Ad Hoc Committees and Other (Unofficial) Creditor Groups: Management, Disclosure and Ethical Issues

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I. Introduction[1]

Ad hoc, or unofficial, committees provide a mechanism by which creditors or equity interest holders with a common agenda can join together on an informal basis to advance their interests in the reorganization process. To put it simply: any group of creditors or equity holders who gets together and hires counsel to advance a common agenda in a bankruptcy case can be an ad hoc committee, whether or not it so labels itself. The theory behind ad hoc committees is that multiple creditors or equity holders singing together in chorus is better than a cacophony of individual creditors or equity holders each singing its own tune.

Unofficial committees are not appointed by the United States Trustee and do not owe fiduciary duties to any body of constituents. Nevertheless, they are routinely recognized and accepted as a normal part of chapter 11 cases. It is also common for groups of bondholders or other creditors to assemble and confer with the debtor before a bankruptcy petition is filed. After the petition is filed, these groups may continue to function as ad hoc committees. Like official committees, ad hoc committees can play an important role in making sure the interests of creditors or equity holders are protected. On the other hand, ad hoc committees consisting of members with more selfish motives can be vexatious litigants that distract the debtor and generally inhibit the reorganization process.

II. Why Form an Ad Hoc Committee?

Creditors or equity holders may decide to join together and form ad hoc committees for several reasons:

(a) An unofficial committee speaking with one voice can claim more weight for its positions than can individuals alone. As one Bankruptcy Court noted, unofficial committees "implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings."[2]

(b) Ad hoc committees can increase the efficiency of the reorganization process in that they allow creditors and equity holders with similar interests to coordinate action, motions and objections, rather than burdening the Bankruptcy Court with duplicative filings.

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[1] Michael J. Riela and Jennifer H. Sperling, associates in the insolvency practice group at Latham & Watkins LLP, greatly assisted in the preparation of these materials. Portions of these materials have been adapted from an article entitled "Living On The [H]edge: New Ethical Challenges", which was presented at the National Conference of Bankruptcy Judges on October 11, 2007. These materials do not necessarily reflect the views of the panelists' respective institutions.

[2] In re Northwest Airlines, 363 B.R. 701, 703 (Bankr. S.D.N.Y. 2007).

(c) Coordination among members of an ad hoc committee can reduce fees and other expenses for the creditors or equity holders that are members of the ad hoc committee, particularly professionals' fees. For creditors whose claims would be costly or time consuming to pursue individually, joining an ad hoc committee provides them the opportunity to pool resources and reduce expenses.[3]

(d) Ad hoc committees can be significant in shaping or vetoing a reorganization plan. For example, in bankruptcy cases where more than one-third of the amount of claims in a class is held by members of an ad hoc committee, the ad hoc committee could be in a position to effectively block confirmation of a plan.[4]

(e) An ad hoc committee may be used to act as a counterweight if a group of creditors or equity holders believes that the official committee is failing to address their concerns adequately. Ad hoc committees may also try to negotiate directly with the debtor, thus bypassing the official committee completely. For example, a group of hedge funds that purchased stock in Northwest Airlines Corporation post-petition formed an ad hoc stockholder committee that (among other things) opposed the debtor's attempt to commence a rights offering to raise capital to fund its emergence from chapter 11.

(f) In cases where the United States Trustee does not form an official committee, creditors or equity holders may still obtain the benefits of collective action by forming an ad hoc committee.

(g) Members of ad hoc committees do not have the fiduciary duties that are imposed on official committees, nor are they subject to oversight by the United States Trustee. This allows ad hoc committees more flexibility to advance their own self-interest without the need to represent the interests of non-members.

(h) Members of ad hoc committees typically are not subject to the trading restrictions that members of official committees face, provided they not elect to receive any material nonpublic information about the debtor.

There are no restrictions on who may form an ad hoc committee, but they generally are comprised of persons or entities that hold similar types of claims or interests against the estate. These groups have included bondholders, equity holders, trade creditors, unions, holders of tort claims against the estate, secured loan syndicates, landlords and other groups of investors or financial institutions. If a bankruptcy case is

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[3] *See* United States Attorneys' Civil Resource Manual 48: The Bankruptcy "Players" Outline (January 17, 1996), available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title4/civ00048.htm.

[4] *See* Eric B. Fischer, Hedge Funds and the Changing Face of Corporate Bankruptcy Practice, 25-10 AMER. BANKR. INST. J., 24, 88 (2007) ("Ad hoc committees are particularly effective when their members hold a blocking position with respect to a class of claims. In order for a class of claims to accept a reorganization plan, holders of at least two-thirds of the aggregate claims must cast votes in favor of the plan. Thus, if more than one-third of the debt is held by members of an ad hoc committee, that committee's support becomes essential to a consensual confirmation process.").

particularly complex with multiple layers of debt of differing structural and legal priorities (such as the Adelphia Communications chapter 11 case), a number of ad hoc committees could be formed to share legal costs and advance common agendas.

Because membership in an ad hoc committee is at will, the roster of members can change frequently and radically over the course of a bankruptcy. Changes in membership can impact the functioning of an ad hoc committee both internally, by changing the dynamic between members, and externally, if new members push the committee's agenda in different directions. The freedom of members to leave an ad hoc committee ensures that the committee is acting in the interest of its current members. However, an ad hoc committee that is constantly changing its position could run the risk of compromising its credibility with the Bankruptcy Court or other parties.

III. Differences Between Official Committees and Ad Hoc Committees

Section 1102 of the Bankruptcy Code permits the appointment of as many official committees as is necessary to assure adequate representation of creditors and equity holders. Some of the most significant differences between ad hoc committees and official committees are:

(a) Official committees are appointed by the United States Trustee. The United States Trustee determines both the size and composition of the committee, subject to potential intervention by the Bankruptcy Court and subject to the statutory maxim that creditors' committees should ordinarily be made up of "the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee." 11 U.S.C. § 1102(b)(1). Once the official committee members have been chosen, additional appointments or removals remain at the discretion of the United States Trustee, subject to review by the Bankruptcy Court upon motion.[5] Unlike official committees, ad hoc committees are not appointed or removed by the United States Trustee, and parties are free to join and withdraw from ad hoc committees at will, subject to the disclosure requirements of Bankruptcy Rule 2019.

