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NAVIGATING THE MINEFIELDS OF REPRESENTING CHAPTER 11 COMMITTEES – GETTING EMPLOYED, MANAGING INTER-COMMITTEE CONFLICTS AND COMPLYING WITH BAPCPA

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A. While There Is No Clear Right To Carve-Outs For Committee Professionals' Fees, Such Carve-Outs Are Justified By Important Policy Goals And Should, In Many Jurisdictions, Be Viewed As The Practical Rule And Not The Exception.

In some cases, in the context of a cash collateral or post-petition financing stipulation with the debtor, debtor's secured lenders may resist providing for a "carve-out" for the payment of the post-petition fees and expenses of the official committee(s) and its counsel and other professionals. Such carve-outs have been defined as "agreement[s] by a party secured by all or some of the assets of the estate to allow some portion of its lien proceeds to be paid to others, i.e., to carve-out its lien position."[1] Because a carve-out is a charge against its collateral, secured lenders argue that they should have the sole right and discretion to determine who, if anyone, will benefit from the subject carve-out.[2]

On the other hand, creditors' committees have reasoned and argued that the absence of a carve-out for committee professionals would greatly undermine the committee's role and functions in the case, including as a "watchdog" of the debtor and secured lender and the bankruptcy process. Some courts specifically addressing this issue have rejected such arguments, observing that, while a committee's role in the bankruptcy case is generally important, a secured lender's willingness to advance cash collateral and/or provide other financing accommodations to fund the bankruptcy case is critical as well.[3]

The Ninth Circuit in In re Cooper Commons, LLC, 424 F.3d 963 (9th Cir.), amended by 430 F.3d 1215 (9th Cir. 2005), reinforced, to at least some extent, the basic argument that post-petition lenders should have wide discretion to specify the use of loan proceeds, including for case professionals. There, at the outset, the secured lender had agreed to a carve-out for certain professionals, including the debtor's counsel; however, it is unclear from the factual background

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[1] In re Fortier, 299 B.R. 183, 191 n.14 (Bankr. W.D. Mich. 2003) (quoting In re White Glove, Inc., Case No. 98-12493 (DWS), 1998 WL 731611, at *6 (Bankr. E.D. Pa. Oct. 14, 1998)), rev'd and remanded on other grounds, 315 B.R. 829 (W.D. Mich. 2004).

[2] See, e.g., In re Nuclear Imaging Systems, Inc., 270 B.R. 365 (Bankr. E.D. Pa. 2001) (allowing secured lender to designate certain administrative claimants in carve-out); In re Jones Truck Lines, Inc., 156 B.R. 608, 611 (W.D. Ark. 1992); In re Hotel Syracuse, Inc., 275 B.R. 679, 683 (Bankr. N.D.N.Y. 2002) ("The argument, equitable in nature, has been made that where a secured creditor has liens on substantially all of the debtor's assets and either refuses to permit a carve out altogether or where, as here, singles out one administrative claimant to the exclusion of others, it effectively controls the outcome of a large Chapter 11 case. The argument is also made that by allowing the secured creditor to pick and choose the subjects of its largess, it in effect denies certain constituencies (e.g., the creditors committee) effective legal representation. While this argument is tempting, it is just not supported by the law."); In re Labelon Corp., 2006 Bankr. LEXIS 649, at *12 (Bankr. W.D. N.Y. Mar. 24, 2006) ("There is no provision in the Bankruptcy Code or Rules for a Bankruptcy Court to require that there be a carve-out for professionals … in Chapter 11 cases where a prepetition secured creditor has liens on all of the debtor's property, so that there are no free and clear assets available for the payment of administrative expenses. As a result, this Court has never required a secured creditor to grant such a carve-out or become involved in any negotiations for the terms of a carve-out, leaving that to the interested parties.").

[3] See, e.g., Jones Trucking, 156 B.R. at 614 (secured lender has "tremendous" leverage over the liquidation of a debtor company and carve-out will not be required if it would "jeopardize the bank's role in advancing the cash collateral").

provided in the opinion whether any committee professionals were included in the carve-out. Subsequently, a trustee was appointed in this Chapter 11 case, and, before the lapse of the existing financing stipulation, the trustee and lender stipulated to a limited carve-out only for the trustee and his professionals. Not surprisingly, former debtor's counsel was not expressly included within the scope of the carve-out ongoing. Debtor's counsel objected to the approval of the trustee's motion related to this arrangement, but lost at the lower levels. On appeal, debtor's counsel sought several alternative forms of relief: (i) that the Ninth Circuit declare the financing arrangement invalid and order the trustee and lender to renegotiate, this time without ignoring the claims of prior estate professionals, (ii) that the carve-out earmarked for the trustee and his professionals be distributed pro rata among all of the administrative claimants, including debtor's counsel, or (iii) that the court order the lender to loan additional money adequate to cover debtor's counsel's fee demands (subject to the same terms as the existing arrangement). The Ninth Circuit held, among other things, that, because debtor's counsel had failed to obtain a stay of the bankruptcy court order pending appeal, debtor's counsel's claim was mooted because the relief sought would "affect the validity of [the lender's] debt" in contravention of Bankruptcy Code section 364(e).[4] The Cooper Commons court reiterated that section 364(e) was intended to broadly protect any requirement or obligation that was part of a post-petition creditor's agreement to finance, in order to "overcome a good faith lender's reluctance to extend financing in a bankruptcy context by permitting reliance on a bankruptcy judge's authorization."[5] The relief sought by debtor's counsel would disrupt the deference evidenced in the statute:

> [Lender]'s motive in lending money was to ensure the completion of the [debtor's] condominium project; payments to professionals whose services were no longer retained would not likely help. Further, since any unused funds were to be returned to [lender], it was clearly in [lender]'s interest to limit the number of claimants [within the scope of the carve-out]. [Lender]'s interest in loaning only the amount it agreed on and not some larger sum is also transparent. We conclude that the financing agreement cannot be undone, the [carve-out] cannot be ordered redistributed, and the loan amount cannot be adjusted upward ….[6]

Because the bankruptcy court's finding that the lender had acted in good faith for the purposes of section 364(e) was not clearly erroneous, the Ninth Circuit affirmed the lower court decision.

