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Year in Review

By Christopher Patalinghug

As the year draws to a close, Turnarounds & Workouts polled experts from different restructuring firms on how the industry shaped out in the past 12 months and shared their views to our valued readers: Matt Barr, Gary Holtzer, Jeffrey Saferstein and Sunny Singh, Co-Chairs at Weil Gotshal & Manges' Restructuring Department; Samuel Maizel, partner at Dentons and leader of the Firm's healthcare industry restructuring efforts nationwide; Frederick Hyman, partner in Crowell & Moring's Financial Services Practice; Daniel DeFranceschi and Amanda Steele, directors in Richards, Layton & Finger's Bankruptcy & Corporate Restructuring practice group; and Peter S. Kaufman, President of investment banking firm Gordian Group, and Henry Owsley, Gordian's CEO.

Cornerstone Research's report for the first half of 2024, released in September, observes a notable increase in Chapter 7 and 11 bankruptcy

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Experts Sound Off on Private Credit

By Christopher Patalinghug

The growing demand for private credit financing is one of the important trends that came out this year. A Morgan Stanley report[1] projects the size of the private credit market will grow to about $2.8 trillion by 2028, from approximately $1.5 trillion at the start of 2024 and an almost three-fold increase from $1 trillion four years ago. Meanwhile, Blackstone Inc. expects the private credit market to balloon to $30 trillion in size, fueled by lending for infrastructure projects and greater participation from pension funds.[2] "The opportunity set to finance the real economy, whether that's credit cards, whether that's equipment, whether that's data centers, aircraft — that is roughly a $30 trillion opportunity," said Rob Horn, global head of infrastructure and asset-based credit at Blackstone Credit and Insurance unit.[3]

Private credit refers to lending to companies by non-bank institutions. Deutsche

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filings among companies with assets exceeding $100 million. From the second half of 2023 to the first half of 2024, the number of filings rose by 8%, reaching 113, including 60 recorded in the first half of the year. What do you consider as the key drivers of restructuring activity in the past 11 months?

Matt Barr, Gary Holtzer, Jeffrey Saferstein and Sunny Singh, Weil: Although there have been several key factors, a primary factor has been the higher interest rate environment which has exposed weaker companies that are in need of restructurings and right-sizing of their capital structures. Higher interest rates have put greater demands on free cash flow and made it more difficult to refinance debt, especially for weaker borrowers who have historically been able to refinance their way out of problems (or at least kick the can).

Peter Kaufman, Gordian: Rates have remained stubbornly above expectations. With the Fed signaling only two cuts next year compared to prior market estimates of 4-5, borrowers are going to continue to have to deal with elevated borrowing levels. And with the uncertainty of the new administration's policies (tariffs, budget deficits, tax/spending cuts), uncertainty about the future continues to pressure businesses.

Rick Hyman, Crowell & Moring: The buzz from pandemic stimulus finally wore off for many middle-market borrowers in the first half of 2024. With many companies finding that their business models were forever impaired, or that COVID-induced demand was unsustainable, filings were on the upswing to adjust capital and debt structures to a new normal.

Sam Maizel, Dentons: I specialize in distressed healthcare transactions, and this has been a slower year than 2023, although the filings of very large healthcare companies, (those with liabilities exceeding $500 million), nonetheless remain at the elevated levels seen in 2023. A disproportionate amount of filings are from companies with private equity involvement and that may be attributable to their inability in the current market to achieve the return on investment their stakeholders expect. The key drivers of restructuring activity in the past 11 months continue to be (a) low reimbursement rates, primarily from government health insurance programs including Medicare and Medicaid, (b) high labor costs, (c) inflation (related to government reimbursement rates which lag far behind inflation), and (d) cyber costs, including dealing with electronic medical record requirements but also dealing with cyber black mail, which is increasing in the healthcare industry.

Amanda Steele, Richards, Layton: As long ago as the pandemic seems to be, it continues to affect the restructuring practice. Money was cheap and easy to come by during the pandemic, thanks largely to an infusion of government spending, and that led many companies to become overleveraged. In many instances, these infusions applied only a band-aid to a more serious problem. In a higher interest rate environment without free government money and with slowing consumer spending, lenders are unwilling to refinance on such favorable terms. Global political and economic turmoil has also contributed to bankruptcies in some sectors: energy disruptions wrought by the Ukraine invasion, attacks on commercial shipping in the Red Sea, and heightened tension between China and Taiwan are among the geopolitical drivers. And of course, inflation had an impact on consumer spending, which resulted in the restructuring of retailers and others dependent on discretionary consumer spending.

Are there any deals, cases or issues that stood out so far this year?

Barr, Holtzer, Saferstein and Singh: The Supreme Court's decision in *Purdue* was a major decision this year that has had a significant impact on case strategy, especially in mass tort cases. The *Incora* and *Robertshaw* cases also are notable because they offered further guidance on the outer limits of liability management transactions.

