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The Continuing Vitality of the Jay Alix Protocol, and Other Issues Related to the Retention of Distressed Management Consultants

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1. The Jay Alix Protocol

The "Jay Alix Protocol" is a system of requirements related to disclosures and disinterestedness governing a debtor's retention of chief restructuring officers, distressed management consultants, and the like under section 363(b)(1) of the Bankruptcy Code. Section 363(b) contains none of the safeguards related to disclosure, reporting, and compensation imposed under section 327. The Jay Alix protocol has been developed to mimic, in a section 363(b) context, the safeguards of section 327 and Federal Rule of Bankruptcy Procedure 2014, in order to address concerns of the United States Trustee's office regarding the otherwise lack of transparency inherent in a debtor's retention of consultants under 363(b).

The Jay Alix Protocol is modeled on the terms of a 2001 settlement entered into between the U.S. Trustee's office for the District of Delaware and Jay Alix & Associates and its affiliates ("Jay Alix") in an effort to harmonize the Bankruptcy Code with the facts of a CRO retention. The Delaware bankruptcy court approved the settlement, which provided that the U.S. Trustee would not object to a CRO retention under section 363 (which governs transactions outside the ordinary course of business) as long as certain key disclosure and conflict provisions contained in section 327 were followed. Without this settlement, the U.S. Trustee contends that restructuring professionals would fail the "disinterestedness" test of section 327(a) based on their pre-petition employment and status as an officer.

Specifically, the settlement resolved the U.S. Trustee's objections to Jay Alix's employment and compensation in two cases then pending before the Bankruptcy Court for the District of Delaware, in which Jay Alix sought to be retained both as the chief restructuring officer and financial advisor to the debtors.[1] The U.S. Trustee had objected on the basis of lack of disinterestedness under section 101(14) of the Bankruptcy Code, which provides that a person is only disinterested if that person "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.[2]" Because Jay Alix had been an officer pre-petition, the U.S. Trustee argued that Jay Alix was not "disinterested" for purposes of section 101(14). On the other hand, the debtors argued that section 363(b)(1) authorizes a debtor to retain and compensate a CRO, as that section permits debtors to "use . . . other than in the ordinary course of business, property of the estate." The debtors and the U.S. Trustee ultimately reached a settlement as outlined in a stipulation that was approved by the Delaware Bankruptcy Court.

As announced by the U.S. Trustee in its press release dated October 5, 2011, the essential terms of the Jay Alix Protocol are:[3]

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[1] *In re Harnischfeger Indus., Inc.,* Case No. 992171 (Bankr. D. Del.); *In re Safety-Kleen Corp.,* No. 00-2303 (Bankr. D. Del. 2000).

[2] 11 U.S.C. §101(14)(b).

[3] A copy of this press release is attached to these materials, as well as the full text of the Jay Alix protocol currently available on the U.S. Trustee's website at https://www.justice.gov/sites/default/files/ust/legacy/2014/08/11/J_Alix_Protocol_Engagement.pdf.

- Jay Alix and its affiliates agree to serve in only one capacity, i.e., as crisis manager retained under section 363, financial advisor retained under section 327, claims agent/claims administrator appointed pursuant to 28 U.S.C. §156(c), or investor/acquirer.

- Jay Alix will not seek to be retained by a chapter 11 debtor if Jay Alix serves on the debtor's board of directors, nor will it accept a bankruptcy engagement where a person affiliated with Jay Alix sat on the board of directors within the preceding two years. In addition, Jay Alix will not serve on a debtor's board of directors while retained by that company in a bankruptcy case.

- If Jay Alix supplies individuals who serve as officers of a chapter 11 debtor company, those individuals will be retained under 11 U.S.C. §363, with detailed disclosures of any relationship between Jay Alix and the debtor, creditor, lenders, or others, and will be appointed by and accountable to an independent board of directors.

- If Jay Alix provides non-management advisory services, the firm will apply for retention as a professional under 11 U.S.C. §327. Once again, the firm will be allowed to serve in only one capacity in any one case.

- Jay Alix's compensation will be reviewed under a reasonableness standard at the end of the case, whether the firm serves as part of management or as a professional.

The Alix Protocol further specifies that the CRO and his or her firm must not only disclose compensation terms, including success fees, but must also file quarterly fee and expense reports. Any success fee or back-end fees are subject to court review under the "reasonableness" standard set forth in section 328 of the Bankruptcy Code. Finally, a CRO may be indemnified to the same extent as the debtor's other officers and directors.

2. <u>The Jay Alix Protocol is Endorsed by Most Courts Today</u>

The Jay Alix protocol is not contained in the Bankruptcy Code. Instead, the terms of the original 2001 settlement have been informally adopted by bankruptcy courts throughout the country in the years since, including without limitation courts in Delaware,[4] the Southern District of New York,[5] the Northern District of Illinois, the Northern District of Texas, and the Eastern District of Virginia, among others.[6]

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[4] *See, e.g., In re Ctr. European Distrib. Corp.,* Case No. 13-10738 (Bankr. D. Del. 2013); *In re Trident Microsystems Inc.,* Case No. 12-10069 (Bankr. D. Del. 2012); *In re WP Steel Venture LLC,* Case No. 12-11661 (Bankr. D. Del. 2012); *In re Hostess Brands Inc.,* Case No. 12-22052 (Bankr. D. Del. 2012); *In re Delta Petroleum Corp.,* Case No. 11-14006 (Bankr. D. Del. 2011); *In re PJ Fin. Co. LLC,* Case No. 11-10688 (Bankr. D. Del. 2011); *In re Real Mex Rest. Inc.,* Case No. 11-13122 (Bankr. D. Del. 2011); *In re Hussey Copper Corp.,* Case No. 11-13010 (Bankr. D. Del. 2011).

[5] *See, e.g., In re Toisa Ltd.,* Case No. 17-10184 (Bankr. S.D. N.Y. 2018); *In re NII Holdings, Inc*., Case No. 14-12611 (Bankr. S.D. N.Y. 2015); *In re Dewey & LeBoeuf LLP,* Case No. 12-12321 (Bankr. S.D. N.Y. 2012); *In re Saint Vincent's Catholic Med Ctrs. Of N.Y*. Case No. 10-11963 (Bankr. S.D. N.Y. 2010).

[6] *See, e.g. In re Cocopah Nurseries of Ariz., Inc.,* Case No. 12-15292 (Bankr. D. Ariz. 2012); *In re Clare Oaks,* Case No. 11-48903 (Bankr. N.D. 111. 2011); *re Dippin'Dots Inc.,* Case No. 11 - 51077 (Bankr. W.D. Ky. 2011); *In re*

A minority of courts have expressed criticism.[7] However, on the whole, the Jay Alix Protocol is widely recognized as the preferred mechanism for debtors' retention of CROs.[8]

The Bankruptcy Court for the Southern District of New York recently reaffirmed its endorsement of the protocol in a published opinion from the *Nine West* cases.[9] In overruling an objection by the U.S. Trustee to the debtors' retention of a consultant who had provided the debtors with management services pre-petition, the court stated in part:

> [I]t has developed into a national policy adopted by the U.S. Trustee whereby the U.S. Trustee assents to—indeed, directs—the retention of distressed management consultants by a debtor pursuant to section 363 of the Code as long as the firm complies with certain requirements contained in the Protocol.
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> . . . .
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> Requiring parties to comply with the Protocol has served as a way to avoid conflicts of interest. More specifically, the Protocol's "one hat" rule (which requires that the firm sought to be retained serve the debtor in only one capacity) is designed to avoid the "inherent conflict" between an advisor's duty to a debtor and its own business interests where the advisory firm serves both as a financial advisor retained pursuant to section 327 of the Bankruptcy Code and as a crisis manager with firm staff serving as officers of the debtor corporation. Put simply, the Protocol was designed to prevent a party from using its position in one capacity to benefit itself in another capacity. Footnote three to the Protocol states that a financial advisor "shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of [the advisor] serves or has served as a director of the entity or an affiliate thereof within two years prior to the petition date." (Protocol, n.3). Compliance with the Protocol prevents a director of a debtor who is also an employee of the advisory firm sought to be retained from wielding undue influence over the hiring and compensation of such director's firm. The U.S. Trustee has not objected to the section 363 retention of distressed management consultants in scores, if not hundreds, of cases

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Rangers Equity Holdings LP, Case No. 10-43624 (Bankr. N.D. Tex. 2010); *In re Rangers Equity Holdings GP LLC,* Case No. 10-43625 (Bankr. N.D. Tex, 2010); *In re BI-L0 LLC,* Case No. 0902140 (Bankr. D.S.C. 2009); *In re Grede Foundries Inc.,* Case No. 09-14337 (Bankr. W.D. Wis. 2009); *In re LandAmerica Fin. Grp. Inc.,* Case No. 06-35994 (Bankr. E.D. Va. 2008).

[7] *See In re Blue Stone Real Estate, Constr. & Dev. Corp.,* 392 B.R. 897, 907 n.14 (Bankr. M.D. Fla. 2008) ("The so called "Jay Alix" protocol that depends upon section 363 for retention of an executive officer does not provide the Court the same ability to meet the twin goals of section 327 when the candidate for employment is also a professional."); *In re Mirant Corp.,* 354 B.R. 113, 127 (Bankr. N.D. Tex. 2006) ("The UST and other parties acquiesced in this method of retention (which was intended to avoid application to AP of the disinterestedness test of 11 U.S.C. § 101(14) due to AP's personnel serving as officers of [the] Debtors). The court is not satisfied that use of Code § 363 is appropriate for such a purpose, but need not here reach that issue").

[8] *See, e.g.* Clifford J. White III, William K. Harrington, and Nan Roberts Eitel, "The Future of the USTP's CRO 'Protocol,'" 37 *Am. Bankr. Inst. J.* 24, Sept. 2018; Timothy W. Brink and James R. Irving, "Emerging Trends and Lingering Criticisms: A CRO Retention Update," 32 *Am. Bankr. Inst. J.* 18, Sept. 2013. A copy of this article is attached to these materials.

[9] *See In re Nine West Holdings, Inc.*, 588 B.R. 678 (Bankr. S.D.N.Y. 2018). A copy of the *Nine West* opinion is attached to these materials. For the perspective of the Office of the U.S. Trustee on the *Nine West* decision, please see "The Future of the USTP's CRO 'Protocol,'" *supra*, at p.60.

over the past fourteen years where such consultants have purportedly followed the Protocol.[10]

3. Toward Stricter Disclosure Standards?

The name "Jay Alix" has long been associated with its namesake protocol. However, it has also recently become associated with a high profile series of battles between Jay Alix (the individual, and founder of the eponymous restructuring advisory firm)[11] and rival firm McKinsey & Co. Jay Alix has alleged that McKinsey has engaged in a pattern of failing to fully disclose its connections with parties-in-interest in bankruptcy cases in which it had been retained or sought to be retained by debtors. As well as filing objections in some bankruptcy cases, Jay Alix brought a civil action in May of 2018 against McKinsey in the U.S. District Court for the Southern District of New York, alleging civil RICO causes of action. At the time of publication, this suit is presently pending.[12]

In a number of bankruptcy cases, the U.S. Trustee has endorsed Jay Alix's concerns and filed objections accordingly. Recently, the U.S. Trustee and McKinsey announced a settlement applicable to fourteen different bankruptcy cases, including recent cases such as *In re Westmoreland Coal Co.*, No. 18-35672 (Bankr. S.D. Tex.) and *In re Alpha Natural Resources, Inc.*, No. 15-33896 (Bankr. E.D. Va.), as well as older cases including *In re The Hayes Lemmerz International, Inc.*, No. 01-11490 (Bankr. D. Del.) and *In re UAL Corp.*, 02-48191 (Bankr. N.D. Ill.).[13]

Although these disputes arose in connection with McKinsey's retention under section 327, as opposed to section 363, the same concern by U.S. Trustees and bankruptcy courts for transparency applies in either context. The eventual fallout from these disputes may include the adoption of policies requiring closer scrutiny of bankruptcy advisors' disclosures.

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[10] *Id.*, at 688-689.