Arguably, such decisions may be cited as support for the proposition that it is generally within the secured lender's discretion to agree or refuse as to the scope and extent of carve-outs, if any, but there is at least some support for the position that material limits should be imposed on such discretion, especially when it comes to committee professionals. For example, the court in In re Ames Department Stores, Inc., 115 B.R. 34 (Bankr. S.D. N.Y. 1990), observed:

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[4] Section 364(e) provides that "[t]he reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith … unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal."

[5] 430 F.3d at 1219 (quoting In re EDC Holding Co., 676 F.2d 945, 947 (7th Cir. 1982)).

[6] Id. at 1220.

> [I]t has been the uniform practice in this Court … to insist on a carve out from a super-priority status and post-petition lien in a reasonable amount designed to provide for payment of the fees of debtor's and the committees' counsel and possible trustee's counsel in order to preserve the adversary system [in bankruptcy cases]. Absent such protection, the collective rights and expectations of all parties-in-interest are sorely prejudiced…. A failure to provide a reasonable sum for professionals has, in other cases before this Court, left estates, creditors' committees and trustees without the assistance of counsel and the Court without the adversary system contemplated by Congress in 1978 when it, in enacting the Bankruptcy Code, recast the role of bankruptcy judges principally to one of resolving disputes.[7]

Moreover, the bankruptcy courts in a number of jurisdictions have promulgated either in their local rules or in general orders that the norm is for there to be a carve-out for committee professionals' fees and expenses and thus, by implication, any proposed financing order without such a provision would be extraordinary and unlikely to be approved absent exceptional circumstances.[8] Essentially as a matter of public policy, some courts appear wary of having the bankruptcy process unreasonably skewed in favor of the debtor's secured lenders, to the detriment of the debtor, its estate and creditors.[9]

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[7] 115 B.R. at 38, 40.

[8] See, e.g., Bankr. D. Del. Local Rule 4001-2 (in cash collateral/financing motion, movant must highlight any "[p]rovisions that provide disparate treatment for the professionals retained by a creditors' committee from that provided for the professionals retained by the debtor with respect to a professional fee carveout" and must explain justification for such provision); General Order No. M-274 of the United States Bankruptcy Court for the Southern District of New York, pp. 2, 10-11 ("Extraordinary Provisions" in proposed financing request "ordinarily will not be approved in interim orders without substantial cause shown, compelling circumstances and reasonable notice"; "Provisions relating to a carve-out that will be considered 'extraordinary' include those that provide disparate treatment for the professionals retained by the Committee compared to professionals retained by the debtor …, [and] the reasonable expenses of Committee members …; however, reasonable allocations among such expenses can be proposed, and the lender may refuse to include in a carve-out the costs of litigation against it (but not the costs of investigating whether any claims or causes of action exist)."); Bankr. N.D.Ill. Local Rule 4001-2 (movant must highlight in financing motion "[p]rovisions that provide treatment for the professionals retained by a committee appointed by the United States Trustee different from that provided for the professionals retained by the debtor with respect to a professional fee carve-out, and provisions that limit the committee counsel's use of the carve-out"); General Order 82 of United States Bankruptcy Court of the District of Arizona, pp. 2, 3 (movant in cash collateral use and/or financing motion must expressly state and explain therein if there is a carve-out for debtor's professionals but not one for committee professionals; "Absent extraordinary circumstances, the Court will ordinarily not grant such a motion that includes any of the provisions listed above on an interim or accelerated basis, and such provisions may be excluded even from 'final' orders …, unless an official creditors' committee has had sufficient time to be appointed, organize, engage professional(s), and analyze and investigate the requested relief with the advice of such professional(s)."). See also Scott D. Cousins, *Postpetition Financing Of Dot-Coms,* 27 DEL. J. CORP. L. 759, 784 ("While the Delaware Bankruptcy Court does not require that a 'carve out' be included in both DIP financing and cash collateral orders, if the lender grants a carve out, it generally must be shared equally between all estate-compensated professionals, unless the professionals agree otherwise. [At] a minimum, the carve out must include professionals employed by any official committee"); see also In re Ben Franklin Retail Store, Inc., 210 B.R. 315 (Bankr. N.D. Ill. 1997) (rejecting secured party's attempt to compensate debtor's counsel to the exclusion of other estate professionals on the ground that the proceeds of collateral are estate property, subject to estate distribution rules, notwithstanding secured party's lien in those assets).

[9] See also In re Evanston Beauty Supply, Inc., 136 B.R. 171, 177 (Bankr. N.D. Ill. 1992) ("Negotiated 'carveouts' … are viewed as being necessary in order to preserve the balance of the adversary system in reorganization….

While perhaps there is little reported case law requiring the inclusion of a carve-out for committee professionals' fees and expenses in any cash collateral or financing arrangement, based on the practices of various courts (as reflected in their local rules and standing general orders), official committees should nonetheless have some leverage and basis to insist on a reasonable carve-out.

