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Turnaround MANAGEMENT II

A GUIDE TO CORPORATE RESTRUCTURING AND RENEWAL

Tips from the Trenches

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In association with

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What enticed me about the notion of writing this article was the chance to offer something as a practical guide that would speak to the very real issues that crisis managers and workout specialists face on a daily basis. Upon reflection, a grand tour of the field seems too vast in scope to deal with comprehensively in a piece of this length, so I will attempt herein to cover a number of points that are constant issues confronting workout specialists.

The unvarnished truth is that cases are rarely as complex or as unique as every client would have you believe, and there are certainly enough similarities in the process and in the basic fundamentals of business to allow skilled crisis managers and turnaround consultants to thrive and excel when confronted by an array of seemingly unique challenges. As well, there are certain tools and attributes with which knowledgeable turnaround experts must be routinely familiar. In this essay, I have chosen pointedly to focus on five issues: realizing the importance of early intervention in a troubled business is number one, and number two is knowing that bankruptcy is not the only option available and what one should consider when making the choice. The third issue is the crucial matter of communication, both with your client and with the various other constituencies in the turnaround, while the fourth is the importance of the constant and ever-evolving budgeting process during a workout. Finally, the fifth, and perhaps the most important, is appreciating the role of creativity in a successful restructuring. Many of the points I intend to make are simple but are often either forgotten or simply lost in the middle of the chaos that often surrounds a workout situation.

By way of introduction, and as substantiation of my credentials, I offer this article after personally living in the trenches of businesses in insolvency for the last 15 years, all of that time associated with Development Specialists, Inc. ("DSI"), one of the oldest and most prominent of the nation's workout firms, whose roots in the workout business itself go back over 30 years. During my lengthy career, I have personally been involved with hundreds of businesses that span a broad spectrum of industries and organizational types. It is my hope that practitioners, boards of directors, company officers, and business managers can take away something practical and useful from this article. If they find my reasoning to be insightful, all the better, but for some it may be a lightning rod in terms of the discussions and/or disputes they are already experiencing, and therefore my only real hope is that some of the concepts and examples discussed herein at least get the benefit of full consideration from the reader.

To begin with, I must assure you that the ability to successfully restructure is vastly enhanced if the problems or issues faced by a troubled company are identified and reacted to early in the process. While this may seem self-evident, I must tell you that over the last 15

years, I can count on one hand (maybe two) the number of instances in which a company called me, saying that they anticipated a change in their market or product lines, and would like to approach the situation proactively. Unfortunately, the customary declaration I often hear is, "We are not going to make payroll tomorrow," or "The bank has stopped funding," or, for my dot-com friends, "We have spent millions (hundreds of millions) on product development and we ran out of money before the product could get off the ground."

Admittedly, I've made a good living dealing with these situations and, thankfully, regardless of the economy or of managerial ability in any single situation, there will always be a number of these opportunities in the future. However, what I have noticed as a direct result of the recent passage of the Sarbanes-Oxley Act, and the responsibilities it imposes on both officers and boards of directors, is that one can now begin to see what appears to be a decisive, understandable, and, dare I say, positive move by some boards of directors to invite workout professionals and financial experts to serve as outside directors on their boards. Although this may sound self-serving coming from one within the turnaround industry, any selfish intent on my part is more than outweighed by the value that a well-qualified advisor or practitioner can bring to a troubled company, especially if he or she is brought in near the inception of the difficulties. In a time in which lenders are doing everything possible to clean up their balance sheets, the best, and often only, chance for a company to effectuate a reorganization is to first identify and then proactively approach the situation with all dispatch. Similar to any disease, the earlier the detection of the problem, the more options and alternatives there will be available to ultimately deal with the situation.

This offers an introduction to my next point, mainly that not all troubled companies need to file a formal bankruptcy. There are many workout advisors who have a predisposition to reflexively file for bankruptcy, assuming it will be the panacea for all of their client's ills. The first question that the board of directors, the company's managers, or its advisors should ask and have answered is, "What is the source of the problem and, perhaps more importantly, given the problem what are the potential endgames?" At DSI we have a saying, really a cliché, but one that invariably rings true: "Bankruptcy is but one club in the bag."

Like any iron in a golf bag, bankruptcy is a useful club, but is not necessarily the one required for a specific shot. One must be able to articulate why a formal bankruptcy is the proper approach for any particular matter. There are other clubs in the bag, and they often can be more useful in approaching the particular shot than just the blunt one of bankruptcy. Such things as state court receiverships, federal equity receiverships, assignments for the benefit of creditors, out-of-court workouts, creditor compositions, as well as forbearance agreements and/or refinancing arrangements are all possible additional clubs that might be better geared for the shot selection called for under the circumstances.