(b) Official committees speak for and take positions for unsecured creditors or equity holders as a whole. In other words, official committees have fiduciary duties to all members of the class and are obligated to protect their collective interests. This effectively limits an official committee member's right to act only on its own behalf, at least to the extent that it takes action in its capacity as a

[5] The Bankruptcy Abuse and Consumer Protection Act of 2005 ("BAPCPA") added a new provision which gives statutory authority to the bankruptcy court to, on request of a party in interest, order a change in membership of creditors' committees if "necessary to ensure adequate representation of creditors." 11 U.S.C. § 1102(a)(2). The court may also increase the number of committee members to include a creditor that is a "small business concern" if that creditor may be disproportionately affected by nonpayment of claims. *See* 11 U.S.C. § 1102(a)(4). BAPCPA applies to bankruptcy cases filed after October 17, 2005. *See generally* Patrick Reilly, A Primer on Reconstitution of a Creditors' Committee Under § 1102(a)(4), 26-5 AM. BANKR. INST. J., 48 (2007).

member of the official committee. Official committee members may act contrary to the position taken by the majority of the group, so long as that position is still consistent with their fiduciary duties to the class.[6] This is different from ad hoc committees who "cannot (and do not purport to) represent the rights of any party who is not a member of the group."[7] In other words, ad hoc committee members are not restricted from acting in their own self-interest alone, and may take positions contrary to those taken by the other members of the committee.[8]

(c) To fulfill their fiduciary duties, official committee members have access to material nonpublic information about the debtor. These parties cannot trade in the debtor's securities while in possession of such inside information. However, in an effort to permit institutions sitting on official committees to continue trading in the debtor's securities, official committees (or individual members thereof) often request Bankruptcy Court approval of "screening walls" and other procedures. Such screening procedures are designed to ensure that non-public information obtained by committee members is not shared with the committee members' securities trading personnel.[9] Courts commonly grant requests for such screening walls, as long as the proposed walls are appropriate. In contrast to official committees, members of ad hoc committees are not subject to the same trading restrictions, unless they choose to receive confidential information.[10]

(d) Ad hoc committees are not restricted in their communications with the debtor, but nothing requires the debtor to disclose information to ad hoc committees. Thus, in some cases, ad hoc committees may find their access to information severely limited. By contrast, an official committee appointed under section 1102 of the Bankruptcy Code is empowered to (1) consult with the trustee or debtor in possession concerning the administration of the case; (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan; (3) participate in the formulation of a plan, advise those represented by such committee of such

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[6] See Carren Shulman and Timothy Mehok, Membership has its Privileges, Or Does It?, Financier Worldwide (2007) ("Fiduciary duties may restrict activities in which members may otherwise engage … Committee members can face harsh penalties for breaching their fiduciary duties, including removal from the committee and subordination or disallowance of their claims").

[7] Evan D. Flaschen, Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds, 26-7 AMER. BANKR. INST. J. 16 (2007).

[8] See id. (explaining that "individual [ad hoc committee] members are always free to file separate pleadings advocating different positions").

[9] See Honorable Theodore C. Albert et al., Navigating the Minefields of Representing Chapter 11 Committees – Getting Employed, Managing Inter-Committee Conflicts & Complying With BAPCPA, 060907 ABI-CLE 189 (Sept. 2006).

[10] See Shulman and Mehok, supra note 6 (suggesting that forming an ad hoc committee can be a viable alternative for hedge funds who want to serve on a committee without forfeiting its right to trade in the securities of the debtor).

committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan; (4) request the appointment of a trustee or examiner under section 1104 of the Bankruptcy Code; and (5) perform such other services as are in the interest of those represented. See 11 U.S.C. § 1103(c).

(e) As discussed below, unlike official committees, ad hoc committees are not legally entitled to reimbursement of their expenses, or to payment of the fees and expenses of their professionals, unless they can demonstrate that their efforts made a substantial contribution to the debtor's bankruptcy case.

(f) Ad hoc committees do not have automatic standing to be heard by the Bankruptcy Court. Ad hoc committee members must have independent standing to be heard in the reorganization process, but standing is a low bar to clear. Pursuant to section 1109(b) of the Bankruptcy Code, any "party in interest … may raise and may appear and be heard on any issue" in a chapter 11 case. Parties in interest include the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or an indenture trustee.[11]

IV. Management of Ad Hoc Committees and the Treatment of Confidential Information

Ad hoc committee management is just that: ad hoc. The management of official committees tends to follow a structured form and involves a relatively well-managed process, such as adopting by-laws, the formation of subcommittees to engage in communications with the debtor or for other purposes, the appointment of a chair, and scheduling regular meetings for deliberation and conducting official committee business. By contrast, the management of ad hoc committee can take any form that is convenient for its members. That may involve establishing by-laws or other procedures for conducting business, but it may also involve something more impromptu. Decision making may also involve more or less collaboration or deliberation depending on the preference of the members of the ad hoc committee (or depending on the preference of only the most vocal members or the members with the largest claims). An ad hoc committee consisting of sophisticated financial players might operate with members informally discussing matters and then directing their counsel to take action. Other ad hoc committees may decide to leave more discretion for management decisions to the attorney representing the committee.

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[11] See generally, 7-1109 Collier on Bankruptcy, 15th Ed. Rev. P. 1109. See also Unofficial Comm. of Zero Coupon Noteholders v. Grand Union Co. (In re Grand Union Co.), 179 B.R. 56, 59 (D. Del. 1995) (holding that an unofficial committee of zero coupon noteholders who were not creditors or equity security holders had standing because they had a "practical stake" in the outcome of the proceedings); Nathalie D. Martin, Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In, 59 OHIO ST. L. J., 429 (1998) (arguing against limiting standing to persons with current economic interests in the debtor in favor of a "substantial interest" standard).