B. Lessons Gleaned From the *FiberMark* and *Meridian* Cases: Potential Problems For Committee Counsel.

1. Introduction

Recent developments in two bankruptcy cases, In re FiberMark, Inc., Case No. 04-10463 (Bankr. D.Vt.) ("FiberMark"), and In re Meridian Automotive Systems – Composite Operations, Inc., Case No. 05-11168 (MFW) (Bankr. D.Del.) ("Meridian"), raise issues of serious concern for counsel (prospective or actual) for official committees. Specifically, in light of the events in FiberMark, counsel should be wary of creating in substance and just as importantly, creating the appearance of any improper alliance between it and only certain members of the committee.[10] And, the decision in Meridian underscores the importance of counsel making sure that there are no potential or actual conflicts of interest and if unsure, that they err on the side of caution and try to obtain clear and express waivers from prior clients.[11] As these cases illustrate, if the committee's attorneys fall short of their fiduciary duty and other appropriate rules, they stand to suffer adverse consequences including disqualification of the law firm or disallowance or reduction of fees incurred in the committee representation.

'Carveouts' are used in order to avoid skewing the necessary balance of debtor and creditor protection needed to foster the reorganization process. Same is designed to accommodate all classes of creditors and equity interests, rather than one especially crafted for the benefit of the pre-petition lender having a perfected lien on all cash collateral ….") (emphasis added). We note that the basis for an official committee to argue for a carve-out in its favor seems to stem from the committee's general standing to object to a proposed cash-collateral or financing order that is not in the best interest of the committee's constituency and to move for appropriate relief under Bankruptcy Code section 105(a). That is, there is no explicit basis or support under Bankruptcy Code sections 363(c) or 506(c) for a committee to object specifically to the lack of a committee counsel carve-out, thus, arguably, weakening a committee's call for a carve-out. It may have been argued previously that a committee has independent standing and basis to call for a committee counsel carve-out by virtue of section 506(c)'s surcharge provisions. However, the Supreme Court in Hartford Underwriter's Insurance Co. v. Union Planters Bank N.A. (In re Hen House Interstate, Inc.), 530 U.S. 1 (2000), held that the surcharge provisions are not available to any party other than the debtor-in-possession or trustee. With an official committee having no independent ability to surcharge a secured creditor's collateral, section 506 cannot be used by committees as a vehicle to force a committee counsel carve-out.

[10] An attorney serving as counsel to a committee is a fiduciary of the entire committee and the creditors represented by the committee and, thus, has obligations of fidelity, undivided loyalty and impartial service. See generally Woods v. City Nat'l Bank & Trust Co., 312 U.S. 262 (1941) (committee member undertakes to act in fiduciary capacity on behalf of members of entire class he or she represents), reh'g denied by 312 U.S. 715 (1941); Pan Am Corp. v. Delta Airlines Inc., 175 B.R. 438, 514 (S.D.N.Y. 1994) (creditors' committees have fiduciary duty to entire class of creditors); In re Mesta Machine Co., 67 B.R. 151, 158 (Bankr. W.D. Pa. 1986) ("[c]ounsel to a creditors' committee directly owes fiduciary duties to the Court and to the creditors' committee as officers of the Court"; citing In re Arlan's Department Stores, Inc., 615 F.2d 925, 941 (2d Cir. 1979)); In re Johns-Manville, 26 B.R. 919, 925 (Bankr. S.D.N.Y. 1983) (committee representative or agent is in breach of fiduciary duty if he or she represents or advances interests of individual creditors, and not the committee and its constituency).

[11] While the Meridian case dealt with the representation of an informal committee, the same general concern should also be considered by lawyers when contemplating to represent and when representing an official committee.

2. ***FiberMark***

In the FiberMark bankruptcy case, based on a series of pleadings, the court sua sponte appointed an examiner, Harvey R. Miller (the "Examiner"), to investigate, among other things, whether any member of the official committee of unsecured creditors (the "FiberMark Committee" or "Committee") breached its fiduciary duty to act in the best interest of all creditors. After an extensive examination, the FiberMark Examiner submitted his report (the "Examiner's Report"),[12] in which he set forth and detailed his conclusions that, inter alia, two Committee members – AIG Global Investment Corp. ("AIG"), the Committee chair, and Post Advisory Group, LLC ("Post") – had breached their fiduciary duties by basically putting their own interests ahead of the Committee and the entire unsecured creditor class, and in connection therewith, Committee counsel – Akin, Gump, Strauss, Hauer & Feld, LLP ("Akin") – had failed at certain points to objectively and in an independent and disinterested manner represent the interests of the full Committee and its constituency.

More specifically, according to the Examiner, AIG, holder of approximately $65 million or close to 20% of principal amount of FiberMark's public notes, believed that "the debtor should be totally subservient and responsive to the directions of its substantial creditors or its creditors' committee" and created "an atmosphere of stress, anger, distrust and accusations by [the AIG Committee representative] of professional misconduct by FiberMark's attorneys and financial advisors and ineptitude on the part of FiberMark."[13] In connection therewith, "the conduct of [the AIG representative] … caused disharmony among the members of the Committee. [The AIG representative's] desire for control and disrespect for the views of others resulted in a dysfunctional Committee …."[14] As set forth in the Examiner's Report, "[the AIG representative] dominated the activities of the Committee. Indeed, to a large measure, [the representative], with the support of the Committee's professionals, in effect, was the Committee," while another Committee member, Post, for the most part supported AIG in its purportedly improper actions.[15]

According to the Examiner, Akin facilitated explicitly at times and tacitly at other times AIG's self-interested domination of the Committee and thus exacerbated the situation, resulting in actions being taken through the Committee delaying important matters in the bankruptcy case, including an ultimate resolution of the case through a confirmed reorganization plan. The Examiner maintained that Akin took certain improper actions including the following[16]:

(i) In furtherance of AIG's self-interested agenda and approach in the bankruptcy case, instead of trying to facilitate negotiations with the debtors and their professionals in the hopes of an expeditious exit from bankruptcy, Akin adopted a belligerent, litigious attitude on material issues that arose (such as the debtors' proposed KERP and the post-

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[12] See "Report of Harvey R. Miller, As Examiner" (August 16, 2005 Version), Case No. 04-10463 (Bankr. D.Vt.), Docket No. 1805.
[13] Examiner's Report, p. 3.
[14] Id.
[15] Id. at p. 4.
[16] Certainly, we express no opinion on the accuracy of the Examiner's findings as to Akin, and while, as discussed herein, Akin subsequently entered into a settlement with respect to its fees, Akin has denied any liability.

emergence shareholders' agreement and other corporate governance and reorganization plan related matters) and, which, according to the Examiner, resulted in costly and unnecessary delay and expense.