[11] In this section, the term "Jay Alix" shall refer to Jay Alix as an individual, as opposed to Jay Alix & Associates.

[12] The suit is pending at Case No. 18-04141 in the United States District Court for the Southern District of New York.

[13] A copy of the term sheet setting out the settlement, as filed with the bankruptcy court in the *Westmoreland Coal* case, is attached to these materials.

U.S. Trustee's Press Release

U.S. TRUSTEE PROGRAM ARCHIVES

USTP Press Releases
Department of Justice
Executive Office for United States Trustees
For Immediate Release
October 5, 2001
BANKRUPTCY COURT APPROVES SETTLEMENT BETWEEN U.S. TRUSTEE AND JAY ALIX & ASSOCIATES ON FEES AND EMPLOYMENT IN CH. 11 CASES

WASHINGTON, D.C. – The Bankruptcy Court for the District of Delaware yesterday approved a settlement between the United States Trustee and Jay Alix & Associates ("Jay Alix"), under which the turnaround management company agreed to disgorge $3.25 million in fees and to abide by certain guidelines in seeking to be retained in future Chapter 11 bankruptcy cases, announced Martha Davis, Acting Director of the Executive Office for U.S. Trustees.

The settlement resolves objections made by U.S. Trustee Patricia Staiano to the employment and compensation of Jay Alix in two Chapter 11 cases pending before the Bankruptcy Court for the District of Delaware: In re Harnischfeger Industries Inc., et al. (No. 99-2171) and In re Safety-Kleen Corp., et al. (No. 00-2303).

The protocol for retention in future bankruptcy cases provides:

- Jay Alix and its affiliates agree to serve in a case in only one capacity, i.e., as crisis manager, financial advisor, claims agent/claims administrator, or investor/acquirer.
- Jay Alix will not seek to be retained by a Chapter 11 debtor if Jay Alix serves on the debtor's board of directors, nor will it accept a bankruptcy engagement where a person affiliated with Jay Alix sat on the board of directors within the preceding two years. In addition, Jay Alix will not serve on a debtor's board of directors while retained by that company in a bankruptcy case.
- If Jay Alix supplies individuals who serve as officers of a Chapter 11 debtor company, those individuals will be retained under 11 U.S.C. § 363, with detailed disclosures of any relationship between Jay Alix and the debtor, creditor, lenders, or others, and will be appointed by and accountable to an independent board of directors.
- If Jay Alix provides non-management advisory services, the firm will apply for retention as a professional under 11 U.S.C. § 327. Once again, the firm will be allowed to serve in only one capacity in any one case.
- Jay Alix's compensation will be reviewed under a reasonableness standard at the end of the case, whether the firm serves as part of management or as a professional.
- Questor, an affiliate of Jay Alix that invests in special situations and troubled companies, will not invest in a debtor for which Jay Alix is engaged while the case is pending and for three years afterward.

The U.S. Trustee Program is a component of the Justice Department that oversees the administration of bankruptcy cases nationwide and intervenes in cases to enforce the bankruptcy laws.

Contact:

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FRIDAY, FEBRUARY 20, 2015 4:18 PM

Jay Alix Protocol Available on U.S. Trustee's Website

Protocol for Engagement of Jay Alix & Associates and Affiliates

I. Retention Guidelines

A. Jay Alix & Associates ("JA&A") is a firm that provides turnaround and crisis management services, financial advisory services, management consulting services, information systems services and claims management services. In some cases the firm provides these services as advisors to management, in other cases one or more of its staff serve as corporate officers and other of its staff fill positions as full time or part time temporary employees ("crisis manager"), and in still other cases the firm may serve as a claims administrator as an agent of the Bankruptcy Court. JA&A and its affiliates[1] will not act in more than one of the following capacities in any single bankruptcy case: (i) crisis manager retained under Sec. 363, (ii) financial advisor retained under Sec. 327, (iii) claims agent/claims administrator appointed pursuant to 28 U.S.C. § 156(c) and any applicable local rules or (iv) investor/acquirer; and upon confirmation of a Plan may only continue to serve in a similar capacity. Further, once JA&A or one of its affiliates is retained under one of the foregoing categories it may not switch to a different retention capacity in the same case. However, with respect to subsequent investments by Questor this prohibition is subject to the time limitations set forth in IV.B below.

B. Engagements involving the furnishing of interim executive officers[2] whether prepetition or postpetition (hereinafter "crisis management" engagements) shall be provided through JA&A Services LLC ("JAS").

C. JAS shall seek retention under section 363 of the Bankruptcy Code. The application of JAS shall disclose the individuals identified for executive officer positions as well as the names and proposed functions of any additional staff to be furnished by JAS. In the event the Debtor or JAS seeks to assume additional or different executive officer positions, or to modify materially the functions of the persons engaged, a motion to modify the retention shall be filed. It is often not possible for JAS to know the extent to which full time or part time temporary employees will be required when beginning an engagement. In part this is because the

[1] Affiliates of JA&A presently are System Advisory Group (an organization that provides information services), JA&A Services LLC (an entity that provides temporary employees), Questor Management Company LLC, an organization that manages Questor Partners Fund, Questor Partners Fund II, and various Side-by-Side entities, which are limited partnerships that invest in underperforming and troubled companies, and ACT Two (an entity that owns and operates a private airplane). Future affiliates of JA&A, if any, will be subject to the limitations set forth herein.

[2] "Executive officers" shall include but is not necessarily limited to Chief Executive Officer, President, Chief Operating Officer, Treasurer, Chief Financial Officer, Chief Restructuring Officer, Chief Information Officer, and any other officers having similar roles, power or authority, as well as any other officers provided for in the company's bylaws.

extent of the tasks that need to be accomplished is not fully known and in part it is because JAS is not yet knowledgeable about the capability and depth of the client's existing staff. Accordingly, JAS shall file with the Court with copies to the UST and all official committees a report of staffing on the engagement for the previous month. Such report shall include the names and functions filled of individuals assigned. All staffing shall be subject to review by the Court in the event an objection is filed.

D. Persons furnished by JAS for executive officer positions shall be retained in such positions upon the express approval thereof by an independent Board of Directors whose members are performing their duties and obligations as required under applicable law ("Board"), and will act under the direction, control and guidance of the Board and shall serve at the Board's pleasure (*i.e.* may be removed by majority vote of the Board).

E. The application to retain JAS shall make all appropriate disclosures of any and all facts that may have a bearing on whether JAS, its affiliates, and/or the individuals working on the engagement have any conflict of interest or material adverse interest, including but not necessarily limited to the following:

1. Connection, relationship or affiliation with secured creditors, postpetition lenders, significant unsecured lenders, equity holders, current or former officers and directors, prospective buyers, or investors.

2. Involvement as a creditor, service provider or professional of any entity with which JA&A or any affiliate has an alliance agreement, marketing agreement, joint venture, referral arrangement or similar agreement.

3. Any prepetition role as officer, director, employee or consultant,[3] but service as a pre-petition officer will not *per se* cause disqualification.

4. Any prepetition involvement in voting on the decision to engage JA&A or JAS in the bankruptcy case, and/or any prepetition role

[3] In no case shall any principal, employee or independent contractor of JA&A, JAS and affiliates serve as a director of any entity while JA&A, JAS or any affiliate is rendering services in a bankruptcy proceeding, and JA&A, JAS and their affiliates shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of JA&A, JAS and affiliates serves or has previously served as a director of the entity or an affiliate thereof within two years prior to the petition date. During such two year period, neither JA&A, JAS or affiliates shall have provided any professional services to the entity nor shall any individuals associated with JA&A, JAS and affiliates have served as an Executive Officer.

carrying the authority to decide unilaterally to engage JA&A or JAS.

5. Information regarding the size, membership and structure of the Board so as to enable the UST and other interested parties to determine that the Board is independent.

6. Whether the executive officers and other staff for the engagement are expected to be engaged on a full time or part time basis, and if part-time whether any simultaneous or prospective engagement exists that may be pertinent to the question of conflict or adverse interest.

7. The existence of any unpaid balances for prepetition services.

8. The existence of any asserted or threatened claims against JA&A, JAS or any person furnished by JA&A/JAS arising from any act or omission in the course of a prepetition engagement.

F. Disclosures shall be supplemented on a timely basis as needed throughout the engagement.

G. Where JA&A does not act as a crisis manager its retention will be sought as a financial advisor under section 327 of the Code or as a Court appointed claims representative.

II. Compensation

A. Compensation in crisis management engagements shall be paid to JAS.

B. The application to retain JAS shall disclose the compensation terms including hourly rates and the terms under which any success fee or back-end fee may be requested.

C. JAS shall file with the Court, and provide notice to the UST and all official committees, reports of compensation earned and expenses incurred on at least a quarterly basis. Such reports shall summarize the services provided, identify the compensation earned by each executive officer and staff employee provided, and itemize the expenses incurred. The notice shall provide a time period for objections. All compensation shall be subject to review by the Court in the event an objection is filed (*i.e.*, a "negative notice" procedure).

D. Success fees or other back-end fees shall be approved by the Court at the conclusion of the case on a reasonableness standard and shall not be pre-approved under section 328(a). No success fee or back-end fee shall

be sought upon conversion of the case, dismissal of the case for cause or appointment of a trustee.

III. Indemnification

A. Debtor is permitted to indemnify those persons serving as executive officers on the same terms as provided to the debtor's other officers and directors under the corporate bylaws and applicable state law, along with insurance coverage under the debtor's D&O policy.

B. There shall be no other indemnification of JA&A, JAS or affiliates.

IV. Subsequent Engagements

A. Pursuant to the "one hat" policy as stated above, after accepting an engagement in one capacity, JA&A and affiliates shall not accept another engagement for the same or affiliated debtors in another capacity.

B. For a period of three years after the conclusion of the engagement, Questor shall not make any investments in the debtor or reorganized debtor where JA&A, JAS or another affiliate has been engaged.

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ABI Journal Article, "The Future of the USTP's CRO 'Protocol'"

On Our Watch

By Clifford J. White III, William K. Harrington and Nan Roberts Eitel[1]

Future of USTP'S CRO "Protocol"

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Seventeen years ago, the U.S. Trustee Program (USTP) entered into settlement agreements regarding the terms for the retention of firms providing chief restructuring officers (CROs) and other staff to assist debtors in possession (DIPs) with their chapter 11 duties. These settlements, which have come to be known as the "J. Alix Protocol" after the firm involved, apply the conflict-of-interest provisions of the Bankruptcy Code to the hiring of CROs, who are charged with mixed professional and business-management duties. Courts have approved hundreds of these settlements, which allow employment under § 363(b) (the use of estate property outside the ordinary course of business) while applying the relevant conflict protections of § 327(a) (the employment of professionals).

These settlements have brought predictability and consistency to CRO engagements. Nonetheless, after almost two decades during which the complexity of bankruptcy reorganizations and CRO industry practices have changed significantly, the USTP began outreach to stakeholders more than a year ago to discuss how to update the J. Alix Protocol without disturbing its essential features. While that process unfolds, the USTP will continue to follow the J. Alix Protocol and object to applications that do not comply with it.

Background

In 2001, in *In re Safety-Kleen Corp.*[2] and *In re Harnischfeger Industries Inc.*,[3] bankruptcy courts approved the USTP's settlements of its objections to the DIPs' applications to retain a CRO and the CRO's firm as a restructuring advisor. These cases provided a template for USTP agreements on the employment of CROs that allowed the CROs' employment under § 363 and applied § 327(a)'s relevant conflict protections, such as the bar on a professional's service as a director. CROs, which are hybrids of professional responsibilities covered by § 327(a) and executive functions covered by § 363, did not exist 40 years ago when the Bankruptcy Code was adopted.

