

# EXTRA

Trials, transactions and the  
insider's guide to the  
practice of law.

Supplement to the Los Angeles Daily Journal  
and San Francisco Daily Journal

## COVER STORY

By Draeger Martinez

**S**mall companies that dream big hope one day to take on the Microsofts and Wal-Mart's of the world.

But not all of them make it, and some wind up declaring bankruptcy.

As companies that wanted to be big but wound up bust look for insolvency counsel, they're turning to one firm that has made a point of attracting not only the K-Mart's and Enron's of the bankruptcy world but also small and midsize clients with between \$50 million and \$250 million in annual revenue.

Bankruptcy firm Pachulski, Stang, Ziehl, Young, Jones & Weintraub, with 85 attorneys and offices in insolvency hot spots like Delaware and New York, often handles large-company bankruptcies, helping ailing corporate titans rearrange hundreds of millions in debt.

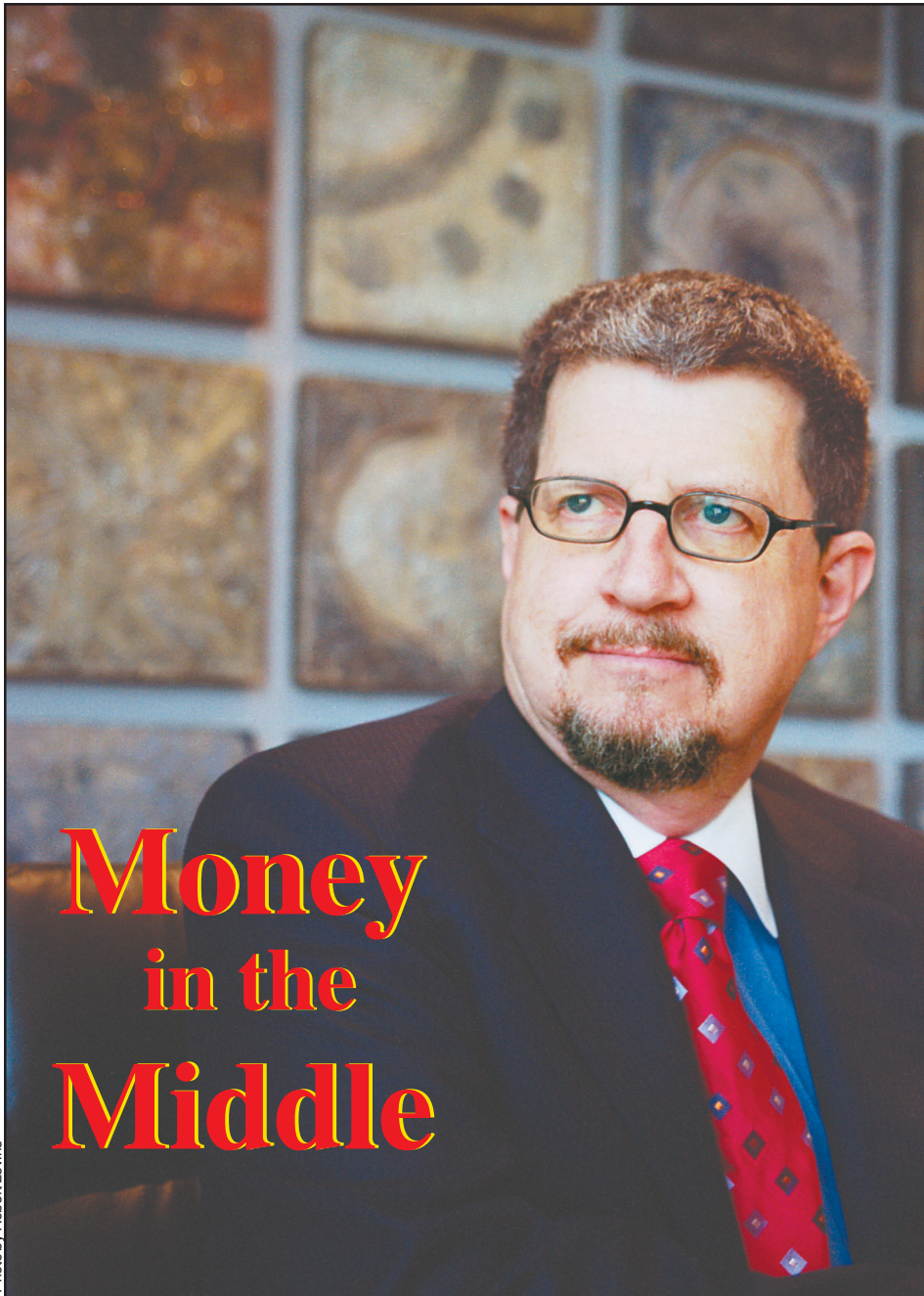
But recently, the firm decided to focus on drumming up business among middle-market companies, rather than outgrowing them completely.

