

BANKRUPTCY & COVID-19 WORKING GROUP

The Honorable Nancy Pelosi
Speaker
House of Representatives
1236 Longworth House Office Building
Washington, DC 20515

The Honorable Mitch McConnell
Senate Majority Leader
United States Senate
317 Russell Senate Office Building
Washington DC 20510

The Honorable Kevin McCarthy
House Minority Leader
House of Representatives
2468 Rayburn House Office Building
Washington, DC 20515

The Honorable Charles Schumer
Senator Minority Leader
United States Senate
322 Hart Senate Office Building
Washington, DC 20510

May 7, 2020

Dear Sens. McConnell and Schumer, and Reps. Pelosi and McCarthy:

We are an interdisciplinary group of scholars who study the corporate bankruptcy system and the problems associated with financial distress. We have formed a committee (the “Large Corporations Committee of the Bankruptcy & COVID-19 Working Group” or the “Large Corporations Committee”)¹ to analyze the effect of the global COVID-19 pandemic on large American businesses and to consider changes that might be needed to improve the ability of the bankruptcy system to cope with the crisis. While we are in the early stages of our work, we write today to recommend strongly that Congress add capacity to the bankruptcy system to prepare for what we fear could be a flood of large corporate bankruptcies arising out of this pandemic. In particular, we urge Congress to appoint additional temporary bankruptcy judges and to increase the budgets of our existing bankruptcy courts so they can bolster their ranks with retired judges, additional clerks, and other necessary personnel that enhance the capacity of the bankruptcy system.

We strongly believe that our bankruptcy system, if properly staffed, will be capable of managing the financial distress that the pandemic has created for large corporations. The

¹ The Large Corporations Committee of the Bankruptcy & COVID-19 Working Group is one of four committees that are part of a larger group studying financial distress and COVID-19, each focused, respectively, on either (1) large corporations, (2) small businesses, (3) consumers, or (4) municipalities. The Large Corporations Committee includes, with institutional affiliations included for identification purposes only: Barry Adler (New York University Law School), Edward Altman (New York University Stern School of Business), Ken Ayotte (UC Berkeley Law), Efraim Benmelech (Northwestern University Kellogg School of Management), Jared A. Ellias (University of California Hastings College of the Law), Stuart Gilson (Harvard Business School), Edith Hotchkiss (Boston College Carroll School of Management), Troy McKenzie (New York University School of Law), Greg Nini (Drexel University LeBow College of Business), Michael Ohlrogge (New York University Law School), Robert K. Rasmussen (University of Southern California Gould School of Law), Mark Roe (Harvard Law School), Steven L. Schwarcz (Duke University School of Law), Alan Schwartz (Yale Law School), Lindsey Simon (University of Georgia School of Law), David C. Smith (University of Virginia McIntire School of Commerce), Frederick Tung (Boston University School of Law), George Triantis (Stanford Law School), Wei Wang (Queen’s University Smith School of Business) and Jay Westbrook (University of Texas School of Law). This Letter represents the consensus view of the Large Corporations Committee, all of whom are signatories to it. Additional members of the Working Group who agree with our recommendations are listed as additional signatories below.

bankruptcy code is now mature law, well-understood by lawyers and businesses and the system has shown an impressive capability to speedily and predictably resolve the wide range of issues that a bankruptcy filing often creates. While no legal regime is perfect, our high-quality bankruptcy law is a key comparative advantage for the United States in this unprecedented pandemic. Bankruptcy law will help many American businesses restructure their operations to re-emerge as strong competitors and employers. To be sure, additional reforms may be needed as the crisis advances, but the existing bankruptcy system proved capable of handling many crises in the past and it will likely be up to this challenge as well.

