Business Track

Disclosure, Conflicts and Other Ethical Problems in Commercial Bankruptcy Cases: Avoiding Litigation, Disgorgement and Malpractice

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[2]

1. Disclosure and Conflicts

DISCLOSURE AND CONFLICTS

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I. Relevant Bankruptcy Code Provisions.

A. 11 U.S.C. § 327 - Employment of Professional Persons.

1. 327(a): Retention of Bankruptcy Professionals.

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

2. 327(c): Disqualification for Actual Conflict.

- In a case under chapter 7, 12, or 11 of this title, *a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor*, unless there is objection by another creditor or the United States trustee, in which case *the court shall disapprove such employment if there is an actual conflict of interest.*

3. **327(e): Employment of Attorney for Special Purpose.**

- The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, *if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.*

B. 11 U.S.C. § 328 - Limitation on Compensation of Professional Persons.

1. **328(a): Reasonable Terms and Conditions.**

- The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis.

- Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

2. **328(c): Requirement of Disinterestedness.**

- Except as provided in section 327(c), 327(e), or 1107(b) of this title, *the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if,* at any time during such professional person's employment under section 327 or 1103 of this title, *such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.*

C. 11 U.S.C. 1103(b) – Powers and Duties of Committees.

1. **Prohibition on Representation of Entities with Adverse Interest.**

- An attorney or accountant employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

D. Bankruptcy Rule 2014(a) – Employment of Professional Person.

1. **Application for an Order of Employment.**

- Requires any professional applying for employment to set forth to the best of the applicant's knowledge all known connections of the applicant with the debtor, creditors, or any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

II. Noteworthy Cases.

1. ***In re Roberts*, 46 B.R. 815 (Bankr. D. Utah 1985).**

- The phrase "hold or represent an interest adverse to the estate," is not defined in the Bankruptcy Code and the legislative history gives no indication of its intended meaning. The court articulates the following definition: (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

- *See also Electro-Wire Prods., Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356 (11th Cir.1994); *In re Perry*, 194 B.R. 875, 879 (E.D.Cal.1996); *In re Rivers*, 167 B.R. 288 (Bankr. N.D. Ga. 1994); *In re Rusty Jones, Inc.*, 134 B.R. 321 (Bankr. N.D. Ill. 1991).

2. ***In re BH & P, Inc.*, 949 F.2d 1300 (3d Cir. 1991).**

- The Third Circuit affirmed the disqualification of a trustee and proposed counsel where actual conflicts of interest existed between two jointly-administered estates.

- The bankruptcy court found that in his capacity as trustee for one debtor, the trustee was obligated to pursue the claims of the debtor against affiliated debtors. "Unless all creditors are paid in full, such claims are materially adverse to those of the other unsecured creditors of [the affiliates], because all allowed unsecured claims will share pro rata in any dividend from the estates of [the affiliates]...."

- Section 101(14)(E), the so-called "catch-all clause" governing lack of disinterest, has been interpreted broadly enough to include anyone who "in the slightest degree might have some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules."

- The court did not adopt a *per se* rule that section 101(14)(E) automatically disqualifies a trustee from serving in jointly administered cases where there are inter-debtor claims. Rather, the court found a "middle ground" approach that required courts to balance the threat of a potential conflict of interest with the likelihood of actual harm to the estate.

3. ***In re Marvel Entm't Group, Inc.*, 140 F.3d 463 (3d Cir. 1998).**

- The Third Circuit permitted the trustee's law firm to represent the trustee where the firm's representation of a creditor in matters unrelated to the case created only the potential for a conflict.

- "Section 327(a), as well as section 327(c), imposes a per se disqualification as trustee's counsel of any attorney who has an actual conflict of interest; (2) the district court may within its discretion - pursuant to [section] 327(a) and consistent with [section] 327(c) - disqualify an attorney who has a potential conflict of interest; and (3) the district court may not disqualify an attorney on the appearance of conflict alone."

4. ***In re Zenith Electronics Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999).**

- Prior to filing for bankruptcy, the debtor, its majority shareholder and single largest creditor, LGE, interviewed investment banking firm PJSC to advise it with respect to its investment in Zenith. For five days following the interview, PJSC spent a substantial amount of time working on LGE matters to permit PJSC to advise LGE about whether to continue to support Zenith. On the fifth day, PJSC and LGE met with the Zenith board of directors. Zenith's board decided that it, rather than LGE, should retain PJSC. The board asked PJSC whether it had a conflict or felt it could advise Zenith. PJSC said it had no conflict, because the engagement letter sent to LGE had not been executed. PJSC worked for Zenith from then on, including during its bankruptcy case.

- Certain creditors of Zenith argued that PJSC's prior retention by LGE presented a conflict of interest and that the court should deny approval of the debtor's plan of reorganization, which relied on financial advice and information provided by PJSC.

- The court agreed and found that PJSC had an actual conflict of interest. The court found it irrelevant that PJSC and LGE never signed an engagement letter and that PJSC did only five days of work for LGE. "It is irrelevant that the retention was two years ago or that it only lasted for five days. It creates an insurmountable barrier to PJSC's retention by Zenith in this case."

5. ***In re Harris Agency, LLC*, 451 B.R. 378 (Bankr. E.D. Pa. 2011).**

- The court found that a law firm's simultaneous representation of the debtor and a part owner and co-obligor of the debtor created an actual conflict of interest.

- The firm could not be an effective and loyal advocate for both of these clients at the same time because their interests are not identical. The duty of the firm "was not to the ***owners*** of the [Debtor] and their related entities but rather to the Debtor and to those who would benefit from maximizing the value of the bankruptcy estate." (emphasis added). The dual representation prevented the firm from having an undivided loyalty to the debtor.

- "While certain of the Debtor's affiliates were creditors of the Debtor whose ownership interests may, at times, have been aligned with the Debtor's (though their overall interests were not the same), it is important to note that there are other creditors, unrelated and unaligned with either the Debtor or its affiliates. The Firm's loyalties were divided because it would have to choose either between what was best for the estate — all creditors included — or between remaining loyal to the interests of the Debtor's owners. This division created an actual conflict of interest."

6. ***In re eToys, Inc.*, 331 B.R. 176 (Bankr. D. Del. 2005).**

- Full, complete, and timely disclosure by an attorney proposing to represent a debtor "goes to the heart of the integrity of the bankruptcy system;" a court cannot effectively determine an attorney's eligibility for employment pursuant to section 327 or "root out impermissible conflicts of interest" without proper disclosure on the part of an applicant.

- Importantly, the duty to disclose does not end once the Rule 2014 Verified Statement has been filed; rather, there is an ongoing duty of counsel to inform the court of its connections and potential conflicts.

