UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
DACCO Transmission Parts (NY), Inc., et al.,[1]	:	Case No. 16-13245 (MKV)
Debtors.	:	Jointly Administered

REPORT OF RICHARD LEVIN, EXAMINER

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March 7, 2017

[1] The Debtors in these chapter 11 cases include, among others, Transtar Holding Company. A full list of the Debtors in these chapter 11 cases and the last four digits of each Debtor's taxpayer identification number is attached as Schedule I to the Declaration of Joseph Santangelo in Support of Chapter 11 Petitions and First Day Pleadings [ECF No. 3] (the "First Day Declaration") and at http://cases.primeclerk.com/transtar. The Debtors' executive headquarters are located at 7350 Young Drive, Walton Hills, OH 44146.

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I. Executive Summary

From his appointment on December 28, 2016 through March 6, 2017, the Examiner investigated "matters related to the employment of counsel for the Debtor and Debtor in Possession, including actual or potential conflicts of interest, disinterestedness, and disclosures,"[1] ("**Counsel Employment Matters"**). The Examiner reviewed over 5,000 documents, conducted 13 interviews, and researched applicable law. The investigation required analysis of the relationship between Willkie Farr & Gallagher LLP ("**Willkie**") and three principal parties during the prepetition work-out, all of whom were Willkie clients: the debtor Transtar,[2] its principal shareholder Friedman Fleischer & Lowe, LLC ("**FFL**"), and its later-arriving controlling First Lien lender Silver Point Capital, L.P. ("**Silver Point**"). During the work-out period, the parties' financial positions shifted, affecting the legal relationships between Willkie and its clients. Accordingly, the investigation analyzed the relationships during each of five periods:

- The initial work-out period, from January through March 2016, during which Willkie was focusing on an "amend-and-extend" transaction between Transtar and its First Lien lenders and Second Lien lenders and a short-term secured loan and small equity investment from FFL.
- The second period, from April through early July 2016, during which a successful work-out with the lenders required a substantial equity infusion, which FFL appeared ready to provide.

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[1] Motion to Approve Examiner's Revised Work Plan at Ex. A, ¶¶ 5, 15, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 18, 2017), ECF No. 215; Order Approving Examiner's Revised Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Feb. 6, 2017), ECF No. 265.

[2] The debtors are Speedstar Holding Corporation ("**Speedstar**"), Transtar Holding Company ("**Transtar Holdings**"), and their direct and indirect subsidiaries (collectively "the **Debtors**," or "**Transtar**"). Declaration of Joseph Santangelo in Support of Chapter 11 Petitions and First Day Pleadings at Schedule II, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Nov. 20, 2016), ECF No. 3 ("**Santangelo Decl.**").

- The third period, from mid-July to early August, when FFL withdrew its proposal to provide an equity investment in Speedstar, and the Second Lien lenders agreed to provide the investment.
- The fourth period, from mid-August through the chapter 11 filing on November 20, 2016, when First Lien lender Silver Point dominated the negotiations.
- The postpetition period.

During the initial period, a potential conflict did not arise until negotiation of a lending transaction between FFL and Transtar. At that point, Willkie terminated its representation of FFL on Transtar matters, and, on Willkie's recommendation, FFL engaged Young Conaway Stargatt & Taylor, LLP ("**Young Conaway**") to represent it. Willkie obtained an appropriate conflict waiver from Transtar to allow Willkie to continue to represent FFL in unrelated matters.

During the second and third periods, conflict issues did not change from the initial period. In addition, during the third period, FFL's withdrawal from the pending deal mitigated any potential conflict. And counsel for the Second Lien lenders provided sufficient creditor representation in connection with any potential claims against FFL.

During the fourth period, Willkie's future conflict waiver from Transtar did not comply fully with the New York Rules of Professional Conduct. Willkie failed to check whether it represented Silver Point, and the Willkie lawyers who participated in the negotiations apparently were unaware of, or did not recall, Willkie's representation of Silver Point on unrelated matters. So Willkie could not advise Transtar with respect to the representation of potentially differing interests.

After the chapter 11 petition, Willkie's initial disclosure under Bankruptcy Rule 2014 did not include its representation of Silver Point, and its disclosure of its representation of FFL was limited. But after counsel for the U.S. Trustee questioned Willkie about its disclosure of its relationship with FFL, Willkie reviewed its disclosures and discovered that it had omitted disclosing that Silver Point was a client. It filed a supplemental disclosure on both issues before

the hearing on approval of Transtar's application for approval of Willkie's employment. Based on both disclosures, Willkie appears to have been eligible to serve as counsel under section 327(a).

The Examiner concludes that Willkie largely complied with its professional obligations. Willkie could have been more cautious in managing potential conflicts in this case, and some aspects of the Young Conaway engagement created an appearance of a lack of independence on Young Conaway's part. In sum, however, the Examiner concludes that Willkie appropriately brought independent counsel into the matter to represent FFL when the potential for a conflict first arose, and Willkie was loyal to the interests of Transtar and sought to advance Transtar's goals throughout the representation. In addition, Young Conaway appears to have been independent from any potential influence by Willkie in its representation of FFL and conducted itself in the best interests of its client FFL. Moreover, while Willkie's initial disclosures to the Court were inadequate, the omission of Silver Point as a Willkie client was an inadvertent omission by a non-lawyer, undiscovered by other members of the legal team until after the initial filing and corrected immediately by Willkie before the hearing on its engagement.

The events of this case raise questions about whether, when a private equity firm's portfolio company encounters financial distress, a law firm that represents both the private equity firm and its portfolio company should represent only the private equity firm and recommend that the portfolio company engage other counsel, and whether a supplemental disclosure declaration under Rule 2014 before the hearing on an employment application satisfies that Rule's requirements. The law does not provide clear answers; in the Conclusion, the Examiner suggests some considerations for addressing those questions.

II. Process

A. The Examiner's Appointment and Mandate

On December 16, 2016, the United States Trustee filed a motion for the appointment of an examiner to review "two discrete issues:" the apparent drop in Transtar's enterprise value over

the course of 2016 and FFL's payment of $2.5 million for a broad release of claims, including a potential fraudulent transfer claim relating to a $90 million dividend that FFL authorized and received in 2012.[3] The U.S. Trustee added:

> The Debtors have disclosed that its proposed counsel was also counsel to FFL in the past and currently – both in connection with matters germane to these proceedings as well as unrelated matters. The examiner will be requested to consider whether the relationships and connections between key players in the negotiations had any impact on the agreement.[4]

On December 22, the Court signed a Stipulation and Order By and Between the United States Trustee and Transtar for the Appointment of an Examiner (the "**Examiner Order**") directing the appointment of an examiner to investigate:

> (a) the facts and circumstances underlying and leading to the entry into and proposed approval of the Restructuring Support Agreement (including the conduct of the parties thereto, including current and former officers and directors, and their respective professionals), including all related terms, term sheets and amendments thereto, including without limitation, whether the Debtors entry into the Restructuring Support Agreement was an arm's-length transaction free of conflicts between the Debtors and their stakeholders and based on the Debtors' reasonable business judgment regarding their business plan, projections, and alternatives; (b) whether the valuation upon which the Restructuring Support Agreement is predicated is based on the Debtors' reasonable business judgment regarding their business plan, projections, and alternatives, and whether entry into the Restructuring Support Agreement is in the best interests of the estate (the "Investigation"); and (c) otherwise perform the duties of an examiner set forth in 11 U.S.C. § 1106(a)(4) of the Bankruptcy Code.[5]

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[3] United States Trustee's Motion, Pursuant to 11 U.S.C. § 1104(c)(1), for the Appointment of an Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 16, 2016), ECF No. 105.

[4] *Id.*

[5] Stipulation and Order By and Between the United States Trustee and the Debtors for the Appointment of an Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 22, 2016), ECF No. 147.

On December 28, the U.S. Trustee appointed Richard Levin as Examiner and filed with the Court a notice of the appointment and the application for approval of the appointment.[6] The Court entered an order approving the appointment that day.[7]

The Examiner filed his initial proposed work plan on January 10, 2017, which proposed an investigation into the matters identified in the Examiner Order (the "**RSA Matters**").[8] The same day, the Examiner moved for an order authorizing him to conduct examinations under Bankruptcy Rule 2004.[9] In the course of the Examiner's investigation into the RSA Matters, Silver Point and the Second Lien lenders reached an agreement on a revised chapter 11 plan. Given this settlement, and the agreement of each of the key parties in interest, on January 18, the Examiner submitted a revised work plan outlining his now modified investigation to address only Counsel Employment Matters and not RSA Matters.[10] On February 6, the Court entered an order approving the Examiner's revised work plan and imposing a March 7 deadline for the Examiner to complete his investigation and file his Report.[11]

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[6] United States Trustee's Notice of Appointment of Examiner Pursuant to 11 U.S.C. § 1104(c)(1), *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 28, 2016), ECF No. 156; United States Trustee's Application, Pursuant to Fed. R. Bankr. P. 2007.1(c), for Order Approving Appointment of Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 28, 2016), ECF No. 157.

[7] Order, Pursuant to Fed. Bankr. P. 2007.1, Approving United States Trustee's Appointment of Richard Levin as Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 28, 2016), ECF No. 158.

[8] Motion to Approve Examiner's Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 10, 2017), ECF No. 189.

[9] Examiner's Motion for an Order Authorizing the Examiner to Conduct 2004 Examinations, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 10, 2017), ECF No. 188.

[10] Motion to Approve Examiner's Revised Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 18, 2017), ECF No. 215.

[11] Order Approving Examiner's Revised Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Feb. 6, 2017), ECF No. 265.

B. The Examiner's Investigation

Between December 29, 2016 and January 7, 2017, the Examiner held telephone conferences with counsel to each of the principal parties to understand their perspectives and views on the merits of the issues raised by the Examiner Order. Over the next six weeks, the Examiner requested documents from Willkie; Latham & Watkins LLP, counsel to the Second Lien lenders; Chapman & Cutler LLP, counsel to Silver Point; and Young Conaway, counsel to FFL.

In total, the Examiner collected approximately 11,000 documents, over 5,000 of which were reviewed. Most of the documents were stored in a Relativity document management system. Documents in the Relativity system that were not responsive to search terms applied in the system were not reviewed. Every document that was not stored in the Relativity system was reviewed. The Examiner is reasonably confident that the repeated and focused searches discovered most if not all of the most relevant documents in its Relativity system.

The Examiner interviewed 13 key participants in person. Each in-person interview lasted between one and three hours. From January 10 to January 13, the Examiner interviewed Transtar CEO Edward Orzetti, Speedstar Director Brad Scher, Transtar CFO Joseph Santangelo, and Agnes Tang of Ducera Partners LLC ("**Ducera**"), financial advisor to Transtar; Jeff Forlizzi and Chaim Fortgang of Silver Point; Robert Del Genio of CDG Group, LLC, financial advisor to the First Lien lenders committee; Neil Augustine of Rothschild Inc., financial advisor to the Second Lien lenders committee; Spencer Fleischer, a Managing Director of FFL and a Transtar Director; and Kenneth Grossman, an investor in Second Lien debt.[12] The Examiner requested, received, and reviewed documents from the parties in preparation for these interviews. From February 17 to February

[12] For a list of key individuals referenced in this Report, see the glossary in Appendix A.

23, the Examiner interviewed Rachel Strickland and Neil Townsend of Willkie and Michael Nestor of Young Conaway about Counsel Employment Matters.

At the start of each interview, the Examiner admonished the participants of their obligation to respond to all questions with candor. During the interviews, the Examiner showed each participant documents produced by the parties and asked questions about them. A Jenner & Block associate attended each interview to take notes. The Examiner found that all participants were generally forthcoming and cooperative during interviews.[13]

The Examiner made additional requests for documents and information during and after interviews as needed. All requests were honored.

As the investigation drew to a close, the Examiner worked with all parties involved to minimize redactions of this Report. Under the Protective Order for Examiner Discovery entered in these cases,[14] on February 28 the Examiner emailed counsel for each party a list of documents on which the Examiner intended to rely in this Report. On March 3, counsel responded, some asserting no privilege or confidentiality, and some with a list of documents or portions of documents they considered privileged or confidential. In the interest of minimizing redactions, the Examiner responded to those parties asserting privilege or confidentiality with specific information regarding how the documents would be referenced in this Report. Through this process, the Examiner was able to resolve all claims of privilege or confidentiality and files this Report without redaction.

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[13] The Examiner notes that all of the participants keep busy schedules and yet were very accommodating during the interview scheduling process. The Examiner expresses his gratitude for each participant's cooperation.

[14] *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Feb. 6, 2017), ECF No. 264.

III. Facts

A. Pre-Workout History

1. Transtar

Transtar is the largest distributor of aftermarket automotive transmission parts in the United States.[15] Since December 2010, FFL has owned over 90% of Speedstar's common stock.[16] GE Capital had owned 1.8%, but had sold its interest in 2015 to an unrelated entity that was not a Willkie client.[17] Current or former company employees, officers, or directors owned or had rights to the remainder of Speedstar's stock.[18]

In 2012, Speedstar's Board of Directors authorized the payment of a $90 million dividend to FFL.[19] In February 2014, Transtar acquired ETX Holdings, Inc. and its subsidiaries DACCO, Inc., based in Cookeville, Tennessee; Alma Products Company, based in Alma, Michigan; and ATCO Products, Inc., based in Ferris, Texas.[20] The ETX companies supplied aftermarket transmission parts and complete transmissions; they also remanufactured torque converters and manufactured and remanufactured other automotive parts.[21] Each ETX subsidiary had an associated manufacturing and production facility.[22]

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[15] Santangelo Decl. ¶ 10.

[16] Santangelo Decl. ¶ 43. The Santangelo Declaration was unclear whether the percentages were actual ownership or fully diluted, after consideration of options and other management incentives. The exact amounts are not important for this Report.

[17] Conversation between Ben Kaminetzky and Angela Allen (Feb. 28, 2017).

[18] Santangelo Decl. ¶ 43.

[19] United States Trustee's Motion, Pursuant to 11 U.S.C. § 1104(c)(1), for the Appointment of an Examiner at 8, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 16, 2016), ECF No. 105. The Examiner Application recites that FFL received the dividend. It does not make clear whether any other shareholder(s) received it. The issue is not important for this Report.

[20] Santangelo Decl. ¶¶ 12, 18–21.

[21] *Id.* ¶ 12.

[22] *See id.* ¶¶ 18–21.

In the summer of 2015, Transtar brought on a new management team led by Chief Executive Officer Ed Orzetti.[23] Orzetti, an outsider with prior CEO experience in aftermarket automotive distribution, had not previously worked with FFL.[24] Orzetti's hiring came as Transtar's balance sheet was weakening, principally as a result of the ETX acquisition, with adjusted EBITDA dropping from $91 million in 2014 to $60 million in 2015.[25] After joining Transtar, Orzetti soon realized, and informed the Board, that Transtar had "bigger issues" than falling EBITDA; it also had issues with torque converter quality, inventory "fill-rate" at Transtar's branches, and reputation.[26]

2. Transtar's Capital Structure

As of the Petition Date, Transtar had the following debt obligations:

Facility	**Principal**	**Interest/Fees**	**Total**	**Maturity**
First Lien revolving credit facility	$45.8 MM	$2.2 MM	$48.0 MM	Oct. 9, 2017
First lien term loan facility	$358.3 MM	$18.3 MM	$376.6 MM	Oct. 9, 2017
Second lien term loan facility	$170.0 MM	$13.2 MM	$183.2 MM	Oct. 9, 2019
Total	$574.1 MM	$33.7 MM	$607.8 MM	

The facilities' interest payment dates were the last business days of March, June, September, and December of each year.[27]

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[23] TRANSTAR, *Edward H. Orzetti*, http://www.transtarholding.com/Leadership (last visited Feb. 27, 2017); Interview of Ed Orzetti (Jan. 11, 2017).

[24] *Id.*

[25] Presentation, "FTI Consulting, Inc. – Project Mission – Presentation to: Royal Bank of Canada as Agent," at 7 (Mar. 2016). [TRANSTAR-DUCERA-00000108, at 0114]

[26] Interview of Ed Orzetti (Jan. 11, 2017).

[27] Santangelo Decl. ¶¶ 35–36, 39–40.

B. Prepetition Workout Process

1. January through March 2016

a. Preliminary Creditor Discussions

In early 2016, Transtar recognized its financial difficulties and took initial steps towards obtaining relief. On January 26, 2016, Transtar began working with FTI Consulting, Inc. ("**FTI**"), which prepared financial reports and forecasts including materials for a lender presentation.[28] On March 13, 2016, Transtar engaged Ducera as financial advisor in connection with potential covenant amendments.[29] After Ducera's retention, a team from Transtar led by Orzetti and including Ducera and FTI representatives met with groups of First Lien lenders and Second Lien lenders. They discussed Transtar's business, including a draft FTI presentation analyzing Transtar's 2015 performance and 2016 operating plan. [30]

The FTI draft presentation showed $91 million Total Adjusted EBITDA in 2014; a preliminary estimate of $60 million in 2015; and a projected $60 million in 2016.[31] The analysis stated that, while Transtar's Adjusted EBITDA and gross margin percentage had declined in Q4 2015, "a large portion" of the factors that contributed to this decline were "not representative of

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[28] Application of Debtors and Debtors in Possession for Entry of an Order Authorizing the Employment and Retention of FTI Consulting, Inc. as Financial Advisor *Nunc Pro Tunc* to the Petition Date ¶ 9, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 2, 2016), ECF No. 66; *see also* Presentation, "FTI Consulting, Inc. – Project Mission – Presentation to: Royal Bank of Canada, as Agent" (Mar. 2016). [TRANSTAR-DUCERA-00000108]

[29] Application of Debtors and Debtors in Possession for Entry of an Order Authorizing the Employment and Retention of Ducera Partners LLC as Investment Banker and Financial Advisor *Nunc Pro Tunc* to the Petition Date ¶ 7, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 2, 2016), ECF No. 67.

[30] Interview of Agnes Tang (Jan. 10, 2017); Interview of Ed Orzetti (Jan. 11, 2017); Email among Agnes Tang, Paul Shin, et al., "FW: Project Mission Update call between RBC, FFL, Company and its advisors" (Mar. 18, 2016). [TRANSTAR-DUCERA-00000106]

[31] Presentation, "FTI Consulting, Inc. – Project Mission – Presentation to: Royal Bank of Canada, as Agent (Draft)," at 17 (Mar. 2016). [TRANSTAR-DUCERA-00000108, at 0124]

the true EBITDA run rate of the business…."[32] The presentation noted the business plan of the new, Orzetti-led management team installed in the second half of 2015 and pointed to "promising results" in the manufacturing side of the business after the Company intentionally slowed torque converter production at its Cookeville facility to address quality issues.[33] Looking ahead, the presentation forecast adjusted EBITDA of $67 million in 2017, $76 million in 2018, and $85 million in 2019.[34] It summarized: "While 2015 continued to be a difficult year for the Company during the 4th Quarter, management believes they will stabilize the business in 2016 creating a very positive outlook for 2017 and beyond."[35]

b. Transtar's Employment of Counsel for the Work-Out

i. Background

Willkie had represented FFL since 2011, when Willkie partner Neil Townsend joined the firm's private equity practice.[36] Since Townsend joined Willkie, fees from representing FFL and its portfolio companies comprised from 25% to 50% of his annual originations.[37] Townsend had represented FFL since 1999, and he was the supervising corporate attorney at his prior firm advising on FFL's purchase of Transtar in 2010.[38] Through their relationship—and as contemplated in the engagement letter[39]—with FFL, Willkie and Townsend also performed legal

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[32] *Id*. at 5. [TRANSTAR-DUCERA-00000108, at 0112]

[33] *Id*. [TRANSTAR-DUCERA-00000108, at 0112]

[34] *Id*. at 22. [TRANSTAR-DUCERA-00000108, at 0129]

[35] *Id*. at 5. [TRANSTAR-DUCERA-00000108, at 0112]

[36] Letter, Neil Townsend to Patty Nykodym, "Re: Representation of Friedman Fleischer & Lowe, LLC" (Oct. 14, 2011) [WFG-TSEXAMINER00040136]; Interview of Neil Townsend (Feb. 23, 2017).

[37] Interview of Neil Townsend (Feb. 23, 2017).

[38] *Id*.

[39] Letter, Neil Townsend to Patty Nykodym, "Re: Representation of Friedman Fleischer & Lowe, LLC" (Oct. 14, 2011). [WFG-TSEXAMINER00040136]

work for FFL portfolio companies such as Transtar.[40] Townsend represented Transtar in its acquisition of ETX in 2014, as well as in other matters.[41] However, Townsend told the Examiner that he was not "heavily involved" in Speedstar's $90 million dividend payment in 2012.[42] Townsend had not previously represented either a private equity firm or a portfolio company in a work-out or bankruptcy.[43]

In early 2016, when it seemed Transtar needed loan agreement covenant relief, Townsend contacted Rachel Strickland, a partner in Willkie's Business Reorganization and Restructuring Department, for assistance.[44] Strickland had not previously worked for either Transtar or FFL.[45] Townsend introduced Strickland to Orzetti and FFL representatives during several phone calls in January 2016.[46]

ii. Internal Willkie Conflicts Discussions

As the internal Willkie discussions unfolded, Strickland raised an issue about Willkie representing both FFL and Transtar.[47] She said she viewed Transtar and FFL's interests as overlapping, at least for the time being, because the work-out appeared then to require only covenant relief, and the likelihood of a chapter 11 case was very low.[48] But she recognized then that if there were a chapter 11 case, because of the disinterestedness requirement that would apply to counsel's employment in a bankruptcy case, Willkie could not represent both in the

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[40] Interview of Ed Orzetti (Jan. 11, 2017); Interview of Neil Townsend (Feb. 23, 2017).

