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Bankruptcy's Role in the COVID-19 Crisis

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Abstract

Policymakers presently minimize the role of bankruptcy law in mitigating the financial fallout from COVID-19. Scholars too are unsure about the merits of bankruptcy, especially Chapter 11, in resolving business distress. We argue that Chapter 11 complements current stimulus policies for large corporations, such as airlines, and that Treasury should consider making it a precondition for receiving government-backed financing, particularly when the corporation was highly leveraged prior to the crisis. For these borrowers, Chapter 11 offers a flexible, speedy, and crisis-tested tool for preserving businesses and restructuring liabilities, permitting them to shed drags on their innovation, while ensuring that the costs of those improvements are borne primarily by investors, not taxpayers. For consumers and small businesses, however, bankruptcy should serve as a backstop to other policies, such as the CARES Act. Consumer bankruptcy law's primary goal is to discharge debts, but that's not what most consumers need right now. What they need is bridge financing and forbearance until the crisis ends and they get back to work. These key policy levers—bridge financing and forbearance—are available in theory to small businesses in Chapter 11 as well. The practical reality, however, is that bankruptcy is unattractive to many owner-managers who are essential to the business, but may have their ownership interests wiped out in bankruptcy. Even putting that issue aside, our bankruptcy courts likely lack the capacity to serve a deluge of small business bankruptcy cases. Although we believe that bankruptcy should serve as a backstop during the current crisis, this backstop may be used heavily in the months ahead. We therefore encourage policymakers to ensure adequate funding for our courts, which may need a greater number of judges and trustees.

¹ We thank Ken Ayotte, Douglas Baird, Vince Buccola, Tony Casey, Jared Ellias, Katharina Pistor, David Skeel, and Kate Waldock for helpful comments.

1. Introduction

Social distancing guidelines have shut down large sectors of the American economy.² Many U.S. households and businesses are now experiencing a sudden decline in income and, with it, a mounting inability to pay debts. This is a problem that bankruptcy law can address. For households, bankruptcy is a pathway to eliminate financial stress: the law can halt collection efforts and reduce or discharge debts in exchange for assets or future income. For businesses, bankruptcy resets the bargaining table with creditors: Companies are given time to renegotiate debts, renovate operations, renegotiate contracts, and propose a repayment plan consistent with their ability to pay. This typically involves wiping out the rights of old shareholders and converting old debt into new equity. Through these procedures, debtors receive a “fresh start” and the economy is, presumptively, better off.

These solutions are time tested. When the financial crisis of 2008 threatened some of the largest U.S. industrial corporations, including General Motors and Chrysler, bankruptcy was the solution.³ When industry-wide distress destabilized the airline industry during the early 2000s, bankruptcy was the solution for Delta, United, Northwest, and U.S. Air, among others.

Should policymakers rely on our bankruptcy laws to help mitigate the financial stress suffered by consumers, small businesses, and large corporations today?⁴ We offer two answers: Bankruptcy should be a central part of policies targeting large corporations, but should be used only as a backup to other policies for consumers and small businesses.

² See, e.g., Michael D. Shear, *Trump Extends Social Distancing Guidelines through End of April*, NEW YORK TIMES, Mar. 29, 2020 (available [here](#)).

³ And the federal government assisted these businesses *through* the bankruptcy process, as discussed later in this essay.

⁴ Our essay is related to the work of Ken Ayotte and David Skeel, who analyzed the pros and cons of bankruptcy versus bailouts for financial institutions during the 2008 financial crisis. Kenneth Ayotte and David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. Corp. Law. 469 (2010).

Before explaining these punchlines, we provide an overview of how bankruptcy works.

