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Banking on Bankruptcy

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Four years ago, Orange County bankruptcy attorney Penelope Parmes was representing a lender who held a mortgage on a defaulted property in Los Angeles, when she discovered that the property owner, an artist who had not sold a painting in 10 years, had managed to purchase several million-dollar homes in the area - all with no source of income.

Times have changed.

"All these lenders were falling all over themselves to lend him money," Parmes, a partner at Rutan & Tucker, recalled. "Now it's the exact reverse. Nobody wants to lend, and values are going down, down, down."

As the subprime lending crisis last year methodically claimed its victims and accelerated the tightening of the credit market, the phones of bankruptcy lawyers across the country began ringing and have not stopped since.

Southern California is no exception.

"We're getting calls from creditors as well as borrowers," said Bennett J. Murphy, a partner at Los Angeles-based Hennigan, Bennett & Dorman. "Clients are saying, 'This time, bankruptcy may be unavoidable. This time we don't think our lenders are going to give us more time. We can't find another lender to take them out. What do we do?'"

Jeffrey C. Krause, a bankruptcy attorney at Century City's Stutman Treister & Glatt, said 2006 and early 2007 were "as slow as any time in the bankruptcy practice in Los Angeles." But in the last six to nine months, he has seen a significant jump in work. He attributes the surge in part to the uncertain economic outlook, which has made lenders jumpy about lending.

"Lenders are getting very nervous because they're not sure if people will buy the completed homes," Krause said. "Lenders don't want to lend the money to complete the projects, which creates problems because they would be the ones to normally fund the expenses."

The feeling of doom most notably has hit Southern California's real estate and housing industries. Lawyers said much of their work in recent months has been in advising real estate-related clients, such as home builders, real estate developers and lenders, both in and out of bankruptcy court.

Krause said one of his clients, a hotel company based in Kansas, was struggling to maintain ownership of four hotels in California and filed for Chapter 11 in 2004. The struggle intensified with the subprime crisis in 2007, and the company was unable to raise the cash to finish a construction project on one of its hotels and was forced to halt the project.

So, Krause stepped in and helped the client come up with a different strategy for each of the hotels. It included selling one hotel to a new investor, who completed the construction project; surrendering another to the leaser; maintaining ownership of the third; and selling the last one to pay back the creditor in full.

In the next year, lawyers expect bankruptcy law to be the fastest area of growth, according to a March survey conducted by Robert Half Legal, a legal placement firm. The firm surveyed 300 attorneys from large firms and corporations. One in four participants predicted bankruptcy to be the area of law that would experience the greatest rise in work.

In Southern California, law firms have begun beefing up their bankruptcy and finance capabilities with laterals to put themselves in a better position for the years ahead.

Goodwin Procter gained four corporate finance partners in Century City from McDermott, Will &



ROBERT LEVINS
Penelope Parmes

Emery, including Eric R. Reimer. In January, Sonnenschein Nath & Rosenthal hired Sara L. Chentz, a bankruptcy partner formerly with DLA Piper in Los Angeles in anticipation of continuing financial distress in real estate and health care. In the same month, Margaret M. Mann, formerly the chair of Heller Ehrman's restructuring practice, jumped to Sheppard Mullin Richter & Hampton's San Diego office.

Although Murphy expects the amount of bankruptcy work to continue growing, he expects some uncertainty associated with the shaky economy.

"I think bankruptcy lawyers and other professionals are in the waiting for the other shoe to drop situation," Murphy said. "There are a lot of reasons to suggest that the volume and complexity of bankruptcy work will grow in coming months or years, but it all depends on how long and severe the business recession is and how long and severe the contraction of liquidity in the economy and financial markets turns out to be."

Rutan & Tucker's Parmes said a freeze in the home-building sector has exploded the volume of her work since November. She represents a lender, California Bank & Trust, in the Chapter 11 proceedings of home builder Reynen & Bardis, a Sacramento company that filed for bankruptcy in April. As its construction projects stopped, Reynen & Bardis found itself owing about \$750 million to its lenders, including about \$10 million to Parmes' client. Such cases are typical in the current economic times, she said.

"A developer says, 'I will continue to build these houses, and then I put them on the market. But the price of houses has dropped so dramatically, I won't get money out of it,'" Parmes said.

"As a result of that," she said, "so many housing developers have stopped building. Housing developers are in significant trouble."

The stress has spread to other sectors, as well, Parmes said. The May announcement that retail giant Linens 'n Things was filing Chapter 11 and closing 120 stores, a quarter of which are in California, indicated that industries outside of finance and real estate will not be immune to the ripple effects of subprime woes. Parmes represents a California landlord in the case.

Although most corporate bankruptcies are filed on the East Coast, Southern California bankruptcy attorneys took on their share of those related to the subprime industry.

Winston & Strawn's Los Angeles attorneys are representing creditors of People's Choice Home Loan, a major subprime lender that filed for Chapter 11 in 2007, in cases pending in the U.S. Bankruptcy Court of the Central District of California.

Ownit Mortgage Solutions, a subprime lender based in Agoura Hills, hired Pachulski Stang Ziehl & Jones to represent it in a Chapter 11 proceeding in 2007, also in California's Central District.

As more companies become financially vulnerable, one area of bankruptcy work that has seen a boost in recent months is in the sale of troubled companies.

Robert A. Klyman, a bankruptcy mergers and acquisitions partner in Latham & Watkins' Los Angeles office, represented Los Angeles-based Yucapia Companies in its 2007 takeover of Allied Holdings, one of the largest automobile transporters in North America, which filed for bankruptcy in 2005.

Klyman said a number of companies have become increasingly interested in buying up distressed companies, and he hopes for the interest to continue during the troubled economic times.

"A lot of it's going to be driven by how tight the credit market continues to be," Klyman said. "If financial institutions and investment banks don't want to make loans, I think I will see great opportunities."