7. ***In re Molten Metal Tech., Inc.*, 289 B.R. 505 (Bankr. D. Mass. 2003).**

- Disclosure must be complete and is not discretionary; that is, "[t]he professional cannot pick and choose which connections to disclose."

- *See also In re Source Enters., Inc.*, 2008 WL 850229, at *8 (Bankr. S.D.N.Y. Mar. 27, 2008) ("The term 'connections' is broad and is strictly construed for purposes of Bankruptcy Rule 2014 ... The existence of an arguable conflict must be disclosed if only to be explained away") (internal citations and quotations omitted); *In re Hot Tin Roof, Inc.*, 205 B.R. 1000, 1003 (1st Cir. BAP 1997) ("The duty of professionals is to disclose all connections with the debtor, debtor-in-possession, insiders, creditors, and parties in interest.... They cannot pick and choose which connections are irrelevant or trivial").

8. ***Rome v. Braunstein*, 19 F.3d 54 (1st Cir.1994).**

- Together, the statutory requirements of disinterestedness and no interest adverse to the estate "serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."

9. ***In re West Delta Oil Co., Inc.*, 432 F. 3d 347 (5th Cir. 2005).**

- The debtor's counsel attempted to surreptitiously purchase the debtor though an outside investor, while also suppressing other bids to artificially depress the purchase price. The court held that disgorgement of all fees was required due to the profound nature of the conflict.

- "A lawyer who simultaneously represents a debtor in a bankruptcy proceeding and seeks to acquire a financial interest in the debtor faces myriad quandaries, particularly in the liquidation context. In essence, the lawyer is representing a seller (the debtor) and a buyer (himself). Efforts to preserve and enhance the value of the seller's assets will work inevitably against the buyer's interest in purchasing at the lowest price possible. In addition, efforts to market the seller to other potential bidders may drive up the price, forcing buyers to increase their bids."

- "Moreover, opting to reorganize rather than liquidate may reduce or eliminate possible avenues for anyone wishing to acquire specific economic interests. In short, by operating as a potential buyer, a lawyer for a bankruptcy estate possesses a predisposition to reduce the price of the estate's assets which works to the detriment of the estate, its creditors, and its equity stakeholders."

- Courts are sensitive to preventing conflicts of interest and require a painstaking analysis of the facts and precise application of precedent when inquiring into alleged conflicts. If an actual conflict of interest is present, no more need be shown to support a denial of compensation.

- Courts may deny compensation for services provided by an attorney who holds an adverse interest. Allowance or disallowance of fees is an issue that rests within the discretion of the bankruptcy court. These determinations can be made at the time employment is approved, or even after the fact, on a court's own motion or when the attorney seeks court approval of compensation for services previously rendered.

- Case law has uniformly held that under Rule 2014(a), full disclosure is a continuing responsibility and an attorney is under a duty to promptly notify the court if any potential for conflict arises.

10. ***In re Southern Kitchens*, 216 B.R. 819 (Bankr. D. Minn. 1998).**

- The trustee attempted to retain counsel to pursue claims against a secured creditor and former director of the debtor. In its application, counsel failed to disclose that it previously had represented an individual, Gunberg, who was a former director and equity holder of the debtor and who had wrestled with the targets of the trustee's proposed suit for control of the company.

- Applying section 327(e), the court rejected the application because counsel had, by virtue of its representation of Gunberg, represented interests that "were or are adverse to the bankruptcy estate 'with respect to' this adversary proceeding." In particular, the court noted that section 327(e) bars retention of "special counsel who, on any matter of substance, represent or have represented a client that is an actual or potential opponent of the estate in the dispute for which counsel would be engaged."

- The court noted that it "must be sensitive to the possibility of strategic abuse of disqualification motions."

11. ***In re Red Lion, Inc.*, 166 B.R. 296 (Bankr. S.D. Tex. 1994).**

- The debtor sought to employ law firm on a contingency basis. The firm already represented two individual principals of debtor. The firm asked the court to approve their employment to pursue claims against the bank and its officers and/or

directors arising out of the banking relationship between the principals.

- "The bankruptcy courts have consistently held that when there is a conflict or potential conflict of interest between the debtor corporation and the owner of such corporation, representation by the same counsel should not be allowed. *See In re Carrousel Motels, Inc.*, 97 B.R. 898 (S.D.Ohio 1989); *In re American Thrift Loan Association*, 137 B.R. 381 (Bankr.S.D.Cal. 1992); *In re Smuggler's Beach Properties*, 149 B.R. 740 (Bankr.Mass. 1993)."

- The court found the employment of the firm as counsel for both the debtor and the principals created a potential conflict of interest due to the fact that the debtor may have a cause of action against one or both of the principals.

12. ***Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy LLP (In re Enron Corp.)*, 2003 U.S. Dist. LEXIS 1442 (S.D.N.Y. Feb. 3, 2003).**

- One of the creditors of the estate moved to disqualify committee counsel on the grounds that it had numerous relationships with entities having interests in the debtor, its affiliates and the bankruptcy estate. The court denied the motion, and the district court affirmed.

- In denying the motion, the court did an analysis of the disclosure requirements of Bankruptcy Rule 2014(a) and the conflict-of-interest provisions of 11 U.S.C. §§ 101, 327, 328 & 1103. The court also approved of a system using "ethical walls" and conflicts counsel to monitor situations that might require employment of other counsel.

13. ***In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir. 2002).**

- A conflict is deemed actual and *per se* disqualifying if "it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest."

14. ***In re Muma Services, Inc.*, 286 B.R. 583 (Bankr. D. Del. 2002).**

- The indenture trustee moved to disqualify committee counsel on the grounds that the firm had represented the indenture trustee in a prior unrelated bankruptcy case and had not obtained a written waiver of the conflict. The indenture trustee had not objected to the firm's retention. The firm, on behalf of the committee, brought an adversary suit against indenture trustee seeking to challenge its liens.

- The indenture trustee subsequently sought assistance from the firm on the prior matter, at which point the firm learned that a written waiver for the current representation was never obtained. The indenture trustee refused to give the waiver and brought a motion to disqualify the firm.

- The court found that the firm's representation of the committee was not directly adverse to the indenture trustee from the outset and that the indenture trustee's interests were aligned with the committee when the firm was initially retained. It was not until later, when the committee's investigation disclosed a possible infirmity in the indenture trustee's claim and lien position, that the firm's representation of the committee became adverse to the indenture trustee.

- Weighing the evidence, the court found that the firm had obtained verbal client consent to the adverse representation, which was sufficient. Even if the indenture trustee had not verbally consented, it had impliedly consented by not objecting to the firm's representation when it was initially retained.