One decision ad hoc committee members must make early in the reorganization process is whether they wish to receive material nonpublic information about the debtor. The free flow of information is important to allow members to make decisions which best advance their interests, and access to confidential information is important to a full understanding of the debtor's business and its prospects for reorganization.[12] However, once a member has material nonpublic information about the debtor, it becomes restricted from trading its interests in the debtor's securities. This is a particular concern for investors who are focused on creating value in the short-term and want to be able to trade their positions.[13] Ultimately, ad hoc committee members have to balance their desire to trade claims and interests in the debtor freely, with their need to obtain material non-public information to make informed decisions regarding the bankruptcy case. Some ad hoc committee members might conclude that it is in their best interests to restrict themselves at some point, while other members may conclude otherwise. For example, a long-term investor may wish to obtain confidential information so that it can make well-informed decisions, while short-term distressed debt traders may not wish to restrict their ability to trade.

Large institutions may be able to establish a trading wall between individuals in the institution that receive confidential information and individuals who are involved in trading the debtor's securities.[14] However, trading walls may be completely impractical for hedge funds. One commentator noted that "[g]iven the lean staffing of most hedge funds, however, it is likely that a single individual or a small group of individuals will be responsible for all the fund's investments in a particular debtor. Thus, if a hedge fund serves on an ad hoc committee and elects to become restricted and receive confidential information, that fund may be restricted from trading any of its positions (not just those represented by the ad hoc committee) due to the difficulty of creating and maintaining ethical walls. This has become a high-profile issue both inside and outside bankruptcy as the SEC continues to scrutinize the trading practices of hedge funds that lend to distressed companies and that may have access to nonpublic information."[15]

To allow ad hoc committee members to obtain confidential information but at the same time protect the debtor against improper disclosure, members of ad hoc committees

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[12] See Fischer, supra note 4.

[13] Id. See also Jonathan S. Henes, Rule 2019 Opinion May Transform the Dynamics of Chapter 11 Cases, Daily Bankruptcy Review (2007), available at http://www.kirkland.com/print.cfm?contentID=223&itemID=2242 (last visited January 29, 2008) ("It is axiomatic that traders cannot tie their hands and restrict their ability to trade. As a result, trading-oriented funds rarely enter into confidentiality agreements and, therefore, are not provided with material, non-public information, which would allow them to work with the debtor to establish a business plan focused on long-term wealth maximization.").

[14] See Shulman and Mehok, supra note 6 (discussing the various forms approved ethics walls can take, including physical separation of office space, employing different people to do different tasks, and using separate phone and fax lines).

[15] Fischer, supra note 4 at 88.

and debtors may enter into confidentiality agreements or protective orders.[16] Depending on the needs of the parties, confidentiality agreements can be executed between the debtor and the committee as a whole, individual committee members, or committee counsel. If a particular ad hoc committee consists of some members who wish to obtain confidential information and some members who do not, it is possible to isolate members receiving confidential information from those who wish to remain unrestricted.

If all the members of the ad hoc committee wish to remain unrestricted and do not wish to obtain confidential information about the debtor, then the debtor could provide confidential information only to the committee's attorney and/or the committee's financial professionals, rather than its principals. Not only can this information-sharing arrangement make it difficult for debtors to negotiate workable reorganization plans with the ad hoc committee, but it also could place the professionals in the uncomfortable position of knowing much more than its clients, and possibly being expected to make business decisions on behalf of the committee. While many attorneys may be adept at making business decisions, that simply is not their typical job. When an attorney makes the business decisions for the ad hoc committee, that attorney may be sued by committee members under malpractice and other legal theories later if the attorney's decisions proved unwise. Of course, the committee members who sue their attorney would have the benefit of 20/20 hindsight, while the attorney did not have that benefit when it made the decisions that led to the litigation.

Another issue arises when some (but not all) the members of an ad hoc committee receive confidential information about the debtor. In that case, the committee's attorney must determine how to keep the parties that are not privy to confidential information as informed as possible, while making sure that there is no disclosure of confidential information to the parties that are not supposed to be receiving it. If some members do not wish to be restricted, then the balance of information among members of the committee would likely become tilted heavily in favor of the restricted members. This is particularly true when the information is so important that it would influence the committee's decisions. The attorney might decide to provide only the non-confidential portions of such information to the unrestricted members, or have the restricted members make recommendations to the unrestricted members based on what they know (without divulging the confidential information). On the other hand, counsel to the ad hoc committee may try to persuade or force the debtor to publicly disclose the confidential information, so that all of the ad hoc committee members may access that information. This is particularly true for information that is so important, that it would clearly influence the committee's decisions. Pressure from an ad hoc committee's attorney to disclose information may create considerable tension where the debtor and the official committees in the case truly believe that the information is confidential, and that public disclosure of that information would harm the debtor.

[16] See generally John W. Mills, Committee Confidentiality?, The National Law Journal, November 21, 2005 (discussing confidentiality issues arising for official committees which are equally applicable to ad hoc committees).

V. Payment of an Ad Hoc Committee's Professional Fees and Expenses

Unlike professionals retained by official committees, professionals representing ad hoc committees generally are not eligible to have their fees paid from the debtor's bankruptcy estate. An exception to this rule is set forth in section 503(b) of the Bankruptcy Code, which provides that after notice and a hearing, administrative expenses shall be allowed of "a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title."[17] Section 503(b)(4) of the Bankruptcy Code allows for reimbursement of "reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable" under section 503(b)(3)(D), based on the time, the nature, the extent, and the value of the services, and the cost of comparable services in the non-bankruptcy context.[18] This means that counsel or other professionals for ad hoc committees can have their fees and expenses paid, if they can demonstrate that the ad hoc committee made a substantial contribution to the bankruptcy case. However, demonstrating that an ad hoc committee substantially contributed to the debtor's bankruptcy case is not an easy feat, and section 503(b) applications are not always granted.

Bankruptcy Courts do not follow a uniform standard in considering applications for substantial contribution, but they generally have been strict in interpreting the "substantial contribution" requirement with respect to unofficial committees and their members. It is clear that "merely representing a client in an active role in a chapter 11 case is not sufficient to trigger section 503(b)(4)."[19] The burden is on the committee to demonstrate to the Bankruptcy Court that its efforts in fact made a substantial contribution to the debtors' estate and creditors generally; not just to the pockets of their own members. In considering applications for substantial contribution, Bankruptcy Courts have considered several factors, including the following:[20]

(a) whether the committee's actions fostered and enhanced, rather than inhibited or interrupted, the progress of the debtor's bankruptcy case;

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[17] 11 U.S.C. § 503(b)(3)(D).

[18] 11 U.S.C. § 503(b)(4).