Although DIPs retain the authority to appoint *traditional* corporate officers and *salaried* professionals without court approval,[4] the hybrid nature of the CRO's engagement makes them neither fish nor fowl, or (perhaps more accurately) both fish *and* fowl. CROs are not wholly traditional corporate officers, no matter how traditional many of their duties might be, and a DIP's decision to hire a CRO is, by definition, outside the ordinary course of business.[5]

In settling, the USTP recognized the dual nature of the engagements, the litigation risk arising from a CRO's legally uncertain status under a Bankruptcy Code that never contemplated their existence, and the debtors' legitimate need for CRO services at the time of a crisis. The USTP's goal was twofold: (1) Take a principled approach in harmonizing the applicable Code provisions,[6] and (2) provide notice of the USTP's litigating position on this complex issue.

As the U.S. Supreme Court has stated many times, statutory interpretation is a "holistic" endeavor[7] that should avoid (1) rendering other statutory provisions unnecessary and (2) interpreting them inconsistently with the policy of another provision.[8] Statutory construction requires reading "the statutes to give effect to each if we can do so while preserving their sense and purpose."[9] Consistent with these canons, the J. Alix Protocol gives the fullest effect to all of the pertinent Code provisions, including §§ 363(b) and 327(a).

The J. Alix Protocol has no force of law. It merely telegraphs to the bankruptcy community how the USTP interprets and will apply the law in carrying out its statutory duty to review applications to employ. Even though a few courts have criticized the J. Alix Protocol as being too accommodating to the CRO industry,[10] most courts and the CRO firms

1 Mr. White served as an *ex officio* member of ABI's Commission to Study the Reform of Chapter 11 and currently serves in the same capacity on ABI's Commission on Consumer Bankruptcy.
2 Case No. 00-2303 (Bankr. D. Del. 2000).
3 Case No. 99-2171 (Bankr. D. Del. 1999).
4 *See Jacobson v. AEG Capital Corp.*, 50 F.3d 1493, 1500 (9th Cir. 1995) ("[D]irectors still have the power to elect officers.") (quotation omitted); 11 U.S.C. § 327(b) (professionals regularly employed on salary are subject to § 327(b), not § 327(a)).
5 Restructuring in bankruptcy can never be considered "ordinary course" for any business, and courts have approved the retention of restructuring professionals under § 363(b). *See, e.g., In re Liberty Asset Mgmt. Corp.*, No. 16-13575 (Bankr. C.D. Cal. June 9, 2016), Docket No. 94; *In re Interfaith Med. Ctr.*, No. 12-48226 (Bankr. E.D.N.Y. Jan. 25, 2013), Docket No. 177; *In re Qualteq Inc.*, No. 11-12572 (KJC) (Bankr. D. Del. Sept. 2, 2011), Docket No. 135; *In re Hartford Computer Hardware Inc.*, No. 11-49744 (PSH) (Bankr. N.D. Ill. April 12, 2012), Docket No. 270; *In re Colad Grp. Inc.*, 324 B.R. 208, 215 (Bankr. W.D.N.Y. 2005).
6 Section 327(a)'s rigorous disinterestedness requirement makes any officer ineligible for professional employment notwithstanding § 363's more deferential business-judgment standard. It is this statutory conflict and the hybrid nature of CRO engagements that was the genesis for the protocol in 2001.
7 *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. Ltd.*, 484 U.S. 365, 371 (1988).
8 *Ratzlaf v. United States*, 510 U.S. 135, 140 (1994); *Timbers of Inwood*, 484 U.S. at 371.
9 *Matter of Spanish Peaks Holdings II LLC*, 872 F.3d 892, 899 (9th Cir. 2017) (quoting *Watt v. Alaska*, 451 U.S. 259 (1981)).
10 *See, e.g., In re Mirant Corp.*, 354 B.R. 113, 127 n.29 (Bankr. N.D. Tex. 2006) ("The [U.S. Trustee] and other parties acquiesced in this method of retention [under § 363] (which was intended to avoid application to AP of the disinterestedness test of 11 U.S.C. § 101(14) due to AP's personnel serving as officers of Debtors). The court is not satisfied that use of Code § 363 is appropriate for such a purpose, but need not here reach that issue." *Id.*; *contra In re Ajubeo LLC*, 2017 WL 5466655, *4 (Bankr. D. Colo. Sept. 27, 2017) (approving CRO's retention under § 363 and stating that the "[c]ourt believes it is enforcing the Code").

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On Our Watch: Future of USTP's CRO "Protocol"

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have widely accepted and followed the J. Alix Protocol. Therefore, the USTP intends to continue to follow the J. Alix Protocol and to enforce it consistently. Likewise, if proposed CROs deviate from the J. Alix Protocol, the USTP will continue to object to their employment applications under § 327.

Key Provisions of the CRO Protocol

The key ethical and disclosure components of the protocol can be summarized in the following manner.

- *The J. Alix Protocol incorporates §§ 327(a) and 101(14)'s prohibition on serving, or having served within two years, on a debtor's board.* This is important, because the two-year ban is a bright-line rule set forth in statute. Directors — not officers — are vested with ultimate management authority and owe a duty of loyalty to the corporation. A board must be independent of the CRO in order to prevent actual or apparent conflicts of interest, which are key aspects of § 327(a). For example, if the CRO serves on the board while that same board decides to retain the CRO's firm, this insider transaction presents a conflict of interest.
- *The J. Alix Protocol incorporates § 327(a)'s conflict-of-interest rules to bar those with an actual conflict of interest from being retained.* The protocol also avoids conflicts of interest by preventing the CRO from managing the engagement to the financial benefit of the CRO's firm. It does so by establishing the so-called "one hat rule: allowing the professional to serve in only one capacity, such as CRO, crisis manager, financial advisor, claims agent or investor. Similarly, it also bans the CRO's firm from investing in the DIP for two years after the engagement concludes.
- *The J. Alix Protocol incorporates the disclosure requirements governing a § 327(a) application by requiring an affidavit setting forth connections with parties and professionals.* These disclosures are analogous to those required under Fed. R. Bankr. P. 2014. Disclosure and transparency are key to evaluating potential conflicts of interest and enhancing public confidence in the integrity of the system.
- *The J. Alix Protocol requires disclosure of staffing and compensation, as well as a court review of compensation under a "reasonableness" standard, which is analogous to the review of compensation of professionals employed under § 327(a).* Approval of retention under § 363 alone would deprive the court and the parties of their critical role in protecting the estate by evaluating the justifications for the fees and other payments made to key players who are employed to guide the debtor company through the bankruptcy process.

USTP Consistently Follows J. Alix Protocol

The USTP widely disseminated and posted the J. Alix Protocol, as well as gave notice that the USTP would object under § 327 to any CRO employment application that failed to comply with every component of the protocol.[11] As stated in the USTP manual posted online, "[I]f the debtor or crisis manager rejects any term of the [*J. Alix Protocol*], the [U.S.] Trustee retains the right to object to all issues regarding the crisis manager's employment, including the request to be retained under section 363 rather than section 327."[12] It is fair to say that the USTP's reserved § 327 objection for violations of the J. Alix Protocol is as much a part of the protocol itself as are the conflict and disclosure provisions.

The USTP has occasionally, but rarely, been forced to object to CRO retentions under § 327.[13] More commonly, the USTP resolves these objections once the CRO comes into compliance with the protocol or the debtor withdraws its application if compliance is not possible. The relative absence of CRO retention litigation over the last 17 years is a testament both to the J. Alix Protocol's widespread acceptance and to the CRO firms' adherence to it.

Just as the USTP seeks to bring integrity and efficiency to the bankruptcy system, it also seeks to bring predictability and stability through consistent litigating positions. Any major changes in the jurisprudence governing CRO retentions would create uncertainty and inefficiency for all parties, the court and the USTP.

One recent court decision calls into question the future viability of the J. Alix Protocol and could reopen previously settled questions about CRO retentions going forward. In *Nine West*, the debtors sought to retain a restructuring firm to provide an interim CEO and retain the firm itself to provide additional restructuring services.[14] The CEO had served on one debtor's board of directors for several years and resigned only once a bankruptcy filing was imminent. Thus, given the failure to comply with the J. Alix Protocol's *sine qua non* of an independent board, the USTP objected to the retention under § 327.[15]

The *Nine West* court seemingly approved of the J. Alix Protocol and its ethical protections, noting that "[r]equiring parties to comply with the Protocol has served as a way to avoid conflicts of interest."[16] However, in overruling the USTP's § 327 objection, the court applied neither § 327 nor the J. Alix Protocol and instead ruled that "nothing precludes the Debtors from relying on section 363(b) to seek authorization for the retention of [the restructuring firm and CEO]."[17]

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11 *See* "Volume 3: Chapter 11 Case Administration," *available at* justice.gov/ust/file/volume_3_chapter_11_case_administration.pdf/download (hereinafter the "USTP Manual"; unless otherwise specified, all links in this article were last visited on July 26, 2018).

12 *Id.* at 106-07.

13 *See, e.g., In re Patriot Nat'l Inc.* (Bankr. D. Del. 2018); *Ajubeo*, 2017 WL 5466655; *In re Adams Res. Exploration Corp.* (Bankr. D. Del. 2017); *In re The Adoni Grp. Inc.* (Bankr. S.D.N.Y. 2014); *In re Revstone* (Bankr. D. Del. 2013).

14 *In re Nine West Holdings Inc.*, 2018 WL 3238695 (Bankr. S.D.N.Y. July 2, 2018).

15 The USTP has never knowingly failed to object to a CRO's and his/her firm's retention when a firm member has served on a debtor's board. For example, in *In re Allen Systems Grp.* (Bankr. D. Del. 2015), one of the principals of the CRO's firm had served on the board pre-petition in violation of the J. Alix Protocol. The USTP filed an objection under § 327, and the firm withdrew its application because the conflict could not be remedied.

16 *Nine West* at *6. The court further recognized that the J. Alix Protocol is "designed to avoid the 'inherent conflict' between an advisor's duty to a debtor and its own business interests where the advisory firm serves both as a financial advisor retained pursuant to § 327 of the Bankruptcy Code and as a crisis manager with firm staff serving as officers of the debtor corporation." *Id.*

17 *Id.* at *8.

If case law develops that § 363 is the sole hurdle for CRO applicants, then the J. Alix Protocol might become obsolete and other unintended consequences could follow. For example, because § 363 independently imposes no disclosure requirements or conflict-of-interest standards,[18] the result could be little transparency and accountability for those arguably serving in the most critical role in the chapter 11 case. Furthermore, a "§ 363 only" rule renders future CRO applications susceptible to ad hoc standards, thereby depriving debtors and the CRO industry of the predictability and stability that the J. Alix Protocol affords. If officers provided by restructuring firms are like any other corporate officers and are not subject to § 327's constraints incorporated in the protocol, then those officers are likely insiders for all purposes, including § 503(c)'s limits on insider compensation and bonuses for the firm.

Future of the J. Alix Protocol

Like all policies and practices, the J. Alix Protocol is worthy of reevaluation from time to time. Indeed, the USTP has publicly stated, "We have reached out to participants in the restructuring business and other stakeholders for information on how the Protocol should be updated to account for the facts of modern practice, while remaining faithful to the conflict of interest provisions of the Code."[19] In this outreach to stakeholders, we have explained that in considering any changes to the J. Alix Protocol, we will follow a process similar to that followed for the large-case fee guidelines issued in 2013: Acquire information, publish for comment (even though the Administrative Procedure Act does not apply), convene a public meeting, and issue an updated CRO protocol for final publication.

The USTP should be prudent and careful when considering whether to modify longstanding policy on which creditors, debtors and professionals alike have relied. Thus, we are considering potential consequences as we deliberately reevaluate and study the J. Alix Protocol. For now and the foreseeable future, however, the USTP intends to continue to abide by the protocol and consistently enforce it as we have for almost two decades, because we believe the J. Alix Protocol to be a legally principled approach for employing CROs.

Conclusion

The USTP understands the valuable role that CROs play in business reorganizations. We developed the J. Alix Protocol as a workable framework for analyzing employment applications in a manner that faithfully follows the law and ensures that statutory safeguards against conflicts of interest are observed. With the growing complexity of the CRO industry, some modifications to the protocol might be appropriate. However, it would be a mistake and contrary to statute to jettison the conflict and disclosure provisions of the J. Alix Protocol that govern all other professional retentions in chapter 11.

