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Salvaging Drexel: the 'inside' story

By Gwen Finegan

The prodigious efforts of one woman largely are responsible for creditors and shareholders recouping anything from bankrupt Drexel Burnham Lambert Inc.

Deborah Hicks Midanek, a former Drexel employee and now managing director of Montgomery Asset Management L.P., San Francisco, was a significant force behind the reorganization — rather than liquidation — of Drexel.

Although Drexel's fall was trumpeted by many as proof of the financial excesses of the 1980s, the importance of its reorganization into New Street Capital Corp. (named for the street

behind Drexel where its garbage containers were kept) has been unchronicled.

Drexel's reorganization was significant because it:

- showed a securities firm, a service business with no fixed assets, has the potential to reorganize;
- resolved more than \$30 billion in claims and emerged from bankruptcy in a little more than two years, record time for such a complex case;
- established a number of legal precedents, especially with respect to the Employee Retirement Income Security Act;
- illustrated the value of an independent board of directors in an extremely contentious situation; and
- proved an equity committee can

significantly influence the outcome, despite its weak position in the hierarchy of claims.

More than \$30 billion of senior claims was outstanding when Drexel's plan of reorganization was approved by the bankruptcy court and the various parties involved last March. Employee shareholders, who owned about 75% of the stock, stand to receive a recovery valued at that time at \$35.3 million.

That's a 5% minimum recovery (Drexel claimed a net worth of about \$700 million at the time of the bankruptcy filing). In many corporate insolvencies, shareholders receive nothing; in this one, it is particularly noteworthy in view of the more than \$30 billion in senior claims.

The firm's employees will participate in the fortunes of the two entities resulting from the reorganization.

Former Drexel shareholders now own warrants to purchase shares in Drexel's legal successor, New Street Capital, a merchant bank holding about \$400 million in assets culled from the bankrupt Drexel. They also have received certificates of beneficial interest in DBL Liquidating Trust, owner of New Street and other assets inherited from Drexel.

But there's another story behind the numbers, a tale of how all of the warring constituents came together to reorganize Drexel Burnham Lambert. Much of that story is Ms. Midanek's.

Ms. Midanek built a list of Drexel shareholders; organized the employee shareholders following the bankruptcy; chaired the court-appointed equity committee; lobbied for an independent board of directors of which she became a member; and pushed to reorganize.

"Many of the things we accomplished could not have been done without her," said Claude Montgomery, legal counsel to the equity committee.

Ms. Midanek's equity committee was the only voice asking for an independent board of directors and reorganization. The reorganization, which wouldn't have oc-



Deborah Hicks Midanek helped pull together the scraps of troubled Drexel Burnham Lambert for its shareholders and creditors.

curred without the actions of the resulting independent board, is potent testimony to the power of effective shareholder representation.

The equity committee "spark-plugged" the reorganization effort, said Ralph Saul, chairman of Drexel's independent board and former chairman of CIGNA Corp.

If the reorganization plan had not been approved by the court, the alternative was Chapter 7 liquidation.

Liquidation likely would have involved an immediate sale of the assets held by the Drexel estate, many of them severely depressed by conditions in the high-yield bond market at the time, which would have reduced recoveries substantially.

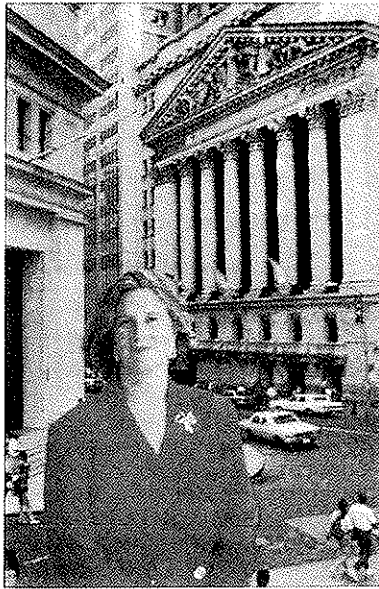
Liquidation, however, also would have greatly increased the potential for litigation. Lawsuits could continue as long as \$1 of value remains, and it's possible no assets would have remained intact for creditors or shareholders to claim.