15. ***In re Newbury Common Assocs, LLC*, No. 15-12507 (Bankr. D. Del. February 16, 2016).**

- The trustee objected to the debtors' application to employ debtors' counsel under section 327(a) on the grounds that the firm was retained to represent both debtor and related non-debtor entities. Prior to the petition date, both debtors and non-debtors commingled cash receipts. During the case, the debtors used operating funds from three bank accounts of non-debtor entities and used a non-debtor entity to make payments. The debtors had not opened any post-petition bank accounts or filed a cash management motion. In addition, there appeared to be allegations that one of the equity owners of an entity that serves a managing member for some but not all of

the debtors misrepresented the financial condition of the debtors and non-debtor affiliates.

- The trustee argued that the firm could not adequately represent the debtors given their representation of the non-debtor affiliates and the likelihood of claims between the parties, which the trustee characterized as materially adverse conflicts of interest. The court ultimately denied the application.

16. ***Caesars Entertainment Operating Co., Inc., et al.***, Case No. 15 B 1145 pending in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division.

- The financial advisory firm to the debtors ("Firm") filed a first and final application for compensation ("Application"), along with several related declarations. Based upon the declarations, the bankruptcy court preliminarily determined to deny the Application in its entirety, based on an initially undisclosed close inter-personal relationship between a principal of the Firm and a professional representing a party with an adverse interest to the debtors. However, the court extended the applicable objection deadline and required the Office of the United States Trustee and the Firm to file memorandum responding to the proposed denial. The court also invited any other party in interest to file memorandum.

- The United States Trustee filed a memorandum in opposition to the Application, based on the failure to timely disclose the relationship.

- The failure to make a timely full disclosure of the relationship caused the Firm to ultimately withdraw the Application in its entirety.

III. Considerations and Limits on Bankruptcy Professionals.

A. Types of Professionals.

1. Debtor's Counsel.
2. Committee Counsel.
3. Conflicts Counsel.
4. Ordinary Course Professionals.

B. Limitations on Professionals.

1. Effective Representation.

2. Efficiency.

3. Other Limitations.

IV. Model Rules of Professional Conduct (ABA).

A. Rule 1.7 - Conflict of Interest: Current Clients.

1. 1.7(a): Concurrent Conflict of Interest.

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. *A concurrent conflict of interest exists if*:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients *will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.*

2. 1.7(b): Representation Despite Concurrent Conflict of Interest.

(a) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) *the representation is not prohibited by law*;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives *informed consent*, confirmed in writing.

3. **Identifying Conflicts: Materiality Limitation.**

(a) *Even where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests.*

(b) The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

(c) Comment on Rule 1.7, [8].

4. **ABA/BNA Guidance on Concurrent Conflicts of Interest.**

(a) *Small ownership interests* in clients do not give rise to a conflict and need not be disclosed.

(b) Slight interests that would be *unlikely to have much if any impact on a representation* do not even need to be disclosed to the client.

(c) Lawyer's Interests Adverse to Client, ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:407, 51:405 (2012).

(d) What constitutes a "small" or "slight" interest?

(1) Conflicts may be avoided by limiting ownership in a client to a nonmaterial sum, *such as less than 5%.*

(2) Mallen & Smith, Legal Malpractice § 16.8 (2014 ed.).

5. **ABA/BNA Guidance on Evaluating Conflicts of Interest.**

(a) "The circumstances of each potential conflict must be analyzed, taking into account such factors as the extent and value of the lawyer's ownership interest relative to [his or] her overall income and assets and the client's capitalization, the type of legal service being provided, and the possible effect of the lawyer's ownership stake upon the lawyer's actions and recommendations."

(b) Lawyers' Manual on Professional Conduct, 51:407 (2012).

6. **ABA Committee on Ethics and Professional Responsibility.**

(a) "A lawyer's representation of a corporation in which she owns stock creates no inherent conflict of interest . . . ."

(b) "Rule 1.8(a) does not . . . apply when the lawyer acquires stock in an open market purchase or in other circumstances not involving direct intervention by the client."

(c) ABA Acquiring Ownership in a Client in Connection with Performing Legal Services, Formal Op. 00-418 at 7, n.7 (July 7, 2000).

B. Rule 1.8 - Conflict Of Interest: Current Clients: Specific Rules.

1. **1.8(a): Prohibition on Business Transactions and Other Interests.**

a. A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

i. the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

ii. the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

iii. the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

2. **1.8(b): Use of Information to Client's Disadvantage.**

a. A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, *except as permitted or required by these Rules.*

3. **1.8(f): Limit on Compensation.**

a. A lawyer shall not accept compensation for representing a client from one other than the client unless:

i. the client gives informed consent;

ii. there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

iii. information relating to representation of a client is protected as required by Rule 1.6.

4. **1.8(k): Imputed Conflicts.**

a. Prohibitions in this Rule applicable to one attorney in a firm are applicable to all attorneys in the firm.

V. Case Study: Indalex.

A. Background.

- Prior to its liquidation, Indalex Inc. and its affiliated debtors were the second largest aluminum extruder and the largest independent extruder in the U.S. and Canada.
- In 2005, an affiliate of Sun Capital Partners, Inc. purchased the Debtors from Honeywell International Inc. in an LBO that the trustee claims reduced the Debtors' asset-to-debt ratio from 3:1 to 1:1.
- In May 2007, Indalex's board of directors voted to pay its shareholders (comprised largely of Sun entities and executives) a dividend totaling $76.6 million, in addition to paying Sun millions in management and transaction fees under a management services agreement.
- In March 2009, following several quarters of declining financial performance, the Debtors sought protection under the Bankruptcy Code and sold substantially all of their assets to a competing extrusion company.

B. Players.

1. **Indalex Holdings Finance, Inc.** – parent entity and lead debtor

2. **Sun Indalex LLC** – held 90% of stock in Indalex Holdings Finance, Inc.

3. **Sun Capital Partners, Inc.** – parent entity that controls three investment funds that control Sun Indalex LLC:

(a) Sun Capital Partners III, QP, LP

(b) Sun Capital Partners III, LP

(c) Sun Capital Partners IV, LP

C. Dual Role of K&E.

1. **Evaluation & Acquisition of Indalex.**

(a) In 2005, Sun retained K&E to represent it in connection with its acquisition of Indalex.

2. **Issuance of $76 Million Dividend.**

(a) In February 2006, Indalex retained K&E to provide general legal services, including in connection with, among other things, the decision to pay a $76.6 million dividend to shareholders (including controlling shareholder Sun Indalex LLC).

D. K&E's Private Equity Funds or "PEFs."

1. **"Passive Investments."**

(a) Characterized as "passive investments" that committee of K&E partners manages.

