

Corporate bankruptcies in America

The boom in busts

Jul 2nd 2009 | NEW YORK

From The Economist print edition

Bankruptcies are at near-record levels

IT IS not quite the Armageddon that was being predicted in the weeks after Lehman Brothers became America's biggest corporate bankruptcy last September. But this recession is still on course to be second only to the Depression in terms of companies going bust. Measured by the firm's assets at the time of filing for protection from their creditors, the past year has seen five of the eight biggest bankruptcy filings in the history of American business—with Washington Mutual, Thornburg Mortgage, General Motors (GM) and Chrysler joining Lehman on the list.

A good indicator of the awfulness of the downturn is the market for junk bonds, which surely deserve the name again after nearly two decades of attempts to rebrand them as safer-sounding "high-yield debt". At the end of May 9.2% of high-yield debt issues (globally, but

dominated by American paper) had defaulted during the previous 12 months, compared with less than 1% in the year to December 2007. The failure rate is on course to hit 13.8% in the fourth quarter of this year, according to Moody's, a credit-rating agency, after which it should start to decline. That would be slightly higher than in the two previous recessions, when the percentage of defaults peaked at 10.9% (in January 2002) and 12.8% (in June 1991), but below the all-time high of around 16.3% in 1933.

Although they have wobbled a bit lately, junk-bond prices have recovered sharply in the past few months. This is particularly true of distressed issues (the ones trading at yields at least ten percentage points higher than those of Treasury bonds). In the fourth quarter of last year 87.5% of high-yield issues were distressed, which on past form implied an eventual default rate of more than 20% in the fourth quarter of this year, says Martin Fridson, of Fridson Investment Advisors. Now about 40% of issues are distressed, implying a default rate of 10% this time next year. According to JPMorgan, there were 15 defaults a month in the first four months of 2009, but the rate fell by half in May and June.

Not surprisingly, many prominent recent failures have been firms reliant on the American consumer, such as Eddie Bauer, a clothing retailer, and Six Flags, a theme-park operator. On July 1st Crabtree & Evelyn, a maker of soap and fragrances, filed for Chapter 11

bankruptcy protection. There is much speculation about possible bankruptcy for Harrah's Entertainment, a huge casino operator. Lear, a supplier of car parts, was expected to file as *The Economist* went to press.

The leading role of the federal government in the bankruptcies of GM and Chrysler has prompted fierce debate about the future of the Chapter 11 bankruptcy process. The government's proposals gave much less to some classes of creditors—including those who thought their debt was secured—than the usually strict rules of Chapter 11 dictate. This has prompted fury, lawsuits and talk of a slippery slope. Others argue that GM and Chrysler are exceptionally politicised.

Some courts are also giving bosses of bankrupt firms shorter shrift. On June 29th a bankruptcy judge ordered the executives of Gainey, a bankrupt trucking firm, to fly coach, "not first class, not business class. You'll travel like most of the rest of us do." At a bankruptcy hearing on July 21st for LyondellBasell, a petrochemicals giant, a judge will rule on a proposed \$32m remuneration package for its putative new boss, James Gallogly.

What is clear is that law firms are doing very nicely out of corporate failure, as usual. The bill submitted by Jones Day for the first month of the Chrysler bankruptcy was for more than \$12m.

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