Middle Class

The action in bankruptcy is shifting to the mid-market, making Holland & Knight the top law firm and creating a scramble among restructuring advisers

by Terry Brennan

The migration from bankruptcy work has begun. The big-buck glamour cases, if you can call them that, are again few and far between. Except for Parmalat Finanziaria SpA, there haven't even been sporadic megabankruptcy filings. Now, too, other dealmaking disciplines have reemerged for lawyers and bankers, such as M&A. Even the new-issues market has shown solid signs of life.

Bankruptcy work is still keeping lawyers and restructuring advisers busy. But busy serving corporate America's middle market, not its behemoths. And even in the middle market, there's now a concerned effort to restructure out of court instead of reorganizing within it.

"The end of the megacases and the multiple bankruptcy filings they spawned means professional fees are now a much larger percentage of a debtor's asset base," says Larry Larose, the co-head of the financial restructuring practice at King & Spalding LLP who works in the Atlanta law firm's New York office. "As a consequence, we're seeing a trend to restructure more cases or to get in and out of court more quickly."

It's evident from The Deal's quarterly bankruptcy league tables that middle-market law and restructuring are having a better time of it than their rivals who thrive on large corporate cases. Holland & Knight LLP led the legal pack with 169 active cases as of March 31, thanks to its concentration on companies with sales between $100 million and $1 billion, says the head of its bankruptcy practice, Sandra Mayerson.

Among investment banks, Houlihan Lokey Howard & Zukin (28 active cases) held firm when compared with its workload at the end of January. But the call of more M&A work clearly affected the rest of the group.

Jefferies & Co. (16 active cases, down from 25 on Jan. 31) and Greenhill & Co. (eight cases, down from 17) have reported upticks in their M&A advisory businesses, explaining their business shift.

Non-investment banks seem to focus more effectively. In fact, when the dust settled on what was a tumultuous winter for FTI Consulting Inc., it actually had more active cases on March 31 (108) than on Jan. 31 (102). And firms such as Huron Consulting Group LLC (28), Bridge Associates Inc. (17) and Goldin Associates LLC (13) appear to have benefited from the shift in bankruptcy filings from large companies to the middle market.

It was inevitable that the preponderance of bankruptcy-related legal and financial advisory work would return to the middle market. The recent bankruptcy exits of WorldCom Inc. (now MCI Inc.), Pacific Gas & Electric Co. and Global Crossing Ltd.—Enron Corp., too, was due for a June emergence until a $2.2 billion bid was made for its pipeline assets on May 21—not only took the megabankruptcies out of circulation, but serve as a reminder of just how unusual 2001 and 2002 were for huge insolvencies.

Middle-market companies generally are the ones most prone to restructurings, since they use high-yield bond financing and are sensitive to major economic shifts, such as rising energy costs.

But midmarket companies, which have traditionally resisted filing for bankruptcy until they absolutely had to, are now trying to restructure out of court more often, says R. Michael Farquhar, head of restructuring at Winstead Sechrest & Minick PC, which has gained five cases since Jan. 31 to finish with 152 at the end of the first quarter.

King & Spalding's Larose agrees, adding that bondholders of middle-market companies also are reluctant to troop into court. "The creditors also seem to be more concerned about the length and the cost of a long bankruptcy and are often anxious to end it early," he says.

There's been a thrust toward developing prepackaged or prenegotiated filings so debtors can more quickly reach a consensual plan, Larose explains. And he notes that debtors and bondholders seem more willing to stage a debt-for-equity swap to resolve the case early.

Meanwhile, the dip in bankruptcy-related financial advisory work is directly tied to a drop in the number of issuances of high-yield bonds in the last two to three years, says Eric Siegert, a Houlihan Lokey managing director who has the most active cases (13) among investment bankers.

"The general rule is that the restructuring market lags the high-yield market by about two to three years," Siegert explains. "There was very little high-yield activity two to three years ago, so that's why there's very little restructuring work out there now."

But even as bankruptcy slowly gravitates back to the middle market, one part of the practice hasn't stopped thriving for all practitioners: Chapter 11 dealmaking. Whether it's Enron selling controlling interests in its domestic pipelines or Spiegel Inc. unloading its signature catalog business, asset sales have been a key part of the current bankruptcy cycle.