This choice is not simple and over the last decade I have seen a giant shift in perceptions. In particular, with the passing of the usual cycles of the economy and the deflating of the market bubble, I have seen both troubled businesses and their creditors become significantly more market-savvy. Everything else being equal, this at least should allow for the decision-making process to move on an accelerated and more efficient basis. For many years, I have expended a fair amount of energy in trying to explain to my clients why the filing of a bankruptcy petition is not a sign of either personal failure or intellectual shortcoming.

The downside to this argument, however, is that the very notion that there is now no social stigma attached to the bankruptcy process is a two-edged sword. On the one hand, it makes companies more willing to accept the need to address the trouble; on the other hand, it makes some companies believe that quickly filing a bankruptcy is mandatory and provides their only option. I have had clients who unfortunately wanted to base the strategy for their workout on the fact that certain market leaders or competitors in their industry had filed a Chapter 11, and therefore this course of action must be acceptable, required, or countenanced in their own matter. Some have even taken it so far as to demand that their case be filed in a particular jurisdiction just because they had read in the newspapers or a trade magazine that someone else they knew had done so.

This article is not about venue choice and its related issues; suffice it to say that venue is important and that the issues relating to its choice should be considered carefully and methodically by the business and its advisors prior to any filing. My point is more general. I believe it is critical to educate clients as to their options as well as to the ramifications of their choices on the end point they desire to see for their business's restructuring. This point would seem to be intuitive and customarily barely worthy of note. However, I have seen that it is not uncommon for consultants to seize upon the notion of filing a bankruptcy

no matter what the situation calls for or dictates. The dynamics and logistics of filing a bankruptcy usually ensure that a consultant or crisis manager will be hired and then retained through the bankruptcy court process for a significant period of time. The average length of the active portion of a middle market Chapter 11, according to my experience, is approximately 18 months, which is no short period of time. There is no doubt that there may be many in my industry who will resent the implication that cases are filed merely to institutionalize the crisis manager's retention. Regardless, I believe that there are many practitioners who knowingly endorse the filing of a bankruptcy both because it is the path of least resistance for their own retention and because it is in their own best interests in terms of the duration of the assignment. As well, I suspect that there are just as many practitioners that bow to the forces and preconceived whims of the company and its management to file for bankruptcy, and do so without giving the array of alternatives suitable thought.

This is not a simple issue, and demands some thought. Boards of directors, officers, and managers of an enterprise are, by and large, reasonably aware of their customary fiduciary duties. For many of these persons, the need to shift from the classic goal of maximizing shareholder value to a stricter duty to maximize values for all constituencies and creditors in the circumstance is difficult to implement, much less fully comprehend and internalize. This means that both advisors and counsel to the company must thoroughly vet which path or "golf club" should be pursued to maximize value, and should do so ever mindful of what the endgame being proposed as the best alternative for the restructuring should be.

Just because a company owes its creditors a bit of overdue money does not mean that Chapter 11 is the answer. A company must evaluate the nature of its financial woes, in particular reflecting on the internal composition of the creditor body, asking itself, for example, who actually are the creditors, what are the rights of these creditors, and are they secured, unsecured, or do they represent public debt that the company has issued? A troubled company must also carefully review the impact of a bankruptcy filing on its vendors and customers, as the answer to all of these questions can have a profound impact upon which "iron" from the bag the company elects to use.

Given certain circumstances, bankruptcy is an appropriate response; in other situations, other alternative "clubs" must be considered. Among the issues to consider when choosing is that bankruptcy can be both expensive and time consuming. The number of customers and/or vendors a business possesses can also have a big impact on whether a filing is either appropriate or workable. Some managers of troubled companies cannot become accustomed to the level of disclosure that will be required in the bankruptcy process, while others will become intransigent because they find the process counter to their basic competitive interests. Yet, despite all of these reasons, a Chapter 11 may be necessary and required.

In such instances, these matters may revolve around the need for a company to avail itself of the "automatic stay" provision. This provision prevents creditors from taking legal action or seeking other relief to collect their debts. A further reason that a company may choose to file bankruptcy is to effectuate a sale of the assets or the business following a review of the situation and discovering that such a sale process is needed virtually immediately. It is not uncommon for a party interested in buying assets from a troubled company to seek and demand that the business provide a bankruptcy court order in order to effectuate the sale and complete the conveyance. This is particularly relevant when buyers are concerned about successor liability or a way to "perfect" their title to the assets purchased.

This can also benefit the reorganizing company, as nearly all bankruptcy sales involve the sale of assets on an "as-is, where-is" basis, requiring neither express or implied warranties nor other customary terms and conditions as are warranted in the normal sales process. The bankruptcy sale process is also an opportune way to memorialize certain terms and to create a competitive forum for the disposal of assets through such a sale.

Others opt for bankruptcy court protection to shield a viable business from "non-core" litigation, as was the case with Texaco's filing in the 1980s or, similarly, the myriad cases that have been filed over the last few years seeking to create a systemic way to deal with the liability created by tort claims and environmental issues, such as the asbestos litigation.