2. How It Works: Consumer and Corporate Bankruptcy

Three “chapters” of the U.S. bankruptcy law provide the primary avenues of relief for distressed consumers and businesses:

- Chapter 7 (a liquidation proceeding available to both individuals and businesses);⁵
- Chapter 11 (a restructuring proceeding used primarily by corporations);⁶ and
- Chapter 13 (a repayment plan available to individuals with regular income).⁷

A bankruptcy petition triggers an “automatic stay,” halting collection efforts by all creditors anywhere in the world.⁸ For individuals, the automatic stay gives the debtor time to assess his or her situation, negotiate with creditors (especially secured creditors), and either liquidate assets (Chapter 7) or propose a plan of repayment (Chapter 13). For businesses in Chapter 11, the stay affords time to assess firm value, determine claim amounts, restructure operations or contracts or leases, and propose a plan of reorganization.

The automatic stay may be the most important benefit of a bankruptcy filing, especially during the COVID-19 crisis, because it prevents most creditors from collecting or liquidating their debts. During a crisis that is

⁵ 11 U.S.C. §§ 701 *et seq.*

⁶ §§ 1101 *et seq.*

⁷ §§ 1301 *et seq.*

⁸ § 362. There are important exemptions to the automatic stay. One permits the counterparties to swaps, repos, and other financial contracts to terminate the contracts and seize collateral. *See generally* Edward R. Morrison, Mark, J. Roe, and Christopher S. Sontchi, *Rolling Back the Repo Safe Harbors*, 69 *Bus. Lawyer* 1015 (2014). This exception was critically important during the previous crisis, which began in the banking sector where many financial contracts loom large, but will likely play a less significant role in this current crisis because, presently, bank insolvency is not a precipitating factor.

expected to be temporary, this “pause button” may be all that many debtors and businesses need. Equally important, it is a benefit that debtors obtain simply by filing a bankruptcy petition; no judicial action is needed.

For consumers, Chapters 7 and 13 offer different kinds of trade-offs. Both discharge virtually all of the consumer’s debts, but at different costs. In Chapter 7, the consumer must relinquish assets that exceed what state or federal law says the consumer absolutely needs for his or her fresh start. She will also lose some assets, such as a home or car, if these are subject to mortgages or liens. The process is speedy: For the honest debtor who discloses all assets to the court, it can be completed within a matter of weeks.

For consumers who want to retain assets that would be lost in Chapter 7, the better option is Chapter 13. Instead of giving up assets, the consumer gives up “disposable income” for a period of three to five years.⁹ Every month, the consumer pays off secured creditors and, if any income remains after covering living expenses, pays the remainder to unsecured creditors.¹⁰ This isn’t easy. Legal fees are substantially higher in Chapter 13 as compared to Chapter 7.¹¹ Worse, roughly two-thirds of consumers are unable to make the payments required by Chapter 13.¹² Their cases are dismissed or converted to Chapter 7.

For businesses, the choice between Chapters 7 and 11 is more straightforward. Chapter 7 is a funeral; Chapter 11 is a shot at renewal. Specifically, Chapter 7 turns the business over to a trustee, who is charged with liquidating its assets and distributing proceeds to creditors. Chapter 11 leaves the business in the hands of management, which is given an opportunity to

⁹ § 1325(b)(2). *See also* Official Form 122C-2, available [here](#).

¹⁰ § 1326.

¹¹ *See, e.g.*, Pamela Foohey, Robert M. Lawless, Katherine Porter, and Deborah Thorne, “No Money Down” *Bankruptcy*, 90 S. Cal. L. Rev 1055 (2016).

¹² *See, e.g.*, Edward R. Morrison and Antoine Uettwiller, *Consumer Bankruptcy Pathologies*, 173 J. Instit. & Theoret. Econ. 174 (2017), and sources cited therein.

obtain new, senior financing¹³ and propose a reorganization plan that values the going concern firm, reduces debts to a level consistent with the firm's ability to pay, and implements essential operational changes (e.g., renegotiating labor contracts). Creditors vote on the proposed plan. If the court approves the plan, the reorganized firm exits bankruptcy with a new capital structure: Old debts are eliminated and replaced with new debts owed by the newly reorganized firm; old shares are deleted and replaced with new shares issued by the reorganized firm. One fundamental rule looms in the background as management crafts a plan: Senior creditors must be paid before junior creditors, who must be paid before shareholders receive anything. This is the "absolute priority rule," which generally means that shareholders are wiped out in Chapter 11 reorganizations.¹⁴ Junior debt may be wiped out too. The only creditors who retain rights after the firm is reorganized are those whose claims are (a) most senior and (b) collectively consistent with the firm's ability to pay. Among these creditors, equity in the reorganized firm is typically transferred to the most junior creditors.