One little-known accomplishment is the ERISA settlement, crafted by attorneys at Milgrim Thomajan & Lee (now Varet Marcus & Pink). Ms. Midanek and her equity committee successfully pushed the concept that shares held by the employees — purchased as a condition of employment and salable only upon death or termination — were more properly defined as a form of deferred compensation. Management, the committee said, was subject to the fiduciary standards of ERISA, and management had breached its fiduciary duty by not disclosing to its shareholders the extent and adverse effect of civil and criminal violations of securities laws.

When Drexel filed for Chapter 11 bankruptcy protection, Ms. Midanek had just given notice. After toiling in obscurity in Drexel's mortgage-backed securities area, she was leaving to start her own business — Solon Asset Management (which since has been bought by Montgomery Asset Management).

When Fred Joseph, Drexel's chief executive officer at the time, announced the firm was filing for bankruptcy protection and would be liquidated, she stood in shock with hundreds of fellow employees on the trading floor in New York.

Ms. Midanek quickly realized



Deborah Hicks Midanek was a driving force behind Drexel's reorganization.

that, in the chaos to follow, her colleagues would scatter in all directions as they were laid off or found new jobs. Armed with a clipboard, she started then and there to collect home addresses. Her list proved essential, because no directory of employee shareholders was available.

With advice from Milgrim Thomajan & Lee, Ms. Midanek called a meeting of shareholders to discuss equity representation in the bankruptcy. She wrote, copied and distributed a memo to announce the meeting. She spent hours rushing from one floor to the next, traveling up and down the elevator banks, and, with supplies disrupted, changing copy machines as they ran out of paper.

Ms. Midanek quizzed passers-by, "Are you a shareholder? Are you a shareholder?" Even the building's security guards directed despondent, now jobless, Drexel employees to her.

Several hundred shareholders showed up at the meeting at the New York Society of Securities Analysts, three days after the memo was circulated and 10 days after the filing. After listening to Ms. Midanek discuss the need for representation in the proceedings, the attendees agreed to petition the bankruptcy court for official status as an equity committee. That status was granted in April

1990, and Ms. Midanek, although very near the bottom in number of shares, was elected chairman. The remaining eight members of the committee were among the top 10% of shareholders.

As legal counsel, Mr. Montgomery worked around the clock with Ms. Midanek to give her a crash course in bankruptcy law. As a result, the pair was "the driving force" behind the formation of an independent board, Mr. Montgomery said.

Indeed, he said, attorneys at Weil, Gotshal & Manges, representing Drexel, "referred to us as the 'Praetorian Guard of (New Street),' " referring to the powerful Roman bodyguards who could make or break emperors.

Ms. Midanek's equity committee was the first committee to suggest reorganization, not liquidation. Otherwise, shareholders likely would never have recovered a penny of their money. The creditors were pushing for liquidation, and management had assumed initially that its role would be supervising the winding down of operations and disposal of assets.

Ms. Midanek and the equity committee also became convinced that reorganization and a restructured board of directors were in the best interests of the equity holders. Yet when she proposed an independent board, Mr. Joseph was strongly opposed. The majority of the nine-member board at that point was company officers who still reported directly to him.

Mr. Joseph countered with a compromise: He'd agree to add two shareholders, and Ms. Midanek could be one of them. She refused on the grounds that if management did not agree to allow a board independent of management, the creditors likely would take it all.

When management presented its first reorganization plan in June 1990, it was met with hoots of derision. Many creditors had been threatening legal action to remove management; in fact, 97 lawyers attended the meeting. John Sorte, who had just replaced Mr. Joseph as CEO, was heard to lament: "I don't have even one committee supporting me."

As head of the equity committee, Ms. Midanek offered management the support of her committee in exchange for a truly independent board. On July 18, following six weeks of negotiations, four board members re-