Last April, four top Pachulski Stang attorneys formed a "firm within the firm" to seek smaller companies in what it calls the middle-market niche. Although the group is in its infancy, it has helped companies in bankruptcy such as Health Care of the Redlands, Country Home Bakers, Gingiss Formalwear and Sega GameWorks.

Pachulski Stang has grown from two lawyers at its founding 20 years ago to attorneys in four offices nationwide. Throughout this period, Pachulski Stang worked to establish itself as a nationwide specialty firm capable of handling the biggest corporations' bankruptcies, competing for business with regional and national bankruptcy shops.

As part of that effort, Pachulski Stang added 35 lawyers in the last few years. It opened its San Francisco office in 1996, its Delaware office in 2000 and its New York office in 2002, in each case expanding into markets ripe with bankruptcy prospects.

The firm's New York and Delaware offices gave it greater access to large troubled companies than the California offices alone could. Large companies frequently incorporate under Delaware business laws and file for Chapter 11 protection in Delaware Chancery Court, which has a reputation for being more predictable and business-friendly.



## Money in the Middle

Photo by Robert Levins

**Who says bigger is better? Four bankruptcy partners at Pachulski, Stang, Ziehl, Young, Jones & Weintraub are letting the Enrons and Kmart's of the world pass them by. Led by partner Thomsen Young, these lawyers created a firm within their firm to ensure Pachulski Stang keeps a lock on the middle market.**



# Smaller Fry

Catching a 20-pound bass is nice, but four lawyers at Pachulski, Stang, Ziehl, Young Jones & Weintraub say they eat perfectly well pulling medium-sized fish from the bankruptcy pond. Leaving the larger troubled companies to their firm compatriots, these attorneys are frying 'middle market' fish.



Photo by Robert Levins

**From left, Hamid Rafatjoo, Sam Maizel, Jeffrey Pomerantz and Thomsen Young have formed a group in Pachulski Stang to seek companies in the middle-market niche.**

As middle-market partner Jeffrey Pomerantz puts it, "the bench there has a sophistication that allows them to administer the procedures efficiently."

"And with some of the judges there," Pomerantz says, "you know what you're going to get when you come before them."

Laura Davis Jones, who heads the firm's Delaware office, says the firm's recent major clients include Exide Technologies, which according to its Securities and Exchange Commission filings posted \$141 million in losses for fiscal 2003 on revenues totaling \$2.36 billion; Sleepmaster Mattress, which posted a \$7.32 million loss on \$86 million in sales during the second quarter of 2001; and online grocer Webvan Group Inc., which posted a \$241 million loss in the first quarter of 2001.

However, Pomerantz and other attorneys began

to worry in the late 1990s that the firm had begun overlooking middle-market companies.

The signals we got from prospects were that, if you had a \$50-million-per-year company," he says, "you didn't want to give it to Pachulski because now they're a national firm and they'll put their 'B team' on it."

"But that's not the case," Pomerantz says. "We have senior attorneys who would want to do that business, who don't want to travel so much, and who would like to handle middle-market companies here in Southern California."

Pomerantz says the firm was especially well positioned for middle-market work because of its San Francisco office. The northern California outpost allowed Pachulski Stang lawyers to attract Bay Area dot-com bankruptcies, he says.

The middle-market group's leader, Thomsen "Tom" Young, says that, as Pachulski Stang grew,

some attorneys worried that landing larger and larger clients would mean leaving middle-market clients behind. Young didn't want that to happen because he considers the middle-market home to the firm's longtime bread-and-butter clients. He believes that, when other growing bankruptcy firms have abandoned the middle market, they have seldom recaptured it.

"It's like the dinosaur and the small mammals that succeeded them: There are lots of small firms waiting around, waiting to grow and competing for those accounts," Young says. "They'll pitch [to prospective clients] that they'll put their name partners on the account, not some low-level associate. And once they have that space, they usually don't give it back."

Young says that he talked with name partner Richard Pachulski about establishing a "firm within the firm" to handle middle-market clients. The move meant changing some firm policies to accommodate the group. Young says the changes occurred gradually during the group's first few months in practice.