(b) Committee has sole discretion to decide whether the PEFs will invest in a specific fund.

2. **"Blind" Trusts.**

(a) K&E partners do not know how committee will invest the PEF's money.

(b) Committee does not know how the PE fund will invest the PEF's money.

E. K&E's Disclosures.

1. **Bond Offering Memorandum.**

(a) In July 2005, Sun Capital started to analyze whether to acquire Indalex, an aluminum extrusion company.

(b) K&E provided legal services to Sun Capital in connection with the Indalex acquisition, including preparing the bond offering memorandum.

(c) K&E included language in the bond offering memorandum that identified the PEFs' investments in funds affiliated with Sun Capital.

(d) "Certain legal matters with regard to the validity of the notes and other legal matters will be passed upon for us by Kirkland & Ellis LLP .... Kirkland & Ellis LLP has from time to time represented, and may continue to represent, Sun Capital Partners and some of its affiliate in connection with various legal matters. Some of the partners of Kirkland & Ellis LLP are partners in a partnership that is an investor in one or more of the investment funds affiliated with Sun Capital Partners that may purchase common stock of Indalex parent in connection with the Acquisition."

2. **Retention Letter.**

(a) On February 2, 2006, K&E issued a retention letter to Indalex Holdings Finance, Inc. relating to legal services to be provided by K&E to Indalex.

(b) Retention letter disclosed K&E's representation of Sun Capital Partners, Inc. and its affiliated investment funds and management companies, including with respect to Sun's investment in Indalex.

(c) Retention letter included a broad waiver whereby Indalex consented to K&E's representation of Sun in:

(1) Matters in which K&E currently represents Sun, its affiliates or portfolio companies, including the Indalex matters;

(2) Past matters in which K&E represented Indalex, Sun, Sun's affiliates or Sun's portfolio companies (or any combination thereof); and

(3) Future matters in which K&E might represent Sun (whether or not such matter is related to Indalex).

(d) Retention letter included a provision authorizing K&E to simultaneously represent Indalex and Sun and (but included a provision terminating Indalex's representation if K&E or Sun determined that a conflict of interest existed).

(e) At the time of K&E's retention, two groups of K&E partners were already investors in one or more of the investment funds that owned Sun Indalex LLC. Indalex's retention letter did not disclose this investment.

(f) In his April 17, 2012 deposition, a co-founder of Sun Capital testified that the K&E attorney who issued the Indalex retention letter is an investor in the Sun PEFs.

F. Issuance of Dividend.

1. As part of Sun's acquisition of Indalex, Sun Capital disclosed in February 2006 to Indalex's creditors and bondholders that Indalex might sell its interest in Chinese aluminum extruder AAG, and declare a dividend in the future.

2. Credit agreement and bond indenture used to finance the acquisition included a formula governing the amount of sale proceeds Indalex could use to declare a dividend.

3. Indalex hired FTI to confirm the dividend would not render Indalex insolvent.

4. FTI's report determined that Indalex would pass the three relevant solvency tests under Delaware law if it paid a $114.4 million dividend from the proceeds of the AAG sale.

5. K&E reviewed and commented on the opinion.

6. K&E drafted the unanimous consents that Indalex's board of directors used to declare the dividend.

7. On June 1, 2007, Indalex paid a $76 million pro rata dividend to its shareholders.

G. Indalex Files for Chapter 11.

1. In May and November 2008, Indalex received separate $15 million term loans from Sun Capital to inject liquidity into its struggling business.

2. On March 20, 2009, four years after being acquired by Sun and less than two years after payment of the dividend, Indalex filed petitions for relief under chapter 11 of the Bankruptcy Code.

H. Trustee's Complaint.

1. **Aiding & Abetting Breach of Fiduciary Duty Allegations.**

(a) The Trustee alleges that K&E, while purporting to give Indalex legal advice regarding the dividend:

(1) Prepared patently false Board resolutions so that proceeds from the sale of its interest in a Chinese aluminum extruder could be used to pay the dividend;

(2) Failed to advise the Board as to the illegality of the dividend payment;

(3) Prepared Board consents that it knew or should have known were patently false so that the dividend could be paid;

(4) Failed to ensure FTI's professional competence; and

(5) Insisted on the inclusion of language that shielded controlling insiders from liability.

(b) The Trustee alleges that these actions were taken in complicity with controlling insiders of Indalex, including Sun, and that, as a result of its advice, K&E partners received proceeds from the dividend.

(1) Had the dividend not been paid, the Debtors' insolvency may have been avoided.

(2) The close relationship between K&E and Sun, and the financial interest of K&E partners in Indalex, rendered K&E an insider of Indalex.

(3) K&E thus owed fiduciary duties to Indalex, which the Trustee alleges were breached by K&E's actions with respect to its role in the dividend payment.

2. **Professional Negligence Allegations.**

(a) K&E had attorney-client relationship with Indalex and was in a position of trust/confidence.

(b) K&E failed to satisfy its duty to act in the highest degree of fidelity, loyalty and good faith towards Indalex.

(c) K&E failed to deal with Indalex honestly.

(d) K&E failed to explain the existence of a conflict between K&E, Indalex and Sun so as to permit Indalex to make an informed decision regarding the representation.

(e) K&E performed services which benefitted K&E partners, Sun and other insiders of Indalex.

I. K&E Defenses.

1. **Disclosure of Relevant Facts.**

(a) Bond offering memorandum published in January 2006 makes clear that Indalex itself knew and disclosed that certain K&E partners indirectly invested in Indalex.

(b) Indalex retention letter specifically advised Indalex that K&E had represented Sun Capital on a variety of matters, including Sun's investment in Indalex and anticipated that the Firm would continue to represent Sun Capital in the future.

(c) Indalex expressly waived any conflict with respect to K&E's representation of Sun on all past, present and future matters.

2. **Lack of Control/Direction over PEFs.**

(a) PEFs' investments, individually and collectively, represented a *de minimis* indirect interest in Indalex.

(b) K&E lawyers did not have control over the Committee's decision to invest in Sun Capital.

(c) Committee did not have control over how the Sun Capital funds invested the PEFs' money.

3. **No Adverse Interest.**

(a) K&E did not acquire an interest adverse to the client – as investors, their interest was to see the Sun Capital funds, and their portfolio companies, like Indalex, succeed.