Kaufman: LME transactions continue to dominate as parties try to

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avoid expensive filings. However, these transactions are inevitably ending up in Chapter 11 and will continue to do so because in essence, you are just adding debt to the balance sheet for short-term liquidity instead of really addressing the problem today. And as these companies are filing, it's increasing the cost of the case due to expensive litigation among creditors (the haves and have nots form the original LME). LMEs appear here to stay, but companies need to focus on deleveraging to appropriate levels instead of just delaying the inevitable by a few quarters so that certain creditors get to cut in line.

Maizel: In the healthcare industry space, the *Steward Health Care* chapter 11 case stood out, in part because of its size ($9 billion in debt), but also because of (a) the public relations nightmare it caused for its private equity sponsor, which included national legislation proposed by Senator Elizabeth Warren and a Congressional subpoena for its CEO, and (b) the light it shown on the classic private equity strategy of acquiring healthcare facilities and then selling the real estate to raise funds to repay its investors which results in a separation of the opco and propco entities, with the opco now having to pay rent for the real estate it formerly owned and, inevitably, dealing with minimum rent escalators in the leases (in *Steward* it was Medical Properties Trust which bought the properties and had to forgive $7.5 billion in outstanding obligations in exchange for, among other things, *Steward* waiving its right to sue MPT on the grounds that the sale was a disguised financing), and

Which sectors saw the most restructuring activity the past year? Any sectors caught you by surprise?

Maizel: The consumer discretionary sector saw the most activity in 2024, including companies like 99 Cents Only Stores, Sam Ash Music, Rue 21, and Conn's HomePlus.

Kaufman: Retail/Consumer and healthcare. Neither really a surprise given underlying fundamentals of both industries..

What trends emerged in the second half of 2024? Are there restructuring-related matters in the past year that, in your opinion, should be talked about more?

Hyman: LMEs can't be talked about enough! Liability management transactions have transformed restructurings and continued to gain steam through the second half of 2024. There is no stopping this train in the short time and the traditional banks will need to get involved or they will be left behind in these transactions.

Henry Owsley, Gordian: The number of "extend and pretend" exchange offers (i.e., kicking the can down the road) involving bank debt and other private facilities seem to be increasing. However, the degree of difficulty in executing these out-of-court deals will significantly increase as more public debt maturities come into play. Relatedly, the prevalence of the LMEs and cooperation agreements among lenders has led to litigation when these restructuring inevitably file because the underlying balance sheet issues have not been addressed, and we would expect the prevalence of those issues to increase over time.

Maizel: Certainly the continuing debates over non-consensual releases continues to be a hot topic.

Daniel DeFranceschi, Richards, Layton: I would point to the increasing reliance on the United States as a forum for cross-border restructurings in a context where U.S. law offers greater flexibility than many foreign debtor "home" jurisdictions. Creative lawyers are pushing the boundaries as they seek to leverage the benefits of Chapter 11, at times drawing complaints from foreign creditors—and in some cases, the U.S. Trustee—that these efforts are an end run around the otherwise applicable foreign restructuring law. Many countries lack a Chapter 11 equivalent, so the incentive to file in the United States is certainly understandable. I will be watching this tug of war closely.

What changed in your outlook since early January 2024?

Barr, Holtzer, Saferstein and Singh: It was surprising that there were not even more chapter 11 filings. This is in large part due to: liability management transactions that allowed many borrowers to avoid chapter

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11; capital structures with a smaller number of direct lenders and the increasing costs of an in-court process (as compared to a tip for junior stakeholders) which has resulted in more transactions being consummated out of court.

Owsley: (a) Interest rates appear to now be staying higher for longer. Inflation is reduced but will remain in stubborn territory for the Fed; (b) There appears to be a significant cutback in retail sales of items greater than $1,000; (c) Financing for development-stage biotechnology has become much more difficult; and (d) Cannabis will continue to be adversely affected by tax section 280E for the foreseeable future.

Maizel: The election and the new administration is a wild card. I believe that large tariffs, if the incoming administration follows through on its promises, will cause an economic recession and more restructurings. I also believe that the new administration, if it follows through on its promises, which disrupt the international order of trade, resulting in increased business failures in the US.

DeFranceschi: This was a rollercoaster of a year. Early on, like many others, I was pessimistic about the economic outlook. The vestiges of the pandemic were still exerting a destabilizing effect, interest rates remained high, and inflation continued to be front of mind. Deteriorating conditions in the Middle East, combined with the lack of progress in Ukraine, created a sense of deepening involvement in a series of global crises. As year-end approaches, I'm feeling more optimistic because I anticipate that a shift towards prioritizing the American consumer and sending fewer resources abroad will have a positive effect. But that cautiously positive outlook is tempered by my belief that there are still a large number of companies that took on an unsustainable capital structure during the COVID era and have dragged their feet on an inevitable restructuring. Some of these companies should have filed years ago, and in 2025 they may well have to pay the piper.