The firm came up with a new billing procedure for clients of the middle-market group. Although partners charge \$400 an hour, the same as other firm partners, the total bill for a middle-market client is often less than for larger clients, even if partners have billed the same amount of time.

The firm uses rate caps and blended rates that emphasize the lower fees of associates, \$300 to \$350 an hour, Young says. The billing innovations are generally not available to larger clients, firm attorneys say.

"It would mean less money for the firm, but not so much less that the firm would actually lose money," Young says.

He adds that most larger clients have not asked about receiving financial accommodations, but to secure one new big-bankruptcy case, Metropolitan Mortgage and Securities Co. in Spokane, Wash., the firm offered blended rates.

"We also developed a whole new network of referral sources to nurture our middle-market portfolio," Young says. "There would be different accounting firms, turnaround firms, investment

bankers and so forth who dealt with clients in this market.”

Yet while the middle-market group can charge less than its big-bankruptcy brethren, Pomerantz says that he and his colleagues enjoy the same financial rewards as other Pachulski Stang partners. Their salaries and profit participation remain the same, and middle-market partners do not face penalties if they’re unwilling to travel as frequently as colleagues working on larger bankruptcies, for instance.

“The size of the company does not always dictate the size of the revenues [from its bankruptcy],” Pomerantz says. “Some big clients might yield revenues in the mid six-figures, while some middle-market cases can yield seven-figure revenues.”

According to Pachulski, the smaller debts in a middle-market bankruptcy do not make matters easier than a larger bankruptcy; if anything, they make the problems more difficult.

“It’s ironic but true that it nearly costs a creditor as much to handle a \$5 million credit as with a \$50 million credit from a bigger company,” Pachulski says. “If a middle-market company owes \$10 million to a bank and a larger company, say an Enron, owes the bank \$150 million, the bank is more willing with the larger company to work things out.

“With a middle-market company, there’s a greater temptation for them to say, ‘Let’s just liquidate it. Let’s get this \$10 million off our books.’”

The group has four dedicated partners: Young, Pomerantz, Hamid Rafatjoo and Sam Maizel. But no associates are specifically assigned to work on middle-market companies.

Rafatjoo says that the midsize bankruptcies interest him because they typically involve many of the same problems as big bankruptcies, but the smaller companies have fewer resources available to solve their problems.

“When bankruptcy comes into play, they want the same kind of representation for their proceedings [as bigger companies],” Rafatjoo says. “We believe that the expertise we can provide will help them in the short and the long term, maybe more so than a firm that will charge clients \$150 per hour and not really do a lot for them.

“These usually are good people hit by hard times, and you can take a lot of satisfaction from helping them plan their comeback.”

Rafatjoo says that his colleagues in Pachulski Stang have provided the group excellent support as they pursue middle-market clients.

“Often, when a firm reaches a certain size or a certain status level, they avoid the small cases because they think that will prevent them from pursuing the big clients,” Rafatjoo says.

Young says the hardest obstacle the group has faced is marketing its services effectively and changing the attitudes of prospective clients.

“We were identified by other professionals as only being interested in, or able to, handle big

firms and not mid-market companies,” he says.

“Competitors would talk this up as a reason not to hire us, and it’s an uphill battle to challenge that,” Young says. “Changing what goes on in people’s heads can be very difficult, and that is our current objective.”

Pomerantz notes that running and building an insolvency practice takes plenty of legwork. Although the work typically provides little to no repeat business — once a company goes through bankruptcy, generally it either turns its operations around or fails for good — Pomerantz says the team has identified some ways to generate busy caseloads.

One of the group’s chief sources is creditors’ committees, which typically comprise a company’s unsecured creditors such as suppliers and landlords. Once interested creditors form a committee, they are empowered to weigh in on bankruptcy proceedings.

“They investigate what got the company where it is and what the plan is for its recovery, or at least to maximize value. The committee doesn’t run things directly, but they do have a very strong voice at the bankruptcy court,” Pomerantz says.

Young says that, each time the group handles a bankruptcy, it keeps all of its records of representation and the parties involved in computerized format. Sometimes, creditors in one case turn out to be creditors in other cases, which tips off the group to further middle-market opportunities.

“We also get referrals from turnaround operators, from accountants and from nonbankruptcy lawyers,” Pomerantz says.

He adds that the firm’s reputation in handling a big bankruptcy sometimes makes good impressions on middle-market companies considering a bankruptcy filing.

