear today as ever.

Your (or your firm's) greatest success?

Adams: Growing Performance Improvement and Litigation Support practices that build on our capabilities in restructuring and provide service lines that our clients wanted despite a slow market for bankruptcies and restructurings.

Goldstein: Market share of *ad hoc* lender group representations.

Green: Our firm's greatest success was the successful sale of the Limetree refinery in St. Croix.

Husnick: It amazes me every year how Kirkland can attract and develop so many talented attorneys year after year. This doesn't come easily — there is a coordinated effort across the firm and within each practice group to identify and recruit talented individuals with diverse backgrounds from law schools across the country to join Kirkland. But that is only the beginning: once those lawyers join the firm, senior attorneys must invest enormous resources into developing and teaching formal training programs, mentoring and sponsoring junior attorneys, and providing new and interesting opportunities to develop "on the job." The output of these efforts is integral to Kirkland's ability to provide top of the line legal services. ¤

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leveraged loan markets in 2023 and 2024, primarily due to weaker macroeconomic growth and rising interest rates. Higher interest rates and weaker capital access, the ratings firm explains, will keep distressed debt exchanges above historical averages next year, particularly in the leveraged loan market that has become more receptive to these exchanges.

Fitch anticipates the 2023 rates to be 2.5%-3.5% for high yield and 2.0%-3.0% for leveraged loans, reflecting the likelihood the U.S. economy will fall into a mild recession. Defaults in 2024, according to the firm, will tick up slightly to 3.0%-4.0% for both high yield and leveraged loans. Fitch expects cumulative 2022-2024 to total 8.0% for high yield and 7.5% for leveraged loans, which are well below the respective 22% and 14% rates during 2007-2009.

Fitch projects European high yield bond default rates to rise materially in 2023 and 2024. "We re-affirmed our base-case bond default rate forecast for YE 2023 at 2.5% and introduced a 2024 projection that assumes defaults rise to 4.0%. We raised our YE 2023 base-case loan default rate forecast to 4.5%, from 3.5% previously. We expect base-case loan default rates to stabilize around 4% by YE 2024," Fitch relates.

Moody's Investors Service reports the default rate among non-financial U.S. companies will likely triple to 4.8% by September 2023, with tighter credit especially straining companies in the durable goods, telecommunications and automotive sectors.

"The Great Restructuring Slowdown of 2021 continued into early 2022, leaving swathes of insolvency professionals to continue scrambling for a piece of a much smaller pie," according to Kirkland's Husnick. "That said, activity began increasing over the summer and into the fall amidst the upheaval in cryptocurrency market. Conventional wisdom is rising interest rates and the cloudy economic horizon will sustain the upward trend for restructuring work in 2023."

"The Great Restructuring Slowdown of 2021 continued into early 2022, leaving swathes of insolvency professionals to continue scrambling for a piece of a much smaller pie,"

Liz Green, a partner with BakerHostetler, sees restructuring industry professionals reshuffling to different firms "as the legal, advisory, and consulting firms gear up for a recession." Green leads her firm's national Bankruptcy and Restructuring team and is co-leader of the Business Restructuring Response team. Green adds, "2022 was a steady year for restructurings in her firm.:

Andrew K. Glenn, Kurt A. Mayr and Shai Schmidt at Glenn Agre Bergman & Fuentes LLP, share, "Restructuring activity was lower volume from a transactional perspective. Fortunately for us, 2022 presented significant bankruptcy/insolvency litigation opportunities to keep us busy."

Shana Elberg and Nicole Stephansen, Corporate Restructuring partners at Skadden, Arps, Slate, Meagher & Flom's New York and London offices, respectively, also report that 2022 was a good year for their firm, and in particular, restructuring. "We had a few major restructuring cases that highlighted our team's creativity and skills," they share, citing Endo, the successful implementation of the China Fishery Group chapter 11 plan, and the innovative restructuring of Markel CATCo, a Bermuda-based insurance investment fund with significant losses and threat of litigation from multiple investors.