[41] *Id.*

[42] Interview of Neil Townsend (Feb. 23, 2017).

[43] *Id.*

[44] Interview of Rachel Strickland (Feb. 17, 2017).

[45] *Id.*

[46] Interview of Neil Townsend (Feb. 23, 2017).

[47] *Id.*; Interview of Rachel Strickland (Feb. 17, 2017).

[48] Interview of Rachel Strickland (Feb. 17, 2017).

case.[49] She preferred to represent Transtar rather than FFL both in work-out negotiations and in a chapter 11 case, if that became necessary, because, as she said, she is a restructuring lawyer, representing the distressed company is what she does, she prefers it, and it is better business.[50] She so advised Townsend.[51]

At least initially, Townsend saw the situation somewhat differently. Townsend agreed a chapter 11 case would require Willkie to choose between representing FFL and Transtar, but he did not think Willkie needed to make that choice while Willkie was working only on amending and extending Transtar's credit agreements.[52] Like Strickland, Townsend did not then believe bankruptcy was remotely likely.[53] Townsend said discussions about conflicts were specific to chapter 11's disinterestedness requirement rather than the conflicts rules that govern attorney representations more broadly; he did not recall discussing non-bankruptcy conflicts law at that time.[54]

At about this time, Townsend ordered a conflicts check within the firm for the parties in interest in the work-out negotiations.[55] On February 1, Willkie administrative staff involved in the conflict check and new matter opening process told Strickland that Townsend wanted FFL to be identified as the client for the new matter rather than Transtar.[56] Strickland wrote to

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[49] *Id.*; Interview of Neil Townsend (Feb. 23, 2017).

[50] Interview of Rachel Strickland (Feb. 17, 2017).

[51] *Id.*

[52] Interview of Neil Townsend (Feb. 23, 2017).

[53] *Id.*

[54] *Id.*

[55] Email, Cheryl Hinds to CONFLICTS – FIRM WIDE; CONFLICTS DIST. TO ADMIN, "NEW CLIENT/MATTERS – CONFLICT CHECK" (Feb. 2, 2016). [WFG-TSEXAMINER00000001, at 0003–0004]

[56] Email among Neil Townsend, Rachel Strickland, et al., "Re: NEW CLIENT/MATTERS -- CONFLICT CHECK" (Feb. 2, 2016). [WFG-TS EXAMINER00002140, at 2140–2141]

Townsend: "We need to open them in the name of portfolio co, not FFL or we'll be conflicted in the event of an 11."[57] The next day, Townsend responded to Strickland:

> Let's discuss. When we talked about this recently, we discussed that both would be client still (as is the case now), and to the extent of a conflict, we would have Y&C [Young Conaway] check boxes for the company…. It clearly doesn't matter what the case opening sheet says. Does matter what the engagement letters say. In this case it will say we also represent FFL, and the company waives any conflict.[58]

Townsend told the Examiner the phrase "we would have Y&C check boxes" expressed his view that, if a claim were to arise between FFL and Transtar, Transtar would need conflicts counsel.[59] Meanwhile, another portion of Townsend's email stated: "As you can see (this morning re buying debt) we get calls on this for just FFL as well,"[60] referring to an FFL call to ask whether FFL could purchase Transtar debt from other lenders."[61]

The Willkie attorneys continued to discuss potential conflicts issues presented by the Transtar engagement. On February 4, Townsend proposed dealing with the "tricky conflict issue" by drafting engagement letters that would allow Willkie to represent both FFL and Transtar until there was a conflict.[62] Strickland responded:

> Let's talk. Before we do that, there is a new case situation (Paul Weiss decision in CZR [Caesars]). I want to first reeducate ourselves on landmines. In reality, the earlier we only rep the [portfolio] the better. I don't love the letter as you envision but want to think about it. For Trans, I think we need FFL to have

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[57] *Id.* [WFG-TS EXAMINER00002140, at 2140]

[58] *Id.* [WFG-TS EXAMINER00002140, at 2140]

[59] Interview of Neil Townsend (Feb. 23, 2017).

[60] Email among Neil Townsend, Rachel Strickland, et al., "Re: NEW CLIENT/MATTERS -- CONFLICT CHECK" (Feb. 2, 2016). [WFG-TS EXAMINER00002140, at 2140]

[61] Interview of Neil Townsend (Feb. 23, 2017).

[62] Email among Rachel Strickland, Matthew Feldman, et al., "Re: TStar[]" (Feb. 4, 2016). [WFG-TSEXAMINER00002176, at 2177]

> counsel now. [ ] We will have a heavy presence and you will speak to them a lot. Your relationship will NOT be compromised."[63]

Townsend replied: "Very delicate on Transtar. Really like to avoid that."[64] Strickland forwarded Townsend's email to Willkie restructuring partner and firm Co-Chairman Matthew Feldman, who advised "if we are repping the portfolio company we strongly need separate counsel for the sponsor asap."[65] Strickland responded: "Getting our PE guys over that wall is always a problem. I have YCST lined up for sponsor. They will never bite us."[66] Explaining this email, Strickland said Willkie private equity partners had expressed reluctance in the past about referring a sponsor client to another law firm for fear of losing the client, and the last sentence meant that Young Conaway would not take the client from Willkie.[67] Strickland said her description of Young Conaway as "lined up" meant she had recommended Young Conaway and asked Young Conaway partner Edmon Morton to run a conflicts check for representing FFL.[68] According to Strickland, she recommended Young Conaway to FFL but did not direct that they be hired.[69]

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[63] *Id.* [WFG-TSEXAMINER00002176, at 2177]. Strickland's email originally stated "the earlier we only rep the sponsor the better," but she clarified in a subsequent email to Townsend that she meant to refer to the portfolio company, and, when forwarding the email to colleagues, Strickland changed "sponsor" to "portfolio." *See* Email between Rachel Strickland & Neil Townsend, "Re: TStar[]" (Feb. 4, 2016). [WFG-TSEXAMINER00002161]. Townsend told the Examiner that he understood from the outset that Strickland meant to write that the "the earlier we only rep the portfolio the better." Interview of Neil Townsend (Feb. 23, 2017).

[64] Email among R. Strickland, M. Feldman, et al., "Re: TStar[]" (Feb. 4, 2016). [WFG-TSEXAMINER00002176, at 2176]

[65] *Id.* [WFG-TSEXAMINER00002176, at 2176]

[66] *Id.* [WFG-TSEXAMINER00002176, at 2176]

[67] Interview of Rachel Strickland (Feb. 17, 2017).

[68] *Id.*

[69] *Id.*

Townsend later said that while he understood Strickland thought he was concerned about losing FFL as a client, he did not have a "heightened degree of concern" with this referral.[70] He added that, while he first advised FFL that Willkie would continue to represent them, he also said that if the restructuring attorneys told Townsend that FFL needed separate representation, Willkie would help FFL get their own counsel.[71] Townsend had told FFL that Young Conaway would be a good choice, should the need arise.[72] FFL said it was willing to accept the recommendation because it thought it would need Delaware counsel in case there was a bankruptcy filing and, though it had retained other national firms that had Delaware offices, it had done so only for specialized legal work, not for general corporate or restructuring work.[73]

In the meantime, Strickland and Willkie private equity partner David Cosgrove corresponded regarding potential conflicts language to be used in a Willkie-Transtar engagement letter.[74]

On February 4, Strickland had asked Willkie restructuring associate (now partner) Jennifer Hardy to research a conflicts issue from the Caesars bankruptcy.[75] Hardy assigned Willkie associate Christopher Koenig, who prepared an analysis of Paul, Weiss's representation of both the parent and portfolio company in that matter on February 9.[76] Hardy forwarded Koenig's analysis to Strickland that day.[77] Strickland replied to Hardy: "Look at the CZR

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[70] Interview of Neil Townsend (Feb. 23, 2017).

[71] *Id.*

[72] *Id.*

[73] Email among Michael Nestor, Richard Levin, et al., "FW: RE:" (Mar. 1, 2017).

[74] Email among Neil Townsend, David Cosgrove, et al., "Re: Transtar" (Feb. 8, 2016). [WFG-TSEXAMINER00003307]

[75] Email among Christopher Koenig, Jennifer Hardy, et al., "Re: TStar[]" (Feb. 9, 2016). [WFG-TS EXAMINER00003631, at 3634-35]

[76] *Id.* [WFG-TS EXAMINER00003631, at 3633-34]

[77] *Id.* [WFG-TS EXAMINER00003631, at 3633]

[Caesars] stuff where K&E [Kirkland & Ellis LLP] escaped too please. Just in case there are clues for how to structure engagement."[78]

On February 9, Strickland emailed Townsend, Hardy, and Cosgrove that Willkie would be best positioned to avoid disqualification in a Transtar bankruptcy if its engagement letter with Transtar stated that Willkie would not represent FFL in connection with Transtar's restructuring.[79] Strickland further wrote to this group that representing Transtar would mean "The board is our client (which is pretty much overlapping with FFL's interests anyway)" and "[t]he rest will be courtesy conversations off line."[80] Strickland said she was referring to her view that a debtor's counsel acts like the quarterback of a restructuring, having conversations with all involved players and keeping track of stakeholders' positions.[81] Townsend said that, presented with a choice, he and the other Willkie attorneys decided it would be a more "conventional" choice to represent Transtar.[82]

Later on February 9, Strickland emailed Townsend and Hardy, attaching a recent article in the *American Bankruptcy Institute Journal* titled "Concurrent Representation of Debtor and Nondebtor Equityholder."[83] Townsend responded with comments to Strickland, Hardy, and Cosgrove, and he characterized the "paradigm" the article proposed as including that "TStar would need conflicts counsel for major issues negotiated b/w TStar and FFL in the bankruptcy,"

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[78] *Id.* [WFG-TS EXAMINER00003631, at 3633]

[79] Email among Rachel Strickland, Neil Townsend, et al., "Re: Transtar Engagement Letter" (Feb. 9, 2016). [WFG-TSEXAMINER00003622, at 3622]

[80] Email among Rachel Strickland, Neil Townsend, et al., "Re: Transtar Engagement Letter" (Feb. 9, 2016). [WFG-TSEXAMINER00003637, at 3637]

[81] Interview of Rachel Strickland (Feb. 17, 2017).

[82] Interview of Neil Townsend (Feb. 23, 2017).

[83] Email among Neil Townsend, David Cosgrove, et al., "FW: Jenn Just Found This Article" (Feb. 9, 2016) [WFG-TSEXAMINER00003639, at 3639]; Bennett L. Spiegel & Monika S. Wiener, *Concurrent Representation of Debtor and Nondebtor Equityholder*, 34-FEB AM. BANKR. INST. J. 38 (2015). [WFG-TSEXAMINER00003640]

if there was a bankruptcy.[84] Townsend's email proposed a further discussion of the conflicts counsel possibility and suggested checking the FFL engagement letter to confirm there was a conflicts waiver.[85] Strickland and Townsend each said they did not recall such a further discussion taking place,[86] and Townsend said he did not check the Willkie-FFL engagement letter to see if it contained a conflicts waiver, nor did Townsend have a discussion with FFL about adding one.[87] The FFL letter contained a waiver for "future conflicts that may arise" should Willkie represent other parties adverse to FFL, so long as those future engagements were unrelated to Willkie's work for FFL, its funds, or its portfolio companies.[88] Willkie did not put an ethical wall in place to screen attorneys working on FFL matters from any Transtar work, as he did not think a screen was necessary.[89]

On February 10, Townsend emailed Strickland and Cosgrove that he planned to tell Speedstar Director and FFL Managing Director Rajat Duggal that it would be a "[g]ame changer if it looks like bankruptcy is a possibility," and FFL would need Delaware bankruptcy counsel while Willkie represented Transtar.[90] Townsend said he believed it was important that Willkie not be disqualified from representing Transtar in the event of a bankruptcy, and he had a conversation with Duggal along the lines described in the email, though he did not recall discussing the possibility of conflicts counsel for Transtar if an actual conflict with FFL arose.[91]

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[84] Email among Neil Townsend, David Cosgrove, et al., "FW: Jenn Just Found This Article" (Feb. 9, 2016). [WFG-TSEXAMINER00003639, at 3639]

[85] *Id.* [WFG-TSEXAMINER00003639, at 3639]

[86] Interview of Rachel Strickland (Feb. 17, 2017); Interview of Neil Townsend (Feb. 23, 2017).

[87] Interview of Neil Townsend (Feb. 23, 2017).

[88] Letter, Neil Townsend to Patty Nykodym, "Re: Representation of Friedman Fleischer & Lowe, LLC" (Oct. 14, 2011). [WFG-TSEXAMINER00040136]

[89] Interview of Neil Townsend (Feb. 23, 2017).

[90] Email among Neil Townsend, Rachel Strickland, et al., "Transtar" (Feb. 10, 2016) [WFG-TSEXAMINER00003666 at 3666]; Interview of Neil Townsend (Feb. 23, 2017).

[91] Interview of Neil Townsend (Feb. 23, 2017).

Townsend said he did not recall if Strickland responded to the email.[92] Strickland said she did not recall this email and she did not contemplate filing for bankruptcy in Delaware.[93] She attributed Townsend's email to his initial lack of clarity as to how the representations would be structured.[94] As stated above, Townsend had not previously been involved in a work-out or bankruptcy engagement.[95]

iii. Transtar's Engagement of Willkie

On February 19, Speedstar, Transtar Holdings, and Transtar Industries Inc. executed an engagement letter with Willkie. Townsend signed for Willkie.[96] The letter described the scope of engagement as being "in connection with a potential restructuring or similar transaction as well as other general corporate matters."[97] The letter stated if Transtar "is ever adverse to FFL, we will work with you to be sure that either you or FFL has independent counsel on that matter."[98] It continued:

> We ask Client to confirm that (i) Willkie Farr may continue to represent or may undertake in the future to represent any existing or future client in any matter (including, but not limited to, transactions, litigation or other dispute resolutions), even if the interests of that client in that other matter are directly adverse to Client, as long as that other matter is not substantially related to this or our other engagements on behalf of Client and does not require us to use proprietary or other confidential information of a non-public nature concerning Client acquired by Willkie Farr as a result of our representation of Client; (ii) Client hereby waives any conflict of interest that exists or might be asserted to exist and any other basis that might be asserted to preclude, challenge or otherwise disqualify Willkie Farr in any representation of any other client with

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[92] *Id*.

[93] Interview of Rachel Strickland (Feb. 17, 2017).

[94] *Id*.

[95] Interview of Neil Townsend (Feb. 23, 2017).

[96] Letter, Neil Townsend to Joseph Santangelo, "Re: Representation of Speedstar Holding Corporation," at 5 (Feb. 19, 2016). [WFG-TSEXAMINER00040099, at 40103]

[97] *Id*. at 1. [WFG-TSEXAMINER00040099, at 40099]

[98] *Id*. at 2. [WFG-TSEXAMINER00040099, at 40100]

> respect to any such matter; and (iii) Client intends for its consent to be effective and fully enforceable, and to be relied upon by Willkie Farr.[99]

Strickland said, in practice, whether bringing in independent counsel for one party was sufficient to resolve a conflict would depend on the particular circumstances.[100] Here, she said she believed that around the time FFL engaged Young Conaway, a potential for a conflict was possible.[101] Strickland also said she was not responsible for setting up the new Transtar matter, even though she had reviewed a draft of the engagement letter.[102] Townsend identified Cosgrove as the primary drafter of the Willkie-Transtar engagement letter.[103]

Ultimately, Transtar never hired independent conflicts counsel for Transtar to examine any potential claims against FFL, such as potential claims regarding the dividend payout, or an FFL release.[104] Strickland said she believed conflicts counsel was unnecessary because the related issues were fully aired and analyzed by well-represented creditors.[105]

iv. FFL's Engagement of Young Conaway

In mid-March, according to Townsend, he told FFL it was time to transition to separate representations for FFL and Transtar, reiterated that Young Conaway would be a good choice for FFL, and offered to connect FFL to Young Conaway.[106] From the Examiner's investigation, it appears that the Willkie lawyers believed that there was no current conflict for Willkie to

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[99] *Id.* at 2. [WFG-TSEXAMINER00040099, at 40100]

[100] Interview of Rachel Strickland (Feb. 17, 2017).

[101] *Id.*

[102] *Id.*

[103] Interview of Neil Townsend (Feb. 23, 2017).

[104] Interview of Rachel Strickland (Feb. 17, 2017).

[105] *Id.*

[106] Interview of Neil Townsend (Feb. 23, 2017).

represent both FFL and Transtar, but that bringing in separate counsel was an appropriate prophylactic measure to prevent conflicts that might arise during negotiations.

On March 21, Michael Nestor of Young Conaway sent a draft Young Conaway-FFL engagement letter to Townsend and offered to discuss the letter with Townsend before sending it to FFL.[107] Nestor, who had not previously worked with Strickland or Townsend, became involved through Edmon Morton.[108] Townsend responded with a comment on how the letter should be addressed along with the overall comment "I think the letter is fine" and added that he was trying to set up a call with Rajat Duggal of FFL (and the Speedstar Board) "to introduce you and get us started."[109] Nestor then sent an updated draft of the engagement letter back to Townsend.[110] Duggal executed the engagement letter,[111] and, that night, Nestor received what he described as "an initial download" from Townsend.[112] Nestor said that it was not unusual for him to work out an engagement letter with referring counsel before sending it to the client.[113]

On March 23, Willkie Corporate and Financial Services Department partner Leonard Klingbaum wrote Nestor that "the Company is looking to the Sponsor for support," and delivered a draft term sheet regarding a potential bridge loan from FFL to Transtar.[114] In the

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[107] Email among Neil Townsend, Michael Nestor, et al., "Re: Engagement Letter" (Mar. 21, 2016). [YCST01105, at 1105-06]

[108] Interview of Rachel Strickland (Feb. 17, 2017); Interview of Michael Nestor (Feb. 20, 2017); Interview of Neil Townsend (Feb. 23, 2017).

[109] Email among Neil Townsend, Michael Nestor, et al., "Re: Engagement Letter" (Mar. 21, 2016). [YCST01105, at 1105]

[110] Email among Michael Nestor, Neil Townsend, et al., "Engagement letter," (March 21, 2016). [YCST01107, at 1107]

[111] Letter, Michael Nestor to Rajat Duggal, "Re: Engagement Agreement with Young Conaway Stargatt & Taylor, LLP and Friedman, Fleischer & Lowe, LLC" (Mar. 21, 2016). [YCST10901, at 10903]

[112] Email among Kristin Toppeta, Michael Nestor, et al., "FW: Speedstar/Transtar Documents" (Mar. 22, 2016). [TRANSTAR-WFG-00000508, at 0509]

[113] Interview of Michael Nestor (Feb. 20, 2017).

[114] Email among Rachel Strickland, Michael Nestor, et al., "Re: Mission – Sponsor Bridge Loan" (Mar. 23, 2016). [TRANSTAR-WFG-00003166, at 3166-67]

context of that proposal, Strickland suggested to Nestor that "it would be valuable to meet the client in person tomorrow."[115] On March 24, Nestor wrote Willkie attorneys including Townsend and Strickland, "We had a good call [with] Rajat and Neil earlier today."[116] Nestor said after an initial warming up period, FFL quickly engaged with him, and Duggal called him several times a week.[117]

Willkie's assistance in educating Young Conaway during this period and Transtar's concurrent pursuit of a liquidity transaction came as Transtar faced a March 31 deadline to make an interest payment on each of its secured loans.[118] Nestor described the ten days between Young Conaway's retention and the end of the quarter as a period in which his team "had its mouth on the end of a fire hose."[119]

On March 25, Townsend and Strickland exchanged emails regarding a particular FFL fund issue.[120] After Townsend responded that the issue was not immediately relevant, Strickland suggested it "may be important just for YCST to understand cost benefit analysis of FFL putting in money on less than commercial terms vs avoiding wasting good money after bad."[121] Townsend responded "I think that kind of thing has to come from FFL not us," and "I'm sure Rajat will open up to him. They had a very good first day yesterday."[122] Strickland forwarded the

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[115] *Id.* [TRANSTAR-WFG-00003166, at 3166]

[116] Email among Michael Nestor, Rachael Strickland, et al., "RE: Mission – Sponsor Bridge Loan" (Mar. 24, 2016). [TRANSTAR-WFG-00003217, at 3217]

[117] Interview of Michael Nestor (Feb. 20, 2017).

[118] Santangelo Decl. ¶¶ 35–36, 39–40.

[119] Interview of Michael Nestor (Feb. 20, 2017).

[120] Email among Michael Nestor, Rachel Strickland, et al., "Re: Stuck on Call" (Mar. 25, 2016). [YCST11136, at 11137]

[121] *Id.* [YCST11136, at 11137]

[122] *Id*. [YCST11136, at 11136]

email chain to Nestor, with the note "See below. Probe generally but don't ask please …." (ellipses in original).[123]

While Strickland was unable to recall the nature of the underlying issue, she said that she had forwarded it to Young Conaway to ensure Young Conaway could take it into account in its representation of FFL.[124] Townsend told the Examiner that he believed at the time and now that Strickland had misunderstood the issue as relating to potential new FFL funding of Transtar, but in fact the issue related solely to internal FFL fund management.[125] Townsend told the Examiner his email, "that kind of thing has to come from FFL," referred to the information about the issue, and he believed it would be odd for Willkie to introduce Young Conaway to issues he had not discussed with FFL in connection with this transaction.[126]

v. FFL's Interim Funding of Transtar

On March 29, following the earlier Klingbaum email, Willkie and Young Conaway corresponded regarding an FFL $7.5 million accounts receivable bridge loan to Transtar.[127] In the early morning hours of March 30, a separate financing option arose, with Townsend writing to Young Conaway that the "Company is proposing, and FFL is considering, a contribution to capital of $2 million at closing."[128] Later on March 30, Townsend emailed Speedstar and Transtar

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[123] *Id.* [YCST11136, at 11136]

[124] Interview of Rachel Strickland (Feb. 17, 2017).

