

Boston and New England – Law Firms

Master Planning For The Future

The Editor interviews Steven M. Ellis, Partner in Proskauer Rose LLP's Corporate Department, Head of the Firm's Boston office, Co-head of the Distressed Debt Group and Junior Capital Group, and Co-chair of the Firm's Corporate Finance Group.

Editor: As co-head of Proskauer's Distressed Debt and Junior Capital Groups and co-chair of its Corporate Finance Group, would you please describe the size of these groups, primary responsibilities and principal industry focuses?

Ellis: The Junior Capital Group is where I have spent most of my time the past few years. We developed the group about five years ago. The group consists of restructuring lawyers with an understanding of insolvency law who do front-end financing work. We typically represent non-traditional lenders who specialize in multi-tranche financing. Our focus has been the area between senior debt and pure equity, including the last-out piece of senior debt, mezzanine and second-lien financings. Across our various offices, there are approximately 25 lawyers in the Junior Capital Group, which overlaps with the Distressed Debt Group, which includes about 10 additional lawyers in our Bankruptcy Group. The Junior Capital Group also works closely with our private equity, tax and fund formation lawyers – the numbers I mentioned are the pure financing people. The firm's Corporate Finance Group has a number of other practice groups such as the High Yield Debt Group, the Sports Funding Group, the Capital Markets Group, the Structured Finance Group and a traditional Senior Lender Group. It is a fairly broad umbrella that includes another 25 or so lawyers.

When we started the Junior Capital Group in the early 2000s, there was no other firm that focused on multitranchise financings with insolvency and intercreditor expertise. We grew from six clients five years ago to around 50 today. I think that had a lot to do with the fact that there was a thirst out there for a firm with this expertise focused on unique issues for multi-tranche lenders in one group.

We tend to be industry agnostic in our finance practice, but Proskauer has long been recognized for its expertise in healthcare, lodging and gaming and sports.

Editor: Are there any industry specialties that drew you to the capital markets in Boston?

Ellis: The industry specialty for our group is finance. Our practice has become an international practice. We represent people who are doing deals all over North America, South America, Asia and Europe. Borrowers seeking financing are facing the same challenges everywhere. There is very little liquidity in the senior bank market. Companies looking to find financing have to go to our clients, the non-traditional lenders and the private equity community. Many private equity firms are looking for distressed opportunities. What is happening in Boston is very similar to what is happening across the country.

Editor: When we last spoke in September 2005, the condition of the economy was far from what it is today. Could you please tell our readers how Proskauer's

corporate finance practice groups, particularly those involving mezzanine and distressed debt, have evolved to meet today's financial challenges?

Ellis: Having lived through the last few downturns, the Junior Capital and Distressed Debt Groups have applied much of our experience from these restructurings to our finance practice over the last four or five years, bringing our restructuring expertise to bear on finance deals. While last year we had 75 front-end deals, we have only two at present, but we are extremely busy with restructurings for our biggest clients in the finance world – the non-traditional lenders, the hedge funds, the mezzanine funds and the BDC's. There are a number of non-traditional lenders out there with money who are willing to finance deals – but at a price.

Editor: We have all heard about how credit has dried up. Have you experienced any success in obtaining senior lending for any of your private equity or other projects? What is the status of mezzanine debt lending institutions today?

Ellis: Clearly the senior lending market is really slow, and liquidity is the biggest issue in getting deals done. While the senior banks have pulled back, the non-traditional lenders are front and center. The problem is that their pricing tends to be higher and their leverage tests tend to be lower. Since seller multiples have not come down, there's a gap between the amount of senior debt available, especially at the traditional pricing, and the amount of equity needed to fill out the deal.

Our mezzanine clients are telling us that they're seeing more opportunities than they've seen in a long time. Mezzanine players are receiving mezzanine pricing with senior-type leverage. We are not seeing the big mega deals, but we're starting to see some smaller deals getting done with mezzanine financing.

Editor: What has been your experience regarding funds specializing in distressed debt in today's environment? Are they able to raise capital?

Ellis: Last year there was a significant amount of distressed-debt money raised and much of it is still sitting on the sidelines. Fast forward to today – many funds are trying to raise distressed-debt money, but it's much more difficult now. One reason is that some distressed-debt funds jumped in too soon – they were buying senior debt at, say, 80 cents on the dollar when a short time later it dropped to 60 cents on the dollar.

Editor: Do you think it might be some of the distressed debt funds that will come to the Treasury Department's aid in joining with public bail-out funds to aid the banks?

