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COVID-19 Ushers In New Normal For Bankruptcy Proceedings

By **James Peck**

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(March 25, 2020, 3:05 PM EDT) -- It was almost 12 years ago when it happened to me. I was a sitting bankruptcy judge dealing with the defining moment of the global financial crisis. I had a one-of-a-kind emergency on my hands that required immediate action. Systemic risk was roiling the markets and an emergency hearing had to take place just days after the Lehman filing to consider the urgent sale of Lehman's North American business. My courtroom overflowed with anxiety that day, and that hearing became perhaps the most riveting and consequential hearing in bankruptcy history.

I approach the current COVID-19 crisis with that experience firmly in mind. Could a hearing such as that one, if mandated by exigent circumstances, take place today?

This article considers some of the consequences and limitations of the suddenly familiar new normal for bankruptcy courts and professionals — a world without in-person meetings and without actually going to physical courtrooms for hearings. Technology allows for expedient processing of work in the pinch of the moment, but with the expected crush of new business cases, will restructuring outcomes suffer and will new procedures be up to the task of managing genuine emergencies?

Due to its exceptional systemic significance, the Lehman sale hearing could not be postponed, but that is not true of most bankruptcy hearings. They are important to the parties and the administration of justice in bankruptcy cases, but scheduling is generally at the convenience of the court and crafted to satisfy the timing needs of each case.

As we observe with growing concern the damage each day to businesses and individuals resulting from COVID-19, it is evident that an influx of new business cases will be coming soon to a bankruptcy court near you. These cases may inundate the bankruptcy system at a time of unprecedented uncertainty and hardship in the real economy and challenging personal circumstances for consumers, judges, bankruptcy court employees and many restructuring professionals.

Based on my time on the bench, I have little doubt that the bankruptcy courts will be heavily burdened by a surge of new filings for impacted individuals and businesses. I am convinced that a business-as-usual approach will not work during this period of the new normal for bankruptcy and restructurings

and believe that insisting on doing things the old way could prove to be counterproductive. This is a time for wise counsel and establishing realistic priorities.

In recognition of a likely exponential increase in filings and the resulting demand for access to the bankruptcy courts, parties, in view of the practical limitations of working and appearing remotely, will be adopting a more nuanced approach to all nonessential activity in bankruptcy cases for their own good and for the good of all stakeholders.

The bankruptcy system, I expect, will encourage such a collective approach. The courts are unable to limit case intake, but judges do have the authority to control their own dockets and will exercise that responsibility in the coming weeks and months. Judges will be dependent on the cooperation of parties and their counsel, and will endeavor to establish priorities and a sequencing of hearings that distinguishes the urgent from the routine.

Hearings now are being conducted virtually, and that may not be optimal for every contest. Parties, under these unique circumstances, will need to decide if going forward or delaying is in their own best interest.

Parties and their counsel should be extra sensitive to this new normal when making requests for hearing dates. Not everything is an emergency, and those who fail to recognize that reality and press for a position on the calendar at time of heavy demands on the courts may find that they are regarded with the same sort of disdain as a shopper who hoards toilet paper. In this environment of competing interests, the system tends to reward generosity of spirit (something not often observed in bankruptcy) and patience, and to penalize those who may seek to grasp for advantage without good cause.

As I note in later paragraphs, there are natural limitations in proceeding with a contested virtual hearing, especially one that depends on the credibility of witnesses. Notwithstanding that disability, conference telephone hearings will be the norm in relation to financing and other manifestly urgent requests for relief that are vital to maintaining liquidity and avoiding value destruction. In fact, we have recently seen several bankruptcy courts mandate that all hearings shall be held telephonically unless otherwise ordered by the court on a properly presented motion.

That trend will become commonplace throughout the country for the duration of the health crisis. Hopefully, requests for emergency relief will be limited, and with the assistance of experienced counsel parties can stipulate to the relief needed to avoid harm while reserving rights for later hearings.

We are in the midst of an existential, life-changing health crisis with huge economic spillover effects and find ourselves now on the cusp of a related crisis in the world of restructuring. The judicial determinations that I made during the last global financial crisis in September 2008 could not easily be replicated today when leading and supporting actors in the bankruptcy system are constrained by social distancing, lockdowns and self-quarantine.

It was truly helpful for me to be able to look Harvey Miller in the eye. He was steady and authoritative and that helped me to perform my judicial functions during that fateful hearing.

The effective administration of bankruptcy cases, in normal times and especially during times of crisis like this one, depends heavily on working in teams and actual face time, not the version loaded onto your iPhone.

Could Lehman have negotiated its quick sale if everyone involved had been working remotely? I doubt it. Lawyers are social beings with delegated areas of responsibility and are accustomed, especially in large firms, to working in teams. Lawyers dedicating time to deals or dispute resolution cannot possibly be as effective when separated as when they are together in the same working environment.

Technology is terrific at connecting us online and on telephones, but we should not pretend that technology provides a seamless workaround and effective substitute for time spent in conference rooms, or that we can suspend the human need for community and carry on business as usual while so many are distracted and fearful.

Virtual bankruptcy hearings conducted by conference calls are not the same as in-person opportunities to be heard and seen and to advocate for clients with all senses engaged. I just participated in one such hearing, and it worked reasonably well, but no one could see the judge, and the judge was unable to see anyone or evaluate their expressions and body language. That is not what we mean by blind justice.

I am quite concerned that the bankruptcy system will not function as it should for the duration of the crisis unless professionals are prepared to act responsibly. Consistent with their obligations of zealous advocacy, professionals will need to provide guidance and direction to their clients regarding the risks of proceeding with virtual hearings. In some instances of manifest need, there will be no option other than to go forward.

But consider the example of a contested confirmation hearing in a mega-Chapter 11 case. Can parties be expected to effectively prepare for such a major case event under the current conditions of remote working, and can evidence be presented properly to the court on a conference line over a period of days or weeks? Is there fundamental fairness in proceeding or should the hearing be adjourned to a future date when parties can appear in person?

These questions will be answered differently depending on whether the party responding sees an advantage or disadvantage in pressing forward despite the obvious challenges.

Ultimately, it will be for the court to decide whether the facts and circumstances of a particular case justify moving ahead despite the unprecedented limitations of the moment. That was the case when Lehman needed extraordinary relief, and I have confidence it will be true during this crisis as well, but only for exceptional cases where timing is truly critical (and not due to fabricated milestones).

Bankruptcy and restructuring will be different during this new business cycle. Unlike every other period of business distress, this one has not been caused by excessive risk-taking or the vagaries of the business cycle. Failures caused by the current pandemic are not due to fraud or mismanagement or greed. The losses are widespread and agnostic and impact all market participants one way or another.

That conceivably could lead to greater mutual understanding and empathy in our business practices. Parties, whether par or distressed players, should expect as a result that judges will be very receptive to reasoned requests for mercy and will encourage creditors to be patient and even compassionate. This will be a time of more measured approaches to conflict resolution.

Working remotely and virtual hearings may persuade parties that it is sensible to defer major bankruptcy battles due to the limits in effectively trying disputed issues of fact. The new normal for bankruptcy, thus, may mean a more nuanced approach to the sequencing of dispute resolution (more status conferences and fewer evidentiary hearings). No doubt we will get through this, with hopes that the system may even be the better for it.

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