(ii) The Examiner concluded that Akin, notwithstanding the complaints of at least one Committee member, essentially did nothing to rectify the exclusionary actions of AIG's representative as to Committee matters (designed to usurp control of the Committee for the benefit of AIG and at the expense of the other members) and failed to adequately provide guidance to Committee members as to their fiduciary duties. The Examiner believed that Akin basically took instructions from AIG (and at times, Post) and, in fact, rarely consulted with and advised Committee members other than AIG on critical issues, including issues regarding the formulation of a reorganization plan, and when it did consult with the other members, Akin purportedly did so act only as an afterthought or in order to give the semblance of full participation by and inclusion of all Committee members.

(iii) According to the Examiner, as to certain significant, controversial matters, Akin did not candidly provide strategic and legal advice to the full Committee. For example, while Akin attorneys had apparently expressed some misgivings internally regarding AIG's positions on certain issues, Akin apparently did not voice such views to the full Committee and instead, "Akin catered to [AIG's Committee representative] and his agenda," and "[a]s the chapter 11 case progressed, Akin became more and more an advocate for AIG and, at times, Post rather than as the independent, impartial attorneys for the full Committee."[17]

(iv) Akin also, according to the Examiner, got embroiled in intercreditor disputes involving AIG, Post and another Committee member, Silver Point Capital, L.P. ("Silver Point"), all then-noteholders which would receive most of the equity in the reorganized company and which were pursuing their own agendas and interests with respect to control of the post-emergence entity. While the one neutral Committee member voiced its concern that these matters were intercreditor issues that should be resolved by the affected parties and not treated as Committee issues, Akin purportedly facilitated AIG's efforts to try to extract concessions for its benefit from Silver Point through Committee actions such as pressing forward on allegations against Silver Point with respect to purportedly improper claims trading, despite some internal misgivings on the issues by Akin attorneys.

Based on his investigation and findings, the Examiner recommended as with respect to Akin, that some significant (unspecified) portion of Akin's requested compensation (for the period after December 1, 2004) be disallowed, and that the law firm bear its own fees and costs in connection with the examination and the corporate governance (intercreditor) dispute described in the Examiner's Report.[18]

Subsequently, Akin entered into a settlement agreement with the debtors, the U.S. Trustee and Silver Point, pursuant to which, without admitting any liability, Akin agreed to reduce its final fee request by approximately one-third.

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[17] Id., at p. 315.
[18] Id., at p. 26.

3. ***Meridian***

In the Meridian case, Stanfield Capital Partners, LLC ("Stanfield"), a pre-petition secured creditor of the debtors (with a first priority lien in some of the debtors' assets and a second priority lien in other assets) moved for disqualification of the firm, Milbank, Tweed, Hadley & McCloy ("Milbank") as counsel to an informal committee of first priority lien holders (of which Stanfield was not a member). Stanfield specifically asserted that Milbank's representation of the informal committee was in contravention of certain requirements under the Model Rules of Professional Conduct of the American Bar Association ("Model Rules"), as adopted by the local district court and bankruptcy court rules, including Rule 1.7 (Concurrent Conflict of Interest) which provides that "a lawyer shall not represent a client if the representation of … [that] client will be directly adverse to another client."[19] Prior to the bankruptcy filing, Stanfield had hired Milbank to analyze certain intercreditor issues related to the current bankruptcy case, and "[a]ccording to Stanfield, Milbank continues to represent it because Stanfield never terminated Milbank's engagement and Milbank never withdrew from the representation."[20] The Bankruptcy Court for the District of Delaware reviewed the evidence and found that, as asserted by Milbank, Stanfield had terminated this prior engagement before the bankruptcy filing.[21]

Stanfield asserted in the alternative that Milbank was in contravention of Rule 1.9 (Duties to Former Clients) of the Model Rules, which provides that "[a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing."[22] Milbank had not sought Stanfield's consent, believing that the two relevant matters (the subject matters of the prior Stanfield representation and the current committee representation) were not the same or substantially related for purposes of Rule 1.9. According to Stanfield, the prior engagement was with respect to (rather broadly) the debtors' pre-petition debt structure and the informal committee representation related to committee members' maximization of their positions vis-à-vis the other tranche of secured creditors, of which Stanfield was a part. In Stanfield's view, this ultimate purpose of the committee members created a conflict as to Milbank's role. On the other hand, Milbank asserted that the Stanfield engagement concerned a discrete refinancing transaction (an accounts receivable facility) that became mooted by the debtors' bankruptcy filing, while the committee representation dealt with intercreditor issues arising within the bankruptcy cases and which were independent of Stanfield's pre-bankruptcy refinancing plans. According to Milbank, while certain operative credit agreements were common to both engagements, the representations were "factually distinct" and did not lead to Milbank "chang[ing] sides."[23]

The Meridian court took a practical, rather than a formalistic, view of what was going on and at issue in the two engagements and determined that said engagements involved sufficiently similar and related matters:

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[19] Meridian, 2006 Bankr. LEXIS 614, at *4-*5.
[20] Id. at *5.
[21] Id. at *6-*7.
[22] Id. at *7-*8
[23] See id. at *9.

…. While Stanfield's immediate objective in hiring Milbank was to implement the proposed receivables facility, its ultimate objective was to protect its second-lien position….

