United States

A spectacular increase in insolvencies in 2005, falling back to 37,000 in 2006

2005

The year 2005 ended with a spectacular 14% increase in company failures in the US with 39,201 cases – the highest figure and biggest rise since the 13% rise and 40,099 cases of 2001 – also putting an end to three years of successive reductions in the figures. In the last quarter, insolvencies literally exploded, shooting up by 35% over the third quarter to 12,798 cases. This exceptional development was mainly the result of action by many companies (and private individuals) anticipating the application of the new Bankruptcy Abuse Prevention and Consumer Protection Act, effective as of October 17, 2005, placing greater constraints on debtors. Thus, for October alone, the number of insolvency filings (10,909) was 3.8 times more than the previous 12-months' average. For its part, Hurricane Katrina does not appear to have had a significant impact on the statistics, which in 2005 showed 918 business insolvencies in Louisiana and Mississippi (or 2.3 % of the total), up by just 16% against 2004, or very little more than the overall US increase.

Sector analysis

The increase in insolvencies of 2005 also related to personal insolvencies, which leapt by 30% and for the first time broke through the 2-million mark. For 2005 overall, the Administrative Office of US Courts recorded a more than 30% increase in insolvencies, to 2.078 million, of which 98% were personal insolvencies and 2% company insolvencies. Of the 39,201 company insolvencies, the breakdown by procedure was rather atypical in 2005, with a stunning 38.7% accounted for by companies in liquidation under Chapter 7, or 71% of procedures, whereas the number of companies going into Chapter 11 reorganisation fell by 35.5%. Two sectors were particularly affected by large company insolvencies: the first of these was the auto sector, with equipment suppliers Delphi, Collins & Aikman Corp., Tower Automotive, Foamex International, Meridian Automotive Systems Inc, EaglePicher Holdings Inc, BBi Enterprises LP, and Jacobs Industries all coming under Chapter 11. In air transport, Delta and Northwest Airlines were among those placed under the protection of Chapter 11.

2006-07 outlook

The exceptional increase in cases arising out of the change in the insolvency legislation should see a correction with a fall in insolvencies in 2006, as indicated by figures for the first quarter, which were down by 68% against the last quarter of 2005. Overall, the economic outlook is for a deceleration in growth to around 3% in 2006 and 2.5% in 2007. The increase in interest rates and higher production costs will weigh on companies' financial results. Taking into account the base effect of the first quarter of 2006, company insolvencies in the US should fall back by 5% towards 37,000 for the year as a whole, before increasing again in 2007. MCS

Major insolvencies by sector, 2005

	% by turnover
Automotive	41%
Transport	29%
Business services	14%
Trade	12%
Industry	2%
Energy	1%
Hotels & restaurants	1%
Total	100%