[125] Interview of Neil Townsend (Feb. 23, 2017).

[126] *Id.*

[127] Email among Leonard Klingbaum, Craig Grear, et al., "RE: FFL – Bridge Loan" (Mar. 29, 2016) [TRANSTAR-WFG-00003510]; Email among Neil Townsend, Michael Nestor, et al., "RE: FFL – Bridge Loan" (Mar, 29, 2016) [YCST11207]; Email among Michael Nestor, Leonard Klingbaum, et al., "Re: Bridge Loan docs" (Mar. 30, 2016). [TRANSTAR-WFG-00004220]

[128] Email among Neil Townsend, Craig Grear, et al., "Re: FFL – Comfort Ltr re Minimum Cash Balance" (Mar. 30, 2016). [TRANSTAR-WFG-00004209, at 4209]

principals, including FFL-affiliated Board members, with Craig Grear of Young Conaway copied, attaching "[a] short letter to memorialize the $2 million capital contribution."[129]

On March 31, FFL and Transtar executed an agreement providing for a $7.5 million secured bridge loan. FFL separately funded a $2 million capital contribution to Speedstar.[130] According to Strickland, FFL agreed to the bridge loan because the parties believed they were close to achieving an out-of-court restructuring solution.[131] Nestor told the Examiner that the additional $2 million was meant to give "comfort" to Orzetti, who expressed concern about liquidity to cover payroll, beyond the amount of the bridge loan.[132] Further to Nestor's point, on March 31, FFL wrote to Orzetti stating, should Transtar's cash fall below $4.5 million at the end of any Friday during a loan forbearance period, FFL would make a capital contribution to Speedstar equivalent to the shortfall plus $500,000, but not to exceed $2 million in total.[133] Townsend described this as a "comfort letter."[134]

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[129] Email among Neil Townsend, Ed Orzetti, et al., "FW: FFL – Capital Contribution letter" (Mar. 30, 2016) [YCST11585, at 11585]; Letter, Rajat Duggal to Ed Orzetti, "Re: Capital Contribution" (Mar. 30, 2016). [YCST11586]

[130] Document, "Secured Bridge Loan Agreement" (Mar. 31, 2016) [YCST11940]; Letter, Rajat Duggal to Ed Orzetti, "Re: Capital Contribution" (Mar. 31, 2016) [WFG-TSEXAMINER00004376]; Email between Michael Nestor & Elizabeth Edmondson, "Re: DACCO Examiner – interview 2/20 or 2/21" (Feb. 21, 2017).

[131] Interview of Rachel Strickland (Feb. 17, 2017).

[132] Interview of Michael Nestor (Feb. 20, 2017); Email between Michael Nestor & Rachel Strickland, "Re: Stuck on call" (Mar. 25, 2016). [YCST11136, at 11136]

[133] Letter, Rajat Duggal to Ed Orzetti, "Re: Forbearance Agreement Compliance" (Mar. 31, 2016). [WFG-TSEXAMINER00005087]

[134] Interview of Neil Townsend (Feb. 23, 2017).

2. April through Early July 2016 – The FFL Deals

a. Speedstar Independent Director

On April 14, 2016, Townsend and Nestor exchanged emails on potential independent directors for Speedstar.[135] Their exchange followed earlier efforts to find an independent director, which Townsend told the Examiner began in late February or early March.[136] Nestor suggested Brad Scher, whom Nestor had known for over 15 years.[137] Townsend spoke with Scher on April 21, and Fleischer and Orzetti also interviewed Scher around the same time.[138] Scher agreed to become a Director on May 3.[139] He was formally elected to the Board on May 15.[140]

b. The Initial FFL Investment Proposal

On April 14, 2016, Hardy emailed Richard Levy of Latham & Watkins, which represented Second Lien creditors, attaching a letter of intent on FFL letterhead signed by Rajat Duggal about a new investment in Speedstar.[141] The letter expressed FFL's "non-binding interest" in making a $35 million equity investment in Speedstar, inclusive of any other equity contributions on or after March 31, in exchange for unspecified amendments to Transtar's credit agreements.[142]

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[135] Email among Neil Townsend & Michael Nestor, "Re: Independent Board Members" (Apr. 21, 2016). [YCST00075]

[136] Interview of Neil Townsend (Feb. 23, 2017).

[137] Interview of Michael Nestor (Feb. 20, 2017).

[138] Email between Neil Townsend & Michael Nestor, "Re: Independent Board Members" (Apr. 21, 2016) [YCST00075, at 0075]; Interview of Spencer Fleischer (Jan. 13, 2017).

[139]Email among Brad Scher, Spencer Fleischer, et al., "RE: Transtar" (May 3, 2016). [WFG-TS EXAMINER00007155, at 7155]

[140] Speedstar Holding Corporation, Minutes of Board Meeting (May 15, 2016).

[141] Email among Jennifer Hardy, Rich Levy, et al., "Transtar – Confidential/Subject to NDA" (Apr. 14, 2016). [TRANSTAR-WFG-00007801]

[142] *Id.* [TRANSTAR-WFG-00007801, at 7802]

On April 29, 2016, Willkie delivered a term sheet to creditors that proposed specific amendments to Transtar's debt covenants.[143] The term sheet provided, in addition to the covenant amendments, an extension of the maturity date on Transtar's term loan facility and revolving credit facility to March 31, 2019, and an FFL cash equity contribution of $30 million.[144] The term sheet did not propose any change to Speedstar's equity structure or FFL's control of Speedstar or Transtar.[145]

Documents the Examiner reviewed do not show how creditors responded to the April 29 term sheet. However, that proposed deal was not consummated, and emails from May 21 to May 23 show Willkie and Young Conaway discussing possible terms for a broader restructuring of Transtar's obligations, including converting Second Lien debt to equity.[146] In the meantime, on May 9, 2016, FFL funded another $1.5 million capital contribution to Speedstar.[147]

c. Transtar's Declining Financial Performance and the Second FFL Investment Proposal

Transtar released updated financial projections on May 24, 2016 that lowered its 2016 EBITDA forecast from $60 million to $52 million.[148] On June 9, Ducera's Tang sent creditors a transaction overview presentation describing an "agreement in principle" among Transtar, FFL, and the Second Lien Steering Committee "regarding a deleveraging transaction in connection

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[143] Email among Daniel Philion, Tyler Nurnberg, et al., "Transtar – Confidential/Subject to NDA" (Apr. 29, 2016). [TRANSTAR-WFG-00008135]

[144] Document, "Transtar: Proposed Terms of Amendments," at 1, 3 (Apr. 29, 2016). [TRANSTAR-WFG-00008135, at 8136, 8138]

[145] Document, "Transtar: Proposed Terms of Amendments," (Apr. 29, 2016). [TRANSTAR-WFG-00008135]

[146] Email among Michael Nestor, Leonard Klingbaum, et al., "Re: FFL Proposal" (May 22, 2016) [TRANSTAR-WFG-00008772]; Email among Neil Townsend, Craig Grear, et al., "RE: $35mm" (May 23, 2016). [YCST00980]

[147] Email between Michael Nestor & Elizabeth Edmondson, "Re: DACCO Examiner – interview 2/20 or 2/21" (Feb. 21, 2017).

[148] Presentation, "Transtar Business / Outlook Update," at 19 (May 24, 2016). [TRANSTAR-DUCERA00000712, at 0730]

with a new money investment."[149] The presentation outlined a deal in which FFL would make a $40 million new equity investment and, based on that contribution and its existing equity, would retain 55% of Speedstar's shares on a fully diluted basis.[150] Second Lien debt holders would convert $77.5 million of Second Lien debt into Speedstar shares representing 45% of its common stock on a fully diluted basis; $92.5 million in Second Lien loans would remain, and the maturity of the First Lien debt and the Second Lien debt would be extended.[151] The presentation referred to a management incentive plan "in an amount to be determined."[152]

Meanwhile, draft term sheets circulated in the days beforehand contemplated a management incentive plan "on terms satisfactory to Sponsor, Company, and Second Lien Steering Committee,"[153] and provided for general releases among all parties of claims, "including without limitation, a release of any claim or cause of action against Sponsor resulting from the dividend recapitalization consummated in 2012."[154] Strickland said Willkie never assessed whether Transtar had a potential claim against FFL related to that dividend.[155] According to Nestor, Young Conaway relied on FFL's belief that it had no exposure.[156]

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[149] Email among Agnes Tang, Neil Augustine, et al., "FW: Updated Mission Discussion Materials" (June 9, 2016) [TRANSTAR-DUCERA-00001033, at 1035]; *see also* Document, "Transtar: Proposed Restructuring Terms" (June 8, 2016). [TRANSTAR-DUCERA-00001016]

[150] Report, "Project Mission; Discussion Materials," at 2 (June 9, 2016). [TRANSTAR-DUCERA-00001033, at 1035]

[151] *Id*. at 5. [TRANSTAR-DUCERA-00001033, at 1038]

[152] *Id*. at 2. [TRANSTAR-DUCERA-00001033, at 1035]

[153] Email among Matthew Warren, Agnes Tang, et al., "RE: Transtar – Restructuring Term Sheet," (June 8, 2016) [TRANSTAR-WFG-00009268]; Document, "Transtar: Proposed Restructuring Terms," at 5 (June 8, 2016). [TRANSTAR-WFG-00009268, at 9277]

[154] Email among Daniel Philion, Richard Levy, et al., "Transtar – Restructuring Term Sheet" (June 7, 2016) [TRANSTAR-WFG-00009135]; Document, "Transtar: Proposed Restructuring Terms," at 5 (June 8, 2016). [TRANSTAR-DUCERA-00001016, at 1020]

[155] Interview of Rachel Strickland (Feb. 17, 2017).

[156] Interview of Michael Nestor (Feb. 20, 2017).

Emails and red-lined term sheets into the beginning of July show that open issues remained between Transtar and First Lien creditors on the June 9 agreement in principle, as well as open issues among FFL, Transtar, and Second Lien creditors related to matters such as board composition and other shareholder rights.[157] Another issue was the scope of the release. The First Lien creditors sought a carve-out for any claim arising out of willful misconduct or fraud.[158] According to Strickland, both First Lien and Second Lien lenders had questioned Transtar's 2012 $90 million dividend to FFL at a contentious early meeting regarding a possible restructuring.[159] Townsend later said that, while FFL was investing money into Transtar, the release was not a heavily contested term, and it was included in the term sheets.[160] According to Townsend, the sponsor release first emerged as a contested issue during the negotiations of the August RSA, when the Second Lien holders, rather than FFL, planned to make the necessary equity investment.[161] Although the Second Lien holders were ultimately willing to grant a release, the First Lien lenders were not.[162]

On July 8, 2016, Strickland wrote all creditor representatives that the sponsor "is prepared to execute a RSA this weekend and fund $40 mm upon consummation of a consensual amendment and/or consummation of a prepackaged plan," provided that the creditors agreed

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[157] Email among Jennifer Hardy, Michael Nestor, et al., "FW: Transtar_ Restructuring Support Agreement (2)," (June 28, 2016) [TRANSTAR-WFG-00011973]; Email among Michael Nestor, Rachel Strickland, et al., "Fwd: FFL/Transtar – Restructuring Term Sheet" (July 1, 2016) [YCST12032]; Email among Leonard Klingbaum, Craig Grear, et al., "Re: FFL/Transtar – Restructuring Term Sheet" (July 3, 2016) [YCST12703]; Email among Rachel Strickland, Michael Nestor, et al., "Fwd: REVISED RSA – SUBJECT TO 408" (July 6, 2016). [YCST13690]

[158] Document, "KS Comments (07.06.2016) to WFG Draft 7/3/16" (July 6, 2016).

[159] Interview of Rachel Strickland (Feb. 17, 2017).

[160] Interview of Neil Townsend (Feb. 23, 2017).

[161] *Id.*

[162] *Id.*

to terms the next day on four open items unrelated to release of claims.[163] On July 10, Strickland wrote Nestor that "dialogue all day yesterday between FFL and 2L lenders" "sounded directionally positive," but needed written memorialization and did not fully resolve the open issues.[164]

d. Willkie's Role During April through Early July 2016

While FFL was considering a new investment in Transtar, Willkie's representation of Transtar involved a division of work between Strickland and Townsend.[165] Townsend said Strickland had primary responsibility for issues relating to restructuring loan covenants, such as negotiations with the lenders and their respective advisors, and interacting with Ducera and FTI.[166] Townsend was mostly involved in the equity negotiations that occurred through June 2016.[167] Townsend said he was in daily contact with Orzetti regarding Transtar's interests and concerns and was on all Speedstar board calls.[168]

During this period, Townsend continued to represent FFL in matters not involving Transtar.[169] In 2016, Townsend worked between 400 and 500 hours on FFL matters unrelated to Transtar, including assisting with valuation and bidding packages for potential new acquisitions by FFL and addressing issues regarding its other portfolio companies.[170] Further, Townsend said Duggal infrequently raised Transtar issues while he was communicating with Townsend about

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[163] Email among Rachel Strickland, Michael Nestor, et al., "FW: Transtar – Next Steps" (July 8, 2016). [YCST13946, at 13946]

[164] Email among Rachel Strickland, Michael Nestor, et al., "4-Issues" (July 10, 2016). [YCST13950, at 13950]

[165] Interview of Neil Townsend (Feb. 23, 2017).

[166] *Id.*

[167] *Id.*

[168] *Id.*

[169] *Id.*; Interview of Rachel Strickland (Feb. 17, 2017).

[170] Interview of Neil Townsend (Feb. 23, 2017); *see also* Response of Willkie to the Examiner's Request for certain timekeeping records pertaining to matters for Transtar, FFL, and Silver Point, at 8. [WFG-TSEXAMINER00039891, at 39898]

another matter.[171] One such example occurred in November 2016, when Duggal asked about the release negotiations while Townsend and he were on a call "on a different deal."[172]

Townsend said he does not believe there was an actual conflict between Transtar and FFL any time in 2016.[173] Townsend said he never spoke to anyone at FFL regarding whether investing additional equity in Speedstar was a good idea for FFL.[174] Strickland said through the period when FFL was considering a new investment in Speedstar, she believed that the interests of Transtar, FFL, and lenders were aligned, as the lenders wanted to remain lenders, while Transtar wanted more runway, liquidity, and flexibility to conduct acquisitions.[175]

3. Mid-July through September 2016 – FFL Steps Aside

a. The Second Lien Investment Deal

Documents after July 10, 2016 do not show FFL's position on deal terms. On July 8, FFL's counsel emailed Willkie, writing, "FFL is in agreement with forwarding a message to all parties that FFL will support a restructuring, preferably out of court, in which FFL will make an equity investment of $40 million, subject to" four requirements.[176] The same day, Strickland relayed FFL's requirements to lenders' counsel.[177] However, by July 12, Transtar and its creditors were contemplating that FFL would not make a new investment after all. Kaye Scholer (representing the First Lien committee) and Latham & Watkins (representing the Second Lien committee)

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[171] Interview of Neil Townsend (Feb. 23, 2017).

[172] Email among Neil Townsend, Rachel Strickland, et al., "Rajat" (Nov. 5, 2016). [WFG-TSEXAMINER00029828, at 29828]

[173] Interview of Neil Townsend (Feb. 23, 2017).

[174] *Id.*

[175] Interview of Rachel Strickland (Feb. 17, 2017).

[176] Email among Craig Grear, Rachel Strickland, et al., "FFL – Communication to All Parties," (July 8, 2016). [TRANSTAR-WFG-00013593, at 13593]

[177] Email among Rachel Strickland, Michael Nestor, et al., "FW: Transtar – Next Steps," (July 8, 2016). [YCST13946]

circulated an open issues list contemplating that, should FFL terminate the RSA or breach its agreements under the RSA, the Second Lien creditors would contribute $50 million to Speedstar, FFL would not object, and FFL would "receive the same release under the plan of reorganization in the primary plan treatment."[178]

In response to the open issues list, Strickland wrote: "Can the 1Ls and 2Ls please make clear whether or not the 2Ls are prepared to step into the plan sponsor/funding shoes now on the same terms if FFL determines not to go forward on the terms you sent us?"[179] Kaye Scholer partner Michael Messersmith responded, "Given the Sponsor's expressed willingness to go forward, we had not discussed with the 2Ls whether they were willing to do the identical deal now. Are you suggesting that the Sponsor is unwilling to go forward at this point? Why do you need this assurance?"[180] Strickland's reply was: "I don't know the answer and represent the company so we need to understand our options. We had heard that the 2Ls were ready and willing but this makes it ambiguous."[181] Nestor followed up with Strickland and Townsend directly, writing that he was in communication with FFL and asking if the Willkie attorneys were available for a phone call.[182]

FFL soon withdrew from the deal, and, on July 22, Second Lien counsel Latham & Watkins circulated a draft term sheet that involved wiping out FFL's equity.[183] Strickland shared the draft with Nestor, who requested a release for FFL and additional consideration as part of a consensual

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[178] Document, "Transtar Open Issues List; KS/LW Draft 07.12.2016," at 4 (July 12, 2016). [TRANSTAR-DUCERA-00001604, at 1607]

[179] Email among Michael Nestor, Neil Townsend, et al., "RE: Transtar" (July 13, 2016). [YCST12087, at 12088]

[180] *Id.* [YCST12087, at 12088]

[181] *Id*. [YCST12087, at 12088]

[182] *Id*. [YCST12087, at 12087]

[183] Email among Michael Nestor, Rachel Strickland, et al., "Re: Transtar" (July 22, 2016) [YCST12387]; Document, "Speedstar Holdings – Equity Term Sheet; L&W 7-21-2016 DRAFT – FOR DISCUSSION PURPOSES ONLY" (July 21, 2016). [YCST12381]

restructuring.[184] A follow-up email from Nestor on July 26 referenced "other more pressing issues with the deal (Silver Point and projections/forecasts)."[185] Strickland later said FFL's withdrawal as sponsor did not change her analysis of the potential for conflicts.[186]

Nestor's reference to Transtar's forecast came as Transtar again downgraded its earnings projections on July 26.[187] From a $52 million EBITDA projection in May 2016, Transtar now projected $45 million[188] Transtar projected an even lower 2016 EBITDA of $40 million if restructuring happened via a pre-packaged chapter 11 plan rather than out of court.[189]

In August, the parties came close to a deal in which Second Lien lenders would take nearly full ownership of Speedstar. On August 4, two Second Lien lenders communicated to Transtar that they were "ok giving a release."[190] Meanwhile, Willkie and Ducera prepared a presentation that described an "agreement in principle" between Transtar, the First Lien Steering Committee, and the Second Lien Steering Committee.[191] The outlined deal contemplated a $50 million new money investment from the Second Lien lenders in addition to converting $140 million of Second Lien debt in exchange for 95% of Speedstar's common stock, with the remainder reserved for a

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[184] Email among Michael Nestor, Rachel Strickland, et al., "Re: Transtar" (July 22, 2016). [YCST12387, at 12387]

[185] Email among Michael Nestor, Rachel Strickland, et al., "RE: Transtar" (July 26, 2016). [YCST12397, at 12397]

[186] Interview of Rachel Strickland (Feb. 17, 2017).

[187] Presentation, "Transtar Financial Outlook Update for Lenders" (July 26, 2016). [TRANSTAR-DUCERA-00001618]

[188] *Id*. at 3. [TRANSTAR-DUCERA-00001618, at 1620]

[189] *Id*. [TRANSTAR-DUCERA-00001618, at 1620]

[190] Email among Agnes Tang, Rachel Strickland, et al., "Fwd: release" (Aug. 4, 2016). [TRANSTAR-DUCERA-00002493, at 2493]

[191] Presentation, "August 2016 – Project Mission – Discussion Materials," at 3. [TRANSTAR-DUCERA-00001823, at 1825]

management incentive plan.[192] Among other amendments to debt terms, the maturity on remaining First Lien and Second Lien loans would be extended to March 2019 or later.[193]

b. Silver Point Capital Steps In

Developing in parallel to the agreement between the First Lien and Second Lien lenders, however, was the Silver Point issue: beginning in June, Silver Point Capital had acquired First Lien debt and emerged as an objector to the developing deal. On July 29, Jeff Forlizzi of Silver Point met with Orzetti, and, on August 2, Forlizzi wrote Orzetti that the pending Second Lien deal "would leave Transtar excessively overlevered and with insufficient runway for its operational restructuring."[194] On August 4, Forlizzi wrote First Lien Agent Royal Bank of Canada that the restructuring proposal on the table was "not feasible" and proposed an alternate deal structure that would impair First Lien debt, extinguish Second Lien debt and equity, and involve a Silver Point cash investment.[195] Forlizzi asked that Silver Point's proposal be shared with all First Lien lenders and requested a First Lien lender call to discuss Silver Point's position.[196] On August 8, Silver Point gave a presentation to First Lien lenders on the "superior" nature of its alternate proposal.[197]

On August 8, a Second Lien lender representative noted the First Lien lenders' discussion with Silver Point, expressing surprise that "the 1Ls [were] giving silverpoint the time of day," and requested that the First Lien lenders execute an RSA based on the prior agreement in

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[192] *Id*. [TRANSTAR-DUCERA-00001823, at 1825]

[193] *Id*. [TRANSTAR-DUCERA-00001823, at 1825]

[194] Letter, Jeff Forlizzi to Ed Orzetti (Aug. 2, 2016). [TRANSTAR-DUCERA-00001759]

[195] Letter, Jeff Forlizzi to Rodica Dutka, "Re: Transtar Industries, Inc. ("Transtar") – 1st Lien (1L) Credit Facility Restructuring," at 1 (Aug. 4, 2016). [TRANSTAR-WFG-00016664, at 16664]

[196] *Id*. at 2. [TRANSTAR-WFG-00016664, at 16665]

[197] Presentation, "Transtar Industries, Inc. – 1st Lien Lender Discussion Materials – Restructuring Overview," at 4 (Aug. 8, 2016).

principle the following day.[198] On August 9, counsel for the First Lien committee expressed concern that an August 22 deadline in the draft RSA for two-thirds of First Lien debt-holders to join the deal created more opportunity for non-steering committee members to entertain bids in the marketplace amidst the possibility of Silver Point obtaining a blocking position.[199] The draft RSA was amended to the First Lien committee's satisfaction, and, on August 10, was signed by the Company, the Second Lien Steering Committee members, the Second Lien Agent, and the First Lien Steering Committee members.[200]

From Strickland's perspective, Silver Point's entrance did little to change the shared goals of everyone at the table—getting to the best result for all parties.[201] But that did not mean negotiations would be easy. Strickland believed that Silver Point had purchased First Lien debt with an eye toward owning Transtar.[202] She felt that by proposing to lighten some of Transtar's debt load, Silver Point was taking positions that ultimately would benefit Transtar more than its lenders, which unraveled some of the progress the First Liens had accomplished and slowed the pace of negotiations among the lenders.[203]

While the creditors' committees finalized the August RSA, Transtar again revised its financial projections. On August 9—the eve of signing day—Transtar released a "lender overview" that projected $40 million Total Adjusted EBITDA for 2016 based on the likelihood of a pre-packaged filing rather than an out-of-court restructuring.[204]

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[198] Email among Daniel Philion, Rachel Strickland, et al., "RE: Transtar update" (Aug. 10, 2016). [TRANSTAR-WFG-00019284, at 19288]

[199] *Id*. [TRANSTAR-WFG-00019284, at 19286-87]

[200] *Id.* [TRANSTAR-WFG-00019284, at 19284-85]

[201] Interview of Rachel Strickland (Feb. 17, 2017).