Ellis: It depends. My sense is that it may work to have private partnerships along with the government taking over troubled



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banks, but the government is going to have to drive this. To the extent that the government provides some kind of incentive for the private equity and distressed debt firms to come in and buy up these troubled assets (assuming people can get their arms around what the valuations are), I think this will happen. However, it is only going to happen if the government subsidizes or guarantees private funding or takes a last-out position. There are all kinds of creative ways to structure these arrangements, but the only way it's going to work is if the funds can analyze their risks so that they can make money in the process. But early signs suggest that significant government regulations and restrictions on these kinds of arrangements will prompt most private money to shy away.

Editor: How has your experience as a former bankruptcy attorney stood you in good stead?

Ellis: This present economic environment is exactly why we built our group with people who had bankruptcy and insolvency experience. We knew that the best finance lawyers are the ones who understand restructuring and insolvency issues, and the best finance practices are the ones that can properly structure front-end deals with insolvency and restructuring concerns in mind in the event the transaction goes south. One advantage for clients is that our bankruptcy experience avoids the need for them to wait for an insolvency specialist to be called in – it is all packaged in one group.

Editor: President Obama has expressed a strong desire to focus on major infrastructure projects as part of his economic stimulus package. To the extent that such projects require complex financing arrangements, do you anticipate extending the make-up and focus of Proskauer's practice groups to accommodate to the new challenges?

Ellis: We have a project finance group that we have been expanding over the past few years. To the extent the Obama plan goes forward, the timing is perfect for that group. They have expertise in all sorts of projects from traditional to alternative energy, water, telecommunications, etc. It is very much both a national and an international focus. We do a lot of project finance in our Paris, São Paulo and New York offices.

Editor: What areas of practice do you see commanding the greatest part of your team's time over the next year or so in the light of the economic downturn? Do you expect to see many of the former financing vehicles transformed into different forms of corporate finance products?

Ellis: It is interesting to compare our practice from a year ago when we were doing over 75 unitranche, mezzanine, second-lien financing transactions to what is on our plates today. Ninety percent of the work we are doing now is some kind of restructuring – converting debt to equity, forbearance agreements, out-of-court restructurings, Chapter 11, representing clients looking to buy up debt to be used to restructure balance sheets either through a foreclosure or a consensual restructuring.

So all that restructuring work is what we think is going to take up most of our time over the next six months.

As to new financial products, we have not seen anything new or exotic. There is a whole group of financial products that are gone – securitizations, CLO's. That is a sizeable piece of the market that is gone and not likely to be back. We believe the non-traditional lenders will fill that gap.

Editor: Are you seeing mergers of distressed companies?

Ellis: While there has been much talk, we have not seen many of these mergers consummated. It is a little too early to say if that is going to be a trend. One of the problems is that mergers of distressed companies take a lot of time and effort. Many lenders are understaffed with experienced workout people. My sense is that there are not enough "boots on the ground" to get these mergers done when the issues can be extremely complicated, trying to merge and compromise two distressed balance sheets.

Editor: While at the time of this interview the Obama administration's plans for addressing the economic problems have not taken final form, do you have any general expectations as to how the philosophies of this new administration will affect your areas of expertise?

Ellis: It has been quite a bit of theater-watching what is going on in Washington over the last few weeks because I think that there is significant tension between Congress and the administration on differing philosophies of the credit crunch. When you listen to Congress and see what has happened over the last few years, we can expect more regulation, especially for hedge funds. Hopefully, it will not result in measures that overcompensate for the problems of the past and put too tight a reign on non-traditional lenders. In contrast, you hear the administration through Tim Geithner talk about fewer restrictions on the banks in order to provide liquidity. There is clearly some tension between Congress and the administration about more regulations on non-traditional lenders versus fewer restrictions on the banks in order to open up liquidity. How that is all going to play out is probably somewhere in the middle with more regulation but not so much as to prevent more liquidity into the market.

Everyone seems to agree that more transparency is needed. Whether that will restrict lenders in what they will do or should do will be interesting to watch. The devil will be in the details.

Editor: With the strengths in Proskauer's various related practice groups – bankruptcy, distressed debt, capital funding sources – do you expect the firm to have a solid basis for what the future will demand?

Ellis: We are actually pretty excited. We think that we are well positioned for this period of time and to the extent that we start coming out of this recession we think that we are even better positioned for 2010-11. It is rewarding to see that the structure we set up is well designed for a transitional period and makes sense for the long term.

Please email the interviewee at sellis@proskauer.com with questions about this interview.