Vulnerable Sectors

M3's Adams believes the Building Products, Healthcare Services, Retail, Non-Bank Mortgage Lenders, Chemicals, and Paper & Packaging sectors remain vulnerable right now "given the current macroeconomic backdrop, inflationary environment and ongoing supply chain challenges."

For Glenn Agre's Glenn, Mayr and Schmidt, it's the Opioid, crypto, and the health care industries. "Middle market companies with refinancing needs in 2023 in any industry are going to face significant challenges to obtain capital and remain out of bankruptcy," they note.

"Healthcare, tech, commercial real estate. In addition, certain COVID related business that amassed too much inventory which is no longer needed," adds BakerHostetler's Green. She believes healthcare in general, skilled

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nursing, commercial real estate, and cryptocurrency are likely to see more activity or challenges in the near term.

Jeff Marwil, a partner at Proskauer and co-head of the Firm's Business Solutions, Governance, Restructuring & Bankruptcy Group, also considers the commercial real estate sector as vulnerable "given interest rates rising, tenant leases expiring and be renewed for much less space if at all and prices/value of properties falling."

For Gibson Dunn's Goldstein, retail will face challenges "as the recessionary economy and high interest rates designed to combat inflation will influence people to cut discretionary spending and save."

According to Skadden's Elberg and Stephansen, any consumer-touching sector is vulnerable as inflation and its effects are still an open story of how it will play out. "This is in particular exacerbated by the energy crisis and increased cost of goods being passed on to the consumer. Industries that may be vulnerable are airlines, food shops/grocery stores, among others. Real estate and housing-adjacent sectors are also vulnerable as mortgage rates rise and as people reassess the recent spike in prices that has already started to fall back. The loss of value in the fintech space also suggests that this sector will be prime for restructuring next year."

"There's still a lot of money in the market but pricing in the capital markets is becoming increasingly aggressive and companies will have less and less options for refinancing existing debt that was incurred at much lower economics," Elberg and Stephansen continue. "These could tip into restructurings, but also there is a potential for market consolidation through increased distressed M&A if funds are willing to put their dry powder to use."

"There's still a lot of money in the market but pricing in the capital markets is becoming increasingly aggressive and companies will have less and less options for refinancing existing debt that was incurred at much lower economics,"

Fitch reports that a handful of large defaults will drive the 2023 rate and be concentrated in retail, telecommunications and broadcasting/media, which are forecast to comprise roughly half of next year's default volume, Fitch reports. Carvana and Bed, Bath & Beyond, according to the ratings firm, are expected to lift the retail default rate as high as 11%. Ligado Networks and Avaya, Fitch adds, are default candidates that could move the telecommunications rate to 10% while Diamond Sports could default again and keep the broadcasting/media rate elevated. Fitch anticipates 2023 produces approximately 30 defaults, a notable increase from the 13 YTD and 11 recorded in 2021, but down from 55 averaged during the 2017-2020 period when energy defaults frequently occurred.

Fitch notes the 2023 U.S. high yield default rate forecast of 2.5%-3.5% still remains below both the 3.8% 21-year historic average and 2020's 5.2% rate. Fitch's Senior Director Eric Rosenthal says the 2023 anticipated default rate equates to roughly $40 billion of volume. This, he says, is in line with the amount tallied in 2019 but less than the 2016 and 2020 figures and well below the $113 billion registered in 2009.

Fitch says the 2024 default rate calls for a higher 3%-4% forecast, reflecting intensifying macroeconomic headwinds and expectations for tightening credit markets and lower liquidity. Technology and healthcare/pharmaceutical are likely to generate significant defaults both by volume and count.

The high yield default rate is expected to close 2022 at 1.5%-1.75%.

Crypto Watch

Are there any bankruptcy-related cases we should be watching in 2023?

"FTX and the contagion across crypto," according to Goldstein.

Elberg and Stephansen note crypto cases will continue to pave the way to new case law or interpretation of existing law.

Proskauer's Marwil suggests crypto cases and upper middle market cases where loans are coming due and values don't support additional extension/increase of credit are a must watch. Lenders may now start taking the view that "first loss is best loss" over "kick the can", he says. ¤