[202] *Id*.

[203] *Id*.

[204] Presentation, "Transtar Industries Lender Overview – August 9, 2016," at 18-19 (Aug. 9, 2016). [TRANSTAR-DUCERA-00001796, at 1813-1814]

On August 11—two days after Transtar's updated financial projections and one day after the creditor committees signed the August RSA—Forlizzi wrote again to the First Lien agent criticizing the August RSA framework.[205] Forlizzi attached a term sheet for a "Revised RSA" reflecting Silver Point's alternative proposal, which he argued would "provide a superior outcome for creditors and substantially increase Transtar's prospects for success upon emergence from chapter 11."[206] The proposed term sheet provided for general releases among all parties, but with exceptions for express contractual obligations and suits for willful misconduct or intentional fraud.[207] Silver Point shared the letter and draft term sheet with Willkie and the Second Lien representatives.[208]

The August RSA failed to obtain the supermajority support among First Lien lenders that it needed to become effective.[209] Then, on August 23, Transtar again lowered its financial projections, to 2016 Total Adjusted EBITDA of $36 million, with a similar number projected for 2017.[210] The analysis stated that, "[a]s the process is now assumed to conclude in early 2017 … the recovery is pushed to late 2017, with 2018 being the 'bounce-back' year."[211] It projected that Total Adjusted EBITDA would not return to 2015 levels until 2019.[212]

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[205] Letter, Jeff Forlizzi to Rodica Dutka, "Transtar Industries, Inc. ("*Transtar*") – Debt Restructuring" (Aug. 11, 2016). [TRANSTAR-WFG-00020253, at 20255]

[206] *Id*. [TRANSTAR-WFG-00020253, at 20255]

[207] Document, "Transtar: Proposed Restructuring Terms," at 9 (Aug. 11, 2016). [TRANSTAR-WFG-00020253, at 20265]

[208] Email among Evan Kramer, Rachel Strickland, et al., "Transtar – Letter & Term Sheet" (Aug. 11, 2016). [TRANSTAR-WFG-00020253]

[209] Interview of Ed Orzetti (Jan. 11, 2017).

[210] Presentation, "Transtar Industries 6 Month Process Scenario – August 23, 2016," at 3 (Aug. 23, 2016). [TRANSTAR-DUCERA-00001866, at 1868]

[211] *Id*. [TRANSTAR-DUCERA-00001866, at 1868]

[212] *Id*. [TRANSTAR-DUCERA-00001866, at 1868]

On August 30, counsel for the First Lien committee communicated to Silver Point that, though issues remained on a deal's contours, "[a]s a conceptual matter, we have adopted the SP Plan Sponsor construct."[213] Discussions thereafter focused on ironing out the details on a deal that would extinguish Second Lien debt and give the equity to First Lien holders. Emails from September 1 to September 6 show Silver Point and the First Lien Committee trading draft term sheets and comments on open issues.[214] Open issues included whether Silver Point's debt would be treated differently from other First Lien debt or whether a deal would involve "pro rata" conversion of First Lien debt for equity.[215]

On September 9, Ducera circulated an analysis comparing Silver Point's "pro rata" terms against a potential Transtar counter-proposal that would involve different treatment of Second Lien debt, greater compensation for Second Lien holders, and a management incentive plan.[216] This analysis did not mention an FFL release.

On September 28, Forlizzi emailed Speedstar's board that Silver Point was "meaningfully concerned by the Company's approach and actions over the last several weeks as it seeks to restructure," and that it sought a meeting with board members.[217] In response, Strickland asked Forlizzi what agenda items he wished to discuss.[218] Forlizzi replied that "[t]he particular agenda items we would like to discuss are whether the numerous requests we have received for 1)

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[213] Email among Jeff Forlizzi, Michael Messersmith, et al., "RE: Transtar – Subject to FRE 408" (Sep. 1, 2016). [TRANSTAR-WFG-00022332, at 22333]

[214] Email among Jeff Forlizzi, Agnes Tang, et al., "FW: Transtar – Subject to FRE 408" (Sep. 6, 2016). [TRANSTAR-WFG-00023828]

[215] *Id*. [TRANSTAR-WFG-00023828]

[216] Presentation, "September 2016 – Project Mission – Discussion Materials", at 4. [TRANSTAR-DUCERA-00001915, at 1920]

[217] Email among Rachel Strickland, Jeff Forlizzi, et al., "Re: Silver Point Capital / Transtar Holding Company" (Oct. 3, 2016). [TRANSTAR-WFG-00025317, at 25318]

[218] *Id*. [TRANSTAR-WFG-00025317, at 25317]

management's reorganized company equity plan and 2) sponsor releases are standing in the way of either getting a viable restructuring support agreement completed or filing for chapter 11."[219] Strickland disputed these characterizations, writing, "This is an incorrect statement phrased as an agenda. The open points on the RSA are numerous and substantive."[220] Forlizzi told the Examiner that his email was designed to pressure the board into stepping up the pace of negotiations.[221] The process was taking longer than he had anticipated, and he wanted the board to remain focused on the restructuring of Transtar rather than the release or the management incentive plan.[222]

4. October through November 2016—Finalization of Silver Point Deal, November RSA, and Chapter 11 Filing

During the first week of October, Transtar and the First Lien lenders (including Silver Point) traded draft RSAs and term sheets while negotiating with Second Lien lenders to obtain their consent to a deal.[223] On October 6, Strickland wrote to Michael Messersmith, of Kaye Scholer, and counsel to the First Lien committee, about open items, naming "The 2Ls/consensus, equity termsheet, MIP termsheet, among others."[224] On October 9, Levy suggested a "way to circumvent Silverpoint" to Messersmith and Strickland, to which Messersmith responded that he did not want "to tilt at windmills while the Company continues to lose value."[225]

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[219] *Id*. [TRANSTAR-WFG-00025317, at 25317]

[220] *Id*. [TRANSTAR-WFG-00025317, at 25317]

[221] Interview of Jeff Forlizzi (Jan. 12, 2017).

[222] *Id*.

[223] Email among Sarah Gryll, Michael Messersmith, et al., "RE: Transtar: Restructuring and DIP Term Sheets" (Oct. 4, 2016) [TRANSTAR-WFG-00025321]; Email among Agnes Tang, Neil Augustine, et al., "RE: Transtar: RSA and Term Sheets" (Oct. 6, 2016).

[224] Email between Michael Messersmith & Rachel Strickland, "Re: Transtar" (Oct. 7, 2016).

[225] Email among Michael Messersmith, Richard Levy, et al., "Re: Transtar" (Oct. 10, 2016). [TRANSTAR-WFG-00025675]

Silver Point soon requested substantial modifications to core aspects of the emerging deal. On October 11, Forlizzi communicated that "most" of the First Lien committee's draft equity sheet "doesn't work for us."[226] On October 14, Forlizzi wrote Transtar and the First Lien committee that Transtar's "overlevered financial position has been increasingly harming its prospects," and that "[w]e do not think the level of indebtedness/liquidity/runway we previously were supporting remains a workable solution."[227] According to Forlizzi, Transtar was at an annual run-rate of about $20 million EBITDA, and it was "prudent to assume" that revenues would decline during a bankruptcy case.[228] Forlizzi proposed reductions in "Takeback 1L," and increases in the "Super-Senior DIP/Exit," the "ABL carve-out," and a covenant holiday.[229]

On October 17, Silver Point's counsel circulated a list of "open issues from SP's perspective relating to the RSA and term sheets."[230] The email went to counsel for the First Lien committee (Kaye Scholer) and Transtar (Willkie), but not to counsel for the Second Lien committee or FFL.[231] On the list of open issues, the third item was "Please provide an update on status of Sponsor release proposal."[232] Strickland forwarded this email to Nestor, copying Neil Townsend, writing "looks like it would be best for you to call [counsel to Silver Point] Steve Wilamowsky directly."[233] Nestor replied, "Agreed—are you free tomorrow morning for a quick

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[226] Email among Jeff Forlizzi, Rachel Strickland, et al., "Re: Transtar – Equity Term Sheet" (Oct. 11, 2016). [TRANSTAR-WFG-00025684, at 25684]

[227] Email among Jeff Forlizzi, Agnes Tang, et al., "Transtar/Leverage" (Oct. 14, 2016). [TRANSTAR-WFG-00025919, at 25919]

[228] *Id*. [TRANSTAR-WFG-00025919, at 25919]

[229] *Id*. [TRANSTAR-WFG-00025919, at 25919]

[230] Email among Michael Nestor, Neil Townsend, et al., "RE: Transtar: Issues List" (Oct. 21, 2016). [YCST12011, at 12012]

[231] *Id*. [YCST12011, at 12012]

[232] *Id*. [YCST12011, at 12012]

[233] *Id*. [YCST12011, at 12011]

catch-up before I speak with him?"[234] Townsend responded "yes," and provided his availability.[235] Four days later, on October 21, this email thread picked up again, with Nestor asking Townsend and Strickland if they were available for a call the following day.[236] At least once shortly after this exchange, Fleischer contacted Townsend directly to share the status of release negotiations and pass along the advice that Nestor had offered to Fleischer regarding a release.[237] Townsend said he did not give FFL advice regarding any aspect of the release.[238]

Townsend did contact FFL at the end of October with a plan that might have resolved the release issue. "Something I thought of," wrote Townsend to Duggal, Fleischer, and Nestor: "Is there a scenario where FFL would buy the alma/atco/fleet businesses or a subset of them for a dollar and a release?"[239] Duggal and Townsend discussed the merits of the idea via email and phone, but the plan never went anywhere.[240] Townsend said he was "wearing the Company hat" while making this suggestion, as he was trying to address a particular problem for Transtar: Orzetti wanted a bankruptcy to be as short and painless as possible.[241] Silver Point was looking for ways to shut down the Alma/Atco/Fleet businesses, but knew it would be difficult and costly during bankruptcy.[242] Townsend thought it might make sense to sell the businesses to FFL, who

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[234] *Id*. [YCST12011, at 12011]

[235] *Id*. [YCST12011, at 12011]

[236] *Id*. [YCST12011, at 12011]

[237] Interview of Neil Townsend (Feb. 23, 2017); *see also* Email between Spencer Fleischer & Neil Townsend, "Re: []," (Oct. 24, 2016). [WFG-TSEXAMINER00040187]

[238] Interview of Neil Townsend (Feb. 23, 2017).

[239] Email among Rajat Duggal, Spencer Fleischer, et al., "RE: Something I thought of" (Oct. 25, 2016). [WFG-TSEXAMINER00023241, at 23242]

[240] *Id*. [WFG-TSEXAMINER00023241, at 23241]; Interview of Neil Townsend (Feb. 23, 2017).

[241] Interview of Neil Townsend (Feb. 23, 2017).

[242] *Id*.

already understood the entities and could take them off Transtar's hands quickly.[243] Townsend said he did not know why FFL did not pursue the idea.[244]

This period also saw Transtar lower its financial projections further. On October 26, Transtar forecast Total Adjusted EBITDA in 2016 to be $25 million, followed by estimated $20 million in 2017, and $28 million in 2018.[245] Its presentation explained, "As the process is now assumed to conclude in April 2017, the negative effects are significantly more detrimental to the 'top-line' of the business and, in addition to significant impact to 2017, carry into 2018 and 2019."[246]

Early November saw apparent resolutions of two outstanding issues on the pending deal structure. Nestor had been negotiating with Chaim Fortgang, an advisor for Silver Point, over the terms of a release.[247] Nestor initially had recommended to FFL that it not offer any payment for its release as a baseline for negotiations; Fortgang set Silver Point's opening offer at $10 million.[248] On November 5, Nestor reported to FFL's Fleischer and Duggal and Willkie's Strickland and Townsend that he had spoken with Fortgang and "3mm gets it down [sic]."[249] Shortly thereafter, Fleischer wrote "We have an agreement and Mike is going to be in touch with the language you requested."[250] Later that evening, Nestor sent language to Strickland and Hardy memorializing a full release of FFL in exchange for, in chief, a $2.5 million payment.[251] On November 6, Neil

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[243] *Id.*

[244] *Id.*

[245] Presentation, "Transtar Industries 6 Month DIP," at 3 (Oct. 26, 2016). [TRANSTAR-DUCERA-00002019, at 2021]

[246] *Id.* [TRANSTAR-DUCERA-00002019, at 2021]

[247] Interview of Michael Nestor (Feb. 20, 2017).

[248] *Id.*

[249] Email among Rachel Strickland, Michael Nestor, et al., "Re: Transtar" (Nov. 5, 2016). [YCST14530, at 14532]

[250] *Id.* [YCST14530, at 14532]

[251] *Id.* [YCST14530, at 14530]

Augustine of the Second Lien lender group informed Forlizzi that the members of the Second Lien committee would consent to a deal in exchange for a $4.5 million cash distribution.[252] That day, the Speedstar board met to discuss the proposal, and Scher approved the terms of the release "to be in the best interests of the Company and its lender constituents."[253] These provisions were reflected in an updated draft RSA Willkie sent to Silver Point on November 7.[254] The red-line version of that document shows the addition of language providing for each Second Lien lender to receive its pro rata share of $4.5 million in cash, and separate language providing that the Sponsor "shall contribute $2.5 million in cash … in exchange for being released."[255]

The Second Lien deal did not last. On November 9, Augustine informed Willkie and Silver Point that he no longer had his group's support for involvement in the deal.[256] Nestor, Strickland, and Townsend thereafter communicated about whether it made sense for FFL to sign the deal without the Second Lien lenders' consent to the release, with Townsend opining that there was "little down side to signing."[257] Several hours later, Nestor wrote to Willkie: "FFL is good with the 2.5mm – please strike 'materially' and ensure that releases are subject to sole discretion of FFL."[258] Nestor later said FFL considers this an overpayment, and FFL did not have concerns about a potential claim.[259]

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[252] Email among Agnes Tang, Rachel Strickland, et al., "RE: RE:" (Nov. 6, 2016).

[253] Speedstar Holding Corporation, Minutes of Board Meeting (Nov. 6, 2016).

[254] Email among Christopher Koenig, Jeff Forlizzi, et al., "RE: Transtar: Updated RSA" (Nov. 7, 2016). [TRANSTAR-WFG-00033729]

[255] Document, "Transtar: Proposed Restructuring Terms (WF&G Draft 11/7/2016)," at 10. [TRANSTAR-WFG-00033729, at 33755]

[256] Email among Agnes Tang, Jeff Forlizzi, et al., "FW:" (Nov. 9, 2016).

[257] Email among Michael Nestor, Neil Townsend, et al., "RE: Release" (Nov. 11, 2016). [YCST14023, at 14023]

[258] Email among Michael Nestor, Rachel Strickland, et al., "RE: Release" (Nov. 11, 2016). [TRANSTAR-WFG-00034992, at 34992]

[259] Interview of Michael Nestor (Feb. 20, 2017).

On November 18, Transtar, Silver Point, and FFL executed an RSA.[260] The RSA term sheet provided for a new delayed draw loan facility, a conversion of First Lien Debt into 100% of the equity of the reorganized company, discharge of all Second Lien loan obligations,[261] distribution of $500,000 on unsecured claims, and cancellation of FFL's equity in Speedstar.[262] The term sheet also provided for a $2.5 million payment from FFL in exchange for release of all claims against it.[263] Transtar filed its chapter 11 case two days later, on November 20, 2016.[264]

5. Willkie's Engagement and Disclosures in the Chapter 11 Cases

On July 7, 2016, Willkie staff circulated a Conflicts Inquiry to all Willkie attorneys regarding Willkie's retention by Transtar to facilitate required disclosures "in the event that Transtar files for chapter 11." The email asked the receiving attorneys to review an attached list of parties in interest for family or firm ties and to respond "No conflict" "Yes conflict" or "Possible conflict."[265] The list of parties in interest did not include Silver Point Capital, which was not yet involved in negotiations.

On October 28, 2016, expecting a Transtar chapter 11 filing within the next week, a Willkie staff member again asked the Conflicts Department to rerun the conflict check.[266] The attached

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[260] Document, "Restructuring Support Agreement (Execution Version)" (Nov. 18, 2016). [TRANSTAR-WFG-00039372]

[261] Document, "Transtar: Proposed Restructuring Terms," at 1-2 (Nov. 18, 2016). [TRANSTAR-WFG-00039372, at 39402-03]

[262] *Id*. at 11, 13. [TRANSTAR-WFG-00039372, at 39412, 39414]

[263] *Id*. at 13. [TRANSTAR-WFG-00039372, at 39414]

[264] Voluntary Petition for Non-Individuals Filing for Bankruptcy, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Nov. 20, 2016), ECF No. 1.

[265] *Id*.

[266] Email, [Staff member] to Conflicts Requests & Inquiries (Oct. 28, 2016). [WFG-TSEXAMINER00023250]

list of parties in interest, unlike the list attached to the February and July 2016 checks, included Silver Point Capital.[267] The Conflicts Department promptly responded with the results.

The October conflicts check showed a relationship between Willkie and Silver Point. Willkie had represented Silver Point on a handful of matters, including some that were still open as of the petition date.[268] Strickland herself had earlier in 2016 represented an ad hoc committee of large debtholders of which Silver Point was a member.[269] Strickland billed only 10 hours to the matter, out of a total of 46 Willkie hours,[270] and Silver Point did not pay Willkie on that matter.[271] All payments from Silver Point represented less than 0.05% of Willkie's total revenue for each of the three years leading up to the Transtar petition date.[272] In 2016, Willkie attorneys billed about 1,110 hours to matters in which Silver Point was a client, but over 80% of those hours were on matters in which Willkie represented a group of creditors that included Silver Point; and the remainder were directly for Silver Point principally on claims trading matters.[273] Based on the Examiner's investigation, it does not appear that any attorneys working on the Transtar matter—

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[267] *Compare* Transtar – Parties in Interest List – INTERNAL USE ONLY.DOC [WFG-TSEXAMINER00023251] *with* [WFG-TSEXAMINER0016169, at 16171] *and* [WFG-TSEXAMINER00000001, at 0003-0004].

[268] Conflict Report, "Transtar Holding Company/General Chapter 11," at 32-40 (Nov. 21, 2016). [WFG-TSEXAMINER00000676, at 1144-52]

[269] Interview of Rachel Strickland (Feb. 17, 2017).

[270] Response of Willkie to the Examiner's request for certain time records. [WFG-TSEXAMINER00039891]; Response of Willkie to the Examiner's request for information regarding Willkie's representation of Silver Point, Email, James Fitzmaurice to Richard Levin, Elizabeth Edmondson, et al., "In re: DACCO Transmission Parts (NY), Inc., et al. (Feb. 24, 2017).

[271] Interview of Rachel Strickland (Feb. 17, 2017); Email among Rachel Strickland, [Staff member], et al., "Re: Brian wants me to file updated disclosure before Tuesday." (Dec. 19, 2016). [WFG-TSEXAMINER00039204, at 9206]

[272] Response of Willkie to the Examiner's request for certain revenue information. [WFG-TSEXAMINER00040134]

[273] Response of Willkie to the Examiner's request for information regarding Willkie's representation of Silver Point, Email among James Fitzmaurice, Richard Levin, Elizabeth Edmondson, et al., "In re: DACCO Transmission Parts (NY), Inc., et al. (Feb. 24, 2017).

including attorneys at Willkie—realized during negotiations that Silver Point was a Willkie client.[274] Speedstar's board members, including Scher and Orzetti, also did not know during negotiations that Silver Point was a Willkie client.[275] Scher told the Examiner in January 2017 that Willkie's representation of Silver Point was "news to [him]."[276] He said that, had he known during negotiations, he might have required Willkie to create an "ethical wall" or to retain separate counsel to deal with matters related to Silver Point.[277] However, he appeared to have been aware of Willkie's concurrent representation of FFL since he joined the Board but did not say during his interview anything about an ethical wall between attorneys working on FFL matters and Transtar matters.