2. The Lawyer as Business Advisor

The Lawyer As Business Advisor

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I. Introduction

A client asks a lawyer to document an unsecured loan to an offshore company. A client negotiates a sale of his own business in exchange for a minimally secured note, payable over time and asks the lawyer to close the transaction. A client asks the lawyer to document secured investment transactions, but advises that the lawyer may not contact the party providing the collateral. A client asks a lawyer to file a chapter 11 petition to avoid the repercussions of an adverse judgment, four months after it is entered and filed as a lien. The question is at what point does the lawyer have an obligation to explain the risks associated with the transaction, or risk being found to have committed legal malpractice. This issue is distinct from those situations in which a mortgage is improperly executed or filed, or a UCC financing statement prepared and filed against the wrong party, or similar mistakes. Instead, the question is, does a lawyer have an obligation to ensure that a client entering into a legal transaction is aware of the alternatives to that structure and the relative risks in various forms of transactions. The clear trend has been to hold lawyers accountable for advising of such risks, culminating in a Circuit Court decision last year allowing a chapter 7 trustee to pursue a legal malpractice claim against a law firm that allegedly failed to protect an investor in a Ponzi scheme.

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[1] Special thanks to Judith Greenstone Miller, Jaffe Raitt Heuer & Weiss, P.C., Southfield, Michigan, for sharing her written materials on the *Peterson v. Katten Muchin Rosenman* decision, which materials are reproduced here, with permission, as the starting point for the discussion.

II. *The Seventh Circuit's Decision: Failure to Advise of Business Risks May Be Legal Malpractice*

Last year, the Seventh Circuit issued a decision which emphasized a lawyer's duty to advise a client about the *business* risks associated with the structure of a transaction that the lawyer was hired to complete:

> **New Ruling by Seventh Circuit Court of Appeals on the Scope of the Duty to Advise a Client Regarding Structure of Transaction and Risks Attendant Thereto:**[2]
>
> In *Peterson v. Katten Muchin Rosenman LLP*, 792 F.3d 789 (7th Cir. July 7, 2015), Judge Easterbook issued a decision in the continuing saga of the Petters case, in which he reversed the ruling of the District Court that had dismissed a complaint filed by the chapter 7 trustee against the law firm under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim on which relief may be granted. The chapter 7 trustee had sued the law firm for failing to fully and adequately advise its client about the potential structures associated with the proposed transaction and the risks associated therewith at two separate time periods and contended that these failures constituted legal malpractice. The chapter 7 trustee contended that the law firm had a duty to advise the client at two specific times – when the transaction was first proposed in 2003 and, second, in 2007 when Petters fell behind in payments to the lockbox and the client contacted the law firm for advice.
>
> The District Court had ruled that the Funds – the client of the law firm – knowingly took a risk and could not blame the law firm for failing to give business advice. In reversing the lower court ruling, Judge Easterbrook noted that the District Court had erred in three specific ways in making its ruling. First, instead of taking the complaint on its own terms, the District Court analyzed the complaint based, among other things, on various narratives of the law firm, alleged facts that were extrinsic to the complaint, which was not appropriate in the context of a Rule 12(b)(6) motion. Second, the District Court failed to engage the complaint's main contention – the duty that the law firm had to alert its client to the risk of allowing repayments to be routed through Petters and drafting and negotiating any additional contracts necessary to contain that risk. According to Judge Easterbrook:
>
> > "A competent transactions lawyer should have appreciated that the former arrangement offers much better security than that latter and alerted its client. If a client rejects that advice, the lawyer does not need to badger

[2] By Judith Greenstone Miller, Jaffe Raitt Heuer & Weiss, P.C., Southfield, Michigan.

> the client; but [here] the complaint alleges that the advice was not offered, leaving the client in the dark about the degree of the risk it was taking."[3]

The third problem identified by Judge Easterbrook with the District Court ruling was that the court did not identify any principle of Illinois law that sharply distinguished between business advice and legal advice. In addressing this issue, Judge Easterbrook stated:

> "It is hard to see how any such bright line could exist, since one function of a transactions lawyer is to counsel the client how different legal structures carry different levels of risk, and then to draft and negotiate contracts that protect the client's interest. A client can make a business decision about how much risk to take; the lawyer must accept and implement that decision… Knowing degrees of risk presented by different legal structures, a client *then* can make a business decision; but it takes a competent lawyer, who understands how the law of secured transactions works (and who knows what's normal in the world of commercial factoring that Petters claimed to practice), to ensure that the client knows which legal devices are available and how they affect risks."[4]

The Court did acknowledge, however, as part of its ruling that a lawyer is not a business consultant. "But within the scope of the engagement a lawyer must tell the client which different forms are available to carry out the client's business, and how (if at all) the risks of that business differ with the different legal forms."[5] The Court also recognized that the needs and sophistication of the client may impact the duty and the nature of the scope of the lawyer's duty, potential defenses that may be asserted by the law firm and whether any neglect on its part caused the injury. But, at least, at this point, the Court has cleared the way for the complaint to proceed. Note, even though this case arose in a business/commercial context, the lack of resources in the consumer area make it more likely that counsel may serve as both a legal and business advisor.

In some respects, this decision is surprising because of the Court's emphasis on the lawyer's duty to warn about *business risks*. However, when the underlying transaction is reviewed, this decision seems less surprising because of certain aspects about the transaction itself. Specifically, as described by the District Court,[6] the debtors were two hedge funds, Lancelot Investors Fund Ltd and Colossus Capital Fund, Ltd. (the "Funds"), founded by

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[3] *Peterson*, 792 F.3d at 791.
[4] *Id.* (emphasis in original).
[5] *Id.* at 792.
[6] Memorandum Opinion and Order 8/8/14, docket no. 29, case number 12-3393, N.D. Illinois.

investment advisor Gregory Bell. Another fund, Thousand Lakes, LLC ("Thousand Lakes"), was a special purpose vehicle formed by Thomas Petters ("Petters") to issue collateralized notes (the "Notes") to finance the purchase of inventory to be sold to a Costco subsidiary. The Funds were supposed to purchase the Notes issued by Thousand Lakes, and Thousand Lakes was supposed to use the proceeds to buy inventory consisting of consumer electronics, which would be sold to Costco. Another Petters entity, the Petters Company, Inc. ("PCI") pre-sold the inventory to Thousand Lakes and assigned the purchase orders to Thousand Lakes. The Notes were supposed to be collateralized by the inventory and accounts receivable from Costco, and guaranteed by Costco. The Court of Appeals also pointed out that the deal was supposed to use a lockbox: collateral for the Notes was supposed to include inventory and "Costco's undertaking to pay, and a 'lockbox' bank account into which Costco would deposit its payments for the Funds to draw on, eliminating any risk that Petters would put his hand into the till."[7] However, it turns out that the purchase orders and receivables were fakes: there were no such assets, and instead, the whole thing was a Ponzi scheme. The troubling part of the note purchase transaction, which was documented by the law firm, is that Petters would not allow Bell[8] or his professionals to verify the collateral by contacting Costco or the warehouses storing the goods.[9] In other words, the complaint alleged that[10] the deal was documented with no documentation directly from the party granting the security interest, which makes the transaction particularly risky and quite unusual in the realm of commercial transactions. In that sense, it is less

[7] *Peterson*, 792 F.3d at 790.
[8] At some point in time, Bell learned of the fraud and perpetrated it, ultimately pleading guilty and spending time in prison as a result. *See Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 744 (7th Cir. 2013).
[9] The District Court said that Petters persuaded Bell to do this by paying a very high interest rate. Memorandum Opinion, docket 29, case number 12-3393, page 2.
[10] It should be noted that the *Peterson* decision was based on a 12(b)(6) motion, and so the case was remanded for further proceedings to determine whether the trustee could prove his claims about the advice given, or not given. Peterson, 792 F.3d at 793. A review of the docket reflects that the matter is ongoing and no decision has been reached.

surprising that the Seventh Circuit said that this risk should have been clearly explained to the Funds.