It is probably true that most accounts payable departments in troubled companies ultimately find the bankruptcy court a safe refuge. The accountants and staff of these departments have usually been involved in "collection wars" for a long period of time prior to any filing. Once a bankruptcy filing is initiated, the company, and especially the people responsible for creditor payment, will have both direction and information to relay to creditors, and will be able to avail themselves of the organizational time granted through the introduction of the

"automatic stay" provision. Similarly, salespeople and managers will now be able to develop a coherent body of information to relay to both customers and employees. In my opinion, this is a critical advantage of bankruptcy, because information and direction tend to have a calming effect on a number of the constituencies in a workout situation. However, the comfort afforded by the automatic stay provision certainly comes at a price, and that price is a measurable loss of control of the company's affairs and operations at various levels.

For instance, as a rule, a reorganizing company finds that it may only make decisions in the ordinary course of business and will be required to seek court approval for all extraordinary decisions that heretofore would have been made by senior officials or the board of directors. While this is not necessarily detrimental, it certainly can be time consuming and limiting in terms of business operations. For example, any sale of assets under section 363 of the bankruptcy code will still require time for proper sales procedures to be set and approved by the court, and certainly will customarily require the court to oversee a competitive bidding process. While I view this as one of the hallmarks and benefits of the bankruptcy process, I have known many companies who have found this process arduous, expensive, and often loaded with uncertainty.

On another level, a reorganizing company with secured debt may lose a measure of independence due to the concessions involved in the logistics of getting further funding from its lenders. Regardless of whether a company obtains funding through the use of its cash collateral or through the provision of additional loans extended following the filing of the bankruptcy petition, it is certainly true that the lenders will gain a meaningful level of control through the terms and conditions which may be attached to, and imposed by, the lending mechanisms which are customarily employed in the bankruptcy setting.

However, two areas over which a reorganizing company still holds a measurable amount of control are the dissemination of information and the promulgation of an operating budget in the bankruptcy process. Both of these exercises are vital. Initially, a practitioner and his or her client must be able to articulate and demonstrate, probably to several parties, what the benefits will be for filing a Chapter 11 versus using another form of workout strategy. Secondly, filing a bankruptcy petition absent prearranged funding, and without a demonstrable exit strategy, certainly dooms the effort to failure. Let me address these matters in turn, beginning with communication, and keeping in mind that expert communication is important in all forms of workouts, not just those confined to the bankruptcy courts.

As witnessed by my earlier plea for companies to identify, accept, and react to difficulties at the outset of troubles, this desirable course of action is not the norm. Even in the best of circumstances, there is invariably a delay while the scope and dimension of the difficulties are reviewed and debated. The time that elapses while all consider what course of action to take is usually rather substantial. As a result, officers, directors, managers, and staff all face differing demands for information. Controlling and managing the information becomes paramount, and this process itself must be managed. There is no way around this particular issue. The management of the information process is difficult and can become one of the single largest stumbling blocks in the workout process. However, regardless of difficulties encountered, keeping this process in workable form is vital to the success of the endeavor.

Absent prior or present involvement in a restructuring situation, it is easy to misunderstand why and how information flow becomes so intrinsic to the turnaround process. The answer is simple: information flow permeates the entire company and impacts every one of its constituencies. Questions and demands for information come from a variety of sources: vendors seeking payments and customers seeking confirmation of orders, deliveries, and warranty issues are only the beginning of a long list of concerns. Managers face a daily flood of employee questions and issues, especially when layoffs have been or are expected to be implemented.

In public companies, newspaper articles, on-line message boards, and their related discussions in Internet chat rooms invariably give rise to questions which beg for answers from both the officers and directors. Further, in public companies the difficulty of managing the information is often compounded by regulatory disclosure rules. Managing the information flow is critical and is, at its best, an art.

It is the job of the company and its advisors to both script and manage the information flow. Regardless of whether an announcement is of upcoming layoffs, the impending cessation of the business, the appointment of advisors, the filing of a bankruptcy, or the procuring of related debtor-in-possession financing, all information must be delivered in an effective way, yet still be in legal compliance with all applicable disclosure rules governing public companies.

It is extremely important to also tailor the information for its intended audience. Many of the "mega-bankruptcies" of recent years have had the means and good sense to use qualified professionals and public relations firms to assist in this early communication process. A recent example of this was the bankruptcy filing by United Airlines. Just following that filing, the newly appointed CEO, Glenn Tilton, could be seen on various television news channels, meeting customers and employees at each of the airline's more important "hub" airports. This was apparently part of a larger promotional campaign which included letters to customers as well as open letters to the general public which appeared in airports and in the print media. As a practitioner, and as an observer as well, I was impressed with the time and attention United Airlines put into its initial post-bankruptcy marketing efforts.