On November 21, 2016, Willkie staff formally opened a new client account within the firm.[278] The new client/matter form listed Townsend as the supervising partner, Strickland as the billing partner, and James Burbage, Jennifer Hardy, Christopher Koenig, and Debra McElligott as the other attorneys expected to be active on the case.[279] It also contained the same list of parties in interest and the results of a conflicts check dated the same day.[280]

After completion of the conflicts check, Andrew Colocotronis, an attorney in the Willkie conflicts department, emailed the results to Dan Kozusko, associate general counsel for the

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[274] *See* Interview of Rachel Strickland (Feb. 17, 2017); Interview of Michael Nestor (Feb. 22, 2017); Interview of Neil Townsend (Feb. 23, 2017).

[275] Interview of Brad Scher (Jan. 11, 2017); Interview of Ed Orzetti (Feb. 12, 2017).

[276] Interview of Brad Scher (Jan. 11, 2017).

[277] *Id*.

[278] New Client/Matter Form, "Transtar Holding Company/General Chapter 11" (Nov. 21, 2016). [WFG-TSEXAMINER00000676]

[279] *Id*. at 1. [WFG-TSEXAMINER00000676, at 0676]

[280] New Client/Matter Form, "Transtar Holding Company/General Chapter 11" (Nov. 21, 2016). [WFG-TSEXAMINER00000676]; *see also* email, Cheryl Hinds to "CONFLICTS – FIRM WIDE; CONFLICTS DIST. TO ADMIN." "NEW CLIENT/MATTERS – CONFLICT CHECK (PART 2)" (Nov. 21, 2016). [WFG-TSEXAMINER00000664]

firm.[281] Colocotronis noted that Transtar was a portfolio company of FFL and that Willkie was "replaced by FFL as its counsel just prior to a reorg attempt (the 'Kirkland & Ellis model')."[282] Colocotronis reported that only one creditor (not Silver Point) had posed a potential conflict, but that the creditor had been paid nearly in full such that it was no longer adverse in the case.[283] "OK," Kozusko responded, "if anything changes, we'll address the conflicts issues as they arise."[284]

Willkie attorneys and staff began preparing a declaration of Strickland under Bankruptcy Rule 2014, to be included with Transtar's application for court approval to employ the firm. Willkie staff used the conflicts report to draft disclosures of connections the firm held with parties in interest in the Transtar chapter 11 case.[285] Strickland forwarded an initial draft of the disclosure language describing Willkie's relationship with FFL to Townsend for review.[286] The initial draft said Willkie's representation of FFL "terminated at the time the Debtors hired WF&G to represent it in these chapter 11 cases."[287] Townsend asked her to make clear that Willkie had stopped representing FFL "long before" the firm was engaged to represent Transtar in its bankruptcy and that FFL had hired Young Conaway early in the restructuring process.[288] Strickland and her staff edited the language to reflect that Willkie's representation of FFL "was terminated prior to the

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[281] Email among Darlene Rogers, Michael Mrozek, et al. "FW: NBI 14207 (TRANSTAR HOLDING)" (Nov. 30, 2016). [WFG-TSEXAMINER00000674, at 0674-75]

[282] *Id.* [WFG-TSEXAMINER00000674, at 0675]

[283] *Id.* [WFG-TSEXAMINER00000674, at 0675]

[284] *Id.* [WFG-TSEXAMINER00000674, at 0674]

[285] Email among [Staff member], Rachel Strickland, et al., "Transtar: FFL Disclosure" (Nov. 28, 2016). [WFG-TSEXAMINER00036088, at 36090]

[286] *Id.* [WFG-TSEXAMINER00036088, at 36089]

[287] *Id.* [WFG-TSEXAMINER00036088, at 36090]

[288] *Id.* [WFG-TSEXAMINER00036088, at 36089]

time the Debtors hired WF&G to represent it in these chapter 11 cases and FFL hired separate counsel in connection with these cases."[289]

Strickland said she personally reviewed her declaration before it was filed, but she did not review the conflicts report.[290] Based on the Examiner's investigation, it appears that at least three Willkie attorneys and one staff member reviewed Strickland's declaration before it was filed.[291] But the investigation did not reveal whether any of those attorneys reviewed the conflicts report on which the declaration was based.

During this time, Willkie posted an announcement on its intranet and on the "News & Events" tab on its public website describing its role leading up to the "filing and solicitation of a prepackaged plan of reorganization" for Transtar.[292] The statement said the matter was "being handled by partners Neil Townsend, Rachel Strickland and Leonard Klingbaum; and associates Jennifer Hardy, Christopher Koenig, Debra McElligott, James Burbage, Daniel Philion, Eric Neidle and Adam Keith."[293]

Transtar filed its application for approval of Willkie's employment, including the Strickland Declaration (the "**Initial Declaration**"), on December 3, 2016.[294] The Initial Declaration listed Strickland, Klingbaum, Hardy, Koenig, McElligott, and Burbage as the attorneys with

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[289] *Id.* [WFG-TSEXAMINER00036088, at 36088]

[290] Interview of Rachel Strickland (Feb. 17, 2017).

[291] *Id.* [WFG-TSEXAMINER00036088]; Interview of Rachel Strickland (Feb. 17, 2017).

[292] WILLKIE, "*Transtar Files for Chapter 11 Bankruptcy Protection*" (Nov. 29, 2016), http://www.willkie.com/news/2016/11/transtar-files-for-bankruptcy-protection (last visited Feb. 27, 2017); *see also*, Email among [Staff member], Jennifer Hardy, et al., "RE: Transtar Deal Description for WillkieNet," (Nov. 28, 2016). [WFG-TSEXAMINER00036079]

[293] *Id*.

[294] Debtors' Application to Employ and Retain Willkie Farr & Gallagher LLP as Counsel to Debtors and Debtors in Possession Pursuant to Sections 327(a), 328(a) and 1107(b) of the Bankruptcy Code, Bankruptcy Rule 2014 and Local Rule 2014-a *Nunc Pro Tunc* to the Petition Date, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 3, 2016), ECF No. 70.

primary responsibility for the matter.[295] It did not mention Townsend, Philion, Neidle, or Keith.[296] Townsend said he was not involved in deciding which attorneys to list on the Initial Declaration but likely would have made the same choices: he had not expected to play a heavy role once Transtar filed its chapter 11 petition.[297] The Initial Declaration also listed a handful of specific connections Willkie had with interested parties, including FFL:

> Prior to its representation of the Debtors in these cases, WF&G represented FFL Partners, LLC and certain of its affiliated funds (collectively, "FFL") in connection with its investment in the Debtors and other transactions related to the debtors. WF&G's representation of FFL in relation to the Debtors was terminated prior to the time the Debtors hired WF&G to represent it in these chapter 11 cases and FFL hired separate counsel in connection with the discussions and negotiations that led to these cases, as well as in connection with these cases. WF&G still represents FFL on matters completely unrelated to these cases and intends to continue to represent FFL on any additional matters unrelated to the Debtors or these cases. FFL represented less than 2% of the Firm's revenue in 2014 and 2015 and represents less than 1% of the Firm's revenue in 2016.[298]

The Initial Declaration included Silver Point on the list of potential parties in interest that Willkie used to determine connections.[299] However, the Initial Declaration did not disclose that Willkie represented Silver Point on prior and current matters.

According to Strickland, counsel for the U.S. Trustee contacted Willkie attorneys about the possible appointment of an examiner and said she had been surprised to learn that Willkie had represented FFL in connection with its acquisition of Transtar.[300] Strickland was surprised by counsel's reaction; she believed that the Initial Disclosure had disclosed Willkie's entire

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[295] Initial Declaration at 8.

[296] *Id.*

[297] Interview of Neil Townsend. (Feb. 23, 2017).

[298] Initial Declaration at 5-6.

[299] *Id.* at Schedule 1.

[300] Interview of Rachel Strickland (Feb. 17, 2017).

relationship with FFL.[301] Out of an abundance of caution, Strickland asked her team to include the word "acquisition" in a supplemental declaration describing the work Willkie had performed for FFL relating to Transtar.[302] She also called Brian O'Connor, Willkie's general counsel, to discuss the issue.[303] During the conversation, O'Connor asked Strickland if she knew that Willkie represented Silver Point in unrelated matters.[304] Strickland decided it was necessary to add Silver Point to Willkie's disclosures in the supplemental declaration that included the new FFL language.[305]

Strickland conferred with her team to draft an updated declaration. Hardy asked what matters Willkie currently had open for Silver Point.[306] Strickland said she had closed an inactive matter the previous week that should have been closed long ago, and Hardy identified another recent engagement.[307] Hardy instructed a staff member to make the Silver Point disclosure "sound as innocuous as it is."[308] The staff member circulated draft language for a Silver Point disclosure. Strickland approved.[309]

Strickland asked the staff member why the Silver Point connection was not listed in the Initial Declaration.[310] The staff member explained that Silver Point appeared in the November conflicts check results, but was omitted from the Initial Declaration.[311] "It was a complete

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[301] *Id.*

[302] *Id.*

[303] *Id.*

[304] *Id.*

[305] *Id.*

[306] Email among Jennifer Hardy, Rachel Strickland, et al., "Re: Brian wants me to file updated disclosure before Tuesday." (Dec. 19, 2016). [WFG-TSEXAMINER00039204, at 9206]

[307] *Id.* [WFG-TSEXAMINER00039204, at 9206]

[308] *Id.* [WFG-TSEXAMINER00039204, at 9206]

[309] *Id.* [WFG-TSEXAMINER00039204, at 9205]

[310] *Id.* [WFG-TSEXAMINER00039204, at 9205]

[311] *Id.* [WFG-TSEXAMINER00039204, at 9204]

oversight that it wasn't included" in the Initial Declaration, "100% my fault."[312] Strickland responded, "Fault is truly a non-issue from my perspective and I am 0% angry."[313] Strickland told the staff member she just wanted to be sure the system was improved going forward.[314] The staff member said work was proceeding with O'Connor to implement a process in which an attorney would sign off on the draft declaration "as another set of eyes."[315]

Before filing her supplemental declaration, Strickland sent a draft to U.S. Trustee's counsel for review.[316] Strickland then filed her supplemental declaration on December 29, 2016.[317] The supplemental declaration disclosed Willkie's representation of FFL in FFL's acquisition of Transtar.[318] It also disclosed Willkie's connection with Silver Point:

> Silver Point Capital, L.P. ("Silver Point") is a pre and postpetition secured lender in these cases. WF&G currently represents and has represented in the past Silver Point in connection with matters wholly unrelated to the Debtors or these cases. WF&G has never represented Silver Point in connection with the Debtors or these cases. I believe that WF&G's representation of Silver Point would not give rise to a finding that WF&G represents or holds an interest adverse to the Debtors with respect to the services for which WF&G is retained.[319]

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[312] *Id.* [WFG-TSEXAMINER00039204, at 9205]

[313] *Id.* [WFG-TSEXAMINER00039204, at 9204]

[314] *Id.* [WFG-TSEXAMINER00039204, at 9204]

[315] *Id.* [WFG-TSEXAMINER00039204, at 9204]

[316] Interview of Rachel Strickland (Feb. 17, 2017).

[317] First Supplemental Declaration of Rachel C. Strickland in Support of Application to Employ and Retain Willkie Farr & Gallagher LLP as Counsel to Debtors and Debtors in Possession, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 29, 2016), ECF No. 161.

[318] *Id.* at 3.

[319] *Id.*

6. The Examiner Appointment and Willkie's Withdrawal

On December 22, 2016, the Court entered an order authorizing the appointment of an examiner.[320] The Examiner was appointed on December 28, 2016 and immediately began his investigation.[321] During the examination, Silver Point and the Second Lien lenders reached an agreement on a revised chapter 11 plan.[322] The Court approved a revised Examiner Work Plan that limited the scope of the examination to matters related to the employment of counsel for Transtar, including actual or potential conflicts of interest, disinterestedness, and disclosures.[323]

On January 20, 2017, Willkie announced to the Court that it would be withdrawing as debtors' counsel for Transtar,[324] because it could not provide legal advice on the production of Transtar's privileged documents pertaining to potential conflict issues.[325] The Court granted Willkie's motion to withdraw as debtor's counsel on February 1, 2017.[326]

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[320] Stipulation and Order By and Between the United States Trustee and the Debtors for the Appointment of an Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 22, 2016), ECF No. 147.

[321] Order, Pursuant to Fed. Bankr. P. 2007.1, Approving United States Trustee's Appointment of Richard Levin as Examiner, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Dec. 28, 2016), ECF No. 158; Motion to Approve Examiner's Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 10, 2016), ECF No. 189.

[322] Transcript of Record at 25-29, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 24, 2017).

[323] Motion to Approve Examiner's Revised Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 17, 2017), ECF No. 215.

[324] Debtors' Interim Objection to Examiner's Proposed Protective Order at 2, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 20, 2017), ECF No. 221.

[325] *Id.*

[326] Order Granting Motion of Willkie Farr & Gallagher LLP to Withdraw, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Feb. 1, 2017), ECF No. 256.

IV. Prepetition Analysis

A. New York Conflict of Interest Rules

1. In General

The New York Rules of Professional Responsibility (the "**NY Rules**") apply here.[327] NY Rule 1.7 governs representations involving a conflict of interest among current clients:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:
>
> (1) the representation will involve the lawyer in representing differing interests; or
>
> (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.
>
> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.[328]

Except as provided in paragraph (b), paragraph (a)(1) prohibits a lawyer's concurrent representation of adverse parties in the same matter, representation of a party adverse to a client in a related matter, and representation of a party adverse to a current client even in an unrelated

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[327] The Examiner analyzed Willkie Farr's conduct under the NY Rules and Second Circuit cases interpreting those rules. The NY Rules' choice of law principles embodied in Rule 8.5, and applicable through Local Civil Rules 1.3 & 1.5 of the U.S. District Courts for the Southern and Eastern Districts of New York, dictate that an application of the substantive NY Rules is appropriate. Further, federal courts have an inherent power to regulate the conduct of attorneys who appear before them, *see Hempstead Video, Inc. v. Village of Valley Stream*, 409 F.3d 127, 132 (2d Cir. 2005), and the Second Circuit already has developed a body of law regarding professional responsibility that is based substantially on the NY Rules their predecessors, and New York state case law interpreting those ethical guidelines. Those factors all dictate the application of New York law to this matter.

[328] NY Rules r. 1.7.

matter.[329] Paragraph (a)(2), which is also subject to the exceptions in paragraph (b), requires a more subjective analysis of whether the lawyer's various interests outside the representation of an adverse party would impair the lawyer's ability to exercise professional judgment on behalf of the client.[330] This paragraph implicates a host of sources of conflict, from the lawyer's own financial interests, to the representation of co-parties in a suit, to personal relationships with parties in a case.[331]

NY Rule 1.7(b) sets forth a conjunctive series of conditions that will "cure" a conflict of interest if all factors are met. It thus identifies the circumstances in which a conflict cannot be waived—when any of the four conditions listed is *not* met. NY Rule 1.7(b)(1) prohibits waiver of a conflict if it is not reasonable to believe that the circumstances would permit the lawyer to obey the duties of loyalty and care to the client; NY Rule 1.7(b)(2) prohibits the waiver of conflicts where the conflicted representation otherwise is prohibited by law; NY Rule 1.7(b)(3) creates a *per se* ban on the representation of two clients directly adverse to each other in the same litigation or other proceeding before a tribunal; and NY Rule 1.7(b)(4) prohibits the waiver of a conflict of interest without the informed, written consent of all affected clients.

The Second Circuit has developed its own body of law to determine when a conflict of interest disqualifies an attorney from representing a client.[332] In so doing, courts "balance 'a

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[329] *See* ELLEN J. BENNETT ET AL., AM. BAR ASSOC., ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 143-44 (8th ed. 2015) ("BENNETT, ANNOTATED RULES").

[330] *See id.* at 146.

[331] *Id.* at 146-52; NY Rules r. 1.7, cmt. 26.

[332] Because this examination arises in a chapter 11 case and its consequences, if any, are likely to be dealt with in the bankruptcy court, the legal analysis focuses on federal court decisions. Federal courts bear the responsibility for the supervision of the attorneys who appear before them. *Hull v. Celanese Corp.*, 513 F.2d 568, 571 (2d Cir. 1975). In the Southern District of New York, the local rules incorporate state ethics rules such that that issues of professional conduct are "essentially governed by New York law." *JPMorgan Case Bank ex rel. Mahonia Ltd. & Mahonia Nat. Gas v. Liberty Mut. Ins. Co.*, 189 F. Supp. 2d 20, 22 (S.D.N.Y. 2002); *see also Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir. 1976) (noting that state ethics rules "are recognized by both Federal and State Courts as appropriate guidelines for the

client's right freely to choose his counsel' against 'the need to maintain the highest standards of the profession.'"[333] This body of law is based substantially on New York's ethical rules.[334]

The standard that courts in the Second Circuit employ to determine whether a disqualifying conflict of interest exists depends on whether the conflict arises from concurrent representation of two adverse clients or from successive representation.[335] If the attorney seeks to represent a party adverse to a former client, the "substantial relationship" test applies.[336] Under that test, an attorney may be disqualified if "there is a substantial relationship between the subject matter of the counsel's prior representation of the [former client] and the issues in the present lawsuit" and the attorney "had access to, or was likely to have had access to, relevant privileged information in the course of his prior representation."[337]

An attorney's concurrent representation of two adverse parties is "prima facie improper," and "the attorney must be prepared to show … that there will be no actual or *apparent* conflict in loyalties or diminution in the vigor of his representation,"[338] "[b]ecause 'an attorney must avoid

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professional conduct of New York lawyers."). "[T]his construction avoids subjecting attorneys to potentially inconsistent sets of ethical requirements in the state and federal courts within the same geographic area. This factor is particularly important because many ethical rules apply even before an action is filed and the forum designated." *Polycast Tech. Corp. v. Uniroyal, Inc.*, 129 F.R.D. 621, 624 (S.D.N.Y. 1990).

[333] *GSI Commerce Sols., Inc. v. BabyCenter, L.L.C.*, 618 F.3d 204, 209 (2d Cir. 2010) (quoting *Hempstead Video*, 409 F.3d at 132)).

[334] *See Hempstead Video*, 409 F.3d at 132. Many federal courts within New York base their analysis on the New York Code of Professional Responsibility and its associated Disciplinary Rules and Ethical Considerations. The New York Code of Professional Responsibility was replaced by the NY Rules in 2009, and the current NY Rule 1.7 is analogous to the Disciplinary Rules and Ethical Considerations associated with Canon 5 of the old Code of Professional Responsibility. *See* Roy Simon, *Comparing the New NY Rules of Professional Conduct to the NY Code of Professional Responsibility*, NYPRR, available at http://www.nysba.org/correlationchart/.

[335] *Hempstead Video*, 409 F.3d at 133.

[336] *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir. 1976).

[337] *Hempstead Video*, 409 F.3d at 133 (quoting *Evans v. Artek Sys. Corp.*, 715 F.2d 788, 791 (2d Cir. 1983).

[338] *Cinema 5 Ltd.*, 528 F.2d at 1387.

not only the fact, but even the appearance, of representing conflicting interests.'"[339] This more stringent test applies even if the attorney's concurrent representation of more than one client is in unrelated matters.[340] "[T]he lawyer who would sue his own client, asserting in justification the lack of 'substantial relationship' between the litigation and the work he has undertaken to perform for that client, is leaning on a slender reed indeed."[341]

"An attorney's conflicts are ordinarily imputed to his firm based on the presumption that 'associated' attorneys share client confidences."[342] The Second Circuit modified the hardline rule that the conflicts of one firm attorney *always* will be imputed to every other lawyer at the firm.[343] The Circuit instead uses a two-step analysis that allows an attorney to rebut the presumption that a conflict infects the entire firm. Courts determine: (1) "whether an attorney [whose client representation creates a conflict] is 'associated' with the firm," and, if so; (2) whether the associated attorney can rebut the presumption of shared confidences with firm colleagues by showing "practices and structures that protect client confidences within a firm."[344] Still, this is a heavy burden to meet, and a conflict of one firm attorney normally will be imputed to colleagues.[345]

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[339] *Id.* (quoting *Edelman v. Levy*, 42 App.Div.2d 758, 346 N.Y.S.2d 347 (2d Dept. 1973)).

[340] *GSI Commerce Sols.*, 618 F.3d at 210.

[341] *Id.* (quoting *Cinema 5 Ltd.*, 528 F.2d at 1386).

[342] *Hempstead Video*, 409 F.3d at 133; *see also* NY Rules r. 1.10(a) ("While lawyers are associated with a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rule 1.7, 1.8, or 1.9, except as otherwise provided therein.").

[343] *See Hempstead Video*, 409 F.3d at 133 ("[T]here is a 'strong trend,' which we join, toward allowing the presumption of confidence sharing within a firm to be rebutted ….").

[344] *Id.* at 134, 137.