"Bankruptcy M&A has been strong for the past three years and should remain strong as the number of filings continues to slow," Holland & Knight's Mayerson says. "The vulture investors, distressed funds and bondholders have been very active buying assets out of bankruptcy at distressed prices."

The law firms that traditionally butter their bread with debtor and creditor work are probably suffering the most from the filing slowdown, Mayerson says. But she notes that many of those firms have been stepping up their litigation activity now that they have more time to proceed in that area.

"The thing we're seeing is a lot of avoidance actions that go up to the $100 million range in tandem with the reduced number of filings," she says. "Lawyers tend to be less willing to settle and push to litigate more when there's less business to go around."

Holland & Knight hasn't had to worry about that. It's been picking up plenty of creditor work in middle-market bankruptcies. Recent assignments include representing unsecured creditor NovAtel Inc. in the case of Orion Telecommunications Corp.; SunTrust Banks Inc. as indenture trustee in the case of Atlas Air Worldwide Holdings Inc.; the unofficial creditors' committee in the case of Sage Enterprises Inc.; Southstar Development Partners Inc., the provider of debtor-in-possession and exit financing to Tidemark Partners LLC; and the creditors of Media 100 Inc.

The firm is now even representing trustees, such as the liquidating trustee in the Sage Enterprises case and the Chapter 11 trustee in the case of the accounting firm Arnold Kilberg & Co.

King & Spalding, too, gained cases, adding 20 to finish with 121 active cases as of March 31.

"One-third of our work is for debtors, another third for creditors and the balance in areas such as representing Chapter 7 trustees," Larose says. "We think that diversity assures us that we'll have work even in a down environment."

While King & Spalding represents debtors such as Dan River Inc. and Perryville Energy Partners LLC, it also provides legal counsel to the liquidating trustees in Oakwood Homes Corp. and Bethlehem Steel Corp.

Duane Morris LLP captured the 10th slot among law firms with 112 active cases. It, too, focuses on middle-market bankruptcies, even as it has grown beyond its traditional creditors' counsel niche over the past three years via a 50-lawyer expansion, says Rudolph DiMassa Jr., the firm's head of bankruptcy.

Duane Morris is representing the Chapter 7 trustee in the Bake-Line Group LLC case and is counsel to Palomar Mountain Spring Water Inc., DiMassa says.

Even as companies exit bankruptcy, law firms stay busy because of all the post-confirmation work that remains. But that's generally not the case with financial advisory firms. When a debtor leaves Chapter 11, their assignment is over. And the first-quarter results are starting to show that.

Mayerson: *love those creditors*

Indeed, Chanin Capital Partners had six fewer cases (22) than on Jan. 31 yet still retained second place among investment banks. Jefferies lost even more—and actually moved up in the standings to third. Ditto for Blackstone Group LP. It had three fewer cases but still climbed from sixth into a fifth place tie with Rothschild Inc. (11).

For these firms, however, there is a silver lining. The bankruptcy decline has been concomitant with a burst in traditional M&A, which is the investment banker's staple.

Greenhill, in fact, fell to the 10th spot among investment banks in the bankruptcy rankings, yet it raised $100.6 million in a May 6 IPO because of the recovery of its banking business.

"Recently, global M&A volume has increased, and restructuring activity has begun to decline," Greenhill said in its IPO-related filing with the Securities and Exchange Commission. "Some of the benefits we expect to experience in connection with the recent increase in M&A volume will be partially offset by the current decline in restructuring activity."

Perhaps the bankruptcy community's most resilient firm has been FTI Consulting, which led the non-investment firm group.

Hit by two rounds of professional defections in January, FTI rebounded with 16 new cases in the quarter while 10 others were completed, giving it a net of six new active cases, according to DeLain Gray, head of FTI's bankruptcy practice.

Annapolis, Md.-based FTI is now working as financial adviser and interim CEO on the prepackaged Chapter 11 filing of Bush Industries Inc.; financial adviser to Footstar Inc. and the senior lenders of Thaxton Group Inc.; salaried and administrative retirees at bankrupt UAL Corp.'s United Airlines; unsecured creditors of Petaluma, Calif., candle maker, Illuminations; and noteholders at Oregon Arena Corp.