Mark Syrstad, CEO of middle market bankruptcy client Gingiss Formalwear, says he interviewed two other bankruptcy firms before deciding to bank on Pachulski Stang’s reputation and track record.

“We felt our deal was pretty complex and that simply attaching the name Pachulski Stang impressed people who might have been problematic,” Syrstad says.

Since the middle-market group formed, it has taken nine months to get up to speed, Young says. Allowing the group to set its own pricing structure and referral network has paid off, as has the firm’s decision to dedicate senior attorneys to this client base, rather than giving middle-market cases sporadically to its lawyers.

Young says that the group has not tallied a solid figure for its middle-market book of business but that its goal for the group is \$5 million in annual revenues. He declines to say how much revenue the firm as a whole generated, but he adds that the middle-market group has brought 12 bankruptcies for the firm to handle in its first year.

“So far, we’ve focused this effort from our L.A. office, and we hope to eventually replicate this effort in New York and San Francisco,” Young says. “I think if you went to any large manufacturing company about branding, they would tell you the same thing, that you spend years and lots of money to build one brand. You can’t just turn on a dime to build another one.”

Pomerantz, who joined the firm in 1992 and became a shareholder three years later, says the middle-market practice group evolved out of a market opportunity that the firm noticed a few years before he arrived.

“In the late 1980s and early ’90s, the firm was trying to distinguish itself from other L.A. bankruptcy boutiques. Another firm named Stutman Treister & Glatt kind of abandoned the middle market, and we decided to target that market,” Pomerantz says.

Kenneth N. Klee, a name partner with insolvency boutique Klee, Tuchin, Bogdanoff & Stern, agrees in part with Pomerantz.

“I think it is fair to say that Stutman did abandon the middle market when they focused more on becoming a national firm,” says Klee, who also teaches bankruptcy law and negotiating business deals at UCLA’s law school.

Klee also thinks of Pachulski Stang “primarily as a national firm.”

“I’d be surprised if their middle-market business is more than 5 percent of the overall firm revenues over the last five years,” he says.

Robert Greenfield, who chairs Stutman Treister’s executive committee, says that, while his firm has added national clients, it never abandoned the middle market.

“We don’t have any attorneys who strictly handle middle-market cases. Our people are experienced with middle-market cases and national ones, and they work on both based on whose expertise could best serve the client,” says Greenfield, whose firm has 35 lawyers in all. “We pride ourselves on being the most experienced bankruptcy firm around, and we have more great lawyers from top to bottom than anyone.”

Greenfield says he knows Pachulski Stang to have a good reputation among both middle-market and larger clients, though he was not aware of that firm’s middle-market group.

With the middle-market group rounding out its first year, Pomerantz says its work has only begun.

“We’re trying to do a lot of word-of-mouth marketing, and people are still surprised that we offer [middle-market service],” Pomerantz says. “There are maybe 10 other firms in L.A. that would compete for mid-market clients, and some clients maybe don’t want to take the effort to check out all 10.

“And they might look at us, a national firm and hence probably more expensive, and say, ‘We don’t need a Rolls Royce solution to our Chevy-level problem.’”

Young named four firms he considers notable competitors for his group's middle-market practice: the Newport Beach office of Irell & Manella; Levene, Neale, Bender, Rankin & Brill in Los Angeles; SulmeyerKupetz, in Los Angeles; and Winthrop Couchot, in Newport Beach.

"I would consider them to be more of a national firm, as opposed to a regional, predominantly middle-market firm like we are," says Paul Couchot of Winthrop Couchot. "They're a very good firm. We have a healthy respect for them and what they've accomplished, and we have a good relationship with the lawyers there."

David Kupetz of SulmeyerKupetz offers no opinion on the size of Pachulski Stang's clients but echoes Couchot's positive impression of the larger firm.

"I think they have a good reputation, handling cases in and out of state," Kupetz says. "For us, we don't concentrate on just the middle-market or the big cases. We try to tackle any case we can where we can bring value to the process, and if it's cost-effective and we're not conflicted out."

The bankruptcy lawyers at Pachulski Stang aren't the only ones innovating to meet the middle market. Joe Coleman, a real estate partner in Snell & Wilmer's Irvine office, says that, as with bankruptcy law, middle-market opportunities have grown in the real estate field.

Coleman adds that, because large firms have been moving away from a real estate focus, firms with lower rates are moving in to fill the void.

The majority of real estate developers fit his firm's middle-market profile, he says.