[19] In re Mirant Corp., 354 B.R. 113, 137 (Bankr. N.D. Tex. 2006).

[20] See id. at 137 (identifying seven factors courts must consider in addressing applications for substantial contribution); See also In re Buckhead Am. Corp., 161 B.R. 11, 13 (Bankr. D. Del. 1993) (holding that the benefits of a substantial contribution claim must be tangible and direct; "[i]ncidental benefit to the estate or extensive participation in the case, without more, are not sufficient bases for section 503(b) status."); In re Lister, 846 F.2d 55, 57 (10th Cir. 1988) (assessing whether the services involved in the contribution were undertaken just for the applying creditor or for the benefit of all parties in the case); Lebron v. Mechem Financial, Inc., 27 F.3d 937, 944 (3d Cir. 1994) (holding that substantial contribution requires an actual and demonstrable benefit to the debtor's estate and the creditors); In re DP Partners, Ltd. P'ship, 106 F.3d 667 (5th Cir. 1997) (holding that "[a]t a minimum … the Court should weigh the cost of the claimed fees and expenses against the benefits conferred upon the estate.").

(b) whether the claimed expenses are duplicative of other parties' expenses in the case;

(c) whether the professional's services provided were provided for the benefit of the committee and only "incidentally benefit the estate," or confer a direct and demonstrable benefit on all parties in the case;

(d) whether the committee's contribution had a demonstrable positive effect on the estate;

(e) whether the benefits conferred by the committee were diminished by selfish motivations;

(f) whether the benefit the committee conferred though "substantial contribution" exceeds the cost the party seeks to assess against the estate;

(g) whether the committee's conduct caused a negative effect on the case that offsets the value of the committee's contribution; and

(h) whether the committee would have proceeded the same way it did in the case, had it not had an expectation of compensation from the debtor.

The "substantial contribution" requirement acts as a check on purely self-interested or antagonistic committee tactics by an ad hoc committee. Nevertheless, reimbursement of an ad hoc committee's professional fees and expenses could be agreed to as part of a settlement agreement with the debtor or other parties in interest. The United States Trustee may object to settlements that provide for payment of an ad hoc committee's professionals' fees, without the requirement that the professionals satisfy the substantial contribution requirements. Some Bankruptcy Courts have overruled these objections and permitted the payment of professionals' fees simply as part of a settlement.

There are both advantages and disadvantages to an expectation of the part of an ad hoc committee that the debtor ultimately will pay its professionals' fees pursuant to a settlement. One effect is that an expectation of payment would certainly increase ad hoc committee activity. Not only would the number of ad hoc committees likely increase if there is an expectation of payment, but ad hoc committees may also take more aggressive positions in the case (which ordinarily require more attorney hours and court time). An active ad hoc committee can be a good thing, to the extent the committee is a constructive participant in the process who is acting to protect the rights of creditors or equity holders. However, increased ad hoc committee activity could also be detrimental, if the committee is acting only selfishly, or in a way that is destructive or hinders the reorganization process. Indeed, the lack of fiduciary duties imposed on ad hoc committees means that they have less incentive, and no obligation, to be a constructive participant in the case.

The payment of professionals' fees can be a powerful bargaining chip for the debtors. For example, if an ad hoc committee has a valid objection to the debtor's proposed course of action, the debtor may be able to negotiate a settlement where the ad hoc committee would abandon its valid objection in exchange for a stipulation that its professionals' fees will be reimbursed, or a guarantee that the ad hoc committee will have the debtors' support for a substantial contribution motion. This kind of horse trading may be good for the members of the ad hoc committee, but might ultimately hurt other creditors or equity holders who may have relied on the ad hoc committee to raise its objection. However, creditors and equity holders rely on an ad hoc committee at their own peril, because unlike official committees, an ad hoc committee has no fiduciary duty to bring any objection or claim, or act for the benefit of any other creditor or equity holder.

VI. Disclosure Under Federal Rule of Bankruptcy Procedure 2019(a)

Federal Rule of Bankruptcy Procedure 2019(a) requires any entity that represents more than one creditor or equity security holder in connection with a bankruptcy case to file a verified statement identifying each client and the nature of their claims or interests, together with certain facts about the attorney's employment.[21] The Rule 2019(a) statement affords the Bankruptcy Court and parties-in-interest information regarding multiple representations by an attorney and can be used by courts as a vehicle to ensure adherence to ethical responsibilities.[22] If an attorney fails to comply with Rule 2019(a), then on motion of any party in interest or on its own initiative, the Bankruptcy Court may refuse to permit the attorney to be heard further or to intervene in the case.[23]

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[21] Bankruptcy Rule 2019(a) provides:

> "In a … chapter 11 reorganization case, except with respect to a committee appointed pursuant to § 1102 or 1114 of the Code, every entity or committee representing more than one creditor or equity security holder and, unless otherwise directed by the court, every indenture trustee, shall file a verified statement setting forth (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and (4) with reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof. …"

Fed. R. Bankr. P. 2019(a).

[22] See, e.g., City of Lafayette v. Oklahoma P.A.C. First Limited Partnership (In re Oklahoma P.A.C. First Limited Partnership), 122 B.R. 387, 392 (Bankr. D. Ariz. 1990) (stating that counsel representing multiple creditors in a bankruptcy case must comply with Rule 2019 and that, as a result of those disclosures, counsel could be forced to withdraw from representation of some creditors where a conflict of interest was found).

[23] See Fed. R. Bankr. P. 2019(b).

In 2007, the Bankruptcy Court in the Northwest Airlines Corporation chapter 11 case ordered the members of an ad hoc committee of stockholders to file a Rule 2019(a) statement to disclose the amount of interests owned by the members of the committee, the times when the interests were acquired, the amounts paid for the interests and any sales or other dispositions of the interests. In ordering the additional disclosure, the Bankruptcy Court determined that the prior Rule 2019(a) statements filed by counsel to the ad hoc committee were insufficient because they had failed to disclose that information.[24] In its opinion, the Bankruptcy Court noted that ad hoc committees generally play an important role in reorganization cases, because their members purport to speak for a group and implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings.[25] The Bankruptcy Court further noted that the purpose of the Rule 2019(a) statement is to require these influential informal committees to disclose possible conflicts of interest.

