

“THE GREAT DEBATES”

***RESOLVED: Large Delaware And New York Reorganization
Cases Failed At A Higher Rate Than Elsewhere***

ABI Annual Meeting
Washington, D.C.
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Thomas J. Salerno is chair of the firm's reorganization and restructuring practice. He has been involved in restructurings in the U.S., UK, Germany, France, Switzerland and the Czech and Slovak Republics. In addition, he has lectured and assisted in revamping the insolvency laws of the Dominican Republic and Costa Rica, and he teaches comparative international insolvency at the University of Salzburg. Mr. Salerno was named as one of twelve Outstanding Bankruptcy Attorneys in 1998 and 2000 by *Turnarounds & Workouts*, a newsletter published by Beard Group, Inc. in Washington DC.

Mr. Salerno has extensive experience representing both creditors and debtors in complex litigation and bankruptcy proceedings, pre- and post-bankruptcy workouts and financial restructurings. He has represented clients in diverse industries such as casinos, resort hotels, real estate, high tech manufacturing, electricity generation, agribusiness, construction, health care, airlines and franchised fast-food operations.

Mr. Salerno is co-author of the *Executive Guide to Corporate Bankruptcy*, published in 2001 by Beard Publications; co-author and an executive editor of the three volume treatise titled *Advanced Chapter 11 Bankruptcy Practice*, published by Aspen Law Publications; and co-author of *Bankruptcy Litigation and Practice; A Practitioners' Guide – 3rd Edition*, also published by Aspen Law Publications.

Mr. Salerno is a director of both the American Bankruptcy Institute, where he also serves on the executive committee, and the American Bankruptcy Board of Certification, Inc. He is a past chair of the Bankruptcy Section of the State Bar of Arizona and a fellow of the American College of Bankruptcy.

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***RESOLVED: Large Delaware And New York Reorganization
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GREAT DEBATE SERIES

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***“While the economic storm continues the proper tactics
for possessors of capital are those of flight and self-defense.
It is a cautionary experience; there are many casualties,
Cruel transfers of individual fortunes.”***

Matthew Josephson
*Robber Barons: The Great
American Capitalists*
(1934)

1. **RESOLVED:** So what? Why should this be a cause for concern?
2. **CHARACTERISTICS OF “CHAPTER 22” IN NEW YORK OR DELAWARE.**
 - First Chapter 11 involved “true reorganization” attempt, not a sale (with a plan to distribute proceeds) or disguised liquidation.
 - Sophisticated debtor and creditor constituencies with experienced financial and legal representation.
3. **“FEASIBILITY”—WHAT IS THE STANDARD?**
 - ***“Legal stuff”***—the feasibility standard of 11 U.S.C. § 1129(a)(11)¹ is a “preponderance of the evidence” standard—*i.e.* “it is more likely than not.” *In re Briscoe Ent. Ltd.*, 994 F.2d 1160, 1163—64, 1165 (5th Cir. 1993). (***NOTE: A NON-NEW YORK/DELAWARE COURT:***

¹ 11 U.S.C. § 1129(a)(11) provides:

Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor, unless such liquidation or reorganization is proposed in the plan.

As numerous courts have explained, “the court need not require a guarantee of success,” which of course would be difficult to predict for any venture much less one emerging from Chapter 11. “Only a reasonable assurance of commercial viability is required.”

Briscoe Ent., 994 F.2d at 1165-66 (footnotes omitted).

- This standard is also supported by independent, learned treatises:

Basically, feasibility involves the question of the emergence of the reorganized debtor in a solvent condition and with reasonable prospects of financial stability and success. It is not necessary that success be guaranteed, but only that the plan present a workable scheme of organization and operation from which there may be a reasonable expectation of success.

L. King, *Collier On Bankruptcy*, P.1129.02 at 1129-61.11 (15th ed. 1996).

4. **THE REAL WORLD FLAWS IN PROF. LOPUCKI'S INDICTMENT OF DELAWARE AND NEW YORK.**

- **The Indictment Is Spurious.** At its core, the indictment of New York and Delaware (and their judges) is premised on a blindered-view of data. See LoPucki and Kalin, “The Failure Of Public Company Bankruptcies In Delaware And New York: Empirical Evidence Of A ‘Race To The Bottom’,” 54 *Vanderbilt L. Rev.* 231 (March 2001) (the “LoPucki Analysis”).
- **The “Real World”—And What The Numbers Cannot And Do Not Show.**
 - **Venue Is A Strategic Choice.** Of course experienced lawyers choose New York or Delaware! At least debtor companies have a fighting chance and won't be destroyed in slow processes.
 - **Let The Real Parties In Interest Decide.** Who's ox is being gored? The creditors with stakes in public company bankruptcies are sophisticated players who understand risks (and rewards).
 - Usually by confirmation, much of the debt has traded hands (including trade debt).
 - The speculative nature of feasibility projections is not only a given, but in fact very few (if any) sophisticated players in Chapter 11 cases rely on a debtor's projections anyway!