The USTP stands ready to listen to stakeholders about updating the J. Alix Protocol in a way that does not violate statutory mandates. Unless and until changes are made to the protocol or law, however, the bankruptcy community can continue to rely on the USTP to follow the protocol and to object to employment applications that deviate from its terms. abi

18 At least, not beyond what would be necessary to show a proper exercise of a DIP's business judgment as opposed to the more rigorous standards of § 327 imported into the J. Alix Protocol.

19 "Director's Remarks Delivered at the 33rd Annual Bankruptcy and Restructuring Conference of the Association of Insolvency and Restructuring Advisors," June 7, 2017, *available at* justice.gov/ust/speeches-testimony/remarks-director-33rd-annual-bankruptcy-and-restructuring-conference-association.

Nine West Opinion

588 B.R. 678
United States Bankruptcy Court, S.D. New York.

IN RE: NINE WEST HOLDINGS, INC., et al.,[1] Debtors.

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Nine West Holdings, Inc. (7645); Jasper Parent LLC (4157); Nine West Management Service LLC (4508); Kasper Group LLC (7906); Kasper U.S. Blocker LLC (2390); Nine West Apparel Holdings LLC (3348); Nine West Development LLC (2089); Nine West Distribution LLC (3029); Nine West Jeanswear Holding LLC (7263); One Jeanswear Group Inc. (0179); and US KIC Top Hat LLC (3076). The location of the Debtors' service address is: 1411 Broadway, New York, New York 10018.

Case No. 18-10947 (SCC) (Jointly Administered)
|
Signed 07/02/2018

Synopsis

Background: Debtor and its affiliates in jointly administered Chapter 11 cases filed application to retain distressed management consultant, which had overseen their daily operations prepetition, to provide them with an interim chief executive officer (CEO) and certain additional personnel, and to designate particular individual employed by consultant, who had served as officer and director of certain debtors, as interim CEO nunc pro tunc to the petition date. United States Trustee (UST) objected.

Holdings: The Bankruptcy Court, Shelley C. Chapman, J., held that:

[1] in seeking authorization for retention of distressed management consultants or turnaround consulting firms, debtors need not rely on the section of the Bankruptcy Code governing employment of professional persons, but may rely on the section of the Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason;

[2] debtors' consultant complied in all material respects with the requirements of the UST's so-called Jay Alix Protocol, even though individual in question had served as a director of a lone debtor entity within two years prior to the petition date;

[3] debtors' retention of consultant and of individual as interim CEO constituted a sound exercise of their business judgment; and

[4] consultant and individual were not "professional persons" within the meaning of the Code.

Objection overruled and application granted.

West Headnotes (12)

[1] Bankruptcy
Possession, Use, Sale, or Lease of Assets

After notice and hearing, a debtor has broad discretion to use, sell, or lease, other than in the ordinary course of business, property of the estate, so long as such use is supported by a good business reason. 11 U.S.C.A. § 363(b).

Cases that cite this headnote

[2] Bankruptcy
Employment of Professional Persons or Debtor's Officers

Bankruptcy
Possession, Use, Sale, or Lease of Assets

In seeking authorization for retention of distressed management consultants or turnaround consulting firms, debtors need not rely on the section of the Bankruptcy Code governing employment of professional persons, but may rely on the section of the Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason. 11 U.S.C.A. §§ 327, 363(b).

Cases that cite this headnote

[3] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers
Bankruptcy
Possession, Use, Sale, or Lease of Assets

"Jay Alix Protocol" is a national policy adopted by the United States Trustee (UST) whose purpose is to prevent conflicts of interest, that is, to prevent a distressed management consultant from using its position in one capacity to benefit itself in another capacity, whereby the UST assents to the retention of such consultants by a debtor pursuant to the section of the Bankruptcy Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason, as long as the firm complies with certain requirements set forth in the Protocol; it is not a provision of the Code or other law, nor is it binding on any court. 11 U.S.C.A. § 363.

Cases that cite this headnote

[4] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers
Bankruptcy
Possession, Use, Sale, or Lease of Assets

Distressed management consultant retained by Chapter 11 debtor and its affiliates, which had overseen debtors' daily operations prepetition, complied in all material respects with core requirements of United States Trustee's (UST) "Jay Alix Protocol," even though particular individual employed by consultant had served as director of lone debtor entity within two years prior to petition date; consultant did not violate purpose of Protocol to prevent a consultant from using its position in one capacity to benefit itself in another capacity, neither individual nor any other of consultant's employees ever served on a parent board responsible for approving the prepetition or postpetition retention or compensation of consultant, and individual's de minimis service on subsidiary boards did not overlap with timing of consideration of either of consultant's engagement letters, but was done at discretion and under direction of parent boards, and primarily involved ministerial duties. 11 U.S.C.A. § 363(b).

Cases that cite this headnote

[5] **Bankruptcy**
Power and Authority

Bankruptcy courts are tasked with ensuring compliance with the Bankruptcy Code and ensuring that the Code is applied with common sense and in a predictable manner.

Cases that cite this headnote

[6] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers
Bankruptcy
Possession, Use, Sale, or Lease of Assets

United States Trustee (UST) could not, without notice, arbitrarily revoke its "Jay Alix Protocol," a national policy adopted by the UST in order to prevent conflicts of interest in connection with debtors' retention of distressed management consultants, given debtors' and advisory firms' reliance on over 14 years of precedent in which the Protocol was followed and firms were employed pursuant to the section of the Bankruptcy Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason, as opposed to the section of the Code governing employment of professional persons. 11 U.S.C.A. §§ 327, 363(b).

Cases that cite this headnote

[7] **Bankruptcy**
Possession, Use, Sale, or Lease of Assets

When considering whether to approve a debtor's use of estate property outside the ordinary course of business, courts review the

business judgment of the debtor. 11 U.S.C.A. § 363(b).

Cases that cite this headnote

[8] Bankruptcy
Possession, Use, Sale, or Lease of Assets

Business judgment standard applied by courts when considering whether to approve a corporate debtor's use of estate property outside the ordinary course of business presumes that the court will not second guess the business judgment of a debtor's board in making a business decision, provided that the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. 11 U.S.C.A. § 363(b).

Cases that cite this headnote

[9] Bankruptcy
Employment of Professional Persons or Debtor's Officers

Bankruptcy
Possession, Use, Sale, or Lease of Assets

Chapter 11 debtors' retention of distressed management consultant and of individual who was consultant's employee as interim chief executive officer (CEO) constituted a sound exercise of their business judgment; during the four years preceding the petition date and continuing postpetition, consultant's personnel had occupied key management positions and supported existing in-house functions, helping to oversee debtors' daily operations, find and pursue corporate opportunities, create and carry out business plans, and otherwise manage the company, individual and his team had overseen all aspects of company's affairs and had developed strong relationships with debtors' customers, vendors, and employees, creditors believed that retention of individual was key to debtors' success, and removing consultant and individual from their management roles at this critical time could put success of entire organization at risk. 11 U.S.C.A. § 363(b).

Cases that cite this headnote

[10] Bankruptcy
Employment of Professional Persons or Debtor's Officers

"Professional person," within meaning of the section of the Bankruptcy Code governing the employment of professional persons, is one who plays an intimate or central role in the administration of the debtor's bankruptcy proceeding. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[11] Bankruptcy
Employment of Professional Persons or Debtor's Officers

"Professional persons," within meaning of the section of the Bankruptcy Code governing the employment of professional persons, are defined to include firms or individuals who have been hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[12] Bankruptcy
Employment of Professional Persons or Debtor's Officers

Distressed management consultant retained prepetition by Chapter 11 debtors and individual who, as consultant's employee, had served as officer and director of certain of debtors were not "professional persons" within meaning of the section of the Bankruptcy Code governing employment of professional persons; although consultant and individual, inter alia, prepared debtors' schedules and statement of financial affairs (SOFAs), assisted in claims work, reviewed contracts for assumption or rejection purposes, and obtained debtor-in-possession (DIP) financing, and were intimately involved

in postpetition sale of substantial portion of debtors' business, they were not hired for the sole purpose of reorganizing, as consultant was hired four years before petition date and, since then, individual and other of consultant's personnel had managed the company, running its daily operations and providing services that would have been needed independent of any bankruptcy filing. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

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MODIFIED BENCH DECISION ON DEBTORS' APPLICATION PURSUANT TO 11 U.S.C. §§ 105(a) AND 363(b) TO (A) RETAIN ALVAREZ & MARSAL NORTH AMERICA, LLC TO PROVIDE THE DEBTORS AN INTERIM CHIEF EXECUTIVE OFFICER AND CERTAIN ADDITIONAL PERSONNEL AND (B) DESIGNATE RALPH SCHIPANI AS INTERIM CHIEF EXECUTIVE OFFICER FOR NINE WEST HOLDINGS, INC. AND ITS DEBTOR AFFILIATES, *NUNC PRO TUNC* TO THE PETITION DATE

SHELLEY C. CHAPMAN, UNITED STATES BANKRUPTCY JUDGE

***682** Before the Court is the application (the "Application") of the Debtors to (a) retain Alvarez & Marsal North America, LLC ("A & M") to provide the Debtors an interim Chief Executive Officer and certain additional personnel and (b) designate Mr. Ralph Schipani as interim Chief Executive Officer for Nine West Holdings, Inc. and its debtor affiliates *nunc pro tunc* to April 6, 2018 (the "Petition Date").[2] In support of the Application, the Debtors filed the Declaration of Mr. Ralph Schipani [Dkt. No. 207] and the Supplemental

Declaration of Mr. Schipani [Dkt. No. 419] ("Schipani Suppl. Decl.").

2 This decision was dictated on the record of the hearing held on June 28, 2018. It has been modified to include full citations and defined terms, and reflects minor additional non-substantive modifications. The findings of fact and conclusions of law herein shall constitute the Court's findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052, made applicable to this proceeding pursuant to Bankruptcy Rule 9014. To the extent any finding of fact later shall be determined to be a conclusion of law, it shall be so deemed, and to the extent any conclusion of law later shall be determined to be a finding of fact, it shall be so deemed.

The sole objection to the relief sought by the Application (the "Objection") was filed by the Office of the United States Trustee (the "U.S. Trustee") on June 21, 2018, together with the Declaration of Andrea Schwartz in support of the Objection [Dkt. Nos. 408 and 409]. Six statements in support of the Application were filed by creditors and/or creditor groups representing virtually all levels of the Debtors' capital structure: (i) Wells Fargo Bank, National Association, in its capacity as ABL/FILO DIP Agent and Prepetition ABL/FILO Agent; (ii) an ad hoc group formed by certain lenders (the "Ad Hoc Secured Lender Group") that collectively beneficially own or manage (or are investment advisors or managers for funds that beneficially own or manage) approximately (a) $227.5 million in aggregate principal amount of the loans under that certain Term Loan Credit Agreement, dated as of April 8, 2014 (as amended, restated, supplemented, waived, or otherwise modified from time to time prior to the Petition Date, the "Prepetition Secured Term Loan Credit Agreement"), (b) $17.5 million in aggregate principal amount of the loans under that certain Secured Superpriority Debtor-in-Possession Term Loan Credit Agreement, dated as of April 11, 2018 (as amended, restated, supplemented, waived, or otherwise modified from time to time, the "DIP Term Loan Credit Agreement"), and (c) $17.5 million in commitments for future fundings under the DIP Term Loan Credit Agreement; (iii) the so-called Ad Hoc Group of Crossover Lenders, a group of holders of loans under the Prepetition Secured Term Loan Credit Agreement and loans under that certain Unsecured Term Loan Credit Agreement, dated as of April 8, 2014 (the "Prepetition Unsecured Term Loan Credit Agreement"); (iv) GLAS Trust Company, LLC, in its capacity as Administrative Agent under the Prepetition Unsecured Term Loan Credit *683 Agreement; (v) Brigade Capital Management, LP, one of the Debtors' largest economic stakeholders, serving as (a) a lender under the DIP Term Loan Credit Agreement, (b) a holder of loans under the Prepetition Secured Term Loan Credit Agreement, (c) a holder of loans under the Prepetition Unsecured Term Loan Credit Agreement, and (d) a holder of 8.25% Senior Notes Due 2019; and (vi) the Official Committee of Unsecured Creditors. Replies to the Objection were filed by the Debtors [Dkt. No. 420] ("Debtors' Reply") and by A & M [Dkt. No. 426] ("A & M Reply").