The ad hoc committee appealed the Bankruptcy Court's order requiring the additional disclosure to the district court, and also requested that the Bankruptcy Court allow it to file portions of its enhanced Rule 2019(a) statement under seal.[26] The Bankruptcy Court denied the ad hoc committee's request to file the Rule 2019(a) statement under seal. In its opinion, the Bankruptcy Court noted that even though the ad hoc committee did not purport to act as a fiduciary for other stockholders, Rule 2019(a) is based on the premise that stockholders have a right to information as to ad hoc committee members' purchases and sales, so that stockholders can decide on an informed basis whether the ad hoc committee truly represents their interests, or whether they should consider forming a more broadly-based committee of their own. The Bankruptcy Court also noted that the information required by Rule 2019(a) provides all parties a greater ability to gauge the credibility of the ad hoc committee, which had chosen voluntarily to appear in the bankruptcy case and play a major role.[27] Because many investors (particularly hedge funds) guard their trading secrets fiercely, the Northwest Airlines decision might curtail investor involvement in bankruptcy cases, or at least dampen their desire to band together with others to form ad hoc committees.[28]

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[24] See In re Northwest Airlines Corp., No. 05-17930, 2007 WL 609214, *2 (Bankr. S.D.N.Y. 2007).

[25] See id. at *3.

[26] The ad hoc committee proposed to seal the portion of its enhanced Rule 2019(a) statement that discloses the specifics of the purchases and sales of the Debtors' securities made by members of that committee. The ad hoc committee argued that the information it sought to seal would allow the members' competitors to discern the members' investment strategies.

[27] On March 21, 2007, the ad hoc committee publicly filed its enhanced Rule 2019(a) statement. See Verified Amended Statement of the Ad Hoc Committee of Equity Security Holders Pursuant to Bankruptcy Rule 2019(a), Case No. 05-17930 (Bankr. S.D.N.Y.), Docket No. 5446.

[28] In an amicus curiae brief in opposition to Scotia Pacific Company LLC's motion for an order compelling members of an ad hoc committee of noteholders to file a Rule 2019(a) statement, two of the nation's leading industry groups in the debt and equity markets argued that a requirement that certain parties publicly disclose their trading activities would "in all likelihood erect a substantial obstacle to the participation of certain parties and stakeholders in bankruptcy cases," which would both prevent involvement by sophisticated parties that frequently have made positive contributions to reorganizations, as

The Northwest Airlines rulings have prompted other requests for court orders requiring disclosure from ad hoc committees under Rule 2019(a), but one court did not follow the Northwest Airlines court in requiring such disclosure. Scotia Pacific Company LLC, a chapter 11 debtor in a bankruptcy case pending in the Southern District of Texas, requested a Bankruptcy Court order compelling an ad hoc committee of noteholders to file a Rule 2019(a) statement.[29] It also requested that the Bankruptcy Court refuse to consider the ad hoc committee's pleadings until that committee files an appropriate Rule 2019(a) statement. In support of its motion, Scotia Pacific alleged that the ad hoc committee has distracted the reorganization process by adopting an aggressive and improper litigation posture and by filing "patently absurd" pleadings with the Bankruptcy Court. Scotia Pacific further alleged that the ad hoc committee adopted this aggressive posture while "hiding behind a veil of secrecy that is patently contrary to the open disclosure policies underlying the Bankruptcy Code and the express provisions of Bankruptcy Rule 2019(a)."[30]

In an amicus brief in opposition to Scotia Pacific's motion, the Securities Industry and Financial Markets Association and the Loan Syndications and Trading Association argued that a public disclosure requirement would create unearned windfalls in favor of debtors and destroy the incentive for investors to purchase claims against debtors. According to these industry groups, such windfalls would occur because if parties are required to disclose their basis in debtors' securities, debtors and other parties would use that information to their advantage in negotiations over such matters as the treatment of the securities under a reorganization plan and the price of the securities in a subsequent disposition thereof. According to these two groups, "[b]y simply requiring that such information be disclosed, the terms of negotiation will unavoidably shift from being focused on the obligations of the debtor under the terms of the relevant instrument to consideration of the relative return to the specific stakeholder, thereby effectuating a significant departure from well-settled law and customary practice."[31] The Bankruptcy Court denied Scotia Pacific's motion, ruling that the ad hoc committee was not a "committee" within the meaning of Rule 2019(a).[32] The Bankruptcy Court also denied the debtors' later motion for reconsideration of that ruling.

Parties' varied investments in a bankrupt company can raise other Rule 2019(a) disclosure issues for their attorneys who also represent other clients in a particular bankruptcy case. For example, suppose that a distressed debt investor purchases unsecured bonds issued by a company and also obtains a short position in the company's stock. Suppose further that after the company files its chapter 11 case, that investor joins an ad hoc committee of unsecured bondholders. Must the investor's short position in the

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well as negatively impact the markets that create liquidity in a debtor's securities. See In re Scotia Development LLC, Case No. 07-20027 (Bankr. S.D. Tex.), Docket No. 610, at 2.

[29] See In re Scotia Development LLC, Case No. 07-20027 (Bankr. S.D. Tex.), Docket No. 492.

[30] Id. at 1-2.

[31] See In re Scotia Development LLC, Case No. 07-20027 (Bankr. S.D. Tex.), Docket No. 610, at 5-6.

[32] See In re Scotia Development LLC, Case No. 07-20027 (Bankr. S.D. Tex.), Docket No. 659.

stock be disclosed when counsel to the ad hoc committee files its Rule 2019(a) statement? Technically, the requirements of Rule 2019(a) relate only to present holdings of claims and interests in the debtor. Because the investor does not own stock issued by the debtor, Rule 2019(a) may not require disclosure of the short position. However, if the investor becomes active during the bankruptcy case, then the existence of its short position would be relevant to understanding its goals and motivations. Attorneys representing ad hoc committees should be aware of all of the investments the committee members have made, and should consider (particularly in light of the Northwest Airlines decision) whether any short positions should be disclosed, even though Rule 2019(a) technically may not require such disclosure.