…. The legal advice which Milbank is now providing to the [informal committee] concerns the same intercreditor issues, only this time Milbank is advising the first lien creditors how to protect themselves from the second lien creditors, including Stanfield….

Milbank obviously cannot advise each tranche of secured debt holders as to its rights vis-à-vis the other under the Credit Documents without 'changing sides in the matter in question.'….

Representing an adverse party in the same transaction or legal dispute frustrates the former client's expectation when seeking legal representation that 'his attorney will never be found helping the other side.'…. This is so whether or not the attorney also violates the duty of confidentiality in the process. The Court finds that Milbank's representation of Stanfield and the [informal committee] with respect to the same loan documents raises duty-of-loyalty concerns that are alone sufficient to support a violation of Model Rule 1.9.[24]

The court further noted it as irrelevant that none of the attorneys who had worked on the Stanfield matter appeared to be involved in the committee representation in that, pursuant to the Model Rules, the conflict of one attorney is imputed to his or her entire firm.[25]

4. Observations

Several lessons can be gleaned from the FiberMark and Meridian cases, including the following:

Subject to the unique circumstances of each case, attorneys for an official committee should generally strive to (i) fully inform and advise as to material issues all committee members and not only the committee chair or other select members, including by keeping all members in the information loop and spelling out the weaknesses and risks of the positions pushed for by some or all of the committee members; (ii) mediate or bridge the gap in any intra-committee disputes, including by promptly and fully responding to any concerns expressed by committee members; (iii) if necessary and appropriate, facilitate those members appearing to lack in representation due to other members trying to exert control over the committee, by, for example, proactively soliciting their comments and thoughts on material issues; (iv) recommend and have adopted early on, and ensure strict compliance with, reasonable committee bylaws, guidelines and/or protocols as to proper individual action by committee members, proper collective action

[24] Id. at *9-*11, *13 (citations omitted).
[25] Id. at *15 n.3 (citing Model Rule 1.10).

by the full committee, and the scope of members' fiduciary duties[26]; and (v) whether by such bylaws or other protocols or by clear committee vote and authorization, have clearly delineated the power and authority of the committee chairperson and other committee members and representatives. As noted, how committee counsel should approach the engagement and how it should handle specific disputes will depend on the particular circumstances and dynamics of the committee and the case. For example, it is not that uncommon in bankruptcy cases, that committee counsel has frequent communications with the committee chairperson, without broadcast to the full committee, and on some committees, there are some, considerably more vocal members, while other members may voluntarily take a more passive role. Moreover, in some cases, committee members, even those especially mindful of their fiduciary duties, will consider to some extent their own individual interests in actions to be taken or not taken by the committee, and the line between the individual and collective interests may become very blurred. In many instances, how counsel should handle a certain committee situation may be a gray-area judgment call.[27] To facilitate the process, however, committee counsel should endeavor for full and proactive consultation and disclosure, as well as transparency in all of its actions and the workings of the committee.

Further, while depending on the circumstances the particular approach may be somewhat different, attorneys should, out of an abundance of caution, be proactive in discussing any potential (or actual) conflict with former clients and should clearly and promptly document any waivers. Of course, the worst scenario is where the law firm is disqualified late in the case, to the harm of both the committee (or other client) and the law firm itself, and thus, early and prompt consideration and resolution of such issues are certainly advisable.

Overall, we believe that perhaps the big picture lesson to be gleaned from these cases is that lawyers should be above-board and transparent in their actions when it comes to representing committees, to minimize any semblance of a conflict of interest or duty. While the substance of a matter should generally be the key goal and consideration of attorneys, it is clear that process and appearance count as well.

C. New Rules for Keeping Creditors Informed: Courts Delineating the Information-Sharing Obligation Under Amended Bankruptcy Code Section 1102.

Bankruptcy Code section 1102(b)(3), as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), provides in pertinent part that a creditors' committee appointed under section 1102(a) "shall (A) provide access to information for creditors who (i) hold claims of the kind represented by the committee; and (ii) are not appointed to the committee; (B) solicit and receive comments from the creditors described in subparagraph (A); and (C) be subject to a court order that compels any additional report or disclosure to be made to

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[26] See Examiner's Report, pp. 42-45 (Akin attorneys testified that there was hostility between AIG and another Committee member, Wilmington Trust Company, from day one, which spilled over into, among various other things, disputes over how much power and authority under the Committee bylaws that AIG, as Committee chair, should have).

[27] Indeed, the impropriety or propriety of some of the actions taken by Akin, pointed out as questionable in the Examiner's Report, may be debated; depending on all of the background and surrounding circumstances, there may not be black-and-white correct actions in all instances.

the creditors described in subparagraph (A).”[28] Prior to BAPCPA, there was no such or similar provision in the Bankruptcy Code requiring the sharing of information by creditors or solicitation of comments from creditors.

On its face, section 1102(b)(3) is patently ambiguous as to the scope of these obligations, and as creditors’ committees and courts have pointed out, there is no informative legislative history on this particular provision.[29] Accordingly, upon the motion of either official committees or debtors, a number of courts have adopted procedures and protocols to flesh out this amendment and make it workable for committees, as well as debtors, including in the following cases: In re Refco Inc., Case No. 05-60006 (RDD), 336 B.R. 187 (Bankr. S.D.N.Y. 2006); In re G+G Retail, Inc., Case No. 06-10152 (RDD) (Bankr. S.D.N.Y.); In re Calpine Corp., Case No. 05-60200 (BRL) (Bankr. S.D.N.Y.); In re Amcast Automotive of Indiana, Inc., Case No. 05-33322 (FJO) (Bankr. S.D.Ind.); In re FLYi Inc., Case No. 05-20011 (MFW) (Bankr. D.Del.); In re Nobex Corp., Case No. 05-20050 (MFW) (Bankr. D.Del.); In re Pliant Corp., 06-10001 (MFW) (Bankr. D.Del.); In re Riverstone Networks Inc., 06-10110 (CSS) (Bankr. D.Del.); In re World Health Alternatives, Inc., Case No. 06-10166 (PJW). (Copies of the applicable orders entered in the Calpine, Amcast, FLYi, Pliant, Riverstone and World Health cases (“[______] Order”) are attached hereto as Exhibits A to F, as examples.)