The legal issue presented is a narrow, technical one: should the Debtors be permitted to retain A & M under section 363(b) of title 11 of the United States Code (the "Bankruptcy Code"), as requested by the Application, or must the retention of A & M be considered solely under section 327(a) of the Code, as the U.S. Trustee asserts? The U.S. Trustee argues that A & M and Mr. Schipani are professional persons within the meaning of section 327 of the Code and that employment of professional persons must be accomplished solely and exclusively under section 327; the U.S. Trustee submits that a debtor cannot use section 363(b) to employ a professional person. Taking its argument a step further, the U.S. Trustee posits that A & M cannot meet the disinterestedness requirement of section 327(a) and that, therefore, the Application must be denied.

The Debtors and A & M vehemently disagree with the arguments of the U.S. Trustee, pointing out that retention of distressed management consultants has been authorized pursuant to section 363(b) in dozens of other bankruptcy cases where the engagement satisfies the business judgment standard, and that the Objection directly contradicts the U.S. Trustee's national policy over the last 14 years of explicitly assenting to retention applications for management consultants pursuant to section 363(b) in similar circumstances, some involving A & M and others involving other turnaround consulting firms and personnel. Moreover, the Debtors and A & M argue that, in the context of these cases, A & M is not functioning as a "professional person" as such term is used in section 327(a), and that section 363(b) provides the appropriate basis for granting the Application.

A hearing on the Application was held today, June 28, 2018 (the "Hearing"). At the Hearing, the Court heard live testimony from Mr. Ralph Schipani.

The Court assumes familiarity with the general background facts of the Debtors' cases; its findings in this Bench Decision pertain solely to the facts surrounding the role of A & M and Mr. Schipani in these cases. The facts described herein are contained in the record and shall constitute the Court's findings of fact.

Background

For over four years, A & M has been providing vital management services to the Debtors and their non-debtor affiliates. Pursuant to A & M's prepetition engagement letter, which is attached to the Debtors' Reply as Exhibit A ("A & M 2014 Engagement Letter"), A & M was hired in April 2014 to assist two separate companies —Jones Holdings LLC and Nine West Holdings Inc. —in achieving strategic and operational goals, namely an internal restructuring of operational functions across the companies' business units following their acquisition by Sycamore Partners, L.P. (Schipani Supp. Decl. ¶ 3; Ex. A to Debtors' Reply (A & M 2014 Engagement Letter)). Following the acquisition, the new board of directors sought the assistance of A & M to implement the new business plan, which focused on organizing and developing the company's various ***684** brands and lines as separate business units. (Schipani Suppl. Decl. ¶ 2).

A & M's Role

Since April 2014, A & M has provided vital management services to the Debtors and their non-debtor affiliates and has overseen virtually all aspects of their day-to-day operations. The duties of A & M personnel and Mr. Schipani have included, among other things, (a) supervising and assisting in operations, finance, accounting, and treasury functions; (b) assisting in the identification of cost reductions and other operational improvements; and (c) assisting in the evaluation and development of budgets and business plans. (Ex. A to Debtors' Reply (A & M 2014 Engagement Letter) ¶ 1(b)). A & M was engaged to manage the day-to-day operations of the business and supplement traditional in-house functions.

As stated by Mr. Schipani in his Supplemental Declaration, A & M was not hired to restructure the obligations of the company, and nothing in A & M's prepetition engagement related to bankruptcy planning; rather, it was not until approximately three years after the engagement began, during the summer of 2017, that the company, in consultation with advisors and independent of A & M's activities and responsibilities, began considering the possibility of a bankruptcy filing. (Schipani Suppl. Decl. ¶ 6).

Since the Petition Date, A & M has continued in its role of managing the daily operations of the Debtors' business; any services it has performed relating to the Debtors' chapter 11 process have been services that could have been performed by existing company personnel, rather than A & M personnel, had the necessary resources been available within the company. (Schipani Suppl. Decl. ¶ 7). For example, A & M personnel assisted in the company's preparation of bankruptcy schedules and disclosures, which bolstered the function of the finance department and was, as Mr. Schipani states, "a necessary extension and continuation of the A & M team's existing role in managing operations." (*Id.*). A & M has continued to provide the type of services it has provided to the company for years, and such work supports the professionals hired by the Debtors specifically for bankruptcy purposes, in Mr. Schipani's words, "in the same way that in-house employees and officers of any company going through a restructuring typically would in my experience." (Schipani Suppl. Decl. ¶ 8). Significantly, Mr. Schipani and his team played an instrumental role in achieving significant success in the recent sale of certain of the Debtors' assets for a winning bid well over 50% higher than the stalking horse bid, which secured over $140 million of additional value for the Debtors' estates.

Mr. Schipani's Role as Officer

At the outset of the A & M engagement in 2014, Mr. Schipani served initially as Interim Vice President of Operations; his principal focus then was assisting the company with an internal restructuring of operational functions across various business units. (Schipani Suppl. Decl. ¶ 3). Subsequently, during A & M's prepetition engagement, Mr. Schipani also served in each of the following roles: (i) commencing after the acquisition, as Interim President of Shared Services, where he was tasked with determining which shared services would be distributed to each of the business units, assigning employees to the different units, and managing the team that ran the non-redistributed services functions; (ii)

commencing in May 2015, as Interim President of Nine West Holdings, Inc., where Mr. Schipani was responsible for public financial reporting, conducting earnings calls, and overseeing cash flow management, overall capital management, and the creation of annual business plans; and (iii) commencing in June 2016, as Interim ***685** CEO of Nine West Holdings, Inc., where he "assumed responsibility for all aspects of the Company, including ensuring that the business plans of the individual business unit heads were coordinated and executed in a consistent manner" and where he became involved with the sale of the *Easy Spirit* brand and the acquisition of Kasper Topco Limited in January 2017. (Schipani Suppl. Decl. ¶¶ 3-5, 11).

Mr. Schipani's Role as Member of Subsidiary Boards

At the time of A & M's engagement, Mr. Schipani served as an officer but not as a director of certain of the Debtors. When the Interim Chief Operating Officer, Mr. Andrew Hede (another A & M Managing Director who had been appointed in connection with A & M's engagement) ceased working on the A & M engagement, Mr. Hede resigned from his positions on the boards of certain of the Debtors' subsidiaries or affiliates. (Schipani Suppl. Decl. ¶¶ 10-11). At that time, in May 2015, Mr. Schipani was appointed to replace Mr. Hede on the boards of Dongguan Jones Commerce and Trading Co. Ltd. and Kasper Global Limited. In September 2015, when Mr. Christopher Cade, Chief Financial Officer, resigned from his positions on certain subsidiary boards, Mr. Schipani was appointed to replace Mr. Cade on the subsidiary boards from which he was departing. Around this time, Mr. Schipani was appointed to the boards of two other subsidiaries (Nine West Group International Limited and GRI Group Ltd.) to replace a company employee who had resigned from her positions. Mr. Schipani was also appointed to the board of Kasper Topco Limited when the company acquired the entity in January 2017.

All of Mr. Schipani's board appointments were made pursuant to the request of and under the supervision of the Debtors' parent level boards, on which he did not serve. (Schipani Suppl. Decl. ¶ 12).

The only legal entity that is a Debtor in these cases on whose board Mr. Schipani has served within the past two years is One Jeanswear Group Inc. Mr. Schipani and Mr. Joseph Donnalley (another officer of the company) served as the two members of this entity's board following Mr. Cade's resignation in September 2015. After Mr. Donnalley left the company in October 2016, Mr. Schipani served as the sole board member of One Jeanswear Group Inc. from October 2016 until August 2017, when Mr. Alan Miller and Mr. Harvey Tepner were appointed as additional board members. (Schipani Suppl. Decl. ¶ 13). Mr. Schipani resigned from each of his board positions on November 22, 2017. (Schipani Suppl. Decl. ¶ 14).

Mr. Schipani's role on each subsidiary board on which he served was "strictly administrative and did not entail substantive decision making as a director." (Schipani Suppl. Decl. ¶ 15). The boards on which he sat did not hold any meetings. His actions as a director were limited to signing written consents to enact decisions that were directed by the parent board, and he did so fewer than twenty times over the two-year period during which he served on the boards. (*Id.*). Prior to approving a transaction as a director, Mr. Schipani had already conducted a "substantive review and deliberation" in his capacity as an officer, and it was incidental that he would sign a written consent in his role as a director in order to formalize the approval. (Schipani Suppl. Decl. ¶¶ 15-16). At the Hearing, Mr. Schipani provided an example of this by referring to his vetting of the amendment of the ABL Credit Agreement in his role as an officer, after which he signed a written consent to the amendment in his role as a director. At no time did Mr. Schipani serve on the board of either (i) Debtor parent Jasper Parent LLC or (ii) lead Debtor Nine West Holdings Inc.; these two boards made all decisions ***686** with respect to the prepetition and postpetition retention and compensation of officers of the company and of professional firms such as A & M. (Schipani Suppl. Decl. ¶ 18).

As set forth in his Supplemental Declaration, of the approximately 9,857 hours Mr. Schipani billed between April 2014 and the Petition Date in connection with A & M's engagement by the company, he estimates that he spent less than one half of one hour, in total, on all matters relating to his service on the subsidiary boards. (Schipani Suppl. Decl. ¶ 17).

Discussion

I. Section 363(b) of the Bankruptcy Code

[1] Pursuant to section 363(b) of the Bankruptcy Code, after notice and hearing, a debtor has broad discretion

to "use, sell, or lease, other than in the ordinary course of business, property of the estate," so long as such use is supported by a good business reason. 11 U.S.C. § 363(b)(1); *see, e.g., Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983) ("The rule we adopt requires that a judge determining a § 363(b) application expressly find from the evidence presented before him [or her] at the hearing a good business reason to grant such an application.").

[2] The Debtors and A & M submit that, pursuant to section 363(b), the Court may authorize the Debtors' retention of A & M and of Mr. Schipani as Interim CEO. They cite to numerous decisions and orders from this District and other districts in which courts have relied on section 363(b) to authorize debtors to retain management consultancy firms, including where a firm's personnel were expected to fill key officer roles and manage the debtor's day-to-day business. *See e.g., In re Enron Corp.*, No. 01-16034, 2006 WL 1030421, at *2 (Bankr. S.D.N.Y. Apr. 12, 2006) (noting that court authorized the debtors, under section 363(b), to retain a management consulting firm to provide a chief executive and chief restructuring officer and additional individuals to serve as additional personnel during the chapter 11 cases); *In re Ajubeo LLC*, No. 17-17924, 2017 WL 5466655, at *4 (Bankr. D. Col. Sept. 27, 2017) (approving retention of management consulting firm to provide a chief restructuring officer under section 363(b)); *In re Copenhaver, Inc.*, 506 B.R. 757, 764-65 (Bankr. C.D. Ill. 2014) (holding that the retention of a current director as consultant and chief restructuring officer under section 363(b) would be appropriate given the "unique and compelling circumstances" of the case, subject to modification of the court's oversight of the officers' fees); *In re Toisa Limited*, No. 17-10184 (Bankr. S.D.N.Y. Jan. 22, 2018) [Dkt. No. 458] (approving employment of a chief restructuring officer pursuant to section 363(b)); *see also* Debtors' Reply n.5 (citing orders entered by this Court authorizing retention pursuant to section 363(b) in sixteen cases); A & M Reply ¶ 22 (citing additional orders entered by this Court). In addition, with respect to A & M specifically, Exhibit A to the A & M Reply lists thirty-seven bankruptcy cases in which A & M itself has been retained as a management consultant pursuant to section 363 of the Bankruptcy Code. Notably, except in the case of *In re Toisa Limited*, the U.S. Trustee did not object in any of the cited cases to the debtor(s)' request to employ the advisors, consultants, and/or chief restructuring officers pursuant to section 363(b) of the Code nor press the position taken here today that such retentions could only proceed under section 327.