As well, all companies must assess the cost benefit of their choices in handling information flow. As, inevitably, liquidity is nearly always an early issue for any company experiencing restructuring, all must evaluate their message and how it could be most economically and effectively distributed during the time of the workout process. For instance, the Internet has become a vital channel for the dissemination of information by restructuring companies. Many such debtors have adopted procedures to update their websites so that they can address the status of their bankruptcy process on a continual basis, and the more successful enterprises have often developed "frequently asked questions" sections on their websites that attempt to address issues of importance to customers, vendors, and employees.

When a company finds itself in trouble, one of its primary goals should be to structure a process of communication which is able to articulate why these troubles beset it and how it intends to proceed with a successful restructuring to cure the problem. The process of managing the information in connection with this communication dictates and directs the perceptions of the constituents to the matter with respect to instilling a level of confidence as to the likelihood of success. For example, just following any filing the company must be able to describe in detail how it plans to continue to operate and why there will be no doubt that it will meet the needs of its creditors on an ongoing basis. Often, the inference of this message is best drawn in conjunction with the announcement that the company has procured sufficient financing to operate normally following the filing of its petition. The mere announcement of this procurement of funds is often designed, solely and only, to provide the market with confidence that the company is still creditworthy and intends to fully support the needs of its business.

The announcement of post-petition funding is then generally followed up with information as to how the company plans to operate, what it intends to do to streamline operations, and how it plans to meet the needs of its customers and the demands of its vendors in this difficult time. In many instances, key customers or critical vendors may be approached on an individual basis immediately prior to and/or shortly after a filing. Over the years, as I have participated in a number of these matters, I have often joined with the senior management of some of our clients on their visits to critical vendors or key customers, meetings which are roughly analogous to an Initial Public Offering "road show." Clearly, the intent of these visits is for the company to be able to demonstrate to both its vendors and its customers that it has a well-thought-out plan to complete the restructuring, possesses the necessary means to fund the restructuring within the bankruptcy forum, and has at least more than a foggy idea of how it plans to exit the restructuring. By way of comparison, much of this communication seems akin to advertising that concerns itself primarily with brand management.

Through the bankruptcy process, the company should use these types of marketing efforts to emphasize both the progress in streamlining the operations of the debtor and the cleansing effect of the proceeding with respect to the company's future business prospects. As, by definition, the restructuring process is one of rehabilitation, the company should take great pains to emphasize the competitive advantage it may expect to enjoy as a result of completing its reorganization process.

A mistake is often made, however, by assuming that virtually all communication should be solely focused toward customers and vendors. A company must do whatever it can to continue to educate, update, and keep its employees informed about the bankruptcy process. Clearly, the perception by both customers and vendors of employee morale, as well as the employees' belief in the eventual success of the turnaround, may have a lot to do with continuing to inspire confidence in the marketplace as to the company's prospects. To that end, and although reductions in force, layoffs, and terminations are customarily a fact of life during the restructuring process, all of these must be accomplished humanely and with the deepest respect for both departing and remaining employees. Again, while this seems like nothing more

than common sense, I am aware of a number of instances in which companies attempted to accomplish this process through mostly impersonal means, such as via e-mail notices or by simply locking employees out of the office or manufacturing site. There may be certain occasions where specific situations dictate that such drastic measures are in order, but they are absolutely the exception rather than the rule. Usually when this occurs there are overriding security or asset preservation issues which must be spoken to, and the nature of dealing with those issues can, by way of explanation, often serve as an excuse, at least in the public relations field, for the way in which the matter was conducted.

Should a company have to resort to this, there are other ways in which one can deal with the fallout. For example, if employees arrive at work to find that the doors are locked, management must make sure that there is a process established to disseminate information on why this had to be done in this fashion, and to allow employees to gain access, on a reasonable basis, to retrieve whatever personal items may be left at their worksites. Similarly, substantial efforts should be expended to keep all of the remaining employees informed as to why the cuts are occurring and the positive effect this downsizing will have on the prospect of future operations. As I see it, the employees of these organizations are, after all, truly the ones on the front lines dealing with both the vendors and the customers on a daily basis. In my experience over the years, many employees have told me that all they ever wanted to know was exactly what was going on so that they could tell both the customers and the vendors the truth and continue to have a level of credibility with these constituencies that they had worked to create over a number of years.

The uncertainty of not knowing the true situation, or being told different or contradictory messages, often creates such bad will and poor morale among the employees that some enterprises are truly unable to ever recover. In some instances the credibility of management has been either damaged or stretched so thin that financial advisors must wind up acting as intermediaries with critical vendors and customers. It's important to note, on a very basic level, that winning the hearts and minds of the employees and other constituencies who have a stake in the process is imperative. One key to winning this battle is keeping all of these constituencies informed and part of the process.

