



*Twenty-First Annual*

# Distressed Investing 2014

*Maximizing Profits in the Distressed Debt Market*

## **Ethics Hour:**

**Navigating Ethical Challenges Examined by the  
American Bankruptcy Institute Ethics Task Force**

**Helmsley Park Lane Hotel  
New York City  
December 1, 2014**

**Ethics Hour:  
Navigating Ethical Challenges Examined by the  
American Bankruptcy Institute Ethics Task Force**

**Panel Moderator**  
**Jack Butler**  
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Managing Director and Founding Partner  
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**Michael P. Richman**  
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Hunton & Williams LLP

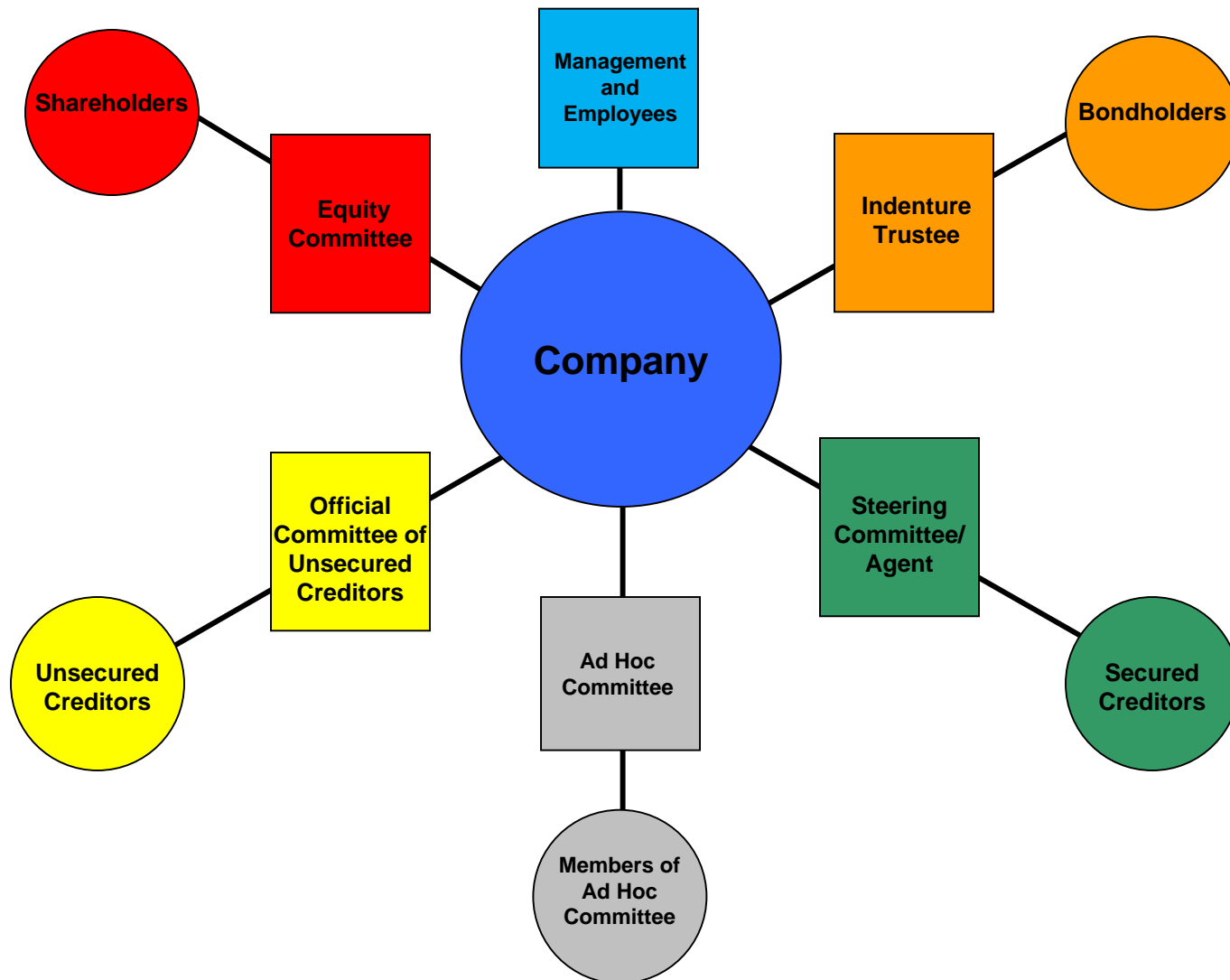
# Defining “Ethic”

noun, \e-thik\

“a set of moral principles; a theory or system of moral values (as in, ‘the present-day materialistic ethic’); the principles of conduct governing an individual or group (as in ‘professional ethics’).”