Seemingly ignoring this mountain of precedent, the U.S. Trustee argues that there is "a limited body of case law under which courts have approved the retention of restructuring professionals under ***687** section 363 and section 105(a)." (Objection, 22). With respect to cases referenced in which A & M was retained pursuant to section 363(b), the U.S. Trustee attempts to distinguish this case from those, asserting that "[n]one involved the retention of A & M to provide an interim CEO and certain additional personnel, and nearly all involved the retention of A & M to provide a Chief Restructuring Officer and other additional personnel or financial advisory services." (Objection, 5).

The Court is not persuaded by any of the U.S. Trustee's arguments with respect to section 363(b) and the Debtors' alleged inability to utilize this section of the Code to provide the basis for retention of A & M and Mr. Schipani in this case. First, with respect to the plethora of cases cited in which section 363(b) has been relied on for the retention of A & M (without objection by the U.S. Trustee), the Court observes that the U.S. Trustee's narrow, factual distinction between the retention of Mr. Schipani as *CEO* here and the retention of an A & M professional as *CRO* in the previous engagements is nonsensical. Is the U.S. Trustee's position that retention of a CRO can be authorized under section 363 but retention of a CEO cannot? While it is true that the Debtors seek to retain Mr. Schipani as CEO and not as CRO, the U.S. Trustee's position here is that A & M and Mr. Schipani cannot be retained under section 363 and must be retained under section 327 because they are playing an intimate, significant, and central role in the Debtors' reorganization and are thus "professional persons" as such term is used in section 327(a) of the Code. (Objection, 18). Had the Debtors sought to retain Mr. Schipani as CRO, however, it appears likely that the U.S. Trustee's position with respect to section 327 would remain unchanged; he would argue that the principal duties of a CRO are to provide support in a bankruptcy case and thus retention under section 327 is required.

The distinction that that U.S. Trustee attempts to make in his Objection is simply illogical. Moreover, a close examination of the thirty-seven cases listed on Exhibit A to the A & M Reply reveals that A & M was not in fact

retained to provide solely a CRO and other additional personnel to the debtors in each and every one of such cases. Instead, here, as in many of the cited cases, A & M employees were retained pursuant to section 363(b) to serve as additional officers of the debtors, including in roles such as Interim Chief Executive Officer, Interim Chief Financial Officer, Interim Chief Operating Officer, and Interim Vice President of Finance, and to provide additional A & M personnel to assist such officers. *See, e.g., In re Angelica Corp., et al.*, No. 17-10870 (Bankr. S.D.N.Y. May 4, 2017) [Dkt. No. 149]; *In re Ignite Restaurant Group, Inc., et al.*, No. 17-33550 (Bankr. S.D. Tex. Jun. 28, 2017) [Dkt. No. 255]; *In re Local Insight Media Holdings, Inc., et al.*, No. 10-13677 (Bankr. D. Del. Dec. 17, 2010; Feb. 11, 2011) [Dkt. Nos. 162, 333].

a. The Jay Alix Protocol

[3] The U.S. Trustee's position that section 363(b) cannot provide the basis for retention of distressed management consultants such as A & M here lacks intellectual honesty and consistency, particularly when considered in light of the so-called Jay Alix Protocol adopted by the U.S. Trustee fourteen years ago. The full text of the Jay Alix Protocol (the "Protocol") can be found on the website of the U.S. Trustee.[3] The Protocol is not a provision of the Bankruptcy Code. It is not law, and it ***688** is not binding on this Court or any other court. As Joe Guzinski, then acting general counsel for the Executive Office for U.S. Trustee, stated on November 13, 2001,

> We have seen any number of situations where turnaround or other advisory services seek to be retained as professionals under Section 327 and also have a role in management .... In our view, that renders them an insider and, therefore, not disinterested. This protocol makes clear how advisory firms will work with the debtor in the future, at least in a way that's acceptable to the UST. We have some cases pending against certain firms at this point—there are some agreements pending that we're trying to bring in under the protocol. The protocol right now only applies to cases in Region 3. But we anticipate making it a policy nationwide after discussion with the USTs.

(*See* "EOUST SAYS JAY ALIX PROTOCOL WILL BE NATIONAL POLICY," Bankruptcy Court Decisions Weekly News & Comments, 38 No. 14 Bankr. Ct. Dec. News 1 (November 13, 2001)).

3 *See* https://www.justice.gov/sites/default/files/ust/legacy/2014/08/11/J_Alix_Protocol_Engagement.pdf.

The Protocol began as a settlement agreement executed in 2004 between the U.S. Trustee and Jay Alix & Associates, a management consultancy firm, in a bankruptcy case unrelated to this one; it has developed into a national policy adopted by the U.S. Trustee whereby the U.S. Trustee assents to—indeed, directs—the retention of distressed management consultants by a debtor pursuant to section 363 of the Code as long as the firm complies with certain requirements contained in the Protocol. (*See* Protocol §§ I.A-C (defining crisis management engagements to include any engagement where the firm "furnishes interim executive officers" either prepetition or postpetition and stating that crisis management firm "shall seek retention under section 363 of the Bankruptcy Code")).

As correctly summarized by the Debtors in their Reply, the core requirements of the Protocol include the following:

(a) the firm sought to be retained must serve in only one capacity (*i.e.*, as either a financial advisor, crisis manager, claims agent, or investor);

(b) the firm's retention application must be filed under section 363 of the Bankruptcy Code and the application must disclose the firm's relationships with interested parties and make other disclosures showing the firm is otherwise disinterested;

(c) the firm must file monthly staffing reports, which must be subject to Court review; and

(d) retention of persons furnished by the firm must be approved by and act under the direction of an independent board of directors.

Requiring parties to comply with the Protocol has served as a way to avoid conflicts of interest. More specifically, the Protocol's "one hat" rule (which requires that the firm sought to be retained serve the debtor in only one capacity) is designed to avoid the "inherent conflict" between an advisor's duty to a debtor and its own business interests where the advisory firm serves both as a financial advisor retained pursuant to section 327 of the Bankruptcy Code and as a crisis manager with firm staff serving as officers of the debtor corporation. *See In re Saint Vincent's Catholic Med. Centers of New York*, No. 05-14945, 2007 WL 2492787, at *3 n.3 (Bankr. S.D.N.Y. Aug. 29, 2007). Put simply, the Protocol was designed to prevent a party from using its position in one capacity to benefit itself in another capacity. Footnote three to the Protocol states that a financial advisor "shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of ***689** [the advisor] serves or has served as a director of the entity or an affiliate thereof within two years prior to the petition date." (Protocol, n.3). Compliance with the Protocol prevents a director of a debtor who is also an employee of the advisory firm sought to be retained from wielding undue influence over the hiring and compensation of such director's firm. The U.S. Trustee has not objected to the section 363 retention of distressed management consultants in scores, if not hundreds, of cases over the past fourteen years where such consultants have purportedly followed the Protocol. [4]

4 Notably, courts in this District and others have approved the retention of restructuring advisors pursuant to section 363(b) well before the U.S. Trustee first implemented the Protocol. *See, e.g., In re Adelphia Commc'ns. Corp.*, No. 02-41729 (Bankr. S.D.N.Y. July 31, 2002) [Dkt. 253] (authorizing the retention of a restructuring advisory firm to provide personnel, including a CRO, pursuant to section 363(b)); *In re Enron Corp.*, No. 01-16034, 2002 WL 32150520 (Bankr. S.D.N.Y. Apr. 4, 2002) [Dkt. 2725] (authorizing the debtors to enter into an agreement with a consulting firm which then provided an individual as Acting CEO and CRO, and certain additional personnel pursuant to section 363(b)); *In re Iridium Operating, LLC*, No. 99-45005 (Bankr. S.D.N.Y. Oct. 12, 1999) [Dkt. 86] (authorizing and approving the terms of retention for restructuring officers pursuant to sections 105(a) and 363(b)); *In re Bill's Dollar Stores, Inc.*, No. 01-0435 (Bankr. D. Del. Mar. 14, 2001) [Dkt. 141] (authorizing the continued retention of an advisory firm to provide the debtors with interim management through their Interim CEO and CRO pursuant to section 363(b)).

[4] Significantly, here, the U.S. Trustee's Objection fails to mention the Protocol at all, let alone A & M's compliance in all material respects with each of its requirements. Instead, the Objection on its face ignores the U.S. Trustee's prior position with respect to section 363 retentions and argues that retention of A & M can only be authorized pursuant to section 327(a) of the Code, implying that there was clear error in every case in which a bankruptcy court has in the past approved an A & M retention pursuant to section 363(b). Both the Debtors and A & M speculate in their respective Replies (and counsel for the U.S. Trustee confirmed at the Hearing) that the true origin of the Objection is A & M's alleged non-compliance with footnote three of the Protocol, given Mr. Schipani's service as a director of a lone Debtor entity within two years prior to the Petition Date.

Returning to first principles, the Court finds that the purpose of the Protocol—preventing a consultant from using its position in one capacity to benefit itself in another capacity—has not been violated by A & M here. As emphasized by the Debtors in their Reply, while Mr. Schipani did in fact serve as a director on a single subsidiary board within two years of the Petition Date, neither he nor any other A & M employee has ever served on the parent boards responsible for approving the prepetition or postpetition retention or compensation of A & M. (Debtors' Reply ¶ 20; Schipani Supp. Decl. ¶ 18). Nor did Mr. Schipani's service on certain subsidiary boards overlap with the timing of the consideration of either A & M's 2014 or 2018 engagement letters. Moreover, as the Court has found, Mr. Schipani's service on certain subsidiary boards was done at the discretion and under the direction of the parent boards and primarily involved what can fairly be characterized as ministerial duties and approvals of transactions he had previously vetted in his role as an officer. Accordingly, the circumstances surrounding the concerns which led to the development of the Protocol—avoiding undue influence by a director in the hiring of professionals—are simply not present here, and the Court finds that A & M has ***690** complied with the core requirements of the Protocol in all material respects.

For fourteen years, the crisis and interim management industry has relied on the implicit consent of the U.S. Trustee that such firms can be retained in a bankruptcy case pursuant to section 363 rather than section 327 if they meet the requirements of the Protocol, and the industry has developed its business model based on the understanding that the U.S. Trustee would enforce this policy consistently and fairly. To permit the U.S. Trustee to now reverse course in this case would be, in the words of A & M, "starkly inequitable." (A & M Reply ¶ 29). The only explanation the U.S. Trustee has provided for this stunning reversal of policy is that "all bets are off" because of Mr. Schipani's *de minimis* board service; the economic disruption that his departure would cause is of no concern to the U.S. Trustee. The U.S. Trustee has chosen to take a position that would unquestionably visit damage on this case, this company, and its creditors; he chooses compliance with a footnote over the interests of every creditor in this case.

[5] Courts are tasked with ensuring compliance with the Code and ensuring that the Code is applied with common sense and in a predictable manner. The U.S. Trustee cites to the Supreme Court's decision in *Jevic* for the proposition that deviating from strict interpretation of the Bankruptcy Code and creating a "rare case" exception to retain professionals pursuant to section 363 who might be ineligible under section 327 should not be permitted, as it may "threaten[ ] to turn a 'rare case' exception into a more general rule." (*See Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S.Ct. 973, 986, 197 L.Ed.2d 398 (2017)). But the U.S. Trustee ignores the Supreme Court's additional statements regarding judicially-created exceptions not specifically found in the Code but which advance significant Code-related objectives. *Jevic* strictly interpreted the absolute priority rule; however, with respect to other instances "in which a court has approved interim distributions that violate ordinary priority rules," including " 'first-day' wage orders that allow payment of employees' prepetition wages, 'critical vendor' orders that allow payment of essential suppliers' prepetition invoices, and 'roll-ups' that allow lenders who continue financing the debtor to be paid first on their prepetition claims," the Supreme Court stated that "one can generally find significant Code-related objectives that the priority-violating distributions serve." *Id.* at 985. So too here.