In addition to information flow, another critical component to a successful restructuring or bankruptcy reorganization is the creation of and adherence to a budget. For illustrative purposes I will focus on the budgets commonly prepared by the debtor-in-possession ("DIP"). The DIP budget is simply nothing more than a compilation of the cash receipts and disbursements that a company expects to experience during the first seminal period of the case. This time frame is often embodied in a 13-26 week budget, depending on the situation and the dictates of the various parties, and displays, among other things, the collateral position of the lender in terms of growth or reduction, as well as the intentions of the company in terms of spending.

This is truly a vast topic and in its own right deserves more attention than I can possibly give it here. For the purposes of this essay, I wanted to highlight both the process and the practical considerations of such a budget. In most cases, a debtor will submit a budget to its lender and the debtor-in-possession financing motion will be one of those included in the company's "first day" bankruptcy court motions. This is done for practical considerations, such as the ability of the debtor to borrow funds and therefore operate with the commencement of the case, and as well so that the debtor can begin signaling to the market, specifically its customers and vendors, by way of damage control and public relations, that it has procured financing necessary to provide it with credit support during this difficult period.

The authorization for the debtor-in-possession budget is usually initially granted on an interim basis, with a final hearing to confirm this arrangement usually scheduled sometime in the future, customarily 30 to 60 days out. This is done so that constituencies to the case who have not yet been enable to fully form, and therefore are not able to submit, a response to these requests by the time of the first-day motions, will thereafter have the chance to do so and then be heard.

It's true, however, that the initial debtor-in-possession budget, even in its most preliminary form on an interim basis, truly does often dictate the ultimate direction of the case. While the debtor-in-possession budget will not specifically address all aspects of the bankruptcy in terms of the streamlining process and restructuring efforts, the assumptions and expectations that underlie the budget formation process can generally be gleaned from a thorough review of this budget and its accompanying notes. In particular, the budget will indicate how customers will be paid (for example, if the debtor expects to pay on a COD basis or assumes it will get credit), and will display whether or not some creditors will be treated

as "critical vendors," thus allowing early payment of their claims.

Further, as mentioned, these budgets often reveal what assumptions the company has made about the direction of its ongoing operations, likely divestitures, the treatment of employee benefits during the restructuring process and thereafter, and, ultimately, the amount of money that the company will have to divert to support the various professionals needed to guide it through the process.

Since this budget and, in particular, the cash flows upon which it is built often become the backbone of the post-petition business plan, the input and thought regarding the debtor-in-possession budget should be considered among the highest priorities in the initial stages of planning for the bankruptcy. The veracity of the debtor-in-possession budget, and therefore the credibility of the company, will also be tied up in this budgeting process because most lenders will require some kind of reconciliation, customarily on a weekly basis, of budget-to-actual expenses, this to allow them to examine significant variances and to determine why they occurred. Moreover, aggregate variances are often controlled and limited by covenants contained within the loan agreements structured to reflect the debtor-in-possession budget. Given such close monitoring by the lenders, and with creditors and customers at a heightened state of awareness, it is easy to see why the debtor-in-possession budget is often treated as so critical to the process, and becomes such a significant work effort for all concerned at the outset of a case.

The moral of this creative structure of budgeting is twofold. First, a poorly crafted debtor-in-possession budget is almost always an indication to the various constituencies that the process has not been well thought out and will likely fail. Secondly, a company can go a long way toward controlling the bankruptcy process through the creation and negotiation of a well-thought-out debtor-in-possession budget, which will set forth the assumptions upon which it intends to base its eventual restructuring.

Moving beyond focusing on the tools which turnaround professionals must employ in connection with the onset of the restructuring, I would like to discuss an attribute that all professionals as well as a company's managers and directors, associated with a restructuring, would do well to cultivate. That attribute is creativity. Many people may cringe at this vestige of "MBA-speak," and yet it is the truth that to be ultimately successful in a restructuring one must truly be able to think "outside the box." Indeed, the ability to be creative in coming up with solutions to the restructuring process is truly what differentiates a great crisis manager from merely a good one.

Some will suggest that creativity, or "thinking outside the box," is a description people give to successful ideas on an after-the-fact basis. I disagree, and believe that, far from being merely a label for already-proven ideas, thinking outside the box is a real skill which calls for intuition, a reasonable level of risk taking, and an above-average understanding of the process, as well as the experience to employ that understanding. In the typical crisis management situation, by definition the client's business is already suffering a substantial amount of distress; merely continuing it without providing a new direction will never be sufficient in most circumstances. As a result, in my opinion one must always make a conscious effort to try and rectify the situation or otherwise alleviate the problem by examining all potential possibilities, not just those which common wisdom would dictate to be the most plausible.