VII. The Attorney-Client Privilege

An ad hoc committee attorney's clients could be considered to be the individual members of the committee, rather than the committee as a whole.[33] Accordingly, the attorney must be aware of attorney-client privilege issues with respect to information that the individual members of the committee share with the attorney in confidence. In accordance with the common law joint client doctrine (to which courts also have referred as the "joint defense privilege," the "common interest rule," the "community of interest doctrine," and other names), when two or more persons jointly consult an attorney on a matter, their confidential communications with the attorney relating to matters in common interest to the clients generally are privileged in a controversy between either client and any third party.[34] As long as it can be demonstrated that the group of clients jointly consulted one attorney or law firm with the intent to keep their communications confidential, the joint client doctrine protects confidential communications from discovery by third parties.[35]

However, under the joint client doctrine, communications between one of the clients and the attorney would not be privileged in litigation between the clients themselves. Thus, for example, if Client X and Client Y retain Attorney A to represent them in a matter, communications between Client X and Attorney A would be privileged in litigation between Client X and an unrelated third party. Meanwhile, the communications between Client X and Attorney A would not be privileged in litigation between Client X and Client Y, at least unless Client X and Client Y have agreed otherwise.[36] Because individual members of an ad hoc committee may later become adversaries, the attorney for the committee must be aware of this doctrine.

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[33] Some have argued that the opposite is true. See, e.g., Evan D. Flaschen & Kurt A. Mayr, Ad Hoc Committees and the Misuse of Bankruptcy Rule 2019, 16 Norton Journal of Bankruptcy Law & Practice, 992 (December 2007) (stating that "[o]therwise, counsel could have a duty to advise the group members individually, even where their interests diverge, which could result in a clear conflict of interest).

[34] This rule first appeared in Chahoon v. Commonwealth, 62 Va. (21 Gratt.) 822 (Va. 1871). See Nicole Garsombk, A Tragedy of the Common: The Common Interest Rule, Its Common Misuses, and an Uncommon Solution, 40 Ga. L.R. 615,624 (Winter 2006).

[35] See Garsombk, supra note 34, at 646-47.

[36] For example, in Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), the Fifth Circuit recognized what it described as the "common interest exception" to the attorney-client privilege, stating that "[i]n

While most, if not all, states have recognized some form of the joint client doctrine,[37] the outcome of a dispute over whether a communication between one of a group of clients and the group's attorney is privileged will depend on the governing state law as divined by the courts. This may lead to aberrant results. For example, courts have confused the joint client doctrine (which applies when multiple clients are represented by a single attorney or law firm) and the common interest rule (which applies when clients are represented by different attorneys, but agree to share information). This confusion has led to courts protecting non-privileged information, while ordering the disclosure of truly privileged information.[38]

Section 75 of the Restatement (Third) of the Law Governing Lawyers sets forth a clear statement of the privilege of joint clients that are represented by a single lawyer.[39] It provides as follows:

> (1) If two or more persons are jointly represented by the same lawyer in a matter, a communication of either co-client that otherwise qualifies as privileged … and relates to matters of common interest is privileged as against third persons, and any co-client may invoke the privilege, unless it has been waived by the client who made the communication.
>
> (2) Unless the co-clients have agreed otherwise, a communication described in Subsection (1) is not privileged as between the co-clients in a subsequent adverse proceeding between them.

Under the Restatement rule, joint clients may agree in advance that communications between an individual client in the group and the attorney would be privileged in litigation between or among members of the group of clients. An attorney for an ad hoc committee may wish to consider drafting an agreement among the members of the committee, which would provide for the protection of communications between the attorney and each member of the committee, even if the committee dissolves and the members wind up in litigation against each other.

It is axiomatic that the attorney-client privilege belongs to the client. However, when the privilege is shared by multiple parties as a group (such as members of an ad hoc committee), it is not clear who owns the privilege and who may waive it.[40] Some

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many situations in which the same attorney acts for two or more parties having a common interest, neither party may exercise the privilege in a subsequent controversy with the other. This is true even where the attorney acts jointly for two or more persons having no formalized business arrangement between them."

[37] See Garsombk, supra note 34, at 642, citing Wastewater Reclamation Dist. v. Cont'l Case. Co., 142 F.R.D. 471, 478 (D. Colo. 1992) (citing cases).

[38] See id., citing 24 Charles Alan Wright & Kenneth W. Graham, Jr., Federal Practice and Procedure § 5505 (2005).

[39] See Restatement (Third) of the Law Governing Lawyers § 75 (2000).

[40] See Katharine Traylor Schaffzin, An Uncertain Privilege: Why the Common Interest Doctrine Does Not Work and How Uniformity Can Fix It, 15 B.U. Pub. Int. L.J. 49, 83 (2005).

members of an ad hoc committee may seek to prevent the disclosure of privileged communication while others may seek disclosure of that communication. Courts typically have held that, because the privilege belongs to the group, no party may waive it absent the consent of all members of the group.[41] These courts have treated the unauthorized waiver of the privilege by one member of a common interest group as a waiver as to that party only. The non-waiving members of the group would retain the privilege.[42] Section 75 of the Restatement is consistent with this view. It provides that each co-client has standing to assert the attorney-client privilege if a third party attempts to gain access to or to introduce a joint client communication. The client asserting the privilege does not need to have been the source of the communication. However, each client may waive the attorney-client privilege as against a third party with respect to that client's own communications with the attorney, so long as the communication relates only to the client that made the communication and makes the waiver. One client does not have the authority to waive the privilege as against a third party with respect to a fellow joint client's communications to the common attorney.[43]

VIII. Conflicts of Interest

Attorneys representing ad hoc committees must be aware of conflicts of interest issues that may arise in the course of the representation. This is true even though section 1103(b) of the Bankruptcy Code does not apply to professionals for ad hoc committees.[44] Counsel to ad hoc committees likely would be deemed to represent the individual members thereof. Joint representation by a single counsel can offer ad hoc committee members economic or tactical advantages, including greater efficiency and greater bargaining power. However, joint representation also involves risks for counsel that committee members will encounter conflicts of interest and divided (or at least shared) attorney-client loyalties as between committee members.