Nor is the idea of a lawyer's duty to counsel a client about business risks entirely new; instead, the obligation to advise a client about risks in particular matters has been an integral part of ethics and professionalism for quite some time.

III. ***Applicable Ethical Rules***

The American Bar Association ("ABA") Model Rules of Professional Conduct (the "Model Rules") were adopted by the ABA House of Delegates in 1983, thereby replacing the Model Code of Professional Responsibility (the "Model Code") which had been adopted in 1969. While the earlier Model Code did not specifically address the kind of advice discussed in *Peterson*, the obligation of attorneys to assume various roles is acknowledged. Specifically, the Preamble to the Model Code recognized that "a lawyer necessarily assumes various roles that require the performance of many difficult tasks." Canon 6 required a lawyer to represent a client competently, and the ethical considerations emphasized that "a lawyer should use proper care to safeguard the interests of his client."[11] The Disciplinary Rules therefore stated that a lawyer shall not handle a matter without competence to do so.[12]

The modern Model Rules take the concept further. The preamble to the 1983 Model Rules provides in relevant part:

> As a representative of clients, a lawyer performs various functions. *As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications.* As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system. As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others. As an evaluator, a lawyer acts by examining a client's legal affairs and reporting about them to the client or to others.[13]

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[11] Ethical Consideration 6-4.
[12] Disciplinary Rule 6-101.
[13] Model Rules, *Preamble: A Lawyer's Responsibilities*, section 2 (emphasis supplied).

The advisory role, while not mentioning business risks *per se*, certainly suggests that such risks are within the lawyer's responsibilities by pointing out the obligations to advise a client about the "practical implications" of the legal rights. And, several of the Rules support this. The competency requirement in general is set forth in Rule 1.1 and the comments make it clear that competency includes assessment of the particular matter. Rule 2.1, the "Advisor" Rule, provides:

> In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

The comments reflect the recognition that a lawyer's advice often includes more than strictly legal considerations, and in a business setting, can even require the lawyer to recommend consultation with professionals in other fields.[14] The Comments also state that when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to the client, the lawyer's duty to the client under Rule 1.4[15] may require that the lawyer offer advice if the client's course of action is related to the representation."[16] Thus, the Model Rules already impose some obligation on lawyers to assess the circumstances and advise the client about possible adverse consequences, which sounds much like the issue that Judge Easterbrook had in *Peterson*. The ABI's Ethics Task Force recognized this, emphasizing that lawyers for business debtors should have "the judgment to aid a client to make decisions in his best interest..."[17]

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[14] *See* Comments 2, 3.
[15] Rule 1. 4 concerns Communication, and includes the requirement that a lawyer promptly inform the client of any circumstance in which the client's informed consent is required, and consult with the client about the means by which the client's objectives are to be accomplished.
[16] *See* Comment 4.
[17] *ABI Ethics Task Force Report, Competency for Debtor's Counsel, Business Practice*, page 73.

IV. ***Pre-Peterson Decisions***

There are cases which arose prior to *Peterson* in which lawyers were held to a standard that arguably required them to delve into more pure business considerations. Some examples:

- *Nomura Asset Capital Corporation v. Cadwalader, Wickersham & Taft*, 115 A.D.3d 228, 980 N.Y.S.2d 95 (1st. Dept. Appellate Division, 2014): Court found a question of fact as to whether there were sufficient "red flags" raised about the value of the collateral in a securitized loan transaction, which would require the law firm to make further inquiry into the appraisals provided.

- *Baker & McKenzie v. Evans*, 123 So.3d 387 (Miss. 2013): Court affirmed a jury verdict on liability (but remanding for proximate cause and damages) in a legal malpractice action based on conflict of interest and breach of fiduciary duty, where the law firm and one of its lawyers "interjected themselves into [Plaintiff's] businesses from 2001 through 2007" advising him to engage in various business dealings, in which the lawyer often represented both sides.

- *In re T. H.*, 529 B.R. 112 (Bankr. E.D.Va. 2015): Sanctioning lawyer for filing bankruptcy petition without, among other things, conducting any due diligence into client's personal and financial circumstances.

- *In re Miller Automotive Group, Inc.*, 521 B.R. 323 (Bankr. W.D. Mo. 2014): Chapter 11 debtor's attorneys' fees denied and retainer ordered disgorged, where among other things, attorney failed to advise the debtor about proof necessary to obtain the use of cash collateral and failed to review the debtor's projections to determine if they were feasible or accurate.

- *Rodin Properties—Shore Mall, N.V. v. Ullman*, 676 N.Y.S.2d 594, 253A.D.2d 403 (1998): Court affirmed denial of motions to dismiss, where allegation of malpractice was that law firm documented loan made based upon a fraudulently inflated appraisal and cash flow projection. Unfortunately, the opinion does not explain how the firm should have known about the fraudulent appraisal, or the basis on which it was obligated to conduct due diligence about it.

There are decisions refusing to require the lawyer to become too involved in the business transactions as well:

- *Abshire v. National Union Fire Insurance Company*, 636 So.2d 238 (La.Ct.App. 1994): Reflecting the close call, the original hearing produced three judges finding attorney malpractice and two dissenting, but on rehearing, three judges concluded there was no malpractice and dissented. The issue was whether the lawyer committed malpractice by failing to procure good collateral for the transaction, or whether the collateral deficiencies were the result of the client's

own negotiations and refusal to take counsel's advice. In siding with the lawyer, the Court on rehearnig found that the client should have instructed the lawyer to take the actions that they now claim he should have taken, without instruction to do so. In addition, the Court emphasized that "[m]uch of what the client now claims the lawyer should have done would have required research and investigation by experts in the field of finance and business."