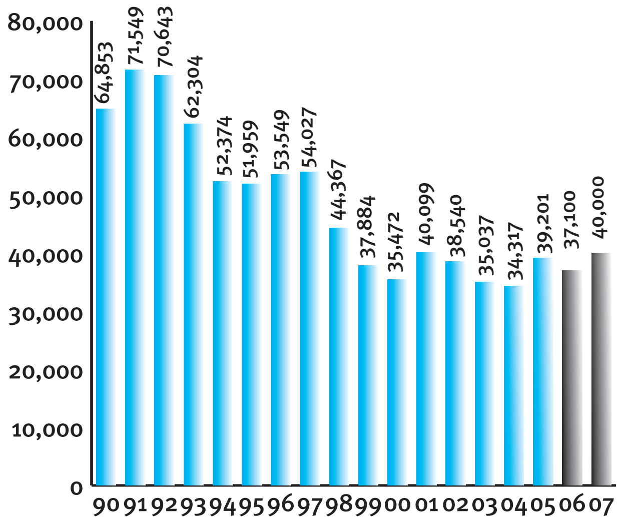
Source: Euler Hermes

Regulation

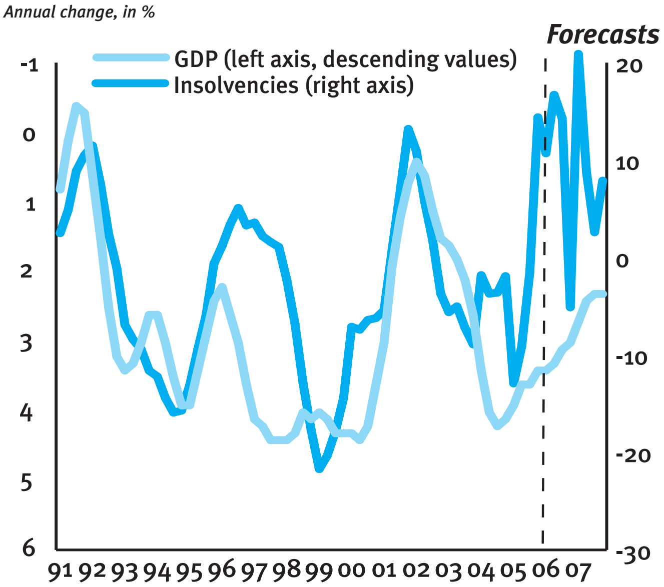
The Bankruptcy Code (1978, Title 11, United States Code) and Federal Rules of Bankruptcy Procedure set out a number of procedures, of which two (Chapter 7 and Chapter 11) mainly relate to private businesses:

- *Chapter 7: this is a procedure for the liquidation of a company. This is notably used in the event that the recovery plan approved under Chapter 11 fails.*
- *Chapter 11: Reorganisation: the objective here is to turn the business around and avoid liquidation. A company may voluntarily file for Chapter 11 protection, for which it is not necessary to establish that the company has stopped payments or is insolvent. Under this procedure, a debtor may negotiate more favourable terms with its creditors. The procedure may also be launched by creditors, in which case the debtor is entitled to be heard by the special Federal bankruptcy court that decides if the debtor should be placed under administration. Under Chapter 11, the directors of an insolvent company retain control of the company, which is protected from its creditors (via an 'automatic stay') and any legal acts or actions are suspended. The 'debtor in possession' (DIP), or Chapter 11 debtor, retains possession of its assets and business under the supervision of the judge. Apart from certain exceptions, the debtor is not placed under the supervision of a court-appointed administrator.*
- *In April 2005, the US Congress adopted the Bankruptcy Abuse Prevention and Consumer Protection Act, which as of October 17, 2005 introduced a certain number of changes to the former regime. The new law places greater limitations on debtors and aims at making it harder to cancel debts. Any business placed under Chapter 11 protection will henceforth have a maximum of 18 months to present a plan for reorganisation and debt rescheduling. After this period, the creditors may present another plan and submit it to the court. In addition, limitations are imposed on extraordinary payments in the form of retention bonuses, severance pay, and certain other payments by businesses under Chapter 11.*

GDP and insolvencies in the United States



Sources: Administrative Office of US Courts, Euler Hermes forecasts



Sources: Administrative Office of US Courts, Euler Hermes forecasts

Number of insolvencies

Number	2004	2005	2006
Q1	10,566	9,063	4,086
Q2	8,249	8,736	
Q3	7,574	9,476	
Q4	7,778	12,798	

Source: Administrative Office of US Courts

DEFINITION and sources of statistics

Businesses: the US Census Board counted a total of 22.6 million American businesses in 2001, of which there were 5.7 million firms with payrolls, and 16.9 million (or 75%) with no employees. Each year, an average of 587,000 companies with payrolls are created, generating more than 3.25 million jobs, and 528,000 companies cease trading, with job losses of 3.22 million.

Insolvencies: The Administrative Office of Courts publishes figures for business and non-business insolvencies each quarter, giving cumulative figures over twelve months, as quarterly figures are often revised. We use only the figures for business bankruptcies, for which the Office provides a breakdown by type and by state. The annual series gives figures for all procedures (Chapters 7, 11, 12 and 13).

Major insolvencies

Company	Turnover in millions of euros	Activity	Date of insolvency	Number of employees
2005				
Delphi	23,850	Automotive	10/05	185,200
Delta Airlines	12,500	Airlines	09/05	69,150
Northwest Airlines	9,330	Airlines	09/05	36,000
Winn-Dixie Stores Inc.	8,860	Grocery retailer	02/05	89,000
Calpine Corp.	7,750	Business services	12/05	3,500
2006 (end of March)				
Dana Corporation	7,094	Automotive	03/06	45,900
Musicland Group Inc	1,648	Retail	01/06	6,000
Integrated Electrical Services Inc.	1,173	Electrics	02/06	8,900
Pliant Corporation	824	Packaging	01/06	3,000
J.L. French Automotive Castings	397	Automotive	02/06	1,800

(*) at 1 euro = $ 1.20

Source: Euler Hermes