The Chapter 11 process was designed with large corporations in mind (indeed, it is modeled on old rules for restructuring railroads) and, during the past forty years, the process has become user-friendly for these businesses. Large corporate Chapter 11 cases tend to be speedy because, among other things, most of the businesses have professional support and the foresight to negotiate with creditors before a bankruptcy filing, thereby clearing the way for a less controversial, or even pre-approved, reorganization plan (these are called "prenegotiated" and "prepackaged" cases). Frequently, this negotiation will not only clear away creditor objections, but will also involve the debtor's commitment to sell the firm quickly after the bankruptcy filing.¹⁵ Proceeds

¹³ The liquidity-enhancing role of Chapter 11 is the focus of Kenneth Ayotte and David A. Skeel, Jr., *Bankruptcy Law as Liquidity Provider*, 80 U. Chi. L. Rev. 1557 (2013).

¹⁴ See, e.g., Barry E. Adler, Vedran Capkun, and Lawrence A. Weiss, *Value Destruction in the New Era of Chapter 11*, 29 J. L., Econ. & Org. 461 (2013).

¹⁵ See, e.g., Melissa B. Jacoby and Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 Yale L. J. 862 (2014); Douglas G. Baird and Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan L Rev 751, 777–88 (2002).

from the sale will then be distributed to creditors in order of lien rights and payment priority.

Some of the largest U.S. corporations have used Chapter 11 to remedy distress and emerge financially healthier. These corporations include airlines (such as United and Delta), car manufacturers (General Motors and Chrysler), financial institutions (CIT Group), and oil companies (Texaco). Other major corporations have used Chapter 11 as a quick way to merge themselves with other corporations via a 363 sale. A good example is American Airlines. It acquired TWA through a 363 sale. Subsequently, during its own Chapter 11 case, American merged with U.S. Airways.

Chapter 11 works well in crises too. General Motors and Chrysler provide good illustrations. Both neared death during the 2008 financial crisis, but were taken into Chapter 11, where each received financial support from the federal government.¹⁶ Each was sold off to a buyer within weeks.¹⁷ The speedy bankruptcies, financed by the federal government, allowed both companies to renegotiate or shed legacy liabilities that had been a drag on innovation for decades. In the process, the U.S. government was also able to, in essence, rescue the supply-side chain of these auto giants, thereby preserving jobs up and down the entire auto industry. Whatever the federal government decides to do now for the aerospace or airlines industries, this is recent precedent that government-supported restructurings can help stabilize the American economy – and prove a good investment for taxpayer funds.

This is not to say that Chapter 11 is perfect. It can generate important disruptions in operations as investors jockey for recoveries. One study, for example, finds that workers suffer long-term declines in wages when their

¹⁶ Many other businesses also used Chapter 11 successfully during the crisis, but received no government support, including Lear Corp. and Visteon Corp. in the auto parts industry and Tronox Inc. in the chemicals industry.