Clearly, an overly broad information-sharing obligation on the part of committees could potentially chill a debtor from sharing confidential and other sensitive, non-public information with the committee (in the fear that such information would have to then be turned over by the committee to creditors, notwithstanding any confidentiality agreements between the debtor and committee), thus hindering and harming the committee’s role and functions in the case. Further, an overly broad construction of section 1102(b)(3) would almost certainly increase compliance expenses of committees and their counsel and other professionals, which would likely be borne by the debtors’ estates.

Based on such concerns, courts have adopted some or all of the following or similar procedures with respect to committees’ obligations under section 1102(b)(3)[30]:

(a) The committee does not have to share with creditors any confidential or privileged information or other non-public sensitive information (such as vendor relationship information, intellectual property, and/or other proprietary information that could give the debtor’s competitors an unfair advantage) obtained from the debtor or otherwise during the course of the case, based on the grounds that the public dissemination of such information could jeopardize the value of the debtor’s assets and business, prohibit meaningful discussions between the committee and debtor, create employee morale problems, potentially violate federal and state securities, privacy and/or other laws, and/or breach or waive attorney-client and/or other

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[28] This particular amended provision applies only to cases filed after October 17, 2005.

[29] See H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 87 (2005) (“Section 405(b) requires the committee to give creditors having claims of the kind represented by the committee access to information. In addition, the committee must solicit and receive comments for these creditors and, pursuant to court order, make additional reports and disclosures available to them.”).

[30] As reflected in the examples attached hereto as Exhibits, there is some variance in the level of detail in the protocols required by courts.

privileges.[31] In some cases, the committee would have reasonable discretion to decide what disclosure would be appropriate and disseminate the applicable information to creditors, provided that, for instance, as may be necessary in some cases, the creditors execute confidentiality agreements or the debtor (or other affected entity) does not object to the proposed disclosure.[32]

(b) The committee must often establish a special email address or telephone number to allow creditors to submit comments or questions, and the committee and/or its counsel must in their reasonable discretion review and/or respond to such comments and questions.[33]

(c) Often, committees have proposed and courts have authorized the setup of websites or other public databases which can be (1) accessed by creditors to obtain and review pleadings, debtors' operating reports, and other public information which the committees reasonably believe should be provided to the creditor body, and (2) used to solicit from creditors comments, questions and information requests.[34]

(d) Creditors' rights to seek specific, additional disclosure are not categorically impacted, and upon creditors' motions, the court may order additional disclosure, depending on the circumstances.[35]

In general, most courts addressing this matter have wisely come down on the side of caution, allowing committees to effectively limit the scope of the ambiguous information-sharing obligation under section 1102(b)(3); otherwise, the role and function of committees, the value of debtors' businesses and assets, and the prospects of a successful outcome in Chapter 11 cases could be jeopardized. This is not to say, however, that committees' obligations under such orders are minimal; some courts, while limiting creditors' access to confidential, privileged or sensitive information, have imposed fairly material tasks on committees to keep creditors informed of the status of and developments in the bankruptcy case.[36]

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[31] See, e.g., Refco Order (committee not required to disseminate to any entity (i) any "confidential, proprietary, or other non-public information concerning the Debtors or the Committee," and (ii) "any other information if the effect of such disclosure would constitute a general waiver of the attorney-client, work-product, or other applicable privilege possessed by the Committee"); Calpine Order (similar); Amcast Order (similar); FLYi Order (similar); Pliant Order (similar); G+G Retail Order (similar).

[32] See, e.g., Refco Order (among other things, committee may deny information request if it implicates confidential information or if it is unduly burdensome; prior notice to and opportunity to object for debtors); Calpine Order (similar); Riverstone Order (similar); Amcast Order (before releasing confidential information provided by third party, committee must obtain written consent from said third party).

[33] See, e.g., Calpine Order (special email address and telephone number required); Pliant Order (special email address required); Global Home Order (committee may establish special email address); Riverstone Order (similar).

[34] See, e.g., Refco Order (also requiring the committee to provide on website, monthly committee reports summarizing recent proceedings and events and calendar of material events, and to distribute case updates via email for creditors who have registered on the website); Calpine Order (materially similar); Pliant Order (ostensibly, less elaborate website required); G+G Retail Order (website permitted but not required).

[35] See, e.g., Calpine Order (after good faith effort to meet and confer, creditor may file motion); Amcast Order (providing for dispute resolution procedures); Pliant Order (creditors' rights to move the court for production of other or further information are not abridged or precluded); Global Home Order (same).

[36] See, e.g., Refco Order (committee required to (i) disseminate general information regarding the case on special website, (ii) provide monthly written reports of the committee summarizing recent proceedings and public financial information, (iii) highlight significant events in the case, (iv) maintain a calendar with upcoming significant events,

In many Chapter 11 cases, it would certainly make sense for the creditors' committee and its counsel to consider at the outset and, if warranted under the circumstances, seek court approval of an information-sharing and solicitation protocol along the lines discussed above, in order to clearly define the parameters of the committee's obligations under section 1102(b)(3), as well as to minimize administrative expenses and logistical difficulties. We note that it is possible that parties in interest may fight the committee on the establishment of such procedures, and substantial litigation over this and related matters may be generated. Notwithstanding that potential difficulty, many courts' response to the ambiguous language in section 1102(b)(3) appears to strike a workable, balancing act.