Assumes that a group has decided upon a specific moral code by which to be commonly bound.

# Restructuring Stakeholders



# Why a Task Force?

- State ethics rules do not always “fit” with realities of bankruptcy practice
- Model Rules don’t scale well to fit practice involving numerous parties with changing allegiances
- Modern practice often departs from the model of a classic two-party adversary proceeding

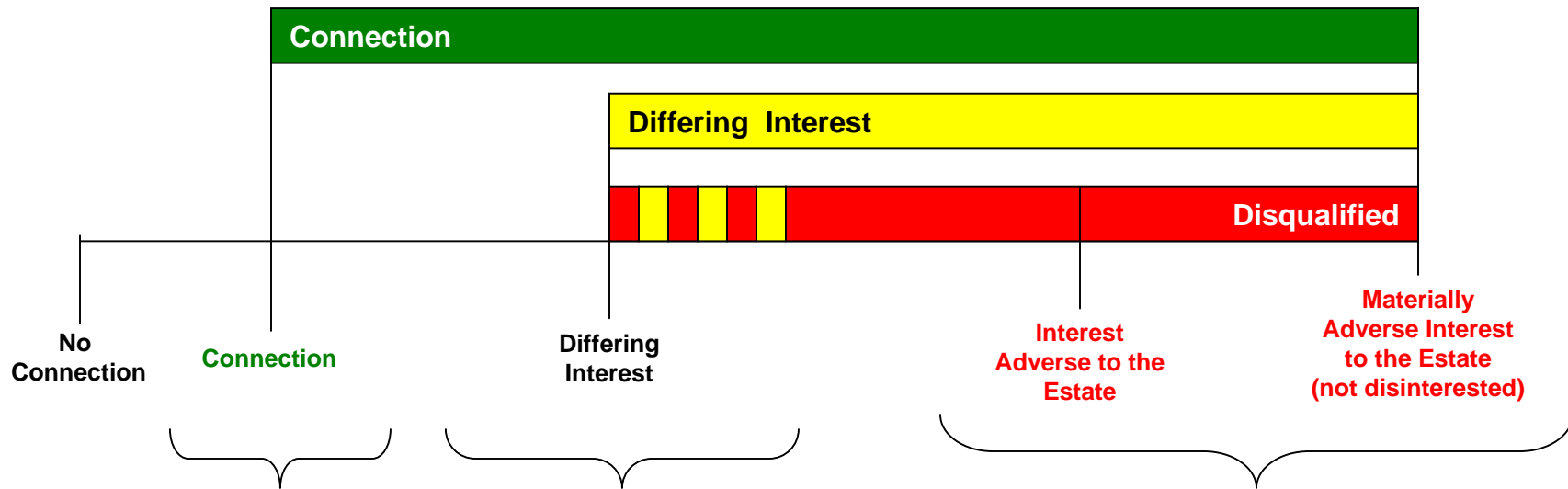
# Topics Task Force Addressed

- Fed. R. Bankr. Proc. 2014
- Duties of Counsel for “DIP as Fiduciary” & Responsibilities to the Estate
- Framework for Pre-Approval of Compensation pursuant to 11 U.S.C. §328
- Use of Conflicts Counsel in Chapter 11 Cases
- Limited Services Representation in Consumer Cases
- Competency for Debtors’ Counsel in Business & Consumer Cases
- Best Practices on Creditors’ Committee Solicitation

# Rule 2014

- Requires disclosure of facts related to actual or potential conflicts of interest by professionals seeking employment
- Does not specify extent of disclosure, provides little discretion
- “Connection” is broad but undefined
- Task Force proposed amendment that provides definition of breadth and depth of disclosure obligations

# Range of “Connectivity”



Fed. R. Bankr. P. 2014 requires disclosure of all connections that are not de minimis.