However, we are concerned with economic indicators that suggest that a wave of bankruptcies is coming, in particular:

- As of the end of 2019, large corporations had borrowed approximately \$1.5 trillion of high-yield bond debt and \$1.4 trillion in the leveraged loan market. Analysts are now projecting that over the next calendar year, 7-16% and 5-7% of these debts could be in default; by the end of 2021, these default rates could reach or exceed 20% and 17%;
- Combined, this equates to expected corporate defaults on as much as \$500 billion in debt over the next 18 months, with much of this likely to end up in the bankruptcy system;
- These sobering projections are already reflected in debt market prices, as more than 34% of high-yield bonds and 40% of leveraged loans are trading at a significant discount to face value, with 14% of high-yield bonds and 9% of leveraged loans trading at a level that credit analysts usually treat as indicating financial distress;
- Bank of America has warned that another \$200 billion of additional, investment grade debt could be subject to a downgrade by the end of the year, and iconic American firms like Occidental Petroleum, Ford and Kraft Heinz have already been downgraded to junk status;
- Additionally, many municipal entities have been downgraded by credit ratings agencies, reflecting their deteriorating finances and signaling a future need for Chapter 9 bankruptcy;
- The unemployment rate, a traditional leading indicator of consumer bankruptcy filings, may have reached 16% in April according to consensus estimates.

The economy may very well recover quickly enough that some of these worrying indicators turn out to be false positives and not signs of a coming bankruptcy surge. But Congress can prepare for a bankruptcy surge at a relatively low cost today. Even in the best economic times, our bankruptcy judges often have busy dockets with some mix of consumers, municipalities, small businesses and large corporations in one unified court system. As a result, a surge among consumers, for example, will reduce the capacity the bankruptcy courts have for the needs of large firms, municipalities and small businesses. By bolstering the bankruptcy courts, Congress can create additional resources that can be deployed against a wide range of possibilities in an uncertain time.

We have every confidence in our existing bankruptcy judges, but we also fear that their courts may be overwhelmed by this flood of cases. To be sure, it is difficult to project the future under any circumstances, and especially so now, but if there is a wave of large corporate bankruptcies caused by this pandemic we will want the bankruptcy courts to have the capacity to handle them well. In normal times, bankruptcy judges are able to hear important requests for judicial orders to stabilize reorganizing businesses on very short notice. This responsiveness is especially critical for large businesses that need the protection of bankruptcy law to hold together complex global operations and supply chains. To the extent that bankruptcy courts become too busy, it will impact

not only bankrupt firms but also their employees and, indirectly, the healthy companies that do business with Chapter 11 debtors and who also rely on the bankruptcy courts to protect Chapter 11 debtors.

Accordingly, we urge Congress to (i) appoint additional temporary bankruptcy judges to increase the capacity of district courts and (ii) increase the budget that Congress provides bankruptcy judges to spend on operations, especially, without limitations, funds for recalling retired judges, supporting the travel of judges providing service outside their appointed districts, and employing staff such as law clerks and judicial assistants. By adding judges, Congress can put capacity in place now that could be brought to bear as our bankruptcy courts begin to fill up with large corporations, consumers, municipalities and small businesses. Under normal circumstances, it takes about a year to fill a vacancy on the bankruptcy courts. While this process can be accelerated, the time to act is now before any flood of bankruptcies begins. As a more immediate measure, Congress can give judges additional money to support recalling additional retired judges, the movement of judges between districts, and the hiring of law clerks and other staff, thus providing new resources for our existing judges to help ensure that corporations and creditors receive the due process that is a hallmark of our bankruptcy system.

Sincerely,

/s/ Jared A. Elias

Jared A. Elias, Chair
Large Corporations Committee of the
Bankruptcy & COVID-19 Working Group

cc:	The Honorable Lindsey Graham Chairman, Committee on the Judiciary United States Senate 290 Russell Senate Office Building Washington, D.C. 20510	The Honorable Jerrold Nadler Chairman, Committee on the Judiciary United States House of Representatives 2132 Rayburn House Office Building Washington, D.C. 20515
	The Honorable Dianne Feinstein Ranking Member, Committee on the Judiciary United States Senate 331 Hart Senate Office Building Washington, D.C. 20510	The Honorable Jim Jordan Ranking Member, Committee on the Judiciary United States House of Representatives 1504 Longworth House Office Building Washington, D.C. 20510

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* “Additional Signatories” are members of the Bankruptcy & COVID-19 Working Group who are not part of the Large Corporate Committee but elected to sign this Letter because they support its conclusions. Institutional affiliations are included for identification purposes only.

[†] Denotes Bankruptcy & COVID-19 Working Group organizer.