¹⁷ See Anthony J. Casey and Eric A. Posner, *A Framework for Bailout Regulation*, 91 *Notre Dame L. Rev.* 479 (2015).

firms enter bankruptcy.¹⁸ Additionally, scholars have shown that the dynamics of a Chapter 11 case, including its duration, costs, and ultimate outcome, depend on contestable and hard-to-predict judicial decisions about creditor priority and firm value.¹⁹ Finally, scholarship has shown that secured creditors have outsized influence over the process. This is because the firm's pre-bankruptcy secured creditors are typically the same financiers (and usually the only available financiers) of the bankrupt business. This gives them outsized influence, which can lead to quick sales at "fire sale" prices instead of reorganization.²⁰

Although these downsides of Chapter 11 are important, we think they can be managed during the current crisis. Workers suffer large declines in wages when their firms become unprofitable, regardless of whether the firms file for bankruptcy. Although a filing can exacerbate this wage decline in normal times, it's unclear whether to expect the same effect during this crisis, especially if the government is the primary supplier of liquidity to the bankrupt firm and uses that power as leverage to influence payroll (as it is currently doing under the CARES Act). The risk of "fire sales" in the current environment depends on the influence exerted by secured lenders. If they too are stressed, the lenders may prefer quick cash from fire sales instead of illiquid (but higher valued) claims against the reorganized firm. The risk of fire sales, therefore, depends critically on the extent to which government policy (through action by the Federal Reserve) mitigates financial stress in the financial sector. Additionally, if a stressed banking sector is unwilling to finance firms in Chapter 11, the government can play an essential role in

¹⁸ The same authors find that workers receive wage premiums at firms with high bankruptcy risk. John R. Graham, Hyunseob Kim, Si Li, and Jiaping Qiu, "Employee Costs of Corporate Bankruptcy," working paper (available [here](#)).

¹⁹ See, e.g., Anthony J. Casey and Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 Mich. L. Rev. 1175 (2015); Douglas G. Baird and Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 Yale L. J. 1930 (2006).

²⁰ See, e.g., Kenneth Ayotte and Jared A. Ellias, "Bankruptcy Process for Sale," working paper (2020); Kenneth M. Ayotte and Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 2 J. LEGAL ANAL. 511 (2009).

providing that financing and, at the same time, prevent unnecessary fire sales and preserve jobs.

A more fundamental weakness of Chapter 11 is that offers a poor fit for many small businesses. Thirty percent of firm value can be burned up by professional fees.²¹ Additionally, around two-thirds of all small-business Chapter 11s terminate in liquidation or dismissal (which leads to liquidation under state law).²² These outcomes are due, in part, to the fact that most small businesses do not undergo regular audits and have few or no human resources dedicated to financial management.²³ Thus, when they enter Chapter 11, their financial affairs are difficult to unscramble. As a result, the vast majority never file a bankruptcy petition; they simply close shop.²⁴ This is one reason why we are skeptical that bankruptcy is an appropriate remedy for small businesses during the current crisis.

Congress has taken steps to mitigate the weaknesses in Chapter 11 for small businesses. Last summer, it passed the “Small Business Reorganization Act of 2019,”²⁵ which went online on February 19, 2020. The Act’s central feature is that it eliminates part of the absolute priority rule in bankruptcy. This is important because many businesses are organized around the skills of the owner-manager. Without her, there is no business. An absolute priority rule that wipes out the owner-manager is a rule that strongly discourages her from helping the business navigate its way through bankruptcy. Under the new law,

²¹ Arturo Bris, Ivo Welch, and Ning Zhu, *The Costs of Bankruptcy*, 61 J. Fin. 1253 (2006).

²² Elizabeth Warren and Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 Mich. L. Rev. 603 (2009); Douglas G. Baird and Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcy*, 105 Colum. L. Rev. 2310 (2005) (“Serial Entrepreneurs”); Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small Business Bankruptcies*, 50 J. L. & Econ. 381 (2007) (“Bankruptcy Decision Making”).

²³ Baird and Morrison, *Serial Entrepreneurs*, *supra*; Morrison, *Bankruptcy Decision Making*, *supra*.

²⁴ Edward R. Morrison, *Bargaining around Bankruptcy: Small Business Distress and State Law*, 38 J. Legal Stud. 255 (2009).