A lawyer shall not represent a client if such representation involves a “differing interest” unless certain waiver requirements are met.

Debtors’ counsel must be attorneys “that do not hold or represent an interest adverse to the estate, and that are disinterested persons.” 11 U.S.C. § 327(a). Section 101(14)(C) defines a “disinterested person” as a person that “does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.” The Bankruptcy Code specifically authorizes an attorney to concurrently represent a debtor-in-possession and a creditor (in an unrelated matter). 11 U.S.C. § 327(c) (“[A] person is not disqualified for employment under this section solely because of such person’s employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.”).



# New Proposed Rule 2014 Disclosures

New Proposed Official Form for Rule 2014 Disclosures

Name and position of professional with Relevant Connection <sup>1</sup>	Debtor	Creditor	Known or anticipated Pre-petition creditors	Equity security holders	Insiders	Investment bankers	U.S. Trustee	Customers /vendors	Parties to executory contracts or unexpired leases	Utility service providers	Governmental units and employees thereof	Committee members	Potential asset buyers	Any professional of any entity listed	Description of Relevant Connection <sup>2</sup>
Mary White, Partner		X			X		X								See ¶ a, c, & f.
Bill Black, Partner		X		X		X				X					See ¶ a, d, g & h.
Deb Gray, Associate		X		X			X								See ¶ a, d, & i.
Sam Blue, Paralegal		X													See ¶ a.

<sup>1</sup> Cross-reference with paragraph in Application itself.

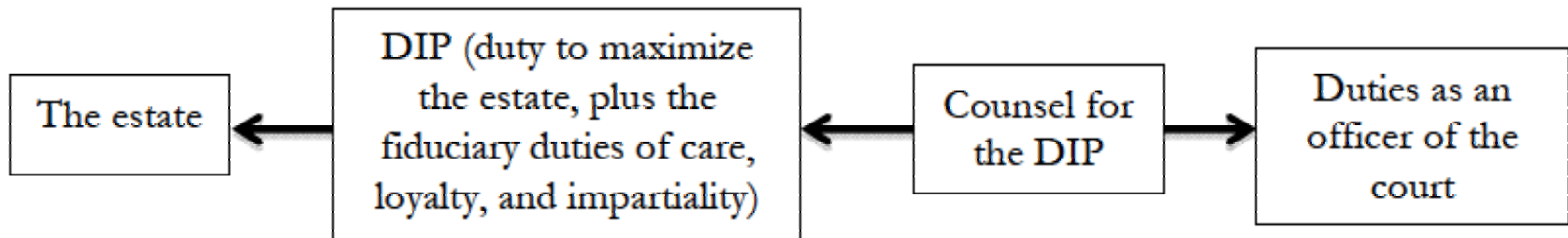
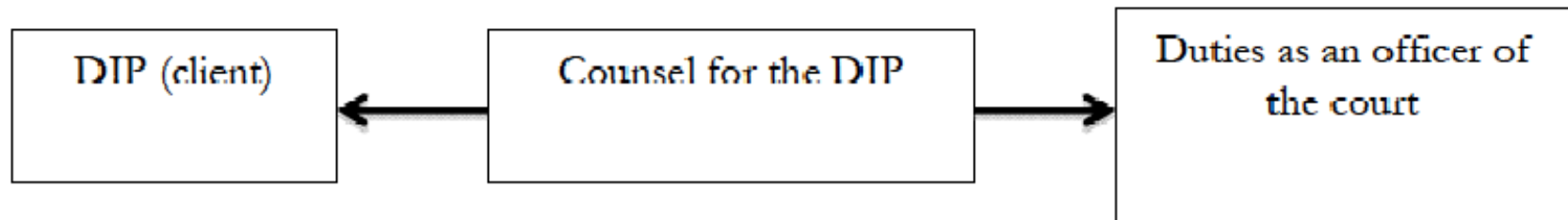
<sup>2</sup> Cross-reference with paragraph in Application itself.

This form is new and implements Revised Rule 2014, which relates to the disclosure of relevant connections for retention purposes. The individual completing the form must sign and date it. By doing so, he or she declares under penalty of perjury that the information provided is true and correct to the best of that individual's knowledge, information, and reasonable belief. The signature is also a certification that the standards of Rule 9011(b) are satisfied.