- *Behrens v. Wedmore*, 2005 S.D. 79, 698 NW 2d 555 (2005): Court affirmed a jury verdict in the lawyer's favor, rejecting arguments that it was malpractice for the lawyer not to have better collateralized the transaction and advised them about the risks of the installment sale of the obligor filed bankruptcy. It was significant that the client had, without assistance of counsel, negotiated and signed a purchase agreement to sell their business. Counsel was retained after the fact to close the transaction, and given the signed agreement, counsel could not renegotiate payment and collateral terms. (this decision was cited in *Peterson*).

V. ***Post-Peterson Decisions***

Despite the import of an attorney's role as business advisor imposed by the Seventh Circuit in a high-profile case, research has not shown any decisions relying on the principles in that decision, yet. An article in Law306 suggests that similar assertions have been made in a recently filed complaint. On March 16, 2016, Law360 reported that former American Apparel, Inc. CEO Dov Charney filed a *pro se* complaint against Glaser Weil Fink Howard Avchen & Shapiro LLP, alleging that the firm did not properly advise him about the risks of signing a deal with hedge fund Standard General LP. *See "Charney Suit Says Glaser Weil Didn't Warn of Contract Risk,"* Kat Greene, 3/16/16. According to the article, Charney claims that he was not advised that there was no indemnity provision in the contract, leading him to sign a contract that ordinarily he would not have signed or that he would have negotiated differently. *Id.* The present status of this case is not known, but it certainly seems that the claims were intended to align with the principles announced in *Peterson*. It should be anticipated that cases like *Peterson* are going to proliferate and so lawyers would be well-advised to take note and ensure that their advice to clients includes a review of the relative business risks associated with transactions.

VI. Conclusion and Practical Implications

While the obligation of lawyers to advise clients about business risks in transactions as set forth in the Seventh Circuit's decision in *Peterson* is not entirely new, the decision is important:

> [It] serves a dual purpose in providing both guidance and a warning to law firms that provide transactional advice. While the court recognized the challenges posed by creating a bright-line test between legal and business advice, its holding makes it clear that a client ultimately decides whether it will follow a lawyer's advice regarding potential risk and the means by which a client can protect itself. However, legal professionals run the risk of opening themselves up to a legal malpractice claim if they fail to offer any advice regarding such risks and possible safety measures.[18]

The practical implications of this guidance seem fairly clear: if a client seeks legal advice about a particular transaction (a loan structured a certain way, filing a chapter 11, etc.), the lawyer should engage in a reasonable inquiry of the facts surrounding the proposed transaction and inquire into the client's goals. If the structure or result suggested by the client poses greater risks to the client than using a different structure or taking a different avenue, the client should be advised of those risks in writing. If the client proceeds anyway, then the client will have made an informed decision as contemplated by the Model Rules, and the lawyer should have satisfied her or his obligations.

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[18] *Potential Malpractice Claims Tied to Petters Ponzi Scheme Revived*, Patrick R. Mohan, 34 DEC Am. Bankr. Inst. J. 24 (Dec. 2015).

3. The Duty of Competence and Other Ethical Issues

The Duty of Competence and Other Ethical Issues

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I. Relevant Rules of Professional Responsibility

- **Michigan Rule 1.1: *Competence*:**

  A lawyer shall provide competent representation to a client. A lawyer shall not:

  (a) handle a legal matter which the lawyer knows or should know that the lawyer is not competent to handle, without associating with a lawyer who is competent to handle it;

  (b) handle a legal matter without preparation adequate in the circumstances; or

  (c) neglect a legal matter entrusted to the lawyer.

- Comment:

  LEGAL KNOWLEDGE AND SKILL

  In determining whether a lawyer is able to provide competent representation in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter, and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

  A lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. A newly admitted lawyer can be as competent as a practitioner with long experience. Some important legal skills, such as the analysis of precedent, the evaluation of evidence and legal drafting, are required in all legal problems. Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge. A lawyer can provide adequate representation in a wholly novel field through necessary study.

Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

In an emergency, a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation or association with another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances, for ill-considered action under emergency conditions can jeopardize the client's interest.

A lawyer may offer representation where the requisite level of competence can be achieved by reasonable preparation. This applies as well to a lawyer who is appointed as counsel for an unrepresented person. See also Rule 6.2.

THOROUGHNESS AND PREPARATION

Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners. It also includes adequate preparation. The required attention and preparation are determined in part by what is at stake; major litigation and complex transactions ordinarily require more elaborate treatment than matters of lesser consequence.

MAINTAINING COMPETENCE

To maintain the requisite knowledge and skill, a lawyer should engage in continuing study and education. If a system of peer review has been established, the lawyer should consider making use of it in appropriate circumstances.

- **Michigan Rule 1.6: *Confidentiality of Information*:**

(a) "Confidence" refers to information protected by the client-lawyer privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

(b) Except when permitted under paragraph (c), a lawyer shall not knowingly:

(1) reveal a confidence or secret of a client;

(2) use a confidence or secret of a client to the disadvantage of the client; or

(3) use a confidence or secret of a client for the advantage of the lawyer or of a third person, unless the client consents after full disclosure.

. . .

(d) A lawyer shall exercise reasonable care to prevent employees, associates, and others whose services are utilized by the lawyer from disclosing or using confidences or secrets of a client, except that a lawyer may reveal the information allowed by paragraph (c) through an employee.

- Unlike the ABA Model Rules, Michigan Rule 1.6 does not deal with inadvertent disclosure.

- **Michigan Rule: 3.3:** ***Candor Toward the Tribunal*****:**

(a) A lawyer shall not knowingly:

(1) make a false statement of material fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; . . .

- Michigan Rule 3.3 is the same as the ABA Model Rule. However, unlike the Model Rule Annotation, there is no statement that "[m]isrepresenting the status of discovery or the availability of information sought in discovery violates Rule 3.3.(a)(1)."

- **Michigan Rule 3.4:** ***Fairness to Opposing Party and Counsel*****:**

A lawyer shall not:

(a) unlawfully obstruct another party's access to evidence; unlawfully alter, destroy, or conceal a document or other material having potential evidentiary value; or counsel or assist another person to do any such act;

. . .

(d) in pretrial procedure, make a frivolous discovery request or fail to make reasonably diligent efforts to comply with a legally proper discovery request by an opposing party;

Comment: The procedure of the adversary system contemplates that the evidence in a case is to be marshaled competitively by the contending parties. Fair competition in the adversary system is secured by prohibitions against destruction or concealment of evidence, improper influence of witnesses, obstructive tactics in discovery procedure, and the like.

