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What Lower Rates? Ch. 11s Expected To Stay Sticky In 2025

By **Hilary Russ**

Law360 (January 1, 2025, 8:01 AM EST) -- With the prospect of big interest rate cuts fading, rates may not dip low enough in 2025 to be a panacea for businesses struggling with high levels of debt, consumer frugality and uncertainty under a new administration.

After Chapter 11 filings rose to the highest level in years in 2024 amid persistent inflation, companies had hoped that sharper drops in rates could be a balm when the Federal Reserve started lowering them in September.

But in December, the Fed forecast only lukewarm rate cuts in 2025. Now, analysts and restructuring lawyers say they expect filings and overall restructuring activity to remain robust — including mega cases from companies with $100 million or more of assets.

"We're going to continue to see an uptick in Chapter 11 and 7 filings, certainly through the first half of next year," Matthew O'Donnell, a partner at Morgan Lewis & Bockius LLP in New York, said.

On Dec. 18, the Fed dropped its target rate by 25 basis points to a range of 4.24% to 4.5%, the third and last cut for the year.

Equity markets then tumbled after Fed Chair Jerome Powell signaled that central bank policymakers would take a cautious approach in 2025 with two more quarter-point cuts — instead of four such cuts as the Fed had predicted in September.

According to John W. Weiss, chair of the bankruptcy, restructuring and creditors' rights practice at Pashman Stein Walder Hayden PC, "Filings are going to remain fairly steady, notwithstanding the fact that rate cuts have occurred."

Bankruptcies Spiked

Commercial Chapter 11 filings peaked in June at 995, the highest monthly total since March 2010, data from Epiq AACER showed. That figure included the new Subchapter V category for smaller companies, for which higher debt limits sunsetted June 21, sparking a rush of new filings.

When commercial bankruptcies are tallied across all applicable chapters, totals in June were the highest since September 2020, during the COVID-19 pandemic, the Epiq data indicated.

Weiss' group continues to see strain among mid-market and smaller companies in particular.

"There is still an extreme amount of leverage in the marketplace," he said. "There still are fundamental problems with companies facing that weight of debt that they took on."

And while by many accounts, the overall economy remains solid, the **costs for goods**, energy, insurance and labor are also stuck at elevated levels.

Retail and restaurant companies in particular will stay stressed, Weiss noted, after a year that saw major bankruptcies including that of TGI Fridays Inc. and World of Beer, both of which cited higher interest rates as one of several reasons for filing.

Prison healthcare provider Wellpath Holdings Inc. also cited higher rates in its bankruptcy, as did medical services company CareMax Inc. which noted the rising rates had ballooned its debt service payments.

Moody's Ratings is expecting a "rather sticky" number of corporate defaults through the first quarter before it moderates around the middle of the year, senior analyst Julia Chursin said.

The ratings agency expects distressed debt exchanges and other defaults particularly among private-equity-backed leveraged buyouts, which at the end of 2024 made up the majority of such situations, especially in the services, consumer products, technology and healthcare industries, according to Chursin.

Wild Cards

While even slightly lower rates will certainly help struggling companies a little, it still takes time for the lower rates to lead to cheaper financing for struggling companies as changes work their way into the market, O'Donnell said.

Geopolitical risk also remains high, with an unclear future for the war in Ukraine and Gaza, among other factors. And the Fed could pause around the middle of the year to assess one of the biggest unknowns of 2025: the new Trump administration.

President-elect Donald Trump has floated a range of potential policies that businesses are watching, including big tariffs on foreign goods, mass deportations, tax cuts and regulatory reductions — although with a slim five-seat Republican majority in the U.S. House of Representatives, it's unclear how much of his agenda will get done.

"I think there's just still so much uncertainty out there between exactly what this next administration's going to do, the extent of regulatory cuts, the extent of potential tax cuts," O'Donnell said.

--Additional reporting by Alex Wittenberg, Ben Zigterman and Yun Park. Editing by Covey Son.