²⁵ It is now Subchapter V of Chapter 11.

by contrast, a small business owner can retain her equity interest even if unsecured creditors will not be paid in full, as long as the Chapter 11 plan commits all of the business's "disposable income" to these creditors for a three to five-year period. This abrogation of the absolute priority rule makes Chapter 11 substantially more attractive to small businesses for two reasons: first, a business owner will no longer be deterred for fear of losing ownership. Second, by retaining her interest, she has a stronger incentive to help the firm revive itself, including paying off its remaining debts.

The trouble with the new law is its limited scope. Originally it applied only to businesses with debt under about \$2.7 million; the CARES Act raised the debt limit to \$7.5 million. Even at that limit, however, scholars estimate that only 59 percent of all Chapter 11 cases would qualify,²⁶ and the vast majority of cases are filed by small businesses. Moreover, the Act has some administrative challenges: It appoints a "standing trustee" to monitor the debtor's progress in proposing and completing the multi-year plan of reorganization. The trustee may help identify nonviable businesses early on (seeking their dismissal or conversion to Chapter 7), and help viable businesses craft a feasible plan. It is unclear whether there are adequate standing trustees to assist with the potential increase in post-COVID-19 filings by small businesses. What we do know, however, is that neither these trustees nor the bankruptcy courts have substantial experience in administering these cases.

3. The Limits of Bankruptcy Law During a Crisis

The weaknesses of bankruptcy law fall into three categories. First is the take-up problem. Those who could benefit from bankruptcy may avoid it because of its costs. This is a big problem in normal times and could exacerbate the current crisis. For consumers, there has long been a perceived stigma associated with a filing. Additionally, a bankruptcy filing is a "flag" on credit reports for many years. As a result, studies have shown that only a fraction of

²⁶ Robert Lawless, "The Small Business Reorganization Act of 2019 and COVID-19," Credit Slips blog post (available [here](#)).

consumers who could benefit from bankruptcy actually petition for bankruptcy protection.²⁷

The take-up problem looms large for businesses too because shareholders' rights take a backseat to creditor demands, particularly if the business is insolvent or undercapitalized. Owners and shareholders of any size business are likely to resist a process that wipes out their rights, especially if they think the business could possibly recover in the near term. Indeed, because shareholders are typically wiped out in bankruptcy, a corporation's directors may delay filing in an effort to preserve share value.

A second weakness is liquidity: For consumers, the "fresh start" of bankruptcy is a discharge of old debts, not access to cash necessary to pay expenses when income has fallen during a crisis. Indeed, for many consumers, a discharge of debts is the wrong prescription for their stress:²⁸ After the crisis ends and they get back to work, they will be able to pay their debts. What they need is financial assistance and perhaps forbearance with respect to debts that are coming due now. For businesses, too, liquidity is a key problem: Their ability to survive depends critically on access to loans (or cash collateral) that allow the firm to make payroll, pay rent, purchase inputs, etc. The current crisis may make banks reluctant to extend credit. To the extent that the crisis harms the financial condition of banks themselves, moreover, we may find that cash-strapped banks are not only reluctant to lend, but also aggressively seek liquidation of firms in bankruptcy. We saw this during the previous crisis.²⁹

²⁷ See, e.g., Michelle J. White, *Why Don't More Households File for Bankruptcy?*, 14 J. L. Econ. & Org. 205 (1998).

²⁸ Both consumers and creditors are harmed by an unnecessary bankruptcy discharge: Consumers become ineligible to obtain another discharge for many years (8 years must pass between Chapter 7 discharges); creditors receive only a fraction of what they are owed in the typical consumer bankruptcy.

²⁹ Sarah Pei Woo, *Regulatory Bankruptcy: How Bank Regulation Causes Fire Sales*, 99 Geo. L.J. 1615 (2011); Sarah Pei Woo, *Simultaneous Distress of Residential Developers and Their Secured Lenders: An Analysis of Bankruptcy and Bank Regulation*, 15 Fordham J. Corp. & Fin. L. 617 (2010).