Documents and other items of evidence are often essential to establish a claim or defense. Subject to evidentiary privileges, the right of an opposing party, including the government, to obtain evidence through discovery or subpoena is an

> important procedural right. The exercise of that right can be frustrated if relevant material is altered, concealed or destroyed. Other law makes it an offense to destroy material for purpose of impairing its availability in a pending proceeding or one whose commencement can be foreseen. Falsifying evidence is also generally a criminal offense. Paragraph (a) applies to evidentiary material generally, including computerized information. . . .

- Michigan Rule 3.4 is substantially the same as the ABA Model Rule

- **Michigan Rule 4.4: *Respect for Rights of Third Persons*:**

> In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person.
>
> Comment: Responsibility to a client requires a lawyer to subordinate the interests of others to those of the client, but that responsibility does not imply that a lawyer may disregard the rights of third persons. It is impractical to catalogue all such rights, but they include legal restrictions on methods of obtaining evidence from third persons.

- Michigan Rule 4.4 does not include ABA Model Rule 4.4(b) regarding the receipt of inadvertently sent information. The Michigan Rules do not explicitly consider the inadvertent sending or receipt of confidential information.

- **Michigan Rule 5.3: *Responsibilities Regarding Nonlawyer Assistants*:**

> With respect to a nonlawyer employed by, retained by, or associated with a lawyer:
>
> (a) a partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer;
>
> (b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and
>
> (c) a lawyer shall be responsible for conduct of such a person that would be a violation of the rules of professional conduct if engaged in by a lawyer if:
>
> > (1) the lawyer orders or, with knowledge of the relevant facts and the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner in the law firm in which the person is employed or has direct supervisory authority over the person and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Comment: Lawyers generally employ assistants in their practice, including secretaries, investigators, law student interns, and paraprofessionals. Such assistants, whether employees or independent contractors, act for the lawyer in rendition of the lawyer's professional services. A lawyer should give such assistants appropriate instruction and supervision concerning the ethical aspects of their employment, particularly regarding the obligation not to disclose information relating to representation of the client, and should be responsible for their work product. The measures employed in supervising nonlawyers should take account of the fact that they do not have legal training and are not subject to professional discipline.

. . .

- Michigan Rule 5.3 is substantially the same as the ABA Model Rule. However, the Michigan comment is not nearly as descriptive as the ABA comments.

II. Ethical Issues Concerning Discovery and ESI:

- **Discovery is a matter of competence. *See, Best Practices Report on Electronic Discovery (ESI) Issues in Bankruptcy Cases*, The Business Lawyer, August 2013, Volume 687, Issue 4, attached as Appendix A.**

- **California Ethics Opinion on duty and responsibility of counsel to deal with ESI, Formal Opinion No. 2015-193 (June 2015), attached as Appendix B:**

The Model Rules of Professional Conduct require, among other things, a duty of competence. *See* Model Rule 1.1. This rule requires an attorney to assess at the outset of each engagement what electronic discovery issues, if any, might arise, including the likelihood that e-discovery will or should be sought by either side. If it is likely that e-discovery will be sought, the duty of competence requires an attorney to assess his or her own e-discovery skills and resources as part of the attorney's duty to provide the client with competent representation.

In addressing potential e-discovery issues, and in recognition of the increasing use of electronic communications, counsel is strongly encouraged to consider and to address the following:

1. Initially assess e-discovery needs and issues, if any;

2. Implement appropriate ESI preservation procedures, including the obligation to advise a client of the legal requirement to take actions to preserve evidence, like electronic information, potentially relevant to the issues raised in the litigation (*i.e.*, the imposition of a "litigation hold") ;

3. Analyze and understand a client's ESI systems and storage;

4. Identify custodians of relevant ESI;

5. Perform appropriate searches;

6. Collect responsive ESI in a manner that preserves the integrity of the ESI;

7. Advise the client about available options for collection and preservation of ESI;

8. Engage in competent and meaningful "meet and confer" with opposing counsel concerning an e-discovery plan; and

9. Produce responsive ESI in a recognized and appropriate manner.

See e.g., Pension Committee of Montreal Pension Plan v. Banc of America Securities, LLC, 685 F.Supp.2d 456, 462-465.

If an attorney lacks the skills and/or resources to address ESI, the attorney should take sufficient steps to acquire sufficient learning and skill, or associate or consult with someone with appropriate expertise to assist or advise the client to retain an IT expert to assist with the technical issues. Failure to do so may result in a finding that the attorney has breached his duty of competence to the client, as well as the issuance of potential sanctions for spoliation.

In this case, the attorney failed to:

(i) Make an assessment of the case's e-discovery need or of his own capability;

(ii) Did not consult with an e-discovery expert prior to agreeing to an ediscovery plan at the initial case management conference;

(iii) Allowed a discovery proposal to become a court order with no expert consultation and, under circumstances, where he lacked sufficient expertise;

(iv) Participated in preparing joint ediscovery search terms, without experience or expert consultation, and did not recognize the danger of overbreath in the agreed upon search terms;

(v) Stipulated to a court order directing a search of the client's network by the other side, without having first understood what was on the system;

(vi) Did not instruct nor supervise the client before allowing the other side's vendor to have direct access to the client's network;

(vii) Did not try to pre-test the agreed upon search terms or otherwise review the data before the network search, and instead relied on his assumption that the client's IT department would know what to do and on the parties' claw-back agreement protecting inadvertently released privileged information;

(viii) Took no action to review the gathered data until opposing counsel asserted spoliation and threatened sanctions;

(ix) Then unsuccessfully attempted to review the search results; and

(x) Damage was done as sensitive, proprietary and privileged material released and not due to inadvertence (*i.e.*, in the context of reasonable steps having been taken to prevent disclosure in the first instance), but rather based on no guidance or instructions having been provided or any evaluation having been conducted.

The "claw-back" provision in the joint discovery agreement did not protect the attorney in this case because the disclosure of the sensitive, confidential information was not due to "inadvertent disclosure" because counsel has taken no action to protect the disclosure of such information.

The lesson of this case is: be competent and stay abreast of changing technology.

NOTE: There are a number of jurisdictions throughout the country that have formulated new local rules, model rules and guidelines governing the handling of treatment of ESI. *See e.g.*, Model Rule (U.S. District Court, E.D. Mich.), Local Bankruptcy Rule (E.D.M.) 7026-4, Local Bankruptcy Rule 7026-3 (D. Delaware), Guidelines for the Discovery of Electronically Stored Information for the United States District Court for the Northern District of California and the Seventh Circuit Electronic Discovery Pilot Program and adoption of Principles Relating to the Discovery of Electronically Stored Information . It is clear from a review of these rules and guidelines that whether an attorney retains an outside consultant to assist with ESI discovery, counsel still is ultimately responsible for what is done as part of his complying with his/her duty of competence.

- **Amended Federal Rule of Civil Procedure 37(e):**

