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Dan Dooley Comments to ABI Commission Studying Chapter 11 Reform

Good afternoon- my name is Dan Dooley and I'm the CEO and majority owner of a national turnaround and loan workout consulting firm called MorrisAnderson. I'm based in Chicago.

My firm MorrisAnderson and I live in the world of the middle market. I do consulting work primarily on the company side for mainly privately owned businesses doing from $50 million to $250 million of annual sales with between $10 million to $50 million of secured debt.

Historically these companies were predominantly owned by individuals and families but with the tremendous growth of private equity investors in the past decade, today perhaps a third of our clients are now owned by private equity groups.

I want to briefly discuss two issues during my testimony:

1. Lessons to be Learned from the increasing popularity of bankruptcy alternatives vs Chapter 11 in the middle market.

Corporate Headquarters
55 West Monroe Street • Suite 2500
Chicago, IL 60603 • (312) 254-0880 • Fax (312) 727-0180

2. Professional Fee Control and Accountability

Lessons Learned from Bankruptcy Alternatives:

It is widely understood and agreed in the insolvency community that Chapter 11 is no longer a cost effective process in the middle market. Chapter 11 no longer provides many companies with a realistic opportunity to rehabilitate themselves and get a fresh start consistent with the original intent of the modern Chapter 11 bankruptcy code as created in 1978. My view is that days of middle market Plans of Reorganization died when the financial engineers of Wall Street created a variety of techniques to heavily leverage a company's balance sheet. My Debtor clients rarely have any real economic value left for their owners and often very little economic value left for the unsecured creditors as well.

Chapter 11 is now viewed as too slow and too costly for the majority of middle market companies to do anything other than sell its going concern assets in a 363 sale or to simply liquidate the company. Both of these outcomes are often pursued almost exclusively for the sole benefit of the secured lender.

As a result of the perception that Chapter 11 is too slow and too costly to benefit the vast majority of middle market Debtors, there is a growing move afoot to utilize a host of bankruptcy alternatives which are mostly rooted in individual state law or local accepted practice. In my view, they are fast becoming, in essence, a "shadow Chapter 11" process.

Additionally there is also a growing use in the insolvency community of federal receiverships. The applicable federal statute on receiverships is rather thin on process and rules. Therefore, a Federal Receiver often chooses to copy the rules of the Chapter 11 process.

As I said, the reason for this growing trend toward bankruptcy alternatives is one of improved speed and cost. It is very important to understand that the rise of bankruptcy alternatives is to address the perceived deficiencies of Chapter 11 in the middle market. This is clearly a growing trend and not a fad.

Therefore, I thought it would be helpful to the Commission to hear what I see as different about these bankruptcy alternatives that better addresses the issues of improved speed and lower cost.

My view is that the perceived Chapter 11 deficiencies regarding slow speed and high cost are one in the same. The more hand to hand legal combat on issues you have in a case, the slower the case progresses and the more expensive the case becomes. It is clear that Chapter 11 has become increasingly litigious of late. Chapter 11 is a game of perverse economic incentives for the professionals because when one stakeholder's attorney throws a hand grenade into the room on an issue, all the other professionals at the bargaining table collect chips courtesy of the hand grenade thrower. That's because the chips or payments come from this amorphous pot of money of the Debtor.

The costs that many of us cite as too high in Chapter 11 today are as follows:

* Professional Fees, which I will address a bit later.

* 503(b)9 claims and utility deposits- both creatures of the 2005 BAPCPA which carved out special treatments for certain unsecured creditors.

* Critical Vendor payments which are creatures of the so called Doctrine of Necessity. Oddly enough before this Doctrine was invoked, we rarely ever conceived of any supplier as so critical to be preferred over others until of course suppliers were advised that they were in fact critical by law and this entitled them to special preferred payments.