In an effort to illustrate some of the more creative approaches that I have observed in the area of restructuring, I have summarized herein six examples of matters in which our firm has been involved, and in which, in each case, we believe creativity was enhanced by the superb teamwork and cooperation that the members of our firm brought to bear on the respective matters.

CHANNELING INJUNCTIONS

Keck Mahin & Cate was a law firm that, at its peak, had approximately 350 attorneys in offices located throughout the country. Following a downturn in profitability in the mid-1990s, the partnership became the subject of an involuntary petition for relief under Chapter 7 in the bankruptcy code. Shortly thereafter, the court entered an order, at the partnership's request, converting the case to reorganization under Chapter 11. At the time of the involuntary filing, a senior consultant from DSI was named as the chief executive officer of the partnership, and our firm was hired, as well, to both support him in that role and serve as a broadly based financial consultant to the reorganization effort.

We first turned our attention to the customary efforts that would be required in a such a circumstance, such as winding down the operations, collecting the receivables, and arranging for the disposition of assets that could be sold. As well, there was an additional need for funding, and the members of our firm saw to the arrangements for that. However, as this was the liquidation of a partnership which contained debt that had both recourse and

non-recourse provisions with respect to current and previous partners, it was necessary, for the long-term reorganization effort, to devise a strategy that addressed some serious and far-reaching issues. First, and as would be the case with any law firm, there were malpractice suits in differing stages of prosecution. As a result, any plan of reorganization had to address these claimants, and to account for the eventual employment of the malpractice insurance, properly apportioned, to cover these claims.

Secondly, since the partners had joint and several liability for most of the obligations, it was necessary to devise a mechanism that equitably parceled out the liability, or, more importantly, the contributions due from each partner to settle respective liabilities. Working with counsel for the company, we proposed a cleverly drafted plan of reorganization that addressed many of these issues by providing for a future claims escrow arrangement. This provision reflected the need to justify any partnership contributions by creating a fund for the equitable disposition of those contributions across a broad array of the debt structure. The contributions required of each partner were based on a complex mathematical formula, devised by our firm and by counsel to the partnership, that put such variables as compensation, length of time of participation in the partnership or length of time since leaving the partnership, remuneration in years prior, and other such factors into a standardized formula to apportion liability by way of differential contributions. The funds that partners contributed were then used to pay the creditors pursuant to the plan of reorganization and, in exchange, each of the partners received, through the Bankruptcy Court, a permanent injunction against any of the creditors seeking to collect against any of the individual partners in the future, as well as mutual releases. Partners that chose not to participate in the escrow agreement continue to be liable, jointly and severally, for all of the debts of the partnership. Those that chose to contribute were able to do so with the understanding that the ultimate amount of money to be distributed to the creditors, in the aggregate, would be less than would be required if all of the partners were found to be liable for all of the obligations.

DISTRIBUTION CHANNELS

As a part of a major insolvency of one of the nation's largest banks in the Southeast, one of the members of our firm served as the Chapter 7 trustee. Early in the tenure of this role, he found that he was custodian of more than 4,400 pieces of contemporary and traditional art that had formed the institution's display collection. While the book value of the collection was in excess of $7.5 million, the marketability of so many pieces at once presented a certain dilemma. The trustee did not want to flood the market by putting all of the pieces up for liquidation at the same time, because a nearby savings and loan which had failed had recently sold its art collection at auction and received only 10¢ on the dollar in terms of estimated value. Similarly, consigning the art to major dealers around the country would have required a substantial system for follow-up and reporting, which could have proved more costly than the value of the art itself.

In order to avoid these problems, and given the size of the collection as well as the diversity of its focus, the trustee sought to establish an alternative distribution channel. After lengthy discussions with various art dealers in and around the Southeast United States, the trustee, together with his counsel, decided to open a retail art gallery for the benefit of the bank's creditors. The gallery, which was designed to be self-liquidating, included artwork ranging in value from $150 to $40,000, and included prints by Andy Warhol and Roy Lichtenstein. The gallery remained opened for nearly three years, and brought in over $3 million in retail sales of the art.

At the same time, and recognizing the loss to the community that the bank's insolvency represented both in terms of corporate philanthropy and community charitable support, the trustee saw to it that the gallery itself also served as an elegant venue for many of the top local charities, which used the backdrop of the gallery for galas, gatherings, and other special events. Local artists were also invited to exhibit in the space. This approach not only maximized the value of the assets for the creditors, it also benefited the local community through the creation of jobs and, secondarily, as a source of sales tax revenue on the liquidation of the art.

In a no less important vein, the gallery also provided support to artists and made several philanthropic and charitable contributions to the community which, while not intended to replace those that had been offered by the bank, still somewhat mitigated the catastrophic and immediate loss that had been created by the bank's failure.