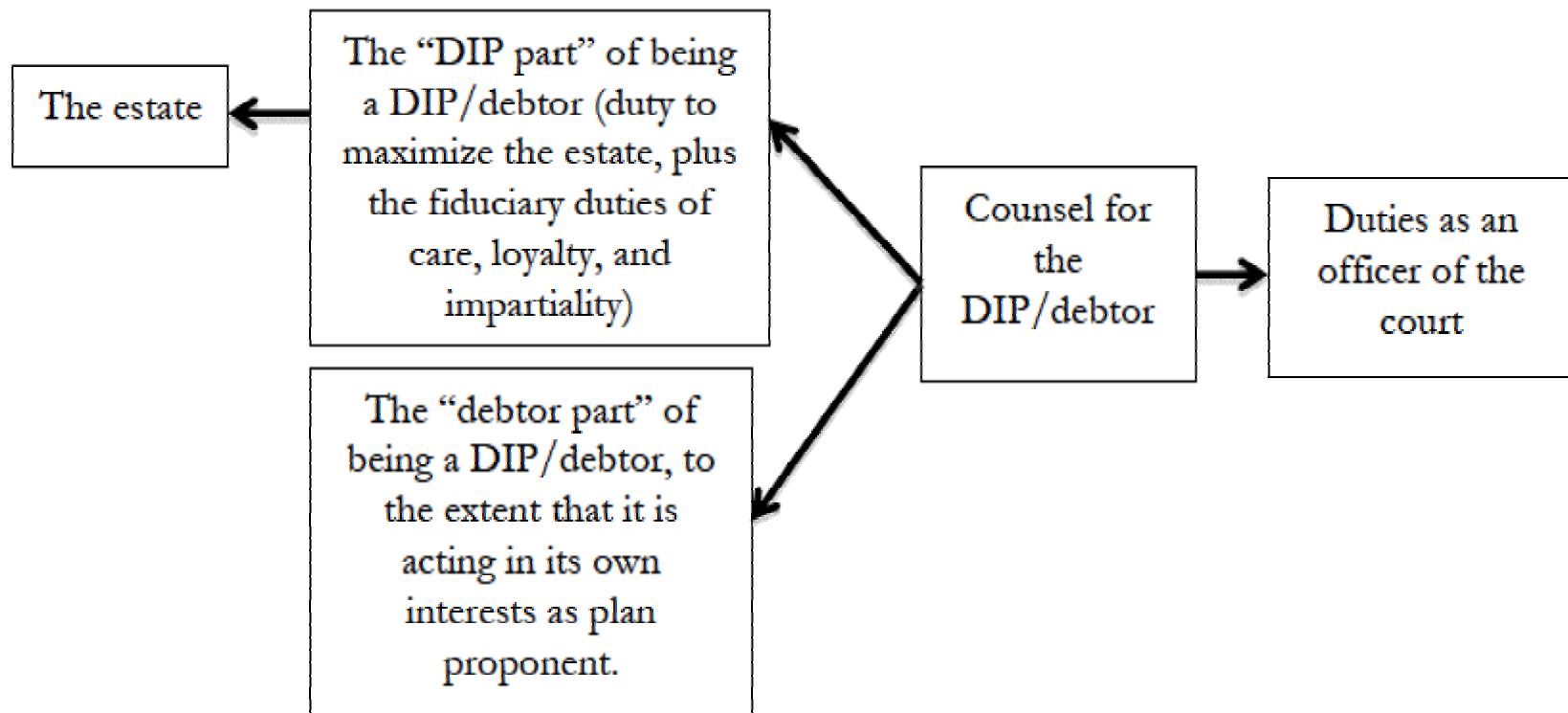
# Duties of Counsel to DIP as Fiduciary

- Counsel for Debtor versus Counsel for “Estate”
- Duties of Loyalty, Care, Impartiality
- Complexity stems from shifting nature of relationship between and among DIP, the estate, other parties in interest
- Case law and best practice presents an evolving view of where counsel fits

# Duties of Counsel to DIP as Fiduciary



# Duties of Counsel to DIP as Fiduciary



# Compensation Under § 328

- Allows for variety of “creative” compensation structures
- Elaborates Court’s latitude Court in approving compensation arrangements
- Can only be changed after approval under severe circumstances (“improvidence”, not dissatisfaction or economics)
- Higher standard of approval to meet