[345] Compare the rather unusual facts of *Hempstead* with the more common scenario in *Cohen v. Strouch*, No. 10 Civ. 7828(DLC), 2011 WL 1143067 (S.D.N.Y. Mar. 24, 2011), in which a firm sought to represent a plaintiff in a suit stemming from a car accident, while its "of counsel" attorney simultaneously represented another party adverse to the plaintiff in a suit stemming from the same accident. There, the *Cohen* court had no trouble disqualifying the firm on the grounds that the "of counsel" attorney created a conflict that should be imputed to the firm as

Many conflicts of interest may be waived with client consent. On this point, the Second Circuit's case law follows the language of New York Rule 1.7(b). Generally, a law firm may maintain conflicted representations if it receives the express, informed consent of all affected clients.[346] But even consent of clients cannot cure a conflict in certain circumstances, including situations where the firm does not reasonably believe it can "provide competent and diligent representation" to the conflicted clients.[347] These situations often arise "[w]hen one [client]'s interest could adversely affect the other."[348]

2. Conflict Rules in Non-Litigation Matters

The NY Rules also apply to lawyers' conduct outside of litigation, although the analysis for out-of-court representations differs from that for representations in court. The comments to NY Rule 1.7 explicitly contemplate that "[c]onflicts of interest under paragraph (a)(1) arise in contexts other than litigation."[349] Whether a conflict exists where a lawyer represents multiple clients in an out-of-court matter must be evaluated on a case-by-case basis:

> For example, a lawyer may not represent multiple parties to a negotiation if their interests are fundamentally antagonistic to one another, but common representation is permissible where the clients are generally aligned in interest, even though there is some difference in interest among them. Thus, a lawyer may seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis. Examples include helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest, and arranging a property distribution in settlement of an estate. The lawyer seeks to

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a whole. 2011 WL 1143067, at *3 ("The concurrent representation of Cohen and Wikautan in actions arising out of the same motor vehicle accident by attorneys associated with each other at [the firm] is a violation of Rule 1.7, prima facie improper and requires disqualification in this Circuit.").

[346] *See GSI Commerce Sols.*, 618 F. 3d at 212.

[347] *Cohen*, 2011 WL 1143067, at *5; *accord* NY Rules r. 1.7(b)(1).

[348] *Cohen*, 2011 WL 1143067, at *5.

[349] NY Rules r. 1.7 cmt. 26.

> resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party might have to obtain separate representation, with the possibility of incurring additional cost, complication or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them.[350]

This is a notable distinction from the conflict analysis in the litigation context; NY Rule 1.7(b)(3) creates an absolute bar against representation of opposing parties in the same litigation (even with client consent), but the rule is not so rigid when assessing the representation of multiple clients out of court.

Courts have provided little additional guidance on non-litigation conflicts, leaving others to fill the gap. Noting this sparse precedent, the Professional Ethics Committee of the New York City Bar issued Formal Opinion 2001-2: Conflicts in Corporate and Transactional Matters ("NYCB Opinion 2001-2"), which is helpful.[351] NYCB Opinion 2001-2 offers five factors to consider when evaluating whether a conflict in a transactional setting is permissible: (1) how adversarial the relationship is between the attorney's clients and whether that adversarial relationship would require the attorney to negotiate against the other client or the attorney's firm; (2) the likelihood that confidential information in one matter will be relevant to the other matter; (3) the ability of the lawyer to ensure that client confidences will be preserved and confidential information segregated; (4) the ability of the lawyer to explain, and the clients' ability to understand, the risks of the conflict such that the clients can provide truly informed consent; and (5) whether the lawyer

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[350] NY Rules r. 1.7 cmt. 28.

[351] NYCB Opinion 2001-2 is based on Canon 5 of the New York Code of Professional Conduct, which essentially was replaced by NY Rule 1.7. *See supra* note 334.

has a disproportionately "important" relationship with one client compared to the other such that the lawyer truly can provide undivided loyalty to both clients.[352]

In summary, the primary consideration for whether a firm's concurrent representation of two clients in a transaction creates a conflict of interest is how adversarial the relationship between the clients is. Where a firm finds itself representing truly adverse parties, it must then consider whether it can continue to do so while still effectively protecting client confidences and providing undivided loyalty to each affected client.

3. Conflict Rules in the Parent-Subsidiary Context

Perhaps the most common instance of a lawyer representing multiple parties in the same transaction is where a law firm represents both a parent company and its subsidiary. In the normal course, this is an unremarkable arrangement that does not pose a serious risk of conflict. Indeed, where a subsidiary is solvent and is wholly owned by its parent company, the two entities' interests are nearly perfectly aligned, and concurrent representation likely does not create a conflict for the lawyer. "[P]arents and their wholly owned subsidiaries have the same interests because all of the duties owed to the subsidiaries flow back up to the parent."[353]

Courts have recognized at least two scenarios that can frustrate the alignment of interests between a parent and its subsidiary: (1) where the subsidiary is controlled but not wholly owned

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[352] NYCB Opinion 2001-2, available at http://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2001-2-conflicts-in-corporate-and-transactional-matters.

[353] *Teleglobe USA Inc. v. BCE Inc. (In re Teleglobe Comms. Corp.)*, 493 F.3d 345, 366 (3d Cir. 2007) (citing *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988) ("[I]n a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders.")).

by its parent company; and (2) where the subsidiary is insolvent. When a subsidiary is wholly owned by its parent, the subsidiary's "only interest … is in serving its parent."[354]

> "If the subsidiary is not wholly owned, however, in the interest of protecting minority shareholders we revert to requiring that whoever controls the subsidiary seek to maximize its economic value with requisite care and loyalty. Similarly, if the subsidiary is insolvent, we require the same in the interest of protecting the subsidiary's creditors."[355]

The presence of minority shareholders or insolvency does not necessarily mean that the subsidiary's interests fall out of line with those of its parent company and thereby create a conflict in a joint representation. As long as the subsidiary's directors are pursuing a course of action that, in their judgment, is reasonably calculated to boost the subsidiary's economic value, they are fulfilling their fiduciary duties—whether those duties are enforceable only by parent company, by multiple shareholders, or by creditors.[356] Accordingly, "[e]ven when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red."[357] In other words, even an insolvent subsidiary and its parent company will have aligned interests where they are working toward a transaction that has the potential to benefit the parent and improve the

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[354] *Id.* at 367; *see also Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P.*, 906 A.2d 168, 173 (Del. Ch. 2006) ("Wholly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created."). Logically, the inverse also is true: "parent corporations do not owe such subsidiaries fiduciary duties." *Trenwick*, 906 A.2d at 173.

[355] *Id.*; *accord Gentile v. Rossette*, 906 A.2d 91, 103 (Del. 2006).

[356] *See Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 792 (Del. Ch. 2004) ("[T]he fact of insolvency does not change the primary objective of the director's duties, which is the firm itself. The firm's insolvency simply makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value ….").

[357] *Id.*

economic value of the subsidiary. And, in turn, a law firm that represents both the insolvent subsidiary and its parent likely is free from conflict.[358]

To be sure, directors of subsidiary companies *always* have certain obligations to creditors. Even where a subsidiary is solvent and acting primarily in the interests of its parent company, directors should not "put aside any consideration of other constituencies, including creditors, when deciding how to manage the firm."[359] Creditors often hold "strong covenants, liens on assets, and other negotiated contractual provisions," as well as protections under the implied covenant of good faith and fair dealing, and state fraudulent transfer laws.[360] But as long as a subsidiary's directors can manage their legal obligations to creditors while still pursuing a course of action that benefits the parent company, there is an alignment of interests—regardless of whether the subsidiary is solvent or insolvent.

Of course, this is not to say that the interests of a parent and subsidiary can never separate to create a conflict of interest for the entities' lawyer. A law firm's concurrent representation of a parent and its subsidiary (or of any two entities) creates a conflict when the interests of the entities diverge such that it becomes reasonably likely that the firm's fiduciary duties to one company will require it to investigate, sue, or negotiate against the other.[361] The case law and common sense

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[358] So too for a firm representing a subsidiary in a transaction designed to benefit both its parent company and its minority shareholders.

[359] *Prod. Res. Grp.*, 863 A.2d at 787.

[360] *Id.* at 790.

[361] *See In re Envirodyne Indus.*, 150 B.R. 1008, 1016 (Bankr. N.D. Ill. 1993) (holding that a law firm had an actual conflict of interest where it represented both a subsidiary corporation and its majority shareholder in transactions that likely would be the subject of the firm's investigation or lawsuit against the parent when acting as debtor's counsel in the subsidiary's bankruptcy). *Accord* William I. Kohn & Michael P. Shuster, *Deciphering Conflicts of Interest in Bankruptcy Representation*, 98 COM. L.J. 127, 148 (1993) ("[I]f the attorney prepared the security agreements between the secured creditor and the debtor, or if the attorney represented a creditor with respect to any matter which the debtor might litigate in a bankruptcy proceeding, then representation should not be considered."); Matthew L. Warren, *The Continuing Lack of Guidance on Professional Retention in Bankruptcy and Its Potential Impact on Corporate Debtors' Retention of Adequate Legal Counsel*, 53 ARIZ. L. REV. 533, 538 (2011) (Simultaneous representation

suggest that this is more likely to arise when bankruptcy becomes a possibility for the subsidiary company.[362]

4. Treatment of Conflicts and Consent to Conflicting Representation

When a law firm cannot maintain concurrent representation of multiple clients due to a conflict, its ability to retain one client or the other may be limited. Courts employ the "hot potato rule" to prevent a lawyer from "simply drop[ping] a client to be free to take on a more attractive one" that otherwise would create a conflict.[363] Under the hot potato rule:

> an attorney cannot avoid disqualification under the *Cinema 5* [prima facie disqualification] rule merely by "firing" the disfavored client, dropping the client like a hot potato, and transforming a continuing relationship to a former relationship by way of client abandonment. Indeed, the offense inherent in taking on the conflicting representation is compounded by seeking to "fire" the client in pursuit of the attorney's interest in taking on a new, more attractive representation.[364]

There is a "thrust-upon" exception to the hot potato rule. Under that exception, courts are more likely to forgive the abandonment of the original client "if the conflict was unforeseeable and arose through no fault of the law firm—as, for example, when a conflict is created by a corporate merger or acquisition."[365]

These two countervailing considerations have led courts to develop a more subjective test for determining when a lawyer may drop its disfavored client. Under this test, courts consider (1)

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of the debtor and another party "requires disqualification when adverse interests either exist or are likely to develop. This gives rise to a fact-specific inquiry into the exact nature of the adverse interest in order to determine the level of materiality.").

[362] *See id.* A more detailed discussion on the impact of bankruptcy on a conflict of interest analysis follows in Section V.B.1.

[363] BENNETT, ANNOTATED RULES, 145.

[364] *Eastman Kodak Co v. Sony Corp.*, No. 04-CV-6095, 2004 WL 2984297, at *6 (W.D.N.Y. Dec. 27, 2004) (citing *Univ. City Studios, Inc. v. Reimerdes*, 98 F. Supp. 2d 449, 453 (S.D.N.Y. 2000)).

[365] BENNETT, ANNOTATED RULES, 145.

prejudice to the parties if counsel is removed, (2) costs and inconvenience of obtaining new counsel, (3) the complexity of the litigation, and (4) the origin of the conflict.[366]

Once again, the case law does not apply neatly to transactional settings, and lawyers are left with little guidance on how to deal with conflicts out of court. It is clear that a law firm must always be evaluating the changing nature of the relationship between its clients, and if it "sees the co-clients' interests diverging to an unacceptable degree, the proper course is to end the joint representation."[367]

The situation is murkier still for a lawyer representing a parent and subsidiary in conflict. At least one court has advised that the proper course of action is "for the parent to secure for the *subsidiary* outside representation."[368] But the solution's futility cannot be ignored. In the parent-subsidiary context, the true conflict of interest runs between the clients—not their joint counsel. As one commentator has noted, if the subsidiary's management takes action that "displeases the corporate parent, the parent corporation would presumably be empowered to replace the subsidiary's management. New management would then presumably follow the directions from headquarters."[369] So too for the lawyer representing management. Regardless of whether two lawyers in a parent-subsidiary transaction work for the same or different firms, they both ultimately will be taking direction from the parent company.

A client also may waive future conflicts of interest that arise from its lawyer's future representations. For a waiver of a future conflict to be valid, the client must "reasonably

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[366] *See Eastman Kodak*, 2004 WL 2984297, at *6.

[367] *Teleglobe USA*, 493 F.3d at 368 (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 cmts. e(1) & (2)).

[368] *Teleglobe USA*, 493 F.3d at 373 (emphasis added).

[369] John K. Villa, *The Attorney-Client Privilege in the Parent-Subsidiary Context*, ACC DOCKET, Dec. 2007, at 76.

understand[] the material risks that the waiver entails."[370] A firm seeking its client's consent to future conflicts must advise the client of (1) the "types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations"; and (2) "the measures that will be taken to protect the client should a conflict arise, including procedures such as screening."[371] Generally, the more specific a firm's description of potential future conflicts and remedies, the more likely that its client's consent will suffice to waive an actual conflict that does arise.[372] But the client's sophistication is important in determining whether consent is informed; the lawyer's burden to provide a detailed analysis of future events is lower for a client who is "an experienced user of the legal services involved" and who can readily appreciate the risks of a waiver.[373] "Thus, in some circumstances, even general and open-ended waivers by experienced users of legal services may be effective."[374]

Even if a firm has received from its client adequate consent to future conflicts, the firm must reassess its ability to maintain multiple representations when an actual conflict arises,[375] taking into account the different standards for measuring an actual conflict in the litigation and

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[370] NY Rules r. 1.7 cmt. 22.

[371] *Id.*; *see also Fisons Corp. v. Atochem N. Am., Inc.*, No. 90 CIV. 1080 (JMC), 1990 WL 180551, at *4-6 (S.D.N.Y. Nov. 14, 1990) (holding that a client had waived a conflict where its attorney previously had clearly identified the nature of the potential future engagement and had informed the client of the effects of the engagement, and the client consented); *Macy's Inc. v. J.C. Penny Corp.*, 107 A.D.3d 616, 616-17, 968 N.Y.S.2d 64 (2013) (holding that a client had waived a conflict created by its firm's future representation where the firm had "unambiguously" explained the nature of the representation). *See generally* NY City Bar Ass'n Comm. On Prof. Ethics Formal Op. 2006- [2006], available at http://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2006-1-multiple-representations-informed-consent-waiver-of-conflicts (describing conditions for effectiveness of advance waivers under former D.R. 5-105, which has been superseded by NY Rule 1.7).

[372] *Id.*

[373] NY Rules r. 1.7 cmt. 22; *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 122 cmt. d (AM. LAW INST. 2000).

[374] NY Rules r. 1.7 cmt. 22.

[375] NY Rules r. 1.7 cmt. 22A.

transactional contexts. If the actual conflict is "materially different" from the conflict contemplated by the client's advance consent, the consent does not effectively waive the actual conflict.[376] If the actual conflict is not waivable under NY Rule 1.7(b), the client's advance consent is also not effective.[377]

B. Did Willkie Have a Conflict and, if so, Did It Take Appropriate Steps to Address the Conflict?

1. January to March 2016

When Willkie began its restructuring work in late January and early February 2016, its lawyers contemplated an "amend-and-extend" transaction, adjusting covenants and maturity dates to give Transtar some breathing room. They did not contemplate an additional FFL investment. If that were all that was involved, it is hard to see how Willkie's continued representation of both FFL and Transtar would violate the NY Rule 1.7(a). FFL's interests did not differ from Transtar's. As the majority shareholder, FFL's interests were in a healthy and profitable portfolio company that could meets its obligations. Transtar had the same interest. An amend-and-extend transaction would enhance Transtar's ability to return to financial health.

One can imagine a scenario in which a portfolio company might prefer a more aggressive restructuring involving a conversion of debt to equity to reduce its total debt obligations, even though that would dilute its shareholders' interests. However, as long as the subsidiary can meet its obligations, the subsidiary exists to serve the parent. With an adequate amend-and-extend transaction, it appeared at the time that Transtar would be able to continue to meet its obligations. In addition, as matters evolved, FFL showed its willingness to invest a substantial additional amount to enable Transtar to continue to meet its obligations.

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[376] *Id.*

[377] *Id.*

Nor did there appear to be a significant risk that Willkie's professional judgment on behalf of either FFL or Transtar would be adversely affected by Willkie's own interests. To be sure, like every law firm, Willkie has an interest in earning fees from its clients. But NY Rule 1.7(a)(2) does not appear to condemn that as an improper interest in an ordinary engagement.

Despite the absence of a conflict under the NY Rules, Strickland thought ahead. She is an experienced restructuring professional who had seen other out-of-court work-out attempts lead to a chapter 11 filing. She knew Willkie could not maintain its representation of both FFL (on Transtar matters) and Transtar in a Transtar chapter 11 case. She moved quickly to line up other counsel. Not having seen that scenario before, Townsend probably did not see the need to line up separate counsel so far in advance and so initially resisted. However, Strickland's view prevailed, and on Willkie's recommendation, FFL engaged Young Conaway to represent it on Transtar matters.

One can question whether retaining the portfolio company as the client and finding separate counsel for the sponsor is the better practice. The ABI Article does not propose that practice.[378] The risk remains that continued loyalty to the sponsor might affect the lawyer's loyalty to the portfolio company. But as shown by the reference to the "K&E model," it apparently has become a common practice that has not been prohibited.

The ABI Article states, without analysis, that before seeking employment in a chapter 11 case, the firm "should put in place an ethical wall to screen attorneys working on unrelated matters for the private equity client from the firm's representation of the debtor."[379] The Examiner does not quarrel with that as an ideal. In this case, however, creating such a wall could have

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[378] Bennett L. Spiegel & Monika S. Wiener, *Concurrent Representation of Debtor and Nondebtor Equityholder*, 34-FEB AM. BANKR. INST. J. 38 (2015).

[379] *Id.*

created inefficiencies, both pre- and postpetition. The Willkie lawyers who had worked on financing documents for Transtar, and who continued to work for FFL on unrelated matters, such as Townsend and Klingbaum, were most knowledgeable about the documents and therefore were best positioned to work on amendments contemplated by an amend-and-extend transaction. In addition, at this early stage, FFL and Transtar did not have differing interests, so educating a new set of lawyers to create an ethical wall was unnecessary to begin with. On the other hand, had Willkie chosen to represent only FFL and not Transtar, consideration of an ethical wall would not have been necessary because Willkie would have ceased representing Transtar.

One can also question whether Willkie's recommendation to FFL to retain independent counsel came later than it should. For example, should separate counsel have begun work at the same time as the Willkie restructuring lawyers, in early February? That might be necessary in some cases. In this case, however, there did not appear to be any differing interests between FFL and Transtar then or at any time before it became apparent that FFL might need to lend or invest additional amounts. It is unclear to the Examiner if that need arose before mid-March, when FFL was asked about new debt or equity funding. At that time, Willkie promptly put FFL in contact with Young Conaway, who started work immediately in documenting both a $7.5 million loan and a $2.0 million equity investment before the end of March. Young Conaway was in a position to undertake the engagement quickly because Willkie had already made the arrangements. The Examiner's review of emails and Young Conaway's time records and his interviews suggest Young Conaway acted independently from Willkie, represented FFL, and protected its interests.

Some aspects of the Young Conaway engagement created an appearance of a lack of independence on Young Conaway's part. Willkie contacted Young Conaway before consulting FFL about its choice of independent counsel. Willkie did not suggest any other firm or even, apparently, that FFL, who is a sophisticated legal services consumer, seek its own independent counsel. Nestor sought comments on the FFL-Young Conaway engagement letter from

Townsend—of the law firm creating the need for separate counsel—before sending it to his prospective client FFL. Although the Examiner recommends against these practices, he did not find that any of them impaired Young Conaway's independence or perpetuated the conflict that its engagement was intended to prevent. In addition, as a sophisticated legal services consumer that uses several major firms,[380] FFL knew how to seek other counsel if it believed its needs were not being adequately served.

Although FFL provided financing to Transtar in late March, it is unclear whether the transactions created an actual conflict under NY Rule 1.7(a). The financing was characterized as a "bridge" financing to the amend-and-extend transaction. If the need for a substantial equity investment had not yet arisen, the interests of FFL and its subsidiary Transtar did not differ. If the need was already apparent, then one could argue that their interests at least potentially differed. If FFL were willing to provide the needed equity investment, Transtar would remain an FFL subsidiary, and the principle that a subsidiary may serve the parent's interests would prevent an actual conflict from arising. If it was uncertain whether FFL would be willing to provide the investment, then a potential conflict probably arose. Willkie addressed that conflict in part by helping FFL engage independent counsel. And Willkie complied with NY Rule 1.7(b) by obtaining Transtar's apparently informed written consent, in its engagement letter, to representation of the potentially differing interests on unrelated matters.[381]

However, while it appears FFL knew of and did not object to Willkie's representation of Transtar, Willkie did not obtain informed written consent from FFL for its representation of Transtar on matters that were unrelated to the matters in which Willkie continued to represent

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[380] Interview of Neil Townsend (Feb. 23, 2017).

[381] There has been no suggestion that the other elements of NY Rule 1.7(b) would prevent the representation.

FFL. Townsend recognized the need for such a consent,[382] but he did not specifically request it.[383] To the extent his failure to obtain the consent violated the NY Rules, it is a matter between FFL and Willkie and not a matter for the Examiner, whose charge addresses only the effect of Willkie's conduct on Transtar.

2. April to Early July 2016

Once the FFL financing solved the immediate liquidity need at the end of March, the nature of the work-out negotiations changed from a simple amend-and-extend transaction. It was not clear to the Examiner exactly when it became apparent that FFL would make a substantial equity investment to preserve its equity ownership interest, but a term sheet to that effect was circulating by the end of April.[384] By this time, Willkie no longer represented FFL on Transtar matters; Young Conaway did. This structure—an FFL investment to preserve its equity position in Transtar—remained until mid-to-late May. During this period, it does not appear that Transtar and FFL had differing interests that created an actual conflict. FFL's position as a short-term lender to Transtar could have led to a conflict if there were any dispute regarding time or manner of repayment. But none arose.

If a dispute arose that could have been resolved short of litigation, the NY Rules on conflicts in transactional situations would have applied. The consent that Willkie had received from Transtar would have been adequate to permit it to continue to represent Transtar in negotiations with FFL over the dispute. And, as noted above, Transtar still remained a wholly-

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[382] Email among Neil Townsend, David Cosgrove, et al., "FW: Jenn Just Found This Article" (Feb. 9, 2016). [WFG-TSEXAMINER00003639, at 3639]

[383] Interview of Neil Townsend (Feb. 23, 2017).