Several reports, citing Adobe Analytics data, state that this year's Cyber Monday sales were expected to rake in $13.2 billion, which is 6.1% up from last year and considered a record. What can retailers and REITs take from this? What's your takeaway from this?

Maizel: Nothing to be seen here… Sales are up because there is, perhaps irrationally, a sense of optimism with a new administration coming. If the new administration follows through on its economic promises, I forsee a new recession.

Hyman: I'm concerned that the consumer is getting even further extended. While on its face, improved sales may look like good news, I fear that any meaningful reversal in the stock markets, might trigger a sever drop in household spending with the obvious effect on retailers and the REITs that house them.

Steele: I would be cautious about extrapolating too enthusiastically from the Cyber Monday data. My sense is that retail will remain challenged in 2025 as the post-pandemic adjustment continues and consumers tighten their spending. If inflation remains above-target and/or the new administration materially increases tariffs, the challenge for retail will be exacerbated. This year we've seen restructurings from retailers such as Express and retail-adjacent consumer products companies such as Tupperware. I expect we'll see more in 2025.

Kaufman: Brick and mortar retail continues to go the way of the dodo bird. REITs if possible need to pivot to redevelopment and a focus on experiential.

Which industries will likely continue to be vulnerable and see heightened activity next year?

Maizel: Healthcare for sure, especially if the new administration carries through on its promises to repeal the Affordable Care Act.

DeFranceschi: The new administration has signaled its intention to pursue a hydrocarbon-first energy policy, which may portend substantially more difficult conditions for green energy companies, including electric vehicle manufacturers and battery companies. The Biden administration has championed these sectors; to the extent the new Trump

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administration succeeds in rolling back subsidies, restructurings may follow. In the EV battery context, for example, constrained access to rare earth minerals due to ongoing global unrest could be an additional headwind.

Owsley: Retail/Consumer, Healthcare/Life Sciences (including development stage pharma), Cannabis and Alternative Energy. In addition, one area to keep any eye on is Manufacturing, in particular companies with supply chains originating in China or other tariff-impacted countries.

Similar to 2024, retail continues to be pressured by online spending and high labor costs. Increases in tariffs would only add fuel to the fire. Healthcare continues to be burdened by high operational costs and staffing concerns. Many businesses had a hole blown in their balance sheet due to the pandemic that they cannot grow out of, necessitating a restructuring.

With respect to Manufacturing, any tariff activity from the new administration could have a meaningful impact on costs and supply chains in an industry already operating on thin margins.

Coming from an election year, what opportunities could the next two or four years present to corporate restructuring professionals?

Maizel: The new president recognizes the value of bankruptcy as a tool, and the new administration's economic policies are likely to cause a new recession.

Kaufman: It will be interesting to see what new policies the administration pursues. Tax cuts, tariffs, DOGE will all have competing impacts on the economy, markets and interest rates, meaning companies (and their advisors) are going to need to be nimble and flexible when it comes to responding to those changes.

Hyman: Given our firm's expertise in international trade and related fields, our restructuring team will be focused on opportunities to help clients navigate through a very uncertain tariff environment. Among other things, we are arming up to provide guidance to lenders that are concerned about the implications of tariffs on their borrowers.

DeFranceschi: The demand for restructuring is primarily driven by macroeconomic factors, which often transcend electoral results. For example, the Federal Reserve appears likely to maintain its planned interest rate cuts notwithstanding the change in government. But the policy priorities of elected leaders also matter. A substantial increase in tariffs could provoke a wave of restructuring activity across multiple sectors, and there will be winners and losers as a result. A reorientation of energy policy towards greater support for hydrocarbon production at the expense of encouraging green alternatives could create sector-specific demand for restructuring advice. For now, I would caution that it remains to be seen how dramatically the new administration will shift policy, whether congressional opposition will mount, and whether the private sector will be adept enough to act on the pronounced shift in policy priorities.

What do you consider as your greatest challenge going into 2025? Describe the preparations, if any, that your firm is making for the next year.

Maizel: The greatest challenge is advising clients when no one knows for sure that policies the new administration will enact.

DeFranceschi: Our greatest challenge will be the same in 2025 as it was in 2024: ensuring we have the best team in place and that everyone on our team is effectively mastering the diverse elements of restructuring practice. Ours is arguably the most generalist practice in the legal field: we are transactional lawyers and also litigators, and our work requires a sophisticated understanding of various other specialties such as corporate governance, finance, tax, and real estate. We can't know for sure what the new administration will do, and we can't confidently predict the path of inflation or interest rates. So we will focus on ensuring that our team is prepared to serve our clients nimbly and capably across a range of economic scenarios. ¤