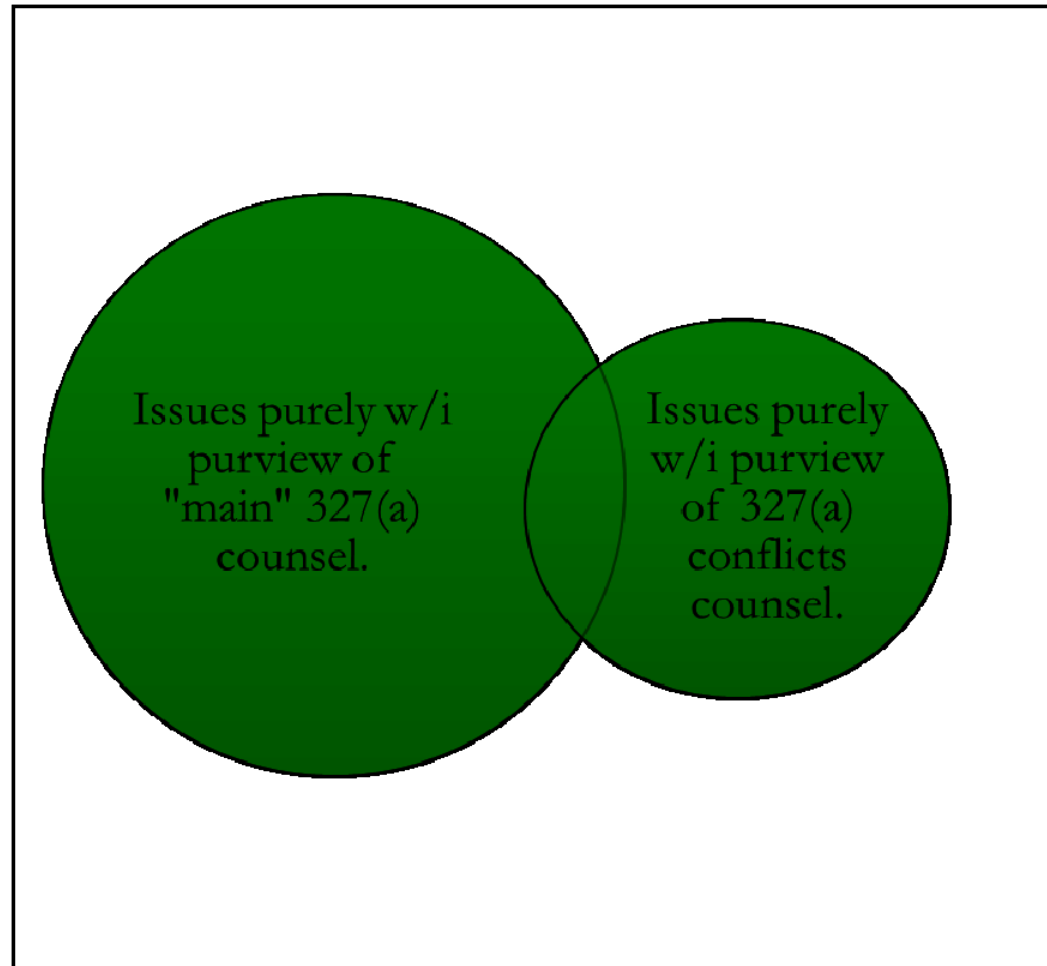
# Compensation Under § 328

- Be clear about under which section professional is seeking approval
- Court has wide discretion in determining reasonableness at the outset
- Professional seeking retention has the burden of proof
- Be mindful of state ethics rules
- Applications must contain truthful assertions supporting the compensation sought

# Conflicts Counsel in Chapter 11

- Conflicts Counsel  $\neq$  Co-Counsel
- Jurisdiction only over the “conflicted-out” issues that hinder main counsel’s appointment
- Main counsel’s Rule 2014 disclosures should articulate need for conflict counsel and why
- Avoiding duplication of efforts is crucial part of relationship
- Alternative view is that co-counsel or “efficiency” counsel who can also handle conflict matters is more efficient and in the estate’s interests

