

VIEWPOINT

Mega-Cases Versus Mid-Market Restructurings*By Jonathan Friedland and Richard Wynne, Kirkland & Ellis LLP*

Mid-market cases are commonly considered to be those involving companies with revenues between about \$25 million to \$200 million, and debt in the same range. While on the surface, they bear little resemblance to the mega-cases involving billions in debt and complex capital structures, the basic truths about a successful restructuring remain the same: The same law applies, the same best practices apply, the same worst practices apply. There are, however, key differences in how the cases need to be handled.

Resource differences

In mid-market cases, the debtor may not be able to afford to bring in the same type of professionals as are typical in larger cases. There may not be, for example, the budget to retain an investment banker, or additional financial or management professionals. The professional on the scene, therefore, may have to wear several hats. Moreover, the sorts of financial controls and information systems that are more common among the largest of companies may be absent, and so the professionals may have to rely on less-reliable data to make key decisions than would be available in a larger case. This can be disconcerting for the uninitiated, but being able to act in what typically is a murkier environment is much more important in smaller cases than in larger ones, as it's the smaller ones that are most likely to be the murkiest.

The need for speed

Many mid-market debtors may not be able to survive a long stay in Chapter 11. The burden of professional fees may quickly overwhelm the financial capability of the business if the case isn't concluded expeditiously. The underlying business may also suffer more from a loss of trade credit, which is often exacerbated in mid-market Chapter 11 cases compared to larger cases. On top of this, a mid-market company is more likely to have entered Chapter 11 without sufficient time to adequately plan and prepare for the systemic shocks that Chapter 11 can produce. At the same time, additional time in Chapter 11 allows competitors to foster the image that the company is floundering, making the retention of key customers, suppliers and employees all the more difficult. Because the number of these key constituents is often smaller, the inevitable losses may be more difficult to absorb and rectify.

We think the key process take-away is two-fold. First, it is best to do restructurings out of bankruptcy court whenever feasible (which, of course, is true with respect to a company of any size). Second, a mid-market debtor needs to move even more quickly in Chapter 11 than do larger debtors.

The analysis of a strategic direction must be immediate, and you are less likely to have the luxury of planning for several different options. While still in the early stages of the case (and often during the early stages of a professional's retention) key decisions must be made: Will a balance sheet restructuring, or debt/equity conversion be sufficient to fix the problems? If the business cannot be restructured quickly enough, is a liquidation preferable? What are the financing options that are realistically available in a timely way? What restructuring options can occur inside

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the Chapter 11 case, and which should occur after its conclusion?

These are hard questions and ought to get as much time as necessary to be answered, but there has to be a balance. Fast, imperfect decisions may be better than perfect but slow ones. The relevant medical expression has a lot of merit here: The patient will die if he is on the operating table too long.

The legal issues may differ markedly

The capital structure of a smaller company is likely to be simpler than that of a larger company. Also, smaller companies are less likely to need a bankruptcy to deal with legacy liability issues. On the other hand, claims against lenders and management for things like lender liability and fraud, respectively, are slightly more common in mid-market cases than in big cases. These are just examples of the way in which the legal issues that predominate in middle market cases may be different than in the largest cases.

Smaller companies may also be more dependent upon a smaller universe of suppliers, and therefore may be less able to use some of the tools of the Bankruptcy Code in dealing with issues like preferences to augment the size of the estate, or even in challenging reclamation claims. The changes to the Bankruptcy Code enacted last fall also provide for dramatically different administrative claims. The increased, early cash needs for utility deposits, and to pay reclamation creditors, may be more than the mid-market company can adequately finance.

More financing options for mid-market debtors are blurring the line

A current economic reality is that there is a lot of money in the market chasing deals. In particular, an unprecedented amount of money has been poured into private-equity funds and hedge funds dedicated to the "troubled company" market in the last few years. One consequence is that the people with the money will have to consider financing ever-smaller deals, and so there should be more "big case" options available in smaller and smaller cases.

One consequence is that these players are introducing a level of sophistication into mid-market cases that was, historically, less prevalent: The financing sources themselves, with their more-sophisticated analytical abilities, may provide some of the sophisticated financial and restructuring advice that would otherwise be available only if the debtor hired its own "team." It may also mean, to some extent, an opportunity for larger firms and a risk for smaller firms. These players are less price-sensitive when buying professional services and are often distrustful of smaller firms they haven't heard of before, or worked with successfully, whether or not such opinions are justified.

What does all of this mean? Notwithstanding the higher hurdles imposed on small companies by the revisions to the Bankruptcy Code, we believe that it may mean that more, and smaller, companies will successfully restructure because it may be easier than in the past to find the financing, and financial restructuring assistance needed to do so.

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