As I write this, I am unaware of any other example of such creativity in a bankruptcy case that both managed to maximize the value for creditors and to offer to offset some of the damage to the community at large. I would argue in this essay that in an arena such as that of restructuring and bankruptcy, anything that can maximize value and simultaneously contribute to the broader

welfare of the community should be applauded, and ought to be considered as a major positive influence in the areas of both social policy and corporate responsibility.

This is but one example of how distribution and sales channels can be broadened for the benefit of a bankrupt estate. In another instance, a member of our firm served as the Chapter 11 trustee for Mallard Coach Company, a major American recreational vehicle manufacturer. In this particular matter, the Chapter 11 trustee maintained operations and continued to produce vehicles for more than nine months after the onset of the bankruptcy. During that time, the trustee converted nearly all of the raw material and work-in-process into millions of dollars' worth of finished goods which were then sold through normal dealer channels on a retail basis.

During the time of the continued production, the trustee's commitment to the highest standards of quality had the net effect of often surpassing the quality of the units that were sold pre-petition. This commitment to enforced quality supervision alleviated the fact that many of the units were being sold without warranty, and even though they were completed, they were being sold off the manufacturing floor on an as-is, where-is basis.

During the bankruptcy process, all of the intellectual property and trade names were marketed and sold, the value of which, as mentioned above, was largely protected because the debtor continued to operate and manufacture vehicles. Furthermore, and in yet one more extension of creative thinking, I would note that, in the end, the company was able to wind down operations and close the affairs of its sales department especially swiftly when the last 35 units off the production line were sold and shipped to Miami within the 48-hour period following the impact of Hurricane Andrew.

SALES AND ENVIRONMENTAL ISSUES

Calumet Industries was a multistage refinery located in Northern Louisiana. Following its bankruptcy petition filing, a member of our firm was appointed as the trustee to operate the business. During that operation, the trustee brought the company from a significant loss position to a positive cash flow situation. The trustee thereafter marketed the operations for sale as a going concern. The sale process was moving along smoothly until Iraq chose to invade Kuwait in 1990. Following that incursion, the price of petroleum products skyrocketed, and the refinery was hit with the problem of generating enough cash to pay for its raw crude oil supplies, supplies which had virtually doubled or tripled in cost overnight. In order to avoid a complete meltdown of the case, the trustee and the secured lenders developed a mechanism wherein the stalking-horse bidder entered into an operating agreement with the debtor and thereafter began to operate the refinery during the culmination of the court-approved process. Under this arrangement, the risk of profit or loss shifted to the potential buyer, thereby massively reducing the cash requirements for the debtor and its secured lender. This approach not only allowed the refinery to be sold, it also eliminated the need for the trustee to shut down the refinery due to a lack of funds in the estate available to buy crude oil, such a shutdown requiring, of course, expensive regulatory oversight due to the various environmental concerns that surround such an enterprise. Further, should the refinery have been shut down, the value would have surely plummeted, as the prospects of selling a mothballed refinery were looking a little gloomy in the aftermath of Iraq's invasion of Kuwait. Indeed, as a result of this process, the trustee was able to hold a well-attended auction and sell the refinery as a going concern.

But the case was not yet over. A second bit of "thinking outside the box" was employed as part of the closing of the ultimate sale of the refinery. By way of background, it is normal for a refinery to own and operate various retention and settling ponds in and about the refinery premises. In this matter, 13 or more acres of retention and settling ponds were specifically carved out of the deal. The trustee was forced to fence off and maintain the special use treatment ponds which comprised this acreage. Initially, the cost of remediation was estimated to be in excess of \$4.5 million. Again, creativity came to the forefront as the trustee worked with Louisiana State University (LSU), the Louisiana Department of Environmental Quality (LDEQ), and local business, specifically a remediation company called Turner Construction. The trustee paid LSU nearly \$500,000 and gave them permission to access the carved-out property, which was then used as a laboratory for the school's environmental department. In exchange, the school provided the monitoring and quality reporting required by LDEQ. LSU and Turner Construction then worked closely together to develop, test, and lay a state-of-the-art protective cap on the pits, completing a comprehensive remediation plan in conjunction with and with the approval of LDEQ. In the end, the trustee saved over \$2.5 million dollars in remediation costs, LSU and its environmental program received both funds and access to an actual remediation site/lab, and Turner Construction and

LSU developed a relationship and goodwill with both LDEQ and the local community of Princeton, Louisiana. Incidentally, the cleaned-up acreage was then sold to the party that had purchased the refinery, for an additional benefit to the creditors.

MANAGING CONSTITUENCIES

Mercury Finance Company is a specialty consumer finance company that acquires sales finance contracts from automobile dealers and retail vendors, provides short-term installment loans directly to consumers, and sells credit insurance and other related products through a network of approximately 200 branch offices. A number of members of our firm were asked to fill a host of senior managerial positions at Mercury Finance Company after the announcement of financial irregularities in January 1997. During our work in this case, DSI implemented a business plan that stabilized the core business, discontinued non-profitable operations, and disposed of non-critical assets. In the process, debt was paid down in excess of $425 million from its original balance of approximately $1 billion.