D. Courts' Adoption of Screening Protocols Allowing Committee Members' Post-Petition Securities Trading.

Frequently, at the outset of a bankruptcy case, parties holding a substantial amount of the debt or equity securities[37] (whether a large investment house, a hedge fund or another entity with securities) of the bankrupt company face the choice of (i) either trying to serve on an official creditors' or equity committee in the debtor company's case in order to have influence over the course of the case or (ii) forgoing such alternative so as to remain unfettered in their discretion as to the selling and trading of their debt or equity securities holdings. A creditors' or equity committee member would potentially be restricted in its buying, selling and trading of its securities holdings; for example, the committee member may, in the course of its duties, become privy to confidential information impacting the debtor's securities and the committee member could be in contravention of its fiduciary duty owed to the estate, as well as federal and state securities laws,[38] if it were to engage in trading activity with respect to the debtor's securities.

However, in order to have and exercise both of the foregoing options (instead of treating it as an "either … or" proposition), official committees, comprised of such securities owners, have begun to more commonly request court approval of, and more and more courts have authorized, "screening walls", "ethical walls" and other procedures, to enable committee members to simultaneously serve on the committees and continue to trade in the applicable securities.[39]

(v) provide access to the claims docket, (vi) provide a general overview of the chapter 11 process, (vii) provide press releases issued by the committee and debtor, (viii) provide registration forms to creditors to request "real-time" case updates via email and provide such updates, (ix) provide forms for creditors to be able to submit questions, comments and requests for access to information, and respond accordingly to such questions, comments and requests, (x) prepare answers to frequently asked questions, and (xi) provide links to relevant websites); Calpine Order (similar).

[37] A "security" includes notes, stocks and bonds, among other financial instruments. See 11 U.S.C. § 101(49)(A).

[38] Generally, securities traders are prohibited from having non-public information by Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) thereunder.

[39] Orders permitting committee members to trade their securities in the debtor corporation have been entered in numerous cases, including the following: In re Oneida Ltd., Case No. 06-10489 (ALG) (Bankru S.D.N.Y. 2006); In re Delta Airlines, Inc., Case No. 05-17923 (PCB) (Bankr. S.D.N.Y.); In re Calpine Corp., Case No. 05-60200 (BRL) (Bankr. S.D.N.Y.); In re Federated Department Stores, Inc., Case No. 90-00130, 1991 Bankr. LEXIS 288 (Bankr. S.D. Ohio Mar. 7, 1991); In re Vista Eyecare, Inc., Case No. A00-65214 (Bankr. D. Ga. 2001); In re America West Airlines, Inc., Case No. 91-07505 (Bankr. D. Ariz. 1991); In re Pacific Gas and Electric Co., Case No. 01-30923-DM (Bankr. N.D.Ca. May 18, 2001) (also applying with respect to publishing of securities related research as part of

In brief, such screening procedures are designed to ensure that insider or other non-public information obtained by the committee member does not get into the hands of the committee member's securities trading personnel.[40] The courts approving such screening walls and related procedures have held that, if said procedures and protocols are followed, the subject committee members would not, by their trading activity, be in per se violation of their fiduciary duties and their equity interests or claims would not be per se subject to disallowance, subordination or other adverse treatment on that basis.[41] The protocols established by the courts frequently share some or all of the following components:

(i) One or more representatives will be designated as the committee representative(s) ("Committee Representative") by the securities holder ("Committee Member"), which representative will be on the committee side of the screening wall and basically shielded from activities and information on the trading side of the wall.

(ii) The Committee Representative, on behalf of the Committee Member, will execute a confidentiality agreement or written acknowledgement pursuant to which the Committee Representative and Committee Member will agree to, among other things, (a) follow the screening procedures, (b) not directly or indirectly share with or circulate to any personnel involved in the trading activities of the Committee Member ("Trading Personnel") any non-public information the Committee Representative may obtain in the course of serving on the committee, (c) maintain information and documents relating to the bankruptcy case in secured files, not accessible by Trading Personnel or other personnel, and (d) notify the committee's counsel and the U.S. Trustee if the screening procedures have been breached.

(iii) Sometimes, courts have further required the Committee Representative to be shielded from information on trading in the debtor's securities in advance of trades, although the Committee Representative may be given reports and information on trades after they are completed by the Committee Member.

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committee members' business); In re Farley, Case No. 91-15610 (Bankr. N.D.Ill.); In re Pliant Corp., 06-10001 (MFW) (Bankr. D.Del.); In re Foamex International Inc., Case No. 05-12685 (PJW) (Bankr. D.Del.); In re NationsRent Inc., Case No. 01-11628 (PJW); In re GST Telecom, Inc., Case No. 00-1982 (GMS) (Bankr. Del. 2000); In re Sun Healthcare Group, Inc., Case No. 99-3657 (Bankr. D. Del. 1999); In re ICO Global Communications Servs. Inc., Case No. 99-2933 (MFW) (Bankr. D. Del. 1999); In re Acme Metals, Inc., Case No. 98-2179 (Bankr. D. Del. 1998); In re Mid Am. Waste Systems, Inc., Case No. 97-104 (Bankr. D. Del. 1997); In re Ace-Texas, Inc., Case No. 96-166 (Bankr. Del. 1996); Wherehouse Entertainment, Inc., Case No. 95-911 (Bankr. D. Del. 1995). Copies of the applicable orders in the Federated, Calpine, Pliant, Vista Eyecare and Pacific Gas and Electric cases are attached hereto as Exhibits G to K, as examples.