- Committees in these cases all have experienced and sophisticated (and high priced) legal and financial advisors.
- The financial advisors always test and vet the debtor's feasibility projections—they are never taken at face value (ever).
- **Why Does The LoPucki Analysis Ignore Disclosed Risk Factors?** The debtor always fully discloses that the feasibility projections are inherently speculative by nature. A glaring flaw in the LoPucki Analysis is its failure to review the Disclosure Statements in the cases it reviewed. The Disclosure Statement filed in *Laidlaw USA, Inc., et al.* on July 28, 2001 (in New York) is instructive:

Projected Financial Information

Introduction

As a condition to confirmation of a plan of reorganization, the Bankruptcy Code requires, among other things, that the Bankruptcy Court determine that confirmation is not likely to be followed by the liquidation or the need for further financial reorganization of the Debtors. See "Voting and Confirmation of the Plan—Confirmation" and "Voting and Confirmation of the Plan—Feasibility." In connection with the development of the plan, and for purposes of determining whether the Plan satisfies this feasibility standard, the Debtors' management analyzed the ability of the Reorganized Debtors to meet their obligations under the Plan with sufficient liquidity and capital resources to conduct their businesses. In that connection, the Debtors' management developed and prepared certain projections (the "Projections") of the estimated consolidated financial position, results of operations and free cash flows and capitalization, together with certain other items for the fiscal years 2001 through 2004 (the "Projection Period").

THE DEBTORS DO NOT, AS A MATTER OF COURSE, PUBLISH THEIR BUSINESS PLANS, BUDGETS OR STRATEGIES OR MAKE EXTERNAL PROJECTIONS OR FORECASTS OF THEIR ANTICIPATED FINANCIAL POSITIONS OR RESULTS OF OPERATIONS. ACCORDINGLY, THE DEBTORS (INCLUDING THE REORGANIZED DEBTORS) DO NOT ANTICIPATE THAT THEY WILL, AND DISCLAIM ANY OBLIGATION TO, FURNISH UPDATED BUSINESS PLANS, BUDGETS OR PROJECTIONS TO HOLDERS OF CLAIMS OR INTERESTS PRIOR TO THE EFFECTIVE DATE OR TO STOCKHOLDERS OR DEBTHOLDERS AFTER THE EFFECTIVE DATE OR TO INCLUDE SUCH INFORMATION IN DOCUMENTS REQUIRED TO BE FILED WITH THE SEC, ANY CSA OR ANY STOCK EXCHANGE OR OTHERWISE MAKE SUCH INFORMATION PUBLICLY AVAILABLE.

* * *

Principal Assumptions for the Projections

The Projections are based on, and assume the successful implementations of, the Reorganized Debtors' business plan. Both the Reorganized Debtors' business plan and the Projections reflect numerous assumptions, including various assumptions regarding the anticipated future performance of the Reorganized Debtors, industry performance, general business and economic conditions and other matters, most of which are beyond the control of the Debtors or the Reorganized Debtors. Specific risks and uncertainties that may affect the accuracy of the Projections include, among others, those relating to:

- the degree to which the Reorganized Debtors will be leveraged and related debt service obligations and substantial capital expenditure requirements;
- competitive factors in the markets in which the Reorganized Debtors will operate;
- the ability of the Reorganized Debtors to control costs, particularly driver wages and fuel costs in the education services and inter-city, transit & tour businesses, or recover increases in these costs by means of price increases where applicable;
- the ability of the healthcare business of the Reorganized Debtors to mitigate the negative effect of the proposed HCFA National Rate Schedule on the pricing of ambulance services;
- the ability of the Reorganized Debtors to respond to any existing or new competition within their markets;
- the impact on claims costs of accident severity and the outcome of litigation relating to the education services, inter-city, transit & tour or healthcare businesses, both of which are largely outside the control of the Reorganized Debtors;
- interest rate levels and their impact on the ability of the inter-city, transit & tour business to effect vehicle sale-leaseback transactions on acceptable terms and conditions; and
- the effect of any new or amended legislation applicable to any of the businesses of the Reorganized Debtors.