Under DSI's leadership, Mercury was able to avoid filing for bankruptcy protection for almost 18 months, allowing for an agreement to be reached with lenders for a "pre-structured" plan. The plan of reorganization provided for a conversion of a portion of the debt to equity and a continuation of its current business. While this case appears to be a straightforward pre-packaged bankruptcy, it actually demanded quite a bit of creativity from the professionals working on the matter, especially in light of the varied and diverse demands and agendas of the constituents. For example, the equity committee and shareholders wanted the bankruptcy case to be filed immediately. From their point of view, this made sense: it would eliminate the need for the debtor to pay default interest rates. But had that direction been followed, not only would equity be out of the money, the creditors would have received a significantly smaller distribution. DSI recognized that, because Mercury was a financial services provider, it was absolutely necessary to work with the debtholders in order to craft a comprehensive reorganization plan that dealt with each of the tranches of debt and types of creditors. The result of this effort, including the complete overhaul of the operations, was the confirmation of a plan of reorganization that addressed the needs of all of the constituents: it allowed for the successful treatment of the creditors and permitted a "distribution/participation" by the equityholders who would have otherwise been completely disenfranchised.

EXPANDING THE ROLE OF THE CRISIS MANAGER

Most receiverships are done in state court as a part of the process in which a secured lender effectuates the foreclosure of its collateral. The vast majority of them are single-asset real estate cases and involve foreclosures of mortgages. Once a receiver is appointed, he or she works exclusively for the benefit of the secured lender, or party requesting relief, to liquidate the collateral subject to the receivership. In some extremely complicated cases, DSI has worked with the parties and the courts to creatively handle the matter so that the debtor's business (the secured lender's collateral) could be operated and/or managed in such a way that it would not require the immediate, "fire sale" type of auction associated with most receiverships.

For example, a senior member of DSI was named as the state court receiver in separate state court actions pending in New Jersey, Illinois, and Florida, with respect to Westholme Partners, et al., a real estate developer headquartered in California. (In California, DSI was appointed as the financial consultant to the state court receiver.) Thereafter, DSI managed the financial operations of these four receiverships which included 25 residential developments in various stages of construction and several thousand residential lots and homes which were still in the development process.

In New Jersey, DSI completed the Winding River Subdivision located in Sayreville, which included the construction of approximately 40 new homes. As part of this process, we worked closely with the Army Corps of Engineers and the EPA to reconstruct wetlands that were adjacent to the lots on which we were building. This included the hand-planting of 6,000 specimens of a rare water-grass indigenous to that area. (I must mention that these seedlings had to be replanted three times because it turns out that rare, expensive water-grass seedlings are also a great delicacy for the local ducks and geese.)

In the Florida Westholme receivership, we were named as receiver for an estate which held approximately 100 acres of land in Seminole County. The land consisted of approximately 20 acres zoned for commercial use and 35 acres zoned for residential use, as well as a further 575 residential lots earmarked for development but not yet built. As receiver, we were able to work with the County Commission in Seminole County, the City of Oviedo, the

Army Corps of Engineers, and the State of Florida in an effort to develop the land to a point suitable for sale, as well as to comply with all necessary environmental and infrastructure requirements mandated by the relevant authorities. This included budgeting and completing a four-lane service road to the commercial and residential properties. In doing so, we were able to clear the way for the future completion of the remaining properties, which is expected to maximize the final return to the secured lender in this matter.

In these cases, the expansion of the role of receiver translated into significantly better returns for the secured lender. The ability to creatively operate within the context of the receivership in this case proved to be the difference between holding a "fire sale" on raw land or half-completed houses, and the alternative of selling completed homes in fully functioning and landscaped subdivisions. This was successful because we were able to work with both the lender and the debtor to convince them that, even in the role of receiver, we could bring value to the situation. We did not permit the usual "knee-jerk reaction" to which most lenders, courts, and even the receivers themselves succumb at the outset of a receivership case, that of calling in auctioneers immediately. Instead, we approached each subdivision as a business unit and operated as the developer by stepping into the shoes of the general contractor. This approach allowed us to complete the construction of both the infrastructure and the housing units. In addition, the receiver used many of the same subcontractors the debtor had used, allowing the receiver to work with the creditors and the secured lenders to address many of the pre-receivership claims.

I complete these thoughts with the admission that I have merely touched on but a few of the items to which crisis managers and financial advisors must evaluate and react. Despite the brevity, I hope that these musings have focused some attention on the critical need to explore and manage the early stages of a restructuring. Early identification of problems and an active review of the viable business and legal options are as important as the participation in the development of the budget and strict attention to the management of information to constituents. Finally, and just as importantly, don't be afraid to "think outside the box."

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