[40] The Securities and Exchange Commission appears to generally support such protocols adopted by bankruptcy courts. See, e.g., Federated, 1991 Bankr. LEXIS 288, at *6 (quoting from memorandum submitted by the SEC: "consistent with the requirements of the federal securities laws and the bankruptcy laws, an entity that is engaged in the trading of securities as a regular part of its business and that has implemented procedures reasonably designed to prevent the transmission to its trading personnel of information obtained through service on an official committee is not precluded from serving on the committee and, at the same time, trading in the debtor's securities").

[41] See, e.g., Calpine Order; Delta Airlines Order; Federated Order; Vista Eyecare Order. Presumably, even if the committee member adheres to the court-approved procedures, said member may take other actions or other circumstances may develop which vitiate any insulation effect that the subject order may have. Such orders should be viewed as basically establishing minimum steps that a committee member should take if it desires to trade in a debtor's securities.

(iv) Often, the Committee Member is required to monitor and report with respect to compliance with the screening procedures and notify the U.S. Trustee and/or other parties of any significant changes in the Committee Member's holdings of the debtor's securities.

Where some or all of the committee's members have material holdings of the debtor's securities, it is certainly worth having the committee consider, and if appropriate under the circumstances, seek court approval of, screening protocols so as to provide its members with flexibility and clear guidance as to post-petition trading activities.[42] The debtor's estate may benefit in that parties with material knowledge, experience and expertise, who would not be inclined to sit on an official committee if not allowed to continue with trading activity in the debtor's securities, would remain onboard and impart expertise in the applicable field and contribute to the bankruptcy case (such as through contributing to the formulation of a better reorganization plan). Further, any court order authorizing and implementing screening procedures would not provide blanket immunization to committee members; as noted, such orders provide at most that securities trading in compliance with the set procedures would not be a per se violation of the committee members' fiduciary duty, and thus, parties in interest may still assert claims if the ethical wall has in fact been breached or other improper actions are taken by the committee members. In short, the interests of the various constituencies involved in a bankruptcy case appear to be taken into account under such court-approved protocols.

E. The Perils of a Beauty Contest – Can Obtaining Too Much Information Conflict a Professional From Other Engagements in a Substantially Related Matter?

Professionals need to take particular care when interviewing for potential engagements so as not to obtain information during the interview process which can impact the professionals' ability to retain other potential clients in that matter if the professional is not retained. Consider the attorney who interviews with a company to serve as restructuring counsel and during that interview the company discloses confidential information. Is that counsel later prohibited from representing the creditors committee if he is not retained by the company? A recent decision issued by the Association of the Bar of the City of New York, Committee on Professional and Judicial Ethics ("NY State Bar"), provides some guidance on this issue.[43] The NY State Bar, in an April 2006 decision concluded that an individual lawyer should not be personally prohibited from later representing a client with materially adverse interests even if the lawyer obtained confidential information during the interview in three situations.

First, the attorney should be allowed to represent the later client unless the confidences or secrets the attorney had received from the initial prospective client could be significantly harmful to the prospective client in the litigation.

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[42] It should be noted, however, that in the typical case, courts have authorized post-petition trading, subject to the implementation of the screening walls, by only those committee members whose day-to-day business involves securities trading; thus, depending on the specific circumstances of the case, it may be difficult to obtain such court authorization as to other committee members. See, e.g., Federated Order (order and procedures therein covering only those committee members actually engaged in the trading of securities as a regular part of their business); Pliant Order (same); Pacific Gas and Electric Order (same); Vista Eyecare Order (same).

[43] Formal Opinion 2006-2, April 2006.

Second, an attorney should be allowed to undertake the later representation if, prior to the beauty contest, the attorney obtained an informed advance waiver of any conflict that might otherwise result from the prospective client sharing confidences or secrets with the attorney during the beauty contest. In order to maximize the likelihood of such a waiver being effective, a lawyer should consider having the waiver (1) in writing, (2) signed by the prospective client, (3) explain the preliminary nature of the beauty contest, (4) request that the prospective client not reveal any confidences or secrets during the beauty contest, and (5) state that, if the prospective client nonetheless divulges confidences or secrets, and the attorney is not retained by the prospective client, the prospective client waives any objection to (a) the attorney's later retention by a client whose interests may be materially adverse to the prospective client's interests, and (b) the attorney's use of the confidences and secrets in that representation. See, e.g., Bridge Prods. Inc. v. Quantum Chem. Corp., 1990 U.S. Dist. LEXIS 5019, at *10-11 (N.D. Ill. Apr. 27, 1990) (placing the burden on the attorney to make clear that "the initial meeting was purely preliminary and that confidences would not necessarily be protected").

Lastly, if the prospective client revealed confidences to the attorney without any intention of retaining the attorney but solely for the purposes of disqualifiying the counsel from later representation of an adverse party, the disclosure should not bar the later representation. That is because the reasonable expectation of confidentiality underlying the ethical restrictions on disclosure is absent, given that the prospective client's purpose in meeting the attorney as part of the beauty contest was merely to preclude the attorney from representing a future client as opposed to selecting counsel.

The NY State Bar Opinion also concluded that even if an individual attorney is conflicted from a future representation by obtaining confidential information, the conflict is not necessarily imputed to the rest of the attorneys' firm. The NY State Bar Opinion found that effective ethical screens can rebut the presumption of shared confidences or secrets, noting the following factors that courts consider in determining the efficacy of an ethical screen: (1) the timeliness of the firm's implementation of the screen; (2) the size of the firm, as courts can be skeptical of a screen's adequacy in small firms; (3) whether the personally prohibited lawyer works in proximity to the lawyers at the firm who will represent the client; (4) whether the lawyer can state that the lawyer has not shared the confidences or secrets with others at the firm, and whether other lawyers at the firm can confirm that they have not received those confidences or secrets; (5) personally prohibited lawyer works on other matters with the lawyers representing the client; and (6) whether the personally prohibited lawyer maintains files containing the confidences or secrets.