# Conflicts Counsel in Chapter 11





# Limited Services Representation

- Addresses need for Consumer debtor representation
  - Premise is “some” > “none”
- Key is clear communication and agreement on how much is “some”
- Informed client consent is paramount
- Some state rules may disallow certain aspects of LSR
  - Ghostwriting”

# Limited Services Representation

- Proposed Rule addressing key tasks, including lawyer's obligation to communicate with client
- Considers different “types” of debtors
  - No secured debt
  - With secured debt
  - Provides for “add-on” services by checklist
- Provides Model Agreement & Consent Form

# Committee Solicitation

- Inconsistency in state ethics rules, particularly Rule 7.3 (and, by extension, 8.4)
- Task Force assessed current practice
- Clear patterns of violation of Rules 7.3 and 8.4 observed by in professional survey data
- Clear questions and concerns raised by Judges
- *“We all do better when we all do better”*

# Committee Solicitation

- Recommendations include:
  - Attorneys be guided by most restrictive state Rules when choice of law questions arise
  - Pre-formation communications with creditors are disclosable under Rule 2014
  - Heed Canon 9 of the Model Code
  - No regulation of use of Proxies by UST, but guidelines for clear and consistent communication and disclosure between principal and proxy holder
  - Real and potential conflicts must be disclosed before engagement
  - Disclose, Disclose, Disclose

# Competency of Debtors' Counsel

- Bankruptcy is a complex and highly varied field of practice
- Model Rule 1.1 provides no specific guidance as to what precise skills constitute “competent”
- Objective is that debtors receive competent representation
  - Requires very different skills for Consumers in Chapter 7 versus Chapter 13, and Debtors in Chapter 11
- Provides guidelines on baseline levels of competence for counsel for Debtors
  - “Attorneys should be able to \_\_\_\_\_”

# Managing Interactions With The Company and Company Management

- Interactions with a company in financial distress and its management in the months leading up to or during a chapter 11 filing can give rise to conflicts of interest that could disqualify counsel from service as a chapter 11 debtor's counsel
- When management of a distressed company reaches out to counsel soliciting advice about its options questions relating to the compensation, duties, and retention of management are inevitable, in terms of continued employment, personal liability, insurance coverage, incentive compensation, tax matters, and similar issues
- As fiduciaries, management's focus should be, and most often is, on what is best for the company and its stakeholders

# Managing Interactions With The Company and Company Management

- While company's counsel can appropriately discuss issues of concern with management, it must navigate the discussion carefully and avoid crossing the line from providing advice to the company with respect to management issues to providing direct legal advice to individual members
- One way to fail the "adverse representation" prong of section 327 of the Bankruptcy Code would be to develop an attorney-client relationship with a member of management prior to a chapter 11 filing -- effort should be made to ensure that prepetition interactions with management cannot subsequently be construed, through the prism of hindsight, to have created such a relationship of management

# Illustrative Middle Market Conflicts

- Closely held businesses
  - Line between “client” and “Management”
  - Line between company and owners
  - Issues related to owner guarantees/pledges
- Multi-generational “family businesses” present special challenges
  - Shareholder “demands” on companies close to insolvency
  - When is “severance” a “dividend”
  - The line between TMM/ISS and breach of fiduciary duty



# Illustrative Middle Market Conflicts

- Blurred Line between Client and Relationship
  - Party that brought you to the dance often not the party to whom duty is owed
  - Pressures from management, lenders, other stakeholders
  - Fiduciary duty doesn't always exist – but when it does, obligations can change
  - Difficult to know exactly the moment actors have a fiduciary duty, and to whom

# Practice Pointers

- Upfront disclosure -- At initial meeting, state clearly that counsel represents only the company and does not represent management and discuss potential need for separate counsel for management, with whom lead counsel can work closely
- Engagement letter -- Include an express, written disclaimer in the engagement letter that counsel will not represent management and its representation of the Company will not create an attorney-client relationship with any member of management – and endeavor to obtain executed engagement letter prior to protracted interactions with company or management

# Practice Pointers

- Corporate law compliance -- In applicable cases, ensure consultation with compensation committee with respect to management issues
- Circumstance-Based Solutions – Recognize that there is no one-size-fits-all solution and tailor the response to the circumstances -- agree on a set of ground rules about what issues can and cannot be addressed by company counsel and avoid ambiguity as to the identity of the client while fully disclosing all “connections” with management



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