THEREFORE, ALTHOUGH THE PROJECTIONS ARE NECESSARILY PRESENTED WITH NUMERICAL SPECIFICITY, THE ACTUAL RESULTS ACHIEVED DURING THE PROJECTION PERIOD WILL VARY FROM THE PROJECTIONS. THESE VARIATIONS MAY BE MATERIAL. ACCORDINGLY, NO REPRESENTATION CAN BE OR IS BEING MADE WITH RESPECT TO THE ACCURACY OF THE PROJECTIONS OR THE ABILITY OF THE REORGANIZED DEBTORS TO ACHIEVE THE PROJECTIONS. See "Risk Factors" for a discussion of certain factors that may affect the future financial performance of the Reorganized Debtors and of various risks associated with the Plan.

Although the Debtors believe that the assumptions underlying the Projections when considered on an overall basis, are reasonable in the light of current circumstances, no assurance can be or is given that the Projections will be realized. *In deciding whether to vote to accept or reject the Plan, holders of Claims must make their own determination as to the reasonableness of such assumptions and the reliability of the Projections. See "Risk Factors."*

The independent auditors for LINC have neither examined nor compiled the Projections presented herein and, accordingly, assume no responsibility for them. Moreover, the Projections have not been prepared to comply with guidelines established with respect to projections by the SEC, any CSA, the American Institute of Certified Public Accountants or the Canadian Institute of Chartered Accountants.

Disclosure Statement at pp. 30-32 (emphasis in original). The Disclosure Statement then goes on for nine (9) pages (pages 63-71) of “Risk Factors,” which are summarized as follows:

RISK FACTORS
Projections, Business Plan and Reorganization Enterprise
Value
Losses Associated with Safety-Kleen; Claims to be asserted
by Safety Kleen Against the Debtors
Substantial Leverage
Security Interests.....
Effective Subordination as a Result of Holding Company
Structure
Noncomparability of Historical Financial Information
Lack of Established Market for New Common Stock
and New Notes; Possible Volatility.....
Treatment of Claims; Dilution.....
Possible Federal Income Tax Claims
Deteriorating Financial Results
Potential Loss of Customers
Bonding
Losses in the Healthcare Businesses
Decreasing Operating Margins in Core Businesses
Increasing Competitive Pressures
Seasonality
Importance of Self-Insurance Authority and
Availability of Insurance
Litigation
Safety-Kleen Environmental Liabilities
Certain Anti-Takeover Effects.....
Dividend Policies; Restrictions on Payment of Dividends.....

Could there be any more disclosures? Doubtful.

- **Feasibility Is Ultimately A Negotiated Risk, Not A Litigation Issue.** In real restructurings, the feasibility analysis occurs at the negotiating table, not in courtrooms. Another fatal flaw in the LoPucki Analysis is to analyze which of the Chapter 22s involved contested feasibility issues at confirmation. A smart bet? None. Why? Because the real parties in interest have done their own assessment of the reorganized company’s future.
- **The LoPucki Analysis Misconstrues The Bankruptcy Court’s Role In Real Reorganizations.** What is the bankruptcy court’s role in the process? The LoPucki Analysis assumes that a reorganization proceeding is a litigation process, with parties

asserting legal positions and prevailing because they met their burden of proof in a trial setting. This is simply wrong and evidences lack of real world experience in a complex process.

- Chapter 11 reorganizations are judicially supervised commercial negotiations. When they devolve into litigation matters, the company (and process) is doomed to failure.
- The bankruptcy judge's role is facilitator and, ultimately, arbiter when parties reach impasse. If usual trial procedures are applied to reorganizations, they will never become a Chapter 22 because they will die a slow (and expensive) death in the first Chapter 11.
- The LoPucki Analysis implicitly argues for a bankruptcy judge to raise (through evidentiary means) feasibility issues when the parties with the money at stake have decided not to do so. This is an absurd proposition that treats reorganization proceedings like trials. The "cure" will certainly remedy the Chapter 22 "problem"—fewer and fewer cases will emerge at all.
- **Let The Capital Markets Work.** The Capital Markets (and capitalism in general) operate on principles of informed risk/reward. Chapter 11 reorganization is just a part of the capital market system. If the LoPucki Analysis makes a case (after further review of the cases which were studied) that there was fraud in these cases, that's a different story and serious remedial actions should be taken. What is much more likely, however, is that the Chapter 22s are a function of the Capital Markets in action.

5. **CONCLUSION.**

- The numbers are of academic interest, but do not tell even one quarter of the whole story.
- Let the constituencies with the real stake in the process determine what scrutiny should be given to feasibility standards—that's the way (absent fraud) the capital markets work.
- ***SO STIPULATED:*** large Delaware and New York Reorganization Cases Failed At A Higher Rate Than Elsewhere.
- ***SO WHAT?*** You pay your money, you take your chances. If there's not fraud, let the capital markets operate. As Matthew Josephson said in the quote from the *Robber Barons* book, economic problems are a "cautionary experience"—that's life, get over it.