As noted above, the clients of the attorney to an ad hoc committee could be the individual members of the committee, rather than the committee as a whole. If that is the case, then the attorney would have a duty to advise the members of the committee individually, even if their interests are profoundly different. Indeed, ad hoc committee

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[41] See id. at 83, citing John Morrell & Co. v. Local Union 304A of United Food & Commercial Workers, 913 F.2d 544, 556 (8th Cir. 1990) (quoting Ohio-Sealy Mattress Mfg. Co. v. Kaplan, 90 F.R.D. 21, 29 (N.D. Ill. 1980)); In re Grand Jury Subpoenas, 89-3 & 89-4, John Doe 89-129, 902 F.2d 244, 248 (4th Cir. 1990) ("[A] joint defense privilege cannot be waived without the consent of all parties who share the privilege."); Niagara Mohawk Power Corp. v. Megan-Racine Assocs., Inc. (In re Megan-Racine Assocs., Inc.), 189 B.R. 562-571 (Bankr. N.D.N.Y. 1995) (stating that "[t]he joint-defense privilege cannot be waived unless all the parties consent or where the parties become adverse litigants.").

[42] See id. at 83-84, citing Western Fuels Ass'n, Inc. v. Burlington N. R.R. Co., 102 F.R.D. 201, 203 (D. Wyo. 1984).

[43] See Restatement (Third) of the Law Governing Lawyers § 75, cmt. e (2000).

[44] Section 1103(b) of the Bankruptcy Code provides that attorneys and accountants employed by official committees may not represent any other entity having an adverse interest in connection with the bankruptcy case. See 11 U.S.C. § 1103(b).

members may have varied economic interests in the debtor's estate or may have differing levels of willingness to compromise with opponents. This is particularly true with hedge funds, which often have holdings at various levels of the debtor's capital structure.[45] Navigating these conflicts of interest can present special challenges to the attorney for an ad hoc committee. This situation is very different from official committees where it is very clear that counsel represents the entire committee, a defined entity with statutory duties to its constituency, and not its individual members.

States have their own laws and rules concerning attorney conflicts of interest. These laws and rules bear various degrees of resemblance to one or both of the two sets of model rules of attorney conduct that the American Bar Association adopted in the past forty years. In 1969, the American Bar Association adopted the Model Code of Professional Responsibility (the "Model Code"). The Model Code consists of three main components: canons, ethical considerations and disciplinary rules. The canons define the professional standards of conduct expected of an attorney, and form the framework for the development of the ethical considerations (which are suggested guidelines for an attorney's appropriate professional behavior) and the disciplinary rules (which are the rules prescribing a minimum acceptable standard of conduct) that follow each canon.[46] Two canons of the Model Code relate to conflicts of interest. First, canon 5 requires attorneys to be disinterested. This canon states that "[a] lawyer should exercise independent professional judgment on behalf of a client." Ethical consideration 5-1 describes how far this loyalty extends:

> "The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client."

If a conflict of interest arises, then the attorney's exercise of his or her own professional judgment determines whether the representation is proper. Attorneys may accept only those representations in which they may argue their clients' position independently of their own needs and the needs of their other clients. If that separation of interests becomes impossible during the course of the representation of a client, then the attorney must withdraw from the representation of that client or the client with the conflicting interest.[47] If an attorney's two clients have differing interests that do not presently result in a conflict, then the attorney may represent both clients only if they both consent to the representation after disclosure. However, if one of the clients does not consent to the dual representation, then the attorney may not represent the non-consenting client, even if the attorney reasonably believes there is no conflict.[48]

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[45] See Fischer, supra note 4.

[46] See Nancy B. Rapoport, Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy, 26 Conn. L. Rev. 913 (1994).

[47] See id.

[48] See id.

Second, canon 9 of the Model Code establishes a "catch-all" ethics principle that calls for a lawyer to "avoid even the appearance of professional impropriety." One scholar noted that the primary justification for canon 9 appears to be that "the avoidance of the appearance of impropriety promotes public confidence in our system and in the legal profession."[49] A number of Bankruptcy Courts that have interpreted canon 9 in conflict of interest situations have applied a very strict standard, holding that all conflicts (whether actual or potential) result in disqualification.[50]

In 1983, the American Bar Association adopted the Model Rules of Professional Conduct (the "Model Rules"), which provide both mandatory and permissive guidelines for an attorney's professional conduct. Model Rule 1.7 governs conflicts of interest, and addresses both multi-client conflicts and conflicts stemming from the competition between an attorney's own interest and the client's interests. Specifically, Model Rule 1.7(a) states, in relevant part, that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."[51] Model Rule 1.7(b) states that notwithstanding the existence of a concurrent conflict of interest, an attorney may represent a client if: (a) the attorney reasonably believes that he or she will be able to provide competent and diligent representation to each affected client; (b) the representation is not prohibited by law; (c) the representation does not involve the assertion of a claim by one client against another client in the same litigation or other proceeding before a tribunal; and (d) each affected client gives informed consent that is confirmed in writing.[52]

The Model Rules also provide that the disqualification of one attorney from representation of a client because of a simultaneous conflict of interest may also vicariously disqualify the other attorneys at his or her firm. Thus, different attorneys working at a single firm are barred from doing that which one attorney at the firm is prohibited from doing. Specifically, Model Rule 1.10(a) provides that "[w]hile lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless the prohibition is based on a personal interest of the prohibited lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining

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[49] Id., citing Ethical Considerations 9-1, 9-2 and 9-6 (internal quotation marks omitted).

[50] See In re Kendavis Indus. Int'l, Inc., 91 B.R. 742, 753-57 (Bankr. N.D. Tex. 1988); In re Michigan General Corp., 78 B.R. 479, 484 (Bankr. N.D. Tex. 1987); see also Joseph D. Vaccaro & Marc R. Milano, Section 327(a): A Statute In Conflict: A Proposed Solution To Conflicts Of Interest In Bankruptcy, 5 AMBKRILR 237, 242 (Spring 1997).

[51] Model Rules of Professional Conduct 1.7(a).