[384] Email among Daniel Philion, Tyler Nurnberg, et al., "Transtar – Confidential/Subject to NDA" (Apr. 29, 2016). [TRANSTAR-WFG-00008135]; Document, "Transtar: Proposed Terms of Amendments," (Apr. 29, 2016). [TRANSTAR-WFG-00008135]

owned FFL subsidiary, subject to FFL's direction for the benefit of FFL. In that circumstance, any potential conflict would have been at the client level, not at the lawyer level.

If a dispute arose that resulted in litigation, Willkie might have been required to withdraw from representing Transtar in the litigation, so as not to be adverse to FFL, its client on unrelated matters. Based on its conduct in the early stages of the work-out and its warnings to FFL and Transtar about the need for conflicts counsel in certain circumstances, it appears that Willkie likely would have recognized its obligation to withdraw. If it had not, it might be subject to criticism. But that is not this case, and it should not be subject to criticism for not doing what the circumstances did not require it to do.

That said, if the circumstances had required Transtar to engage conflicts counsel, Transtar might have suffered from the delay and expense of educating new counsel to address the dispute. If instead, Willkie had chosen to withdraw from any further Transtar engagement and to represent only FFL rather than Transtar, the potential conflict issue never would have arisen, and Transtar would not have risked that additional delay and expense. But in this case, it appears that Willkie explained that risk to Transtar, and Transtar chose to stay with a firm it knew and that knew it, rather than incurring the delay and expense of educating new counsel at the outset on all matters. In any event, this analysis is strictly hypothetical in this case.

In late May, evidence appeared of Transtar's deteriorating financial performance. A May 25 management presentation to the Speedstar board showed a decline in EBITDA forecasts. The new financial analysis appears to have led to the conclusion that Transtar would not be able to support the full amount of the Second Lien debt under the pending deal structure, even with the proposed FFL equity investment. Accordingly, the negotiations shifted to a deal in which FFL would make the investment for 55% of the equity of the reorganized company, with the remaining 45% distributed to Second Lien holders in exchange for cancellation of a portion of the Second Lien debt.

Once the negotiations shifted to a deal in which FFL would not retain full ownership of Transtar, the potential conflict analysis shifted as well. While the negotiations were on this track, Transtar and FFL likely had differing interests. To be sure, their interests were aligned in pursuing a financially healthy reorganized company, a quick and inexpensive process, and broad consensus among all constituencies. But their interests potentially diverged in negotiating the Second Lien debt conversion amount and the equity split with the Second Lien holders. Transtar's interest would have been in reducing its debt to the maximum extent that the Second Lien holders would accept, thereby enhancing its financial health. But greater debt reduction would likely have led the Second Lien holders to demand a greater share of the reorganized company's equity, reducing the amount remaining for FFL.

In addition, negotiations over this revised deal structure included negotiations over a release among all parties, including a release of any claims against FFL, which could have pitted Transtar against FFL. However, as a practical matter, it did not. The two principal kinds of claims that might have been asserted against FFL at this stage of the work-out were claims for breach of fiduciary duty in its management of Transtar and for avoidance and recovery of the 2012 $90 million dividend as a fraudulent transfer.

The latter kind of claim would have belonged only to Transtar's creditors, not to Transtar.[385] The two main creditor bodies—the First Lien holders and the Second Lien holders—were organized and well represented by Kaye Scholer and Latham & Watkins. They did not need Willkie to negotiate against FFL over a release of such a claim, nor would it have been appropriate for Transtar's counsel to do so when Transtar itself could not bring the claim. Although releases from the First Lien holders and the Second Lien holders would not necessarily have bound all

[385] Ohio Uniform Fraudulent Transfer Act, Ohio Rev. Code Ann. § 1336.08.

Transtar creditors, they were the only groups whose claims were likely to be reduced in the work-out, so other creditors would not have had any basis for asserting such a fraudulent transfer claim.[386] Transtar itself could not have released those claims; only the creditors could. Any prebankruptcy release by Transtar would not bind a Transtar bankruptcy trustee or even Transtar as debtor in possession. A restructuring support agreement designed to be effective after a chapter 11 filing and bankruptcy court approval might include such a release, but the creditor groups would have been a party to such an agreement, providing Transtar and its creditors the same protection as a release in an out-of-court work-out.

The former kind of claims would belong to Transtar itself. Courts have recognized the challenge of expecting directors to pursue claims against themselves or the company's controlling shareholder and therefore permit derivative actions.[387] Where a company is insolvent, Delaware courts recognize creditors' standing to bring a derivative action.[388] If creditors are not being paid in full, as would have been the case for the Second Lien holders under the deal structuring under negotiation during late May and June, the company is likely insolvent, so the creditors would have had standing. As a result, they would be in a position to determine whether to provide a release of such claims. Here, they were well represented and determined to include a release in the RSA that was under negotiation at the time. Second Lien holders' counsel was in as good or better position than Willkie to evaluate and advise on whether and to what extent to release FFL, so creditors' interests were protected. And to the extent there was a conflict, the NY Rules' standard in the transactional setting and Transtar's express written consent to Willkie's continued

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[386] *Id.* at § 1336.07(A)(1) (allowing a creditor to avoid a transfer "to the extent necessary to satisfy the claim of the creditor").

[387] *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004) ("A director will be considered unable to act objectively with respect to a presuit demand if he or she is interested in the outcome of the litigation or is otherwise not independent.").

[388] *Quadrant Structured Prod. Co., Ltd. v. Vertin*, 115 A.3d 535, 551 (Del. Ch. 2015).

representation of FFL on unrelated matters permitted Willkie to continue its representation without violating the NY Rules.

Another change occurred in May. Based on discussions between Willkie and Young Conaway in April, Speedstar's board elected Brad Scher as an independent director in early May. Scher attended the May 25 board meeting and appears to have been conversant with Transtar's financial condition and the pending negotiations by that time. His presence helped remove the client-level conflict risk. If an actual conflict arose between Transtar and FFL, the FFL Directors could have recused themselves, leaving Transtar decision-making to Scher and Orzetti. As with Willkie's recommendation that FFL engage independent counsel, its suggestion that Speedstar elect an independent director was based on prior experience in restructuring matters and was a sound prophylactic proposal. And with no loyalty to FFL, Scher was in a position to direct Willkie in its representation, including in negotiation over equity distributions and over a release and, if necessary, to replace Willkie if he concluded that Willkie's loyalty to Transtar was incomplete.

In the Examiner's investigation, Young Conaway appears to have conducted itself in the best interest of FFL. It appears to have acted independently, with sophisticated transaction lawyers actively engaged in negotiating deal documents on FFL's behalf and communicating primarily with and taking instruction exclusively from FFL.

More important from Transtar's perspective is Willkie's conduct. In the Examiner's investigation, Willkie appeared to be an appropriate advocate for Transtar during this period when a potential conflict with FFL might have arisen, seeking to advance management's and the board's goals for a restructuring: speed, a sustainable capital structure with adequate liquidity, and consensus among all constituencies.

3. Mid-July to August 2016

Toward the middle of July, Transtar's financial condition worsened more, putting more pressure on the feasibility of the May-June transaction structure in which FFL would make a substantial equity investment and retain a majority of the reorganized company's equity, and the Second Lien holders would convert a portion of their debt to the remaining equity. By around July 14, FFL had decided not to proceed with the investment. It made the parties aware of its decision around that time. In response, the Second Lien holders determined to step into FFL's position in the deal structure, invest $50 million, convert a portion of their debt to equity, and take 100% of the equity of the reorganized company. From this time forward, FFL had no ongoing interest in a reorganized Transtar. Of course, its partners still sat on Speedstar's board, and it still wished to receive a general release. But the release had already been negotiated for this deal structure, and the Second Lien holders did not appear to raise the issue again. The First Lien holders would not consent, but that position did not get in the way of a deal. The result was an RSA that was circulated to First Lien holders and Second Lien holders in early August, with a request that signature pages be returned by August 10.

Since FFL had no ongoing interest in the restructuring, it did not have a differing interest from Transtar. As a result, Willkie was no longer in a conflict position in any material way. Again, to the extent a potential conflict could be imagined, the NY Rules' standard for conflicts in a transactional setting and Transtar's informed written consent to Willkie's continued representation of FFL on unrelated matters permitted Willkie to continue to represent Transtar without violating the NY Rules.

During July, Silver Point appeared, expressed opposition to the deal under the pending RSA, and became an active, perhaps leading, participant in the work-out. Silver Point was a Willkie client at the time on unrelated matters, but the Willkie lawyers who were working on the Transtar restructuring were apparently unaware of or did not recall the client relationship.

Willkie did not check conflicts when Silver Point appeared. Just as it checked conflicts with Transtar's initial creditor list, Willkie should have checked whether it had a conflict with Silver Point.

In a work-out or restructuring where claims change hands, often without notice to the borrower or its counsel, it might be difficult to check conflicts every time a new creditor appears. To some extent, if the client has consented in writing, as permitted under NY Rule 1.7(b), to a concurrent adverse representation on an unrelated matter, it might not be necessary to do so except at decent intervals.

In this case, however, Silver Point appeared as a major participant in the work-out. Willkie should have checked promptly whether there was a Silver Point conflict, and the firm should have provided Transtar with information about its representation of Silver Point, whose involvement threatened the RSA deal then on the table. Willkie's continued representation of Transtar upon the occurrence of the "thrust upon" conflict with Silver Point would have been permissible based on the written consent to future conflicts that Willkie received from Transtar in its engagement letter, depending on the extent to which Transtar's sophistication as a client obviated the need for a present explanation of the material risks the waiver entailed and any protective measures.

4. August to November 2016

During August, it because apparent that the August 10 RSA would not receive sufficient signatures to become effective. Silver Point had acquired a blocking position. Silver Point continue to acquire First Lien debt so that it became the controlling First Lien holder. From this time forward, the principal negotiations were between Silver Point and the First Lien lenders and between Silver Point and Transtar. Silver Point's continued accretion of First Lien debt and its

negotiations over a new restructuring deal did not change the conflict analysis between Transtar and Silver Point as applied to Willkie.

One additional significant issue arose during this period, the negotiation of an FFL release. As noted above, granting a prepetition release of FFL depended as much if not more on the creditors' willingness to grant the release than on Transtar's willingness. Accordingly, Willkie could be expected to have a diminished role in those negotiations. The Examiner's investigation suggests that Willkie's only role was to encourage a deal, including by suggesting ideas that might facilitate a deal, so that the overall restructuring could be concluded sooner rather than later. All direct negotiations of the release appear to have taken place between Young Conaway and Silver Point's counsel. Therefore, Willkie's conflict profile during this period with respect to the release did not differ from its profile during the spring release negotiations.

V. Postpetition Analysis

A. Eligibility to Serve as Counsel for the Debtor in Possession

1. Disinterestedness and Absence of an Adverse Interest

"The conduct of bankruptcy proceedings not only should be right but must seem right."[389] To that end, the Bankruptcy Code sets forth strict requirements to ensure that professionals retained and paid by a bankruptcy estate are free of any conflicts of interest and beyond reproach. The requirements "'serve the important policy of ensuring that all professionals appointed pursuant to'" the strictures of the Code "'tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.'"[390]

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[389] *In re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966) (Friendly, J.).

[390] *In re Leslie Fay Cos.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994)).

Despite the obvious similarities of state ethical rules discussed above and the Bankruptcy Code's conflicts provisions discussed in this section, the two sources of guidance for attorneys do not fit neatly together. To be sure, courts often cite state ethics rules when making determinations about disinterestedness under the Bankruptcy Code.[391] But some courts also acknowledge that the rules and the Code differ; they generally determine that the strictures of the Code are more constraining than those contained in state ethics rules.[392] Accordingly, courts and commentators alike lament that bankruptcy attorneys are left with inadequate guidance on how state ethics rules and the Bankruptcy Code interact and how an attorney seeking payment from the estate can be assured that representation of another client will not lead to disqualification or disgorgement.[393] Regardless, bankruptcy attorneys must abide by state ethics rules in addition to the provisions of the Bankruptcy Code.[394]

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[391] *See, e.g.*, *In re Mercury*, 280 B.R. 35, 48-51 (Bankr. S.D.N.Y. 2002), *subsequently aff'd*, 122 F. App'x 528 (2d Cir. 2004); *In re Angelika Films 57th, Inc.*, 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998), *aff'd*, 246 B.R. 176 (S.D.N.Y. 2000); *In re Granite Partners, L.P.*, 219 B.R. 22, 33-34 (Bankr. S.D.N.Y. 1998); *Envirodyne*, 150 B.R. at 1020 n.15.

[392] *See In re Persuad*, 496 B.R. 667, 677 (E.D.N.Y. 2013) ("[I]t is generally accepted that the standards for ethical conduct under the Bankruptcy Code are stricter than the local disciplinary rules of professional conduct."); *Envirodyne*, 150 B.R. at 1020 n.15 ("Rule 1.7 gives the attorney greater leeway than the Code.").

[393] *See, e.g.*, *In re Flanigan's Enters., Inc.*, 70 B.R. 248, 250 (Bankr. S.D. Fla. 1987) (noting that the nature of a bankruptcy case makes "it extra difficult to identify just when a conflict exists"); Warren, *The Continuing Lack of Guidance*, 534 ("[S]ignificant uncertainties remain about how exactly the Bankruptcy Code interacts with state ethics codes and how strictly the various provisions of each should be applied in the unique context of representing a debtor in possession."); Charles W. Wolfram, *The Boiling Pot of Lawyer Conflicts in Bankruptcy*, 18 MISS. C. L. REV. 383, 383 (1998) ("[T]here is widespread disagreement about starting points, not to mention finish lines, with respect to lawyer conflicts in bankruptcy. Judicial decisions on the subject sometimes reflect what may charitably be characterized as chaos."); Kohn & Shuster, *Deciphering Conflicts*, 138-39.

[394] *See* Susan Pierson Sonderby & Kathleen M. McGuire, *A Gray Area in the Law? Recent Developments Relating to Conflicts of Interest and the Retention of Attorneys in Bankruptcy Cases*, 105 Com. L.J. 237, 239 (2000) (The duties imposed by rules of professional responsibility "are the same for bankruptcy practitioners and for nonbankruptcy practitioners.").

Section 327(a) of the Bankruptcy Code contains the standard that courts must use to determine whether a professional person is sufficiently independent to represent the estate:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.[395]

Section 327 thus creates a two-part test: a trustee or debtor in possession may employ a professional only if that person (1) does not "hold or represent an interest adverse to the estate," and (2) is a "disinterested person."[396]

The Code does not define the term "hold or represent an interest adverse to the estate," but most courts have coalesced around the meaning of the phrase:

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.[397]

Noting the present tense in section 327(a), the Second Circuit has held that "counsel will be disqualified under section 327(a) only if it presently 'hold[s] or represent[s] an interest adverse to the estate,' notwithstanding any interest it may have held or represented in the past."[398]

The Code does define the term "disinterested person:"

> The term "disinterested person" means a person that—
>
> (A) is not a creditor, an equity security holder, or an insider;

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[395] 11 U.S.C. § 327(a).

[396] *See Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 621 (2d Cir. 1999).

[397] *AroChem*, 176 F.3d at 623 (quoting *In re Roberts*, 46 B.R. 815 (Bankr. D. Utah 1985), *aff'd in relevant part and rev'd and remanded in part on other grounds*, 75 B.R. 402 (D. Utah 1987)); *see also In re Project Orange Assocs., LLC*, 431 B.R. 363, 370 (Bankr. S.D.N.Y. 2010); *Mercury*, 280 B.R. at 54; *Vebeliunas*, 231 B.R. at 188.

[398] *AroChem*, 176 F.3d at 623; *accord Project Orange*, 431 B.R. at 370 ("The test is not retrospective; courts only examine present interests when determining whether a party has an adverse interest.").

> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) 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.[399]

As one court in this District has explained:

> "It is well-recognized that the meaning of the phrase 'interest materially adverse' in the definition of a disinterested person overlaps with that of 'interest adverse' in the first prong of § 327(a) and, together, they form one hallmark with which to evaluate whether professionals seeking court-appointed retention (or to remain retained by the estate) meet the absence of adversity requirements embodied in the bankruptcy code."[400]

Accordingly "'both prongs of the [327(a)] test are satisfied where counsel is not a 'disinterested person,'' because counsel that fails the disinterested test on the ground that it 'has' an interest adverse to the estate automatically fails the first prong of the test because, by definition, it also 'holds' such an interest. Have and hold are synonymous."[401]

Courts routinely counsel that the decision to approve a professional's retention should be made on a case-by-case basis, and a bankruptcy court has discretion,[402] but there are limits to that discretion. On the one hand, "the bankruptcy court should interfere with the trustee's choice of counsel '[o]nly in the rarest cases.'"[403] A court should not take lightly its decision to separate a trustee or debtor in possession from its chosen attorneys.[404] On the other hand, "[b]ankruptcy courts do not have the authority to allow employment of a professional who has a conflict of

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[399] 11 U.S.C. § 101(14).

[400] *Vebeliunas*, 231 B.R. at 189.

[401] *AroChem*, 176 F.3d 610 (quoting *Roger J. Au & Son v. Aetna Ins. Co.*, 64 B.R. 600 (N.D. Ohio 1986)).

[402] *See, e.g.*, *AroChem*, 176 F.3d at 623; *Project Orange*, 431 B.R. at 370-71.

[403] *In re Smith*, 507 F.3d 64, 71 (2d Cir. 2007) (quoting *Pryor v. Ready & Pontisakos (In re Vouzianas)*, 259 F.3d 103, 107-08 (2d Cir. 2001)).

[404] *Vouzianas*, 259 F.3d at 108.

interest."[405] Within those confines, courts must root out whether proposed counsel holds "'any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy rules.'"[406] In making its determination, a bankruptcy court should consider the best interests of the estate.[407]

Courts in the Second Circuit have adopted a functional approach to determining when a conflict is disqualifying under section 327. Previously, courts debated whether only "actual" conflicts are disqualifying or if "potential" conflicts are enough to disqualify proposed counsel.[408] In response to this tension, courts have eschewed formalistic labels and instead analyzed whether the relationship would give the professional "'either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors—an incentive sufficient to place those parties at more than acceptable risk—or the reasonable perception of one.'"[409] Under this test, "[d]isqualification is appropriate 'if it is plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that other representation.'"[410]

The Bankruptcy Code makes explicit that a professional person is not disqualified *per se* by representing a creditor but will be disqualified if the representation creates an actual conflict. Section 327(c) of the Bankruptcy Code provides:

> 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

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[405] *Mercury*, 280 B.R. at 55.

[406] *Project Orange*, 431 B.R. at 370 (quoting *In re Granite Partners, L.P.*, 219 B.R. 22, 33 (Bankr. S.D.N.Y. 1998)).

[407] *Id.*; *see also Vouzianas*, 259 F.3d at 107 ("Relevant considerations are 'the protection of the interests of the bankruptcy estate and its creditors, and the efficient, expeditious, and economical resolution of the bankruptcy proceeding.'").

[408] *See Leslie Fay Cos.*, 175 B.R. at 532 (collecting cases).

[409] *Id.* at 533 (quoting *In re Martin*, 817 F.2d 175, 180-81 (1st Cir. 1987)).

[410] *Granite Partners*, 219 B.R. at 33 (quoting *Leslie Fay Cos.*, 175 B.R. at 533)); *see also Angelika Films 57th*, 227 B.R. at 39 ("What is clear is that undivided loyalty is central to disinterestedness.").

> 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.[411]

The nature of the professional's relationship with the creditor and the importance of the creditor to the reorganization effort are important factors for a bankruptcy court to consider when deciding whether a professional is qualified under section 327.[412]

Similarly, a law firm is not disqualified *per se* because it represents the debtor's controlling shareholder. When a parent and subsidiary are both debtors in bankruptcy, courts allow a single firm to represent both entities concurrently so long as no otherwise disabling conflict exists.[413] Indeed, the Second Circuit has noted that it is inappropriate to "saddle [debtors'] estates with the expense" of hiring separate professionals for each entity unless actually necessary to avoid conflicts.[414] When only the subsidiary is in bankruptcy, some courts apply a *per se* ban on concurrent representation of both a debtor and parent, but a court in this District has noted that "[t]he majority, and better, view rejects that rigid approach and instead allows the court to review potential conflicts based on the facts of the case before it."[415] Plainly, though, courts scrutinize the

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[411] 11 U.S.C. § 327(c).

[412] *See Granite Partners*, 219 B.R. at 36-37 ("[A] lawyer cannot represent a trustee for the purpose of investigating the alleged wrongdoing of another, valuable client."); *Project Orange*, 431 B.R. at 375-76 (it is improper to allow retention "where the proposed general bankruptcy counsel has a conflict of interest with a creditor that is central to the debtor's reorganization").

[413] *See, e.g.*, *In re BH & P Inc.*, 949 F.2d 1300, 1310 (3d Cir. 1991); *In re Int'l Oil Co.*, 427 F.2d 186, 187 (2d Cir. 1970); *In re Rundlett*, 137 B.R. 144, 146 (Bankr. S.D.N.Y. 1992).

[414] *Int'l Oil Co.*, 427 F.2d at 187.