Against that backdrop of Chapter 11 is how a Bankruptcy Alternative typically is different:

1. Debtor's management is not in control of the business but rather a 3rd party fiduciary is in control. This concept is of course blasphemy to bankruptcy purists as eliminates the Debtor-in-Possession. But the elimination of direct ownership and management control as present in the so called Debtor-in-Possession eliminates many self serving motives, actions and issues that often

arise in Chapter 11 cases and thus saves time and money. Note that 3rd party fiduciaries do not just liquidate the business as they do in many creditor friendly law countries in an Administration. Often fiduciaries sell a business and in theory the fiduciary could even reorganize the business for the current owners in some rare cases.

2. The number of professional firms in a case is significantly less because only the fiduciary and his counsel and perhaps his investment banker feeds off of the Debtor's estate. All other creditors must put up real cash to employ attorneys and financial advisors to intervene in the case. Not surprisingly, very few Parties-in-Interest go out of pocket cash to become involved in the case other than the secured lender and perhaps a very large creditor. In essence, the creditors accept the fiduciary and expect that he or she will deal fairly and that he or she doesn't need to be watched carefully to avoid a bad result for each stakeholder. For those of us who have been around in the industry for at least 20 years, this is pretty much how the turnaround and workout consulting industry worked in the 80's and 90's. The stakeholders only started really to lawyer up and consultant up in the last decade or so.

3. All unsecured creditors were treated equally without need to treat certain groups better than others. The fiduciary in these cases has to be skilled at negotiating with creditors. There are cases where an irreplaceable supplier would exert leverage and have to be paid an extortion payment but these were isolated cases and not legally dictated categories of preferred exceptions.

These three factors are essentially why bankruptcy alternatives will continue to rise unless changes are made to Chapter 11 in the middle market. By the way, I am not arguing that the Chapter 11 absolutely must be restored to prior position of grace. It's quite possible that the shadow bankruptcy system that's now developing is a good thing.

Professional Fee Control:

Finally, I'd like to express to the Commission a simple idea on Professional Fees in Chapter 11. The biggest public criticism of Chapter 11 today is the perception, right or wrong, that Professional Fees are out of control and too high. Although this criticism is heard mostly regarding the mega cases, the complaint clearly spills over to my world in the middle market as well.

For what it's worth I agree with the public perception. There is little or no fee control and discipline in mega cases. It simply costs what it costs. Here are the two reasons why that's the case:

1. Professional Fees are controlled with a "form over substance" process using detailed time reporting combined with Fee Examiners in bigger cases. The massive time details only create the illusion of control and do nothing in and of itself to control fees. Frankly, this huge stack of detailed time reporting actually makes it harder to control fees because you get lost in the data. Fee Examiners nibble around the edges because no one in this industry would ever get employed again if he or she really attacked a peer's fees. Therefore, you see Fee Examiners typically asking for just enough fee reductions to justify their own existence and not much more. Any of us could do better at managing the Professional Fees by simply saying I need a 10%, 20%, etc. discount because your fees are huge and I deserve a big volume discount.

2. The reporting of costs in Fee Applications lags at least 7 weeks after the professional time was actually expended. It is impossible to review and control costs in this manner. It is too late to adequately remember and review whether costs from multiple professional firms on a case are reasonable and necessary

with this time delay and then sorting through the quantity of time data that each firm is required to submit.

So here's how you control Professional Fees. Frankly, it's easy and this proposal will not endear me to other insolvency industry professionals for suggesting this. However, I think it's important that the industry police its own fees for the good of the industry.

Proposal- Each week all Professional Firms would be required to submit a report to the Court on Wednesday covering the prior week’s fees and expenses. Fees would simply be detailed by individual, hours billed and billing rate with appropriate total with no time detail. Expenses would be summarized by type of expense for professionals in the firm. Here's the key- each firm would be required to write a simple memo of two pages maximum describing the primary tasks they worked on and what they accomplished that week. The timely reporting and visibility of Professional Fees combined with a few questions by Bankruptcy Judges on these costs would immediately put the spotlight of fees and expenses and the costs would quickly drop. Costs always drop if you measure and publicize them timely. Anyone who manages a business will confirm that this is so.

Thank you for the opportunity to address the Commission. This concludes my remarks.

Dan Dooley

CEO and Principal

MorrisAnderson

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Chicago, IL 60603 • (312) 254-0880 • Fax (312) 727-0180