[6] At the Hearing, counsel for the U.S. Trustee characterized the Application's use of section 363 as a "backdoor" way to avoid the limitations of section 327(a) of the Code, including the disinterestedness requirement. When questioned by the Court, counsel for the U.S. Trustee indicated that, if a turnaround consulting firm complies with the Jay Alix Protocol, however, the U.S. Trustee would "exercise his prosecutorial discretion" and not object to the debtor's seeking retention of the firm under section 363(b) instead of under section 327(a). Counsel's explanation in this regard appears to indicate the U.S. Trustee's belief that only the U.S. Trustee, and not the Court, has discretion to create an "exception" to the Code's requirement that professional persons be retained pursuant to section 327 rather than pursuant to section 363; *i.e.*, that it is only permissible for the Court to approve a section 363 retention if the U.S. Trustee approves. This cannot be. If the U.S. Trustee believes he can, through the Protocol, green-light an "exception" to section 327(a)—which the Protocol clearly does—then he cannot arbitrarily revoke such protocol without notice and inflict substantial harm ***691** on professionals and debtors who have acted in reliance on over fourteen years of precedent with respect to A & M and other similar advisory firms.

As described by counsel to A & M at the Hearing, companies approaching financial distress have been able to meet their needs for operational resources by engaging management consultancy firms to run the day-to-day management of such companies and, at times, to serve as their interim officers. Engagement of management consultancy firms prior to a bankruptcy filing and their continuing retention postpetition has enabled companies to achieve business continuity during their darkest hour. As aptly pointed out by the Debtors, if, however, section 327 is the only path available for a chapter 11 debtor to retain a restructuring advisory firm and officers supplied by such firm, firms that previously provided firm personnel to fill necessary management roles at the company must be jettisoned when the company files for chapter 11 by virtue of the fact that, having served as officers of the debtor, the firm and its personnel are arguably not disinterested within the meaning of section 101(14) and thus cannot be retained under section 327(a).

This practice would disrupt company management at the precise time when management services are most needed —an absurd result, to say the least. The U.S. Trustee's position in this regard appears to be that the more vital a role an advisory firm played at a company prepetition,

the more likely it is that such firm and its personnel will be unable to serve as retained professionals in the company's bankruptcy case pursuant to section 327(a) of the Code. And to what end? Notably and inexplicably, the U.S. Trustee makes the unequivocable statement in its Objection that "[a] debtor cannot use section 363(b) to employ a professional person." (Objection, 21) (citing *In re Bicoastal Corp.*, 149 B.R. 216, 218 (Bankr. M.D. Fla. 1993)). It is quite difficult for this Court to reconcile this statement with the statement in the Protocol that the professional "*shall* seek retention under section 363 of the Bankruptcy Code." (*See* Protocol § I.C. (emphasis added)).

The Court declines to elevate form over substance in the manner sought by the U.S. Trustee, Instead, it concludes that rehabilitating a debtor and preserving the value of the debtor's business—significant Code-related objectives—can be best accomplished here by permitting the Debtors to utilize their estate assets under section 363 of the Code to hire the advisory services firm and its personnel who played key management roles at the company prepetition, thus ensuring the continuity of such services. The Court agrees with the observation made by counsel to the Ad Hoc Secured Lender Group at the Hearing that section 363 is "not a backdoor but, rather, an equally appropriate door" on which the Court can consider the retention of A & M and Mr. Schipani.

Even assuming that the U.S. Trustee was not estopped from arguing that the retention cannot be considered under section 363, an argument on which the Court declines to rule at this time, after considering the extensive case law and precedent cited by the parties providing authority for the retention of A & M and Mr. Schipani pursuant to section 363(b) and the Code-related objectives of rehabilitating a debtor and preserving its economic value for stakeholders, the Court finds that the U.S. Trustee's section 363 argument is without merit. For these reasons, the Court finds that nothing precludes the Debtors from relying on section 363(b) to seek authorization for the retention of A & M and Mr. Schipani.

***692 b. The Debtors' Business Decision to Retain A & M and Mr. Schipani is a Sound Exercise of Their Business Judgment**

[7] **[8]** When considering whether to approve a debtor's use of estate property outside the ordinary course of business pursuant to section 363(b), courts review the business judgment of the debtor. The business judgment standard applied by courts presumes that the court will not second guess the business judgment of a debtor's board in making a business decision, provided that the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. *See In re Lionel Corp.*, 722 F.2d at 1071; *Off. Comm. of Subordinated Bondholders v. Integrated Resources Inc. (In re Integrated Resources Inc.)*, 147 B.R. 650, 656 (S.D.N.Y. 1992); *In re Global Crossing Ltd.*, 295 B.R. 726, 742-43 (Bankr. S.D.N.Y. 2003).

As is evident from the plethora of case law cited by the Debtors and A & M, courts in this District and elsewhere have entered orders permitting management consultant firms to be retained under section 363(b) based upon a finding that the engagement satisfies the business-judgment standard, without requiring applicants to meet a separate burden of proof under section 327(a).

[9] Mr. Schipani's testimony at the Hearing demonstrated that retention of A & M and of Mr. Schipani as Interim CEO are necessary to preserve and maximize the value of the Debtors' businesses and are of critical importance in these cases. During the four years preceding the Petition Date and continuing postpetition, A & M personnel have occupied key management positions and supported existing in-house functions, helping to oversee day-to-day operations, find and pursue corporate opportunities, create and carry out business plans, and otherwise manage the Company at the direction of the board of directors of parent Nine West Holdings, Inc. Mr. Schipani and his team have overseen all aspects of the company's affairs and have developed strong relationships with the Debtors' customers, vendors, and employees, particularly since Mr. Schipani has served as Interim CEO since June 2016. At the Hearing, Mr. Schipani testified in a measured, detailed, and passionate way concerning his responsibilities and role as CEO and acknowledged that he is viewed as the "face of the stability" of the company by creditors, vendors, and the company's 1350 employees, all of whom are counting on him.

As evidenced by the statements in support of the Application filed by six distinct creditor groups

representing virtually all major stakeholders across the Debtors' capital structure, the Debtors' creditors believe that the retention of A & M and Mr. Schipani is critical to the Debtors' success. Mr. Schipani recently played a key role in obtaining dramatically increased value for the Debtors in an auction of certain of their businesses (*see* Dkt. No. 404), and he is expected to be a key participant in discussions regarding chapter 11 resolutions and to play a crucial role in further refining the Debtors' go-forward business plan. (*See* Debtors' Reply ¶¶ 24-25). In fact, were the Debtors *not* to seek to retain the continuing services of Mr. Schipani and A & M, it would be a manifestly *unreasonable* exercise of their business judgment.

Abruptly removing Mr. Schipani and A & M from their management roles at this time, more than four years into A & M's engagement and just as the Debtors are entering the most critical phase in their history as they seek to restructure their obligations in bankruptcy, could, as the Debtors assert, put the success of the entire ***693** reorganization at risk. As counsel for the Debtor emphasized at the Hearing, were Mr. Schipani and A & M to be ousted from the roles at this time, there would likely be insurmountable disruption to the Debtors' business. Their experience in managing the company would be impossible to replicate, and any new executive and supporting personnel would have a significant learning curve that the Debtors cannot afford at this time. In addition, as pointed out in a footnote to the Debtors' Reply, the importance of the continued retention of Mr. Schipani and A & M was recently made even more stark due to the resignation of the Debtors' chief financial officer. (*See* Debtors' Reply ¶ 24, n. 8).

The Debtors have demonstrated that retention of A & M and Mr. Schipani is clearly in the best interests of the Debtors, their estates, and their creditors, and, for all of these reasons, the Court declines to second-guess the business judgment of the parent board with respect to this decision.

II. Section 327 of the Bankruptcy Code

Section 327(a) of the Bankruptcy Code provides that a trustee or debtor in possession "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." 11 U.S.C. § 327(a).

[10] **[11]** "[A] professional person is one who plays an intimate or central role in the administration of the debtor's bankruptcy proceeding." (Objection, 19 (citing *Comm. Of Asbestos-Related Litigants v. Johns-Manville Corp., et al. (In re Johns-Manville Corp.)*, 60 B.R. 612, 619 (Bankr. S.D.N.Y. 1986) (stating that a professional within the meaning of section 327 is one intimately involved in the administration of the reorganization process, for example, one who played a part in negotiating a plan, who is involved with disposing of or acquiring assets, or who interacts with creditors))). In this Circuit, "professional persons" are defined to include firms or individuals who have been "hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process." *In re SageCrest II, LLC*, Nos. 3:10CV978, 3:10CV979, 2011 WL 134893, at *7 (D. Conn. Jan. 14, 2011).

In *SageCrest II*, the Court explained that "[o]fficers responsible for the day-to-day business of the debtor ... stand in contrast to professionals hired for the *sole purpose* of reorganizing the debtor organization." *Id.* (emphasis added); *see also In re Phoenix Steel Corp.*, 110 B.R. 141, 142 (Bankr. D. Del. 1989) (finding that workout managers hired as officers to evaluate company's financial condition and oversee day-to-day operations were not "professional persons" within the meaning of section 327(a)); *In re Dairy Dozen-Milnor, LLP*, 441 B.R. 918, 920 (Bankr. D.N.D. 2010) (stating that a "professional person" under section 327(a) is one who "takes a central role in the administration of the debtor's bankruptcy estate and bankruptcy proceedings as opposed to one who provides services to the debtor that are necessary regardless of whether a bankruptcy petition was filed"); *In re Seatrain Lines, Inc.*, 13 B.R. 980, 981 (Bankr. S.D.N.Y. 1981) (concluding that maritime engineers hired by the debtor were not "professional persons" because they did not play a central role in the administration of the bankruptcy case and the need for their employment did not arise from the bankruptcy itself).

[12] The U.S. Trustee argues that A & M and Mr. Schipani, are "professional persons" within the scope of section 327, as ***694** they "specialize in financial and operational restructuring" and, "[d]espite the label of Interim CEO, they are intimately involved in the

restructuring of the Debtors' businesses and are central to the reorganization." (Objection, 18). In support of his assertion, the U.S. Trustee points to the fact that Mr. Schipani and A & M personnel, among other things, have prepared each of the Debtors' schedules and SOFAs; have assisted in claims work and in reviewing various contracts for the Debtors to determine which contracts to assume or reject; are preparing the Debtors' 13-week cash flow forecast; have been assisting with the debtor-in-possession financing; and were intimately involved in the postpetition sale of a substantial portion of the Debtors' business where they evaluated bids, qualified certain bids, and participated in the auction which ultimately led to a very significant sale for the Debtors. (*See* Objection, 18-19).

After listing these tasks (and others) in the Objection, the U.S. Trustee concludes that Mr. Schipani and A & M have been assisting the Debtors on "nearly every major element" of a large chapter 11 case and, thus, unquestionably are professional persons within the meaning of section 327(a) who must be retained under such Code section. (Objection, 18-19).

In contrast, A & M contends that Mr. Schipani and A & M, who were engaged over four years ago to manage the day-to-day operations of the company's businesses and not for the express purpose of administering the then-nonexistent bankruptcy estates, are not "professional persons" within the meaning of section 327(a). The Court agrees. Here, there can be no doubt that the *SageCrest* "hired for the purpose of reorganizing" formulation is inapplicable to A & M.

A & M was hired four years before the Petition Date, and, since that time, Mr. Schipani and other A & M personnel have managed the company, providing services that would be needed independent of any bankruptcy filing. The evidence supports this conclusion. As stated by Mr. Schipani in his Supplemental Declaration and at the Hearing, A & M was not hired to restructure the obligations of the company, and nothing in A & M's 2014 engagement related to bankruptcy planning; rather, it was not until approximately three years after the engagement began, during the summer of 2017, that the company, in consultation with advisors and independent of A & M's activities and responsibilities, began considering the possibility of a bankruptcy filing. (Schipani Suppl. Decl. ¶ 6).