A third weakness is the limited capacity of our bankruptcy courts. The bankruptcy process is a bargaining environment, overseen by a judge, where creditors and shareholders jockey for payoffs as they decide the fate of the firm. Judges are called on to make critical decisions, under extreme time pressure, based on potentially-biased and highly-contested information supplied by the parties. This is true in normal economic times. The burden on the judicial system will be extreme curing a crisis that brings an unprecedented flood of cases into the courts. We know, for example, that judges change their behavior when caseloads spike: A sudden increase in caseloads makes courts more likely to liquidate small firms, reorganize big firms (but take longer to do so), and terminate cases of firms that end up filing for bankruptcy again.³⁰ If these decisions by time-strapped judges are errors, we should worry about the errors that may occur when courts are inundated by filings.

These weaknesses—take-up, liquidity, and system capacity—mean that bankruptcy law cannot serve as a primary policy response for the stress faced by consumers and small businesses today. For consumers, bankruptcy doesn't provide the essential remedies that they need right now: liquidity and forbearance. For small businesses, it may be possible to tap liquidity from government-backed lenders in bankruptcy, but the flood of cases would overwhelm the bankruptcy courts. Equally important, the prototypical small business is run by an owner-manager whose participation is essential to the business survival. Unless the absolute priority rule is modified for small businesses generally (currently it is modified only for businesses with debt under \$7.5 million), small business owners may prefer to liquidate their businesses outside of bankruptcy than lose their ownership interests in bankruptcy.

For these reasons, we think non-bankruptcy policies, especially those extending liquidity and forbearance, are the optimal response to the distress of

³⁰ Benjamin Iverson, *Get in Line: Chapter 11 Restructuring in Crowded Bankruptcy Courts*, 64 *Mgmt. Science* 5370 (2018).

consumers and small businesses.³¹ Specifically, we recommend that Congress enact policies that create an automatic stay for the benefit of consumers and small businesses. Congress did this for members of the military through the Servicemembers Civil Relief Act of 2003. It is time to do it again, but for consumers and small businesses generally. Many may still file for bankruptcy, especially if government policies are inadequate. For them, bankruptcy can serve as a relief-valve, provided the government takes steps immediately to expand the capacity of our judicial system.

We are more optimistic about the role of bankruptcy law in resolving the distress of large corporations. The crisis has destabilized all businesses, but many were likely to suffer distress regardless of a pandemic. The past decade saw a dramatic increase in corporate debt, especially leveraged loans, that allowed financially distressed “zombie companies” to survive without filing for bankruptcy by repeatedly refinancing their debts. By some estimates, zombies account for sixteen percent of publicly traded U.S. firms.³² By end of 2019, a large proportion of even *investment grade* debt was vulnerable to a ratings downgrade.³³ These statistics imply that a substantial proportion of stressed businesses today merit financial restructuring (or even liquidation) in bankruptcy instead of, or in addition to, financial aid from the federal government, such as the CARES Act.³⁴ It would, in our view, be a mistake to extend further financing without requiring a simultaneous bankruptcy filing:

³¹ The National Bankruptcy Conference (NBC) has made the same recommendation in a recent letter to Congress (available [here](#)). (Disclosure: Morrison is a member of the NBC.)

³² See “International banking and financial market developments,” BIS Quarterly Review (September 2017). See also Ryan Bannerjee and Boris Hoffman, *Zombie Firms: Causes and Consequences*, BIS Quarterly Review (September 2018).

³³ See, e.g., Edward I. Altman, “The Credit Cycle Before And After The Market’s Awareness Of The Coronavirus Crisis In The U.S.,” working paper (April 2, 2020).

³⁴ See Sec. 1105, Senate Bill No. 3548, 116th Congress (Proposed March 19, 2020), available [here](#), and H.R. 748, 116th Congress (signed into law March 27, 2020), available [here](#).