"Most real estate lawyers in our office try to keep their rates below \$400 an hour. We don't use blended rates that much but we do often cap fees at a specified amount," Coleman says.

Blane Prescott, a partner in the consulting firm Hildebrandt International, says that many law firms miss out on opportunities presented by the middle market because they assume bigger clients automatically lead to higher firm revenues.

"Those [big] clients tend to have in-house counsel and a large volume of work, and they tend to parse out their work so that often a law firm is doing a very small piece of the work," Prescott says. "On the other hand, middle-market clients don't have in-house counsel as often, and while they're fee-sensitive, they tend to not extract fee discounts like big companies do. So if you're careful about picking clients, the middle market can be as profitable or more so than big companies."

Although he doesn't consider himself a full member of the firm's middle-market group, Pachulski says he's happy to serve as their consultant and sounding board.

"There's a sensitivity in all bankruptcy cases to the costs of restructuring, but more so in a middle-market case because the pie is so much smaller than with a big company," Pachulski says. "Often, you're dealing with at least as many operational problems as with financial problems, and you have to look at how many resources to bring to bear. A middle-market company often can't afford much for specialized attorneys or accountants, and there's only so much time that creditors are willing to spend to regain their stakes."

Pachulski adds that the middle-market group has handled cases generated from the firm at large as well as cases the group started from scratch.

"We don't want to get across that these cases are different from our bigger clients; we may have fewer resources on these cases, but they're quality attorneys," Pachulski says. "They've done so many middle-market cases that they can handle them very efficiently. They don't spend much time trying to re-invent the wheel."

The margin of error on middle-market cases is much lower, and if you're not careful, you can drown the client in Chapter 11 fees."

Ideally, a company in bankruptcy is able to negotiate an outcome that all parties can live with, rather than proceed to litigation, Pomerantz says.

The thing that attracted me to bankruptcy law is that it's dynamic and it's not as win-lose, zero-sum game as trial work," Pomerantz says. "Working from the debtor's side especially, you have the ability to bring people together, get behind the politics involved and bring everyone together."

A current case in point for Pomerantz: Sega GameWorks, a chain of restaurant/video arcades that recently filed for bankruptcy under Chapter 11. Pomerantz, who is representing the company's creditor committee, says he wants to find a winning solution for everyone.

"GameWorks has 19 locations, 16 that they own and three that they manage under joint ventures. The problem they face is that their revenue has declined over the last few years," Pomerantz says. "They've tried to cut their overhead expenses, but it hasn't been enough to offset the falling revenue, so they've been trying to get rent concessions from the landlords. The leases include portions for the build-out expenses, so they can't afford the rents."

Pomerantz says that the company won't be viable without some kind of deal from its

landlords. The creditor committee is weighing several options, including selling off GameWorks or closing its least-profitable locations.

The company indicates that it might not be an easy fix; a lot of them are making money but maybe not enough to carry the overhead," such as the corporate headquarters and its financial and legal departments, Pomerantz says.

Pomerantz added that the company's annual revenue is \$64 million for fiscal 2003, which ended March 30, 2003, but that projections indicate falling revenue for fiscal 2004.

Pomerantz, like Young and Rafatjoo, are the middle-market group's generalists, unlike Sam Maizel.

Maizel came to the firm seven years ago, after practicing bankruptcy law for the federal Department of Justice. His government experience focused on representing the Medicare program and other health care agencies, which he says prepared him to represent middle-market clients in the medical field.

"There are a lot of hospitals and medical groups and health plans that fall right into that middle-market range, and that's the field of law I've always covered, so that makes me a good fit," Maizel says. "Middle-market companies that expand too quickly or unwisely, or that chose the wrong locations to expand in, can be exactly the kind of client we want to represent."

He cited one of his clients, Health Care of the Redlands, as a good example of his specialty. Although the medical group operates in just four Northern California counties, with 100,000 premium-paying members it usually generates between \$10 million and \$20 million per month.

"A group that size typically doesn't have access to the biggest accounting firms or law firms," Maizel says. "In this particular group's case, they're also nonprofit, and that limits their resources, too. And before you know it, they get into trouble."

Pomerantz says that the group's current challenges come from starting new client relationships and balancing their needs with those of long-standing clients.

"Our firm has a commitment to this," he says, "and we will continue to mine our contacts and continually increase our name recognition and our number of contacts."

"You don't necessarily see the results overnight, and you need to keep people buying into what we're doing here. We don't exactly have a make-or-break point mapped out of a certain number of months or years to make this effort successful."