Since the Petition Date, A & M has continued in its role of managing the daily operations of the Debtors' businesses; any services it has performed relating to the Debtors' chapter 11 processes have been services that could have been performed by existing company personnel, rather than A & M personnel, had the necessary resources been available within the company. (*See* Schipani Suppl. Decl. ¶ 7). During the chapter 11 cases, A & M has continued to provide the types of services it has provided to the company for years, and such work supports the professionals hired by the Debtors specifically for bankruptcy purposes, in Mr. Schipani's words, "in the same way that in-house employees and officers of any company going through a restructuring typically would in my experience." (Schipani Suppl. Decl. ¶ 8). As A & M correctly asserts, "because the firm is not tasked with actually administering the bankruptcy estate," it does not fall within the definition of a "professional person" under section 327(a). (A & M Reply ¶ 6).

At the Hearing, counsel for A & M elicited testimony from Mr. Schipani which illustrated that the services he provides to the company postpetition have remained largely unchanged, albeit augmented by ***695** certain bankruptcy-related responsibilities such as attending section 341 meetings and preparing monthly operating reports. He compared his prepetition and postpetition responsibilities as CEO, testifying that, during both periods, he has been responsible for, among other things, monthly reporting; managing cash flows; controlling inventory; sales of assets; and negotiating the company's financing. For instance, Mr. Schipani testified that, in 2016, he coordinated the sale of the *Easy Spirit* brand and, during the chapter 11 cases, he worked on the sale of the *Nine West* brand; he was also responsible for negotiating amendments to the prepetition credit agreement much as he did in connection with the DIP credit agreement. Mr. Schipani's testimony was supported by a comparison of the scope of services set forth in the A & M 2014 Engagement Letter and in A & M's 2018 postpetition engagement letter. Mr. Schipani likened his role as Interim CEO to the role of other CEOs at distressed companies such as that of the CEO of Chemtura, with whom he worked closely.

The Court declines to find here that Mr. Schipani and A & M are "professional persons" as such term is utilized in section 327(a) of the Code. Their roles—both prepetition

and postpetition—are focused on running the business. As Mr. Schipani's testimony made clear, the services that they have provided to support the Debtors' bankruptcy-specific professionals are largely work that the officers and managers of any bankrupt entity would have to do in the ordinary course. It would be an absurd result if their work in such roles was sufficient to render them "professional persons;" if this were the case, virtually every senior executive of every chapter 11 debtor would have to be retained under section 327(a). This simply cannot be.

As the Court has determined that section 327(a) does not apply to the retention of A & M and Mr. Schipani in these cases, it need not reach the U.S. Trustee's additional argument that they are not "disinterested" under section 101(14) of the Code and thus fail to meet the requirements of section 327(a).

For all of the foregoing reasons, the Objection is overruled, the Application is granted, and the Debtors are authorized to retain A & M to provide the Debtors with an interim CEO and certain additional personnel and to designate Mr. Schipani as Interim CEO pursuant to section 363(b) of the Bankruptcy Code. The Debtors are directed to submit an order consistent with this Bench Decision.

All Citations

588 B.R. 678, 65 Bankr.Ct.Dec. 240

Term Sheet for Settlement Between McKinsey and U.S. Trustee

40208144\2

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
WESTMORELAND COAL COMPANY, *et al*	§	**CASE NO: 18-35672**
	§	**CHAPTER 11**
	§	**(Jointly Administered)**

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

IN RE:	§	
SUNEDISON, INC., *et al.*	§	**CASE NO: 18-35672**
	§	**CHAPTER 11**
	§	**(Jointly Administered)**

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

IN RE:	§	
OLD ANR, LLC, *et al.*	§	**CASE NO: 19-00302 (KRH)**
	§	**MISCELLANEOUS PROCEEDING**

MEDIATOR'S NOTICE TO COURT

The Court-ordered mediation commenced on February 7, 2019. I report:

1. The United States Trustee, McKinsey, the Mar-Bow entities, and Westmoreland Coal each appeared at mediation, and each proceeded with the mediation. Attendance by other entities was optional, and no other entities participated. All parties spent extensive time conferring with me both before and during the mediation. Extensive discussions continued after February 7, 2019 as well. I report to you that all parties complied with your respective orders and participated in good faith.

2. McKinsey and Mar-Bow have not reached a settlement. They have agreed to suspend the mediation, with my renewed involvement as a mediator, as appropriate from time-to-time. Subject to any contrary orders, I have agreed to that proposal.

3. I am pleased to report that the United States Trustee and McKinsey have reached a definitive settlement of all issues between those parties. Based on my observations, the proposed settlement between the United States Trustee and McKinsey resolves the parties' good faith disputes concerning the application of Bankruptcy Rule 2014. A copy of the definitive term sheet is attached as Exhibit "A". I anticipate that the motion to approve the settlement will be filed shortly.

4. I am also pleased to inform you that McKinsey and Westmoreland have reached a definitive agreement. A copy of their agreement is attached as Exhibit "B". I anticipate that a motion seeking implementation and approval of that agreement will be filed shortly.

Respectfully submitted,

Marvin Isgur

EXHIBIT "A"

MEDIATED SETTLEMENT TERM SHEET
BETWEEN THE UNITED STATES TRUSTEE PROGRAM
AND THE MCKINSEY ENTITIES

1. McKinsey[1] will pay:

   a. $5 million to the reorganized debtors in the Alpha cases.
   b. $5 million to the reorganized debtors in the SunEdison cases.
   c. $5 million to the bankruptcy estate in the Westmoreland cases.

2. The payments identified in Paragraph 1 will be distributed in accordance with the terms of the confirmed plans in those cases or other applicable law. If any of the $15 million is distributed to McKinsey, it will be refunded by McKinsey to the distributing party.

3. The United States Trustee Program will release all claims against McKinsey (and all of its agents, directors, officers, attorneys and employees acting on its behalf, solely with respect to actions taken in the course and scope of their duties with McKinsey regarding disclosures in the cases referenced below), and refrain from instituting, directing or maintaining any contested matter, adversary proceeding, or miscellaneous proceeding, or participating in any contested matter, miscellaneous proceeding, or adversary proceeding by a third party (except that the United States Trustees may participate in an action to the extent ordered by a court provided that the United States Trustees may not seek such a court order formally or informally), against McKinsey in which:

   (a) it is alleged that McKinsey failed to (i) make full and complete disclosure under applicable law; or (ii) fully comply with Fed. R. Bankr. P. 2014; or

   (b) any remedy is sought that would be barred by *res judicata* or collateral estoppel principles if McKinsey had (i) made full and complete disclosures in accordance with applicable law; and (ii) fully complied with Fed. R. Bankr. P. 2014.

   For the avoidance of doubt, with respect to paragraph 3(b) above, (x) in the event of: (i) fraud or a material misrepresentation on the record that would have rendered McKinsey "not disinterested" in any of these bankruptcy cases or that would otherwise have disqualified McKinsey from retention, or (ii) a material omission of fact that if made on the record would have rendered McKinsey "not disinterested" in any of these bankruptcy cases or that would otherwise have disqualified McKinsey from retention, (y) the United States Trustee Program may pursue appropriate relief including seeking disqualification, and McKinsey reserves all rights to object to such relief.

[1] For purposes of this Settlement Term Sheet, "McKinsey" means, collectively, McKinsey & Company, Inc., McKinsey Holdings, Inc., McKinsey & Company, Inc. United States and McKinsey Recovery & Transformation Services U.S., LLC."

The release will apply in the following bankruptcy cases (including any jointly administered cases pertaining to the listed cases):

- Westmoreland Coal Company, Case No. 18-35672 (Bankr. S.D. Tex.);
- SunEdison, Inc., Case No. 16-10992 (Bankr. S.D.N.Y);
- Alpha Natural Resources, Inc., Case No. 15-33896 (Bankr. E.D. Va.);
- The Hayes Lemmerz International, Inc., Case No. 01-11490 (Bankr. D. Del.);
- UAL Corporation, Case No. 02-48191 (Bankr. N.D. Ill.);
- Mirant Corp., Case No. 03-46590 (Bankr. N.D. Tex.);
- Lyondell Chemical Company, Case No. 09-10023 (Bankr. S.D.N.Y.);
- Harry & David Holdings, Inc., Case No. 11-10884 (Bankr. D. Del.);
- AMR Corp., Case No. 11-15463 (Bankr. S.D.N.Y.);
- AMF Bowling Worldwide, Inc., Case No. 12-36495 (Bankr. E.D. Va.);
- Edison Mission Energy, Case No. 12-49219 (Bankr. N.D. Ill.);
- NII Holdings, Inc., Case No. 14-12611 (Bankr. S.D.N.Y.);
- SRC Liquidation, LLC (f/k/a The Standard Register Company), Case No. (Bankr. D. Del.); and
- GenOn Energy, Inc., Case No. 17-33695 (Bankr. S.D. Tex.).

4. McKinsey will release all claims against the United States Trustee Program and all of its current and former employees, including all claims under the Equal Access to Justice Act, 28 U.S.C. § 2412, based on the United States Trustee Program's investigation and prosecution of claims arising out of or pertaining to the adequacy of McKinsey's disinterestedness or disclosures in the cases referenced in paragraph 3.

5. The United States Trustee Program reserves all rights to object to McKinsey's disinterestedness or its retention in the Westmoreland case on any grounds other than the adequacy of its past retention related disclosures in the cases referenced in paragraph 3. The existing objection by the United States Trustee is resolved by this Agreement, without prejudice to the rights of the United States Trustee to assert any issue in any new objection that might be filed.

6. McKinsey will request the United States Bankruptcy Court for the Southern District of Texas to defer consideration of McKinsey's retention application until after McKinsey has made additional disclosures[2] in the Westmoreland case. The United States Trustee will consent to the requested extension.

[2] McKinsey will file an appropriate motion before the Bankruptcy Court in which the continuance is requested.

7. This Settlement Term Sheet will be filed of record in the SunEdison, Alpha and Westmoreland bankruptcy cases. Thereafter, the Settlement Term Sheet will be incorporated into a proposed agreed order filed in, and subject to the approval of each of the United States Bankruptcy Courts for the Eastern District of Virginia, the United States Bankruptcy Court for the Southern District of New York, and the United States Bankruptcy Court for the Southern District of Texas.

8. Among other things, the final document will include the United States Trustee Program's usual and customary language concerning the preservation of all other rights by the United States, the right to share information with other agencies of the United States, and an acknowledgement that the agreement set forth herein does not impact the rights of non-parties.

9. Neither this Settlement Term Sheet nor the final documentation will constitute an admission of liability, wrongdoing or misconduct by McKinsey, its employees, officers, directors or agents.

EXHIBIT "B"

MEDIATED TERM SHEET
BETWEEN WESTMORELAND COAL AND
MCKINSEY RECOVERY & TRANFORMATION SERVICES U.S, LLC

1. Westmoreland has requested that McKinsey continue to serve as its financial advisor in the Westmoreland bankruptcy cases. McKinsey has agreed to do so, subject to appropriate approval by the United States Bankruptcy Court for the Southern District of Texas.

2. Westmoreland and McKinsey believe that McKinsey has provided unvarnished and independent advice to Westmoreland in these cases. Although Westmoreland has received allegations that McKinsey has conflicted interests, Westmoreland has observed no conflict and believes that it has received unconflicted advice.

3. McKinsey has requested that Westmoreland file a motion with the United States Bankruptcy Court for the Southern District of Texas asking that the Court defer consideration of McKinsey's retention pending the following:

a. The adoption by McKinsey of a protocol for a review of its connections in bankruptcy cases to assure that McKinsey's disclosures in these cases is full, complete, and in compliance with Fed. R. Bankr. P. 2014.

b. The application of the protocol by McKinsey in this case to allow the preparation of revised disclosures.

c. Westmoreland's review of the revised disclosures to determine whether, in Westmoreland's view, McKinsey may serve under 11 U.S.C. § 327.

d. The filing of the revised disclosures by McKinsey.

Westmoreland has agreed to the request in this paragraph 3.

4. McKinsey has informed Westmoreland of McKinsey's settlement with the United States Trustees Program. Westmoreland fully supports the settlement.