[415] *Hogil Pharm. Corp. v. Sapir (In re Innomed Labs, LLC)*, No. 07 Civ. 4778(WCC), 2008 WL 276490, at *7 (S.D.N.Y. Jan. 29, 2008); *see also TWI Int'l, Inc. v. Vanguard Oil & Serv. Co.*, 162 B.R. 672, 675 (S.D.N.Y. 1994) ("[A]n attorney that represents a corporation in bankruptcy and its principal is not per se interested."); *In re Hurst Lincoln Mercury*, 80 B.R. 894, 895 (Bankr. S.D. Ohio 1987) ("It is fundamental that simultaneous representation of a corporation and its sole stockholder is not in and of itself improper."); Bennett L. Spiegel & Monika S. Wiener, *Concurrent Representation of Debtor and Nondebtor Equityholder*, 34-FEB AM. BANKR. INST. J. 38 (2015) ("[C]oncurrent representation of all debtor entities by a single law firm is the norm. There is no reason why it should not also be the norm in situations where a firm concurrently represents debtors and nondebtors in unrelated matters.").

relationship between the debtor and its parent and will not approve a firm's employment as counsel if the debtor and parent are adverse to each other.[416] Also, a firm is not disinterested if its representation of the non-debtor parent involves matters directly bearing on the debtor's bankruptcy case.[417] Courts are loath to rely on a law firm to investigate transactions or parties for which the firm itself served as counsel.[418]

Client consent does not suffice to waive section 327's requirements. Although a client may consent to a conflict in many circumstances outside of bankruptcy, "the mandatory provisions of section 327(a) do not allow for waiver."[419]

Finally, although courts' concerns with conflicts of interest tend to focus on an estate professional's ability to take adverse positions to other parties during a bankruptcy case, at least one court has determined that section 327's requirements are at least as strict in a "prepackaged" bankruptcy, where most adversarial work is done prepetition. The court acknowledged that "[p]re-packaged plans offer a means of expediting the bankruptcy process by doing most of the work in advance of filing,"[420] but warned that "[t]hat efficiency, however, must not be obtained

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[416] *See In re Plaza Hotel Corp.*, 11 B.R. 882, 890 (Bankr. E.D. Cal.), *aff'd*, 123 B.R. 466 (B.A.P. 9th Cir. 1990), and *aff'd sub nom. Horner v. Webster*, 123 B.R. 466 (B.A.P. 9th Cir. 1990) ("Simultaneous representation of a debtor corporation and the controlling shareholders, although not a disqualifying conflict per se, becomes a basis to disqualify counsel when adverse interests exist or are likely to develop.").

[417] *See Roger J. Au & Son, Inc. v. Aetna Ins. Co.*, 64 B.R. 600, 604-05 (N.D. Ohio 1986) (affirming the disqualification of a firm that represented the debtor's sole shareholder on matters relating to the shareholder's liability for loans obtained by the debtor).

[418] *See Envirodyne*, 150 B.R. at 1019 (noting that the court could not rely on a firm's assessment of claims arising from an LBO where it was "the firm that acted as counsel to the orchestrator of the LBO"); *Leslie Fay Cos.*, 175 B.R. at 535 (holding that attorneys who had significant relationships with a debtor's directors could not be relied upon to act as debtor's counsel and investigate those directors for potential claims).

[419] *Granite Partners*, 219 B.R. at 34 (collecting cases); *see also Project Orange*, 431 B.R. at 374 (holding that a conflict waiver "cannot trump the requirements of section 327(a)").

[420] *In re Congoleum Corp.*, 426 F.3d 675, 693 (3d Cir. 2005).

at the price of diminishing the integrity of the process."[421] *Id.* Accordingly, the court concluded that section 327(a) applied with equal force whether or not a case was a "prepackaged" reorganization.[422]

2. Analysis

Once Transtar filed its chapter 11 petition, section 327 in addition to the NY Rules governs whether Willkie is eligible to serve as counsel to Transtar as debtor in possession. Transtar's prepetition agreement consenting to Willkie's representation of creditors and of FFL on unrelated matters no longer suffices.

Here, the principal focus on Willkie's eligibility is subparagraph (C) of the disinterestedness definition. Did Willkie "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?" Willkie did not have "an interest in" the debtor. And Willkie's "relationship to [or] connection with" the debtor was only as its counsel and does not suggests any reason why that relationship or connection would create and interest adverse to the estate, creditors, or equity security holders.

Did Willkie "have an interest materially adverse … for any other reason?"[423] As noted, courts look to substance over form when answering the question, asking whether counsel has "either a meaningful incentive to act contrary to the best interests of the estates … or the reasonable perception of one" or if the representation "may cause the debtor's attorneys to act any differently" than without the conflict. [424]

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[421] *Id.*

[422] *Id.* at 692-93.

[423] 11 U.S.C. § 101(14).

[424] *Leslie Fay Cos.*, 175 B.R. at 533.

Since FFL had effectively walked away from its investment in Transtar and sought nothing from the estate, Willkie's continued representation of FFL on unrelated matters would not likely give it any incentive to act differently than if it did not represent FFL in other matters. The FFL release issue remained open, because the Second Lien holders had not consented to the release. But on that one issue, creditors were well represented, and Willkie's role would be diminished. To the extent that the proceedings for approval of the release would have caused Willkie to act differently than a vigorous advocate for the estate, either derivative standing for a creditor group or conflicts counsel could have addressed the concern, since the release was not at all central to the reorganization. Moreover, the Examiner's investigation suggests that none of the principal participants in the prepetition restructuring negotiations placed any significant weight on any Transtar or estate claims against FFL or its directors.

Willkie's Silver Point representation on unrelated matters also does not seem to give Willkie a reason to act contrary to the interests of the estate or creditors. Although Silver Point was the largest single creditor, its role does not affect Transtar's ability to continue operating, and it did not have on-going disputes with Transtar, as the principal creditor in *Project Orange* did.[425] Willkie's relationship with Silver Point was limited. Silver Point represented less than 0.05% of Willkie's fee collections, and none of the participants in the restructuring were aware that Silver Point was a Willkie client.

Courts have generally approved the employment of counsel to the debtor in possession who also represents the debtor's shareholder or some of its creditors on unrelated matters, so long as the other client has no material role in the case or the unrelated representation of the unrelated client is not so material to the law firm as to raise the appearance or suspicion that the

[425] *Cf. Project Orange*, 431 B.R. at 373 ("GE and Project Orange remain wholly adverse.")

law firm's loyalty to the estate is reduced. This is consistent with the plain language of section 327(c), which forbids the disqualification of a professional "solely because of such person's employment by or representation of a creditor" unless the representation creates an actual conflict of interest. Although the statute does not address it, the potential conflict risks that section 327(c) permits for a creditor representation seem no greater for a shareholder representation.

Here, those conditions appear satisfied. The Examiner found no evidence that suggested that Willkie's representations of FFL or Silver Point impaired the firm's loyalty to Transtar's estate. Accordingly, it appears that Willkie was did not hold or represent an interest adverse to the estate.

B. Bankruptcy Rule 2014

1. Required Disclosure; Consequences of Nondisclosure

Bankruptcy Rule 2014 sets forth the disclosure a professional person must make before a court will consider its application for employment by the estate. In relevant part, the Rule requires a professional to disclose:

> to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.[426]

Disclosures must be specific; "boilerplate is reasonable to cover inadvertent failures to disclose insignificant connections [but] it is not an adequate substitute for disclosure of representation of known and significant creditors."[427] And disclosures must be ongoing; although

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[426] FED. R. BANKR. P. 2014(a).

[427] *Leslie Fay Cos.*, 175 B.R. at 537.

Rule 2014 does not explicitly require supplemental disclosures, "section 327(a) implies a duty of continuing disclosure, and requires professionals to reveal connections that arise after their retention."[428] Inadequate disclosure on its own is a sufficient basis for a court to disallow a professional's fees or even disqualify the professional.[429] However, disqualification is an extreme remedy and courts should grant it sparingly—especially where the professional has established a meaningful relationship with the client.[430]

The scope of disclosure under Rule 2014 "is much broader than the question of disqualification" under section 327.[431] "The applicant and the professional must disclose all connections and not merely those that rise to the level of conflicts."[432] "[W]hile retention under section 327 is only limited by interests that are 'materially adverse,' under Rule 2014, 'all connections' that are not so remote as to be *de minimis* must be disclosed."[433]

Accordingly, the professional must disclose connections, and the court must decide whether there is a conflict. "The professional must disclose all facts that bear on its disinterestedness, and cannot usurp the court's function by choosing, *ipse dixit*, which connections impact disinterestedness and which do not."[434]

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[428] *Granite Partners*, 219 B.R. at 35.

[429] *Mercury*, 280 B.R. at 56.

[430] *See Leslie Fay Cos.*, 175 B.R. at 538-539 (where a law firm failed to disclose its significant conflict, the court permitted the firm to remain debtor's counsel for matters in which it was currently engaged but required the retention of new counsel for all new matters in the case and disgorged a substantial portion of the law firm's fees).

[431] *Granite Partners*, 219 B.R. at 35.

[432] *Id.*

[433] *Leslie Fay Cos.*, 175 B.R. at 536.

[434] *Granite Partners*, 219 B.R. at 35 (internal citations omitted); *see also Leslie Fay Cos.*, 175 B.R. at 535 (holding that it is not for "the attorneys with the entanglements" to make their own judgment as to whether a connection constitutes an impermissible conflict).

2. Analysis

Willkie's Initial Declaration was inadequate. It did not comply with Rule 2014 in its failure to disclose Willkie's representation of Silver Point on unrelated matters. It also was insufficient in its description of Townsend's prior representation of FFL in its acquisition of Transtar in 2010, before Townsend joined the firm. A conversation between a Willkie attorney and counsel for the U.S. Trustee at some time after the December 3, 2016 filing of the Initial Declaration and December 19, 2016 identified the insufficient FFL disclosure. At around the same time, counsel for the U.S. Trustee and Strickland agreed on the examiner stipulation. The U.S. Trustee filed a motion for the appointment of an examiner on December 16, 2016 and filed the stipulation with Transtar for the appointment the next day.

The conversation appears to have led Willkie to re-check its Rule 2014 disclosures. Upon doing so, Strickland discovered that Silver Point was a client and that the Initial Declaration did not disclose the connection. Email traffic following that discovery strongly suggests that the omission was inadvertent, not intentional, the result of items from a conflict check not being carried over to the Initial Declaration. Willkie itself identified the omission and corrected it in the supplemental declaration that Strickland filed on December 29, 2016, without direct prompting that a connection with Silver Point needed to be disclosed. But it was still an omission.

Further, Willkie's omission meant that, despite Silver Point's central role in the restructuring, additional time passed before Transtar was made aware of Willkie's representation of Silver Point on unrelated matters. Particularly after failing to run a refreshed conflict check and inform Transtar of the Willkie-Silver Point relationship during the work-out process, Willkie should have informed Transtar when it refreshed its conflict check in preparation for its Rule 2014 disclosures and became presently aware of the Silver Point representation. Because Willkie did not do so, Willkie did not provide notice of its representation of Silver Point until the end of

December, when it filed its supplemental declaration, and Speedstar directors did not actually learn of the representation until January 2017.

Courts have been particularly harsh on nondisclosure. A court may disqualify or require disgorgement of fees from a firm that fails to satisfy Rule 2014's disclosure requirements, even if the firm's undisclosed connections would not disqualify it for employment under section 327(a). Several courts in and outside of the Second Circuit have said a professional's failure to disclose all relevant connections under Rule 2014 is an independent basis on which the court may disallow fees or disqualify the professional.[435] The *Mercury* court cited *In re Filene's Basement, Inc.*,[436] in which the bankruptcy court disqualified a financial advisor solely because it failed to comply with the requirements of Rule 2014. There, the court held that "disqualification on the basis of a false Rule 2014 statement alone [was] justified," and therefore it did not have to "reach the issue of whether [the firm was] disinterested with the test of § 327."[437]

These cases and the ones on which they rely typically involve an attorney's representation of adverse parties in connection with the bankruptcy case itself, not representation on unrelated matters, and thus involve the attorney's present awareness of the dual representation, or a failure to disclose compensation under Rule 2016. They also involve intentional nondisclosure and not instances where disclosure occurs as a result of the attorney's voluntary, supplemental declaration. Many involve discovery after the court has already approved the attorney's employment. And several involve egregious violations of either the conflict of interest rules, the connection or fee disclosure rules, or both.

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[435] *Mercury*, 280 B.R. at 56 (collecting cases).

[436] 239 B.R. 845 (Bankr. D. Mass. 1999).

[437] *Id.* at 850.

None of the precedents appear to involve a case with the facts present here: initial, inadvertent nondisclosure of a connection that does not create an impermissible or unwaived conflict under applicable non-bankruptcy law and later voluntary disclosure before the hearing on the application to approve the attorney's employment. Even *In re Leslie Fay Cos.*, which stresses the extreme importance of full disclosure, involved nondisclosure of a serious potential conflict whose disclosure would have created the appearance of partiality into a fraud investigation and warranted disqualification of the attorneys as not disinterested at least for the investigation if not entirely as counsel for the debtor in possession in the reorganization.[438] The court sanctioned the law firm for the consequences of its failure to disclose its connections with targets or affiliates or targets of the fraud investigation. The court also harshly criticized the firm for its failure to disclose its prior role as outside general counsel to the debtor's seventh largest creditor, who was appointed to the creditors committee. But the court did not find a disqualifying conflict and did not impose any sanction for that nondisclosure, suggesting that if an adverse interest arose, conflicts counsel could appropriately handle it.[439]

Despite courts' harsh rhetoric condemning failure to disclose a connection, some cases suggest that a court may take into account the reason for a firm's failure to comply with Rule 2014 when deciding if and how to sanction the firm. When a professional fails to disclose a connection *that would have rendered it ineligible for retention*, "[n]egligent omissions do not vitiate the failure to disclose."[440] When a professional neglects a duty to disclose "however innocently, surely they should stand no better than if it had been performed."[441] Accordingly, the *Rogers-Pyatt* court determined that the disclosure rule forbade "an appointment which could not properly have been

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[438] 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

[439] *Id.* at 536, 538–39.

[440] *In re Plaza Hotel Corp.*, 111 B.R. 882, 883 (Bankr. E.D. Cal.), *aff'd*, 123 B.R. 466 (B.A.P. 9th Cir. 1990).

[441] *In re Rogers-Pyatt Shellac Co.*, 51 F.2d 988, 992 (2d Cir. 1931).

made had the required affidavit been filed."[442] These cases involved actual conflicts, so the reason for the failure to disclose did not affect the decision to disqualify. Other cases suggest that a court may consider a professional's intent. In *Granite Partners*, for example, the court noted that "willful or intentional failure to disclose merits the harshest sanctions."[443] Ultimately, a court has "enormous discretion" in fashioning a remedy for a Rule 2014 violation.[444] The cases suggest the worst sanctions are reserved for the most cavalier professionals.[445] But the cases do not address what sanction, if any, is appropriate for inadvertent, non-disqualifying, pre-approval nondisclosure.

VI. Conclusion

A. Specific Conclusions

The Court charged the Examiner with investigating and reporting on "matters related to the employment of counsel for the Debtor and Debtor in Possession, including actual or potential conflicts of interest, disinterestedness, and disclosures."[446] The Examiner's investigation, described above, addresses each of those three areas. Based on the investigation, the Examiner has concluded as follows:

1. Prepetition Conflicts

Willkie had at least a potential conflict of interest in representing Transtar prepetition. But Willkie remedied any conflict by advising FFL to obtain independent counsel with respect to

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[442] *Id.*

[443] 219 B.R. at 41.

[444] *See GSC Grp.*, 502 B.R. at 750.

[445] *See, e.g.*, *id.* ("Here, the Court's exercise of its discretion is informed in part by [the professional]'s lack of any second thoughts, let alone remorse, at what has here transpired.").

[446] Motion to Approve Examiner's Revised Work Plan at Ex. A, ¶¶ 5, 15, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Jan. 18, 2017), ECF No. 215; Order Approving Examiner's Revised Work Plan, *In re DACCO Transmission Parts (NY), Inc.*, 16-13245 (Bankr. S.D.N.Y. Feb. 6, 2017), ECF No. 265.

Transtar and by obtaining from Transtar the appropriate consent to its representation of FFL on unrelated matters.

Though the consent Willkie obtained to a future conflict was at least formally adequate to address the potential conflict when Silver Point entered the negotiations, Willkie did not then check conflicts with respect to Silver Point, so it could not provide sufficient information or guidance to Transtar to comply with comment 22 of NY Rule 1.7 regarding future conflicts. Moreover, Speedstar directors expressed unhappy surprise in learning during the examination that Silver Point was a Willkie client; one director said he might have asked Willkie to create an "ethical wall" or sought to retain separate counsel for matters related to Silver Point had he learned of that representation when Silver Point entered the negotiations. However, when making that statement, the director did not know the limited extent of Willkie's Silver Point engagement, so the Examiner was unable to test his reaction in light of the size of the relationship between Silver Point and Willkie.

Silver Point was at most a minor Willkie client, and it appears that Willkie lawyers working on the Transtar matter were not aware at the time that Silver Point was a Willkie client on unrelated matters. For this reason, the conflict was very unlikely to have affected or influenced Willkie's representation of Transtar. Willkie's failure to check conflicts in July and to inform Transtar of its representation of Silver Point so as to satisfy the requirements of the future conflict waiver it had obtained from Transtar was a technical violation that did not result in any actual harm to Transtar but might be seen post hoc as creating an appearance of an actual conflict.

2. Willkie's Eligibility to Serve as Counsel for Transtar

Willkie was eligible to be employed under section 327(a) as counsel to Transtar in the chapter 11 case.

3. Disclosure

Willke's Initial Declaration was incomplete, but its supplemental declaration, filed before the hearing on Willkie's employment application, addressed any inadequacies in the Initial Declaration.

The Examiner does not make any recommendation on what sanction, if any, is appropriate for Willkie's initial nondisclosure of its Silver Point connection or its initial insufficient disclosure of its FFL connection. The Examiner notes that in his experience, while complete and full disclosure is required at the outset, supplemental disclosures are common. Yet courts do not typically disqualify or sanction the professional because the initial declaration was supplemented before the hearing. In bankruptcy cases involving large numbers of interested parties and for large firms with an ever expanding list of clients and connections who often delegate the review and assessment of connections to non-lawyers, inadvertent omissions happen. For this reason, professionals must review potential conflicts, connections and disclosures with the utmost care and caution.

To the extent Willkie technically violated any of the prepetition or postpetition rules, the violations seem to cut in the opposite directions: its relationship with FFL as shareholder and Silver Point as controlling First Lien creditor, if they influenced Willkie's conduct at all, would have pulled Willkie in opposite directions. That is not to suggest that the conflicts canceled each other out but rather that Willkie's violations were likely not intentional or designed to favor any particular position in the work-out negotiations. Finally, none of the parties whom the Examiner interviewed sensed any diminished loyalty to Willkie's client Transtar or any favoritism based on any of Willkie's relationships with other parties in interest. The Examiner reached the same conclusion. To all appearances, Willkie acted professionally and in the interests of its client.

B. General Observations

This investigation has raised a more general question about the wisdom of a law firm choosing to represent a portfolio company, rather than its private equity sponsor, in a restructuring transaction where the sponsor is a valuable client of the firm. If the firm is mindful of potential conflicts as Willkie was here, one of the entities will likely need to retain independent counsel before an actual conflict arises. But neither the firm nor its clients can know at the outset whether the two entities will become adverse and create a conflict. If the firm chooses to stay with the sponsor, it will not need to negotiate against its valuable sponsor client. If the firm chooses to switch to the portfolio company, problems might arise. Matters can become more complicated where the firm has also represented the portfolio company since the sponsor's acquisition. Where the firm did so for the portfolio company's financing transactions that are later subject to renegotiation in a work-out, it could be costly to educate new counsel to the firm's existing level of knowledge and understanding.

Here, things worked out. But it is easy to imagine a scenario in which a firm finds itself in the unenviable position of investigating, negotiating against, or even finding its portfolio company client might need to sue its sponsor client in the course of a contentious restructuring effort. Of course, there are countervailing considerations. Asking an insolvent portfolio company to bring on new counsel mid-restructuring is a costly and onerous proposition. If the company ends up in bankruptcy, navigating chapter 11 with unacquainted counsel is an even more daunting task. There is no perfect solution. But lawyers would be wise to think ahead in the early

stages of a work-out and to consider the likelihood of potential intercompany claims before the portfolio company becomes insolvent and well before it becomes a debtor.

DATED: March 7, 2017.

Respectfully submitted,

/s/ Richard Levin
Richard Levin, Examiner

APPENDIX A: Glossary of Key Individuals

Name	Organization	Role in the Transtar Restructuring
Augustine, Neil	Rothschild Inc.	Advisor to certain Second Lien lenders
Cosgrove, David	Willkie	Counsel to Transtar
Duggal, Rajat	FFL	FLL principal, served on Speedstar Board
Fleischer, Spencer	FFL	FFL principal, served on Speedstar Board
Forlizzi, Jeff	Silver Point	Investment analyst for Silver Point
Fortgang, Chaim	Fortgang Consulting LLC	Advisor to Silver Point
Grear, Craig	Young Conaway	Counsel to FFL
Hardy, Jennifer	Willkie	Counsel to Transtar
Klingbaum, Leonard	Willkie	Counsel to Transtar
Levy, Richard	Latham & Watkins LLP	Counsel to certain Second Lien lenders
Messersmith, Michael	Arnold & Porter Kaye Scholer LLP	Counsel to certain First Lien lenders
Nestor, Michael	Young Conaway	Counsel to FFL
Orzetti, Edward	Transtar	Transtar CEO
Scher, Brad	Transtar	Independent director on Speedstar Board
Strickland, Rachel	Willkie	Counsel to Transtar
Tang, Agnes	Ducera Partners	Investment banker for Transtar
Townsend, Neil	Willkie	Counsel to Transtar
Wilamowsky, Steven	Chapman & Cutler LLP	Counsel to Silver Point