[52] See Model Rules of Professional Conduct 1.7(b).

lawyers in the firm."[53] However, a disqualification prescribed by Model Rule 1.10(a) may be waived by the affected client.[54]

To highlight potential issues for clients before forming or joining an ad hoc committee, counsel to an ad hoc committee may require its members to read and sign a joint representation agreement. A typical joint representation agreement explains the risks of multiple representation and spell out what should happen if a conflict arises between counsel and members, or between members themselves. In extreme cases, if conflicts can not be resolved, members may be required to resign from the ad hoc committee, or counsel might have to withdraw from the representation. Joint representation agreements also typically explain that the attorney-client privilege would be waived as between ad hoc committee members. As noted above, any communications between counsel and any individual member of the ad hoc committee are not privileged and can be accessed by any other member of the ad hoc committee in litigation between members. Depending on the dynamic of the ad hoc committee, sharing privilege with other parties might constrain some committee members from disclosing confidential or other sensitive information to the committee's counsel. This in turn may affect the committee's counsel's ability to obtain complete and accurate information about each member and its particular interest in the bankruptcy case. A joint representation agreement may draw attention to these issues before they become a significant problem.

IX. The Meridian Automotive Systems Case

The Meridian Automotive Systems bankruptcy case in Delaware provides an example of the consequences that follow when a court determines that a firm has failed to comply with applicable conflict of interest rules. In that case, Stanfield Capital Partners, LLC ("Stanfield") was a "cross-over" pre-petition secured creditor of the debtors. In other words, Stanfield held both first lien debt and second lien debt. Stanfield requested that the Bankruptcy Court disqualify a law firm that was serving as counsel to an ad hoc committee of lenders holding only first lien debt (of which Stanfield was not a member), because prior to the commencement of the bankruptcy case Stanfield had retained the firm to analyze certain intercreditor issues between the first lien lenders and the second lien lenders. Specifically, Stanfield retained the firm to perform an analysis for the purpose of identifying intercreditor provisions that might affect the second lien lenders' plan to provide additional financing to the debtors secured by first-priority liens in accounts receivable.[55]

In April 2005, in anticipation of filing their bankruptcy petitions, the debtors obtained a commitment for a debtor-in-possession credit facility that would pay off the first lien debt in full. Though the administrative agent for the first lien lenders had obtained legal counsel in anticipation of the debtors' bankruptcy, a group of lenders

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[53] See Model Rules of Professional Conduct 1.10(a).

[54] See Model Rules of Professional Conduct 1.10(c).

[55] In re Meridian Automotive Systems-Composite Operations, Inc., 340 B.R. 740, 743 (Bankr. D. Del. 2006).

holding only first lien debt decided to form their own ad hoc committee because many first lien lenders, such as Stanfield, also held second lien debt. The ad hoc committee retained the firm to advise it with respect to intercreditor issues that might arise if the Bankruptcy Court did not approve the DIP facility. The Bankruptcy Court approved the DIP facility on an interim basis. However, the debtors were unable to meet the conditions necessary to obtain final approval of the DIP facility, and were forced to seek alternative financing that would leave outstanding both tranches of secured debt, as well as prime the pre-petition liens securing that debt. The Bankruptcy Court entered an order approving the priming DIP facility on a final basis, and the firm continued to represent the ad hoc committee on the intercreditor issues after the entry of the final DIP order.

Stanfield asserted that the firm's representation of the ad hoc committee of first lien lenders contravened the Model Rules as adopted by the District Court in Delaware.[56] First, Stanfield asserted that it was a current client of the firm, and Model Rule 1.7(a) prohibited the firm from representing the ad hoc committee because the interests of Stanfield and the ad hoc committee were directly adverse to each other. Stanfield asserted that it was a current client of the firm because it never terminated the firm's engagement, and the firm never withdrew from the representation. The firm replied that Stanfield terminated the engagement and, therefore, Model Rule 1.7(a) was inapposite. The Bankruptcy Court concluded that Stanfield terminated the attorney-client relationship with the firm almost two months before the firm undertook the representation of the ad hoc committee. Consequently, the Bankruptcy Court ruled that Model Rule 1.7(a) did not apply in the case.[57]

Stanfield asserted in the alternative that the firm violated the duty that it was owed as a former client under Model Rule 1.9. The firm conceded that it never sought or obtained Stanfield's consent to its representation of the ad hoc committee.[58] Stanfield argued that the intercreditor issues for which it retained the firm prior to the commencement of the bankruptcy case were the same as those arising in the bankruptcy cases since the collapse of the previously-proposed DIP financing. The firm conceded that the interests of Stanfield and the ad hoc committee were materially adverse. However, the firm asserted that the Stanfield representation concerned only a discrete refinancing transaction (an accounts receivable facility) that became mooted by the debtors' bankruptcy filing, while the ad hoc committee representation dealt with intercreditor issues arising within the bankruptcy cases and were independent of Stanfield's pre-bankruptcy refinancing plans.[59] The firm argued that while certain

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[56] See id. at 743-44. The Model Rules govern the practice of law before the Delaware bankruptcy court. See Del. Bankr. L.R. 1001-1(b) (adopting the Local Rules of Civil Practice and Procedure of the United States District Court for the District of Delaware).

[57] See id. at 744-45.

[58] See id. at 745.

[59] See id. at 746.

operative credit agreements were common to both engagements, the representations were factually distinct and did not lead to the firm "changing sides."[60]

The Bankruptcy Court determined that the two engagements involved sufficiently similar and related matters, noting that while Stanfield's immediate objective in hiring the firm was to implement the proposed accounts receivable facility, its ultimate objective was to protect its second lien position. The firm's representation of the ad hoc committee concerned the same intercreditor issues, but the firm was advising the first lien creditors about how to protect their interests vis-à-vis the second lien creditors, including Stanfield.[61] The Bankruptcy Court further noted that it was irrelevant that none of the attorneys who had worked on the Stanfield matter appeared to be involved in the representation of the ad hoc committee, because the conflict of one attorney is imputed to the entire firm.[62] In conclusion, the Bankruptcy Court stated that "[the firm's] violation of Model Rule 1.9 and dogged refusal to acknowledge the same warrant disqualification from further representation of the [ad hoc committee] in these cases."[63]

One lesson to be learned from the law firm's disqualification in the Meridian Automotive Systems bankruptcy case is that attorneys should, whenever possible and appropriate, be proactive in disclosing any actual or potential conflicts to the affected current and former clients. If waivers are necessary, then attorneys should obtain them as promptly as possible. To ensure that they will not later be disqualified, attorneys should focus on complying with the relevant conflicts of interest rules, and should err on the side of caution.

[60] See id.

[61] See id.

[62] See id. at 748 n. 3, citing Model Rule 1.10.

[63] Id. at 750-51.