Forty-six executives and 16 bankruptcy cases left FTI in late January for newly formed Capstone Corporate Recovery LLC, started by ex-FTI executive Edwin Ordway. (Saddle Brook, N.J.-based Capstone, which handles mainly out-of-court workouts, makes its debut in the rankings, finishing 13th among non-investment banks, with 16 active cases.)

Some major FTI clients did go over to Capstone, including the bank creditors of Adelphia Communications Corp. and National Energy & Gas Transmission Inc. Capstone is also representing the creditors committees in the Spiegel and W.R. Grace & Co. bankruptcies.

Still, FTI has clung to the top spot even as one of its closest rivals, Ernst & Young Corporate Finance LLC (59), had 16 fewer active cases than Jan. 31. KPMG (64) jumped into second place by gaining two cases.

After FTI, two of the bigger stories

among the non-investment banks in the first quarter involved Huron Consulting (28), which nearly doubled the number of active cases it had since Jan. 31, when it had 15.

Chicago-based Huron declined comment, citing a preliminary filing it's made to go public. But the firm has been rapidly expanding, hiring 200 professionals last year to bring its staff total to 483, according to that filing. It also had $102 million in revenue in 2003, the filing said.

Will Huron's expansion, not to mention two new boutiques formed by two former FTI employees, be in vain, given the bankruptcy slowdown?

Capstone's Ordway and others don't think so. "Defaulting companies that might have filed in the past are now refinancing from asset-based lenders and in the bond market," Ordway says.

William Derrough, a managing director at Jefferies, says demand for high-yield bonds has been strong from November 2002 through early April. "Hedge funds really drove the high-yield market because they got tremendous returns in the past 18 months and were looking for higher returns relatives to risk for their money," he says. "There were a number of companies that we handled that were then able to refinance out of court and avoid bankruptcy."

Indeed, the rebirth of the high-yield bond market could trigger more restructuring, if all goes according to form, by the end of 2005 and 2006, says Houlihan Lokey's Siegert.

Others believe macroeconomic factors can figure in, too.

"Midmarket companies try to avoid bankruptcy whenever possible because all the senior debt is usually secured and the trade vendors are rarely happy with what's left," says Winstead's Farquhar. "[But] we could see a lot more restructuring if oil prices remain high, because those smaller companies are more sensitive to hikes in interest rates and the price of oil."

And so the cycle turns. ■

TOP INVESTMENT BANKS

	Investment bank	No. of active cases
1	Houlihan Lokey Howard & Zukin	28
2	Chanin Capital Partners LLC	22
3	Jefferies & Co.	16
4	Lazard	15
5	Blackstone Group LP	11
	Rothschild Inc.	11
7	CIBC World Markets	10
8	Gordian Group LLC	9
	Miller Buckfire Lewis Ying & Co.	9
10	Greenhill & Co.	8
	Morgan Joseph	8

Includes all debtor, creditor and other assignments within active bankruptcy cases. All cases active as of March 31, 2004

Source: The Deal, investment banks

TOP INVESTMENT BANKERS

	Adviser	Firm	No. of active assignments
1	Eric Siegert	Houlihan Lokey Howard & Zukin	13
2	Randall Lambert	Chanin Capital Partners LLC	10
3	Joseph J. Radecki Jr.	CIBC World Markets	8
4	William Derrough	Jefferies & Co.	7
	Michael Kramer	Greenhill & Co.	7
6	Peter Kaufman	Gordian Group LLC	6
	Brent Williams	Chanin Capital Partners LLC	6
8	Patricia Caldwell, Henry Owsley	Gordian Group LLC	5
	B. Geer, D. Hilty, M. Mazzucchi, A. Miller, D. Voukadinov	Houlihan Lokey Howard & Zukin	5
	Seth Lemler	Morgan Joseph	5

Includes all debtor, creditor and other assignments within active bankruptcy cases.
All assignments active as of March 31, 2004.

Source: The Deal, investment banks