The financing would allow these firms to use public funds to further delay a necessary restructuring.³⁵

The government should therefore treat Chapter 11 as a tool that works in tandem with other policies to mitigate financial stress in the corporate sector, particularly for large corporations that were approaching distress prior to COVID-19. For those businesses that need restructuring, the government can still provide liquidity, but in the context of a bankruptcy proceeding that enables financial restructuring, facilitates operational changes necessary to cope with a post-COVID-19 world,³⁶ and forces investors to shoulder the costs of distress that was exacerbated by excess leverage.

Although a large number of big corporate cases would tax our bankruptcy courts, these cases come with professionals (lawyers, accountants, investment bankers) who reduce some of the burden on the courts.³⁷ More importantly, the speed of a bankruptcy case is largely dictated by the institution providing the liquidity. Cash is king. The government, therefore, could play an important role in preventing unnecessary asset fires sales and

³⁵ Our point extends beyond corporations that took on excess leverage. It applies as well to companies that, prior to the crisis, were experiencing operational problems or facing large liability for past errors. Chapter 11 is an appropriate venue for resolving these problems while also receiving government financial assistance. Absent a Chapter 11 filing, government financial assistance will be doing double-duty: (i) mitigating the liquidity shock arising from the COVID-19 crisis and (ii) funding the firm's efforts to resolve pre-crisis mistakes.

³⁶ For example, bankruptcy law gives the firm special powers (unavailable outside of bankruptcy) to renegotiate contracts and labor agreements and jettison assets that are incompatible with expected changes in the economic environment.

³⁷ Costs might also be mitigated if cases are filed in bankruptcy courts with substantial accumulated expertise with corporate distress, such as Delaware and the Southern District of New York. Though controversial, "forum shopping" by corporations has resulted in a large flow of complex corporate bankruptcies to these courts, allowing them to develop expertise that's needed in a crisis. General Motors, for example, is a Detroit corporation that filed for bankruptcy in New York during the 2008 financial crisis. See Jared A. Ellias, *What Drives Bankruptcy Forum Shopping? Evidence from Market Data*, 47 J. Legal Stud. 119 (2018).

pushing the process toward a reorganization that preserves viable firms (and American jobs). This is precisely what we saw in the Chrysler and GM cases. Nonetheless, even if the administrative costs of Chapter 11 would not be low, we think they are offset by an important benefit of a bankruptcy process that permits government-assistance, but forces investors to shoulder the costs of the firm's distress.

4. Conclusion

Federal, state, and local governments are already implementing policies, including financial assistance and forbearance, that will help stabilize household and business finances and limit the need for bankruptcy filings. Nonetheless, bankruptcy undoubtedly has an important role to play in the fallout from the COVID-19 crisis. Many consumers and businesses will file for bankruptcy when their inability to pay debts results in default or otherwise triggers creditor debt collection efforts, such as foreclosure.

Accordingly, it is important for lawmakers to consider how best to prepare the landscape for this new, and likely historic, wave of distress. For large corporations, Chapter 11 should be openly and seriously considered as an optimizing tool to prevent firm liquidation and equally protect the public fisc, particularly for businesses that require more than short-term liquidity to survive post-COVID-19. In fact, Chapter 11 may even pave the way for industry consolidation or other innovations to operations. While shareholders may lose their investments, businesses and jobs will be preserved.

Similarly, for consumers and small businesses, while bankruptcy is not as immediately helpful as forbearance or direct income supplements, it will certainly be utilized if this short-term liquidity crisis becomes long term.³⁸ For this reason, we believe it's equally important for lawmakers to expand the

³⁸ Indeed, the CARES Act has taken steps to make the bankruptcy code more attractive to distressed consumers. The Act amends the code to exclude emergency payments to individuals from the code's income eligibility thresholds. The Act also permits existing Chapter 13 debtors to request plan modifications based on changes in income due to COVID-19. *See* CARES Act, § 1113.

capacity of the courts to administer this influx of cases, particularly if lawmakers want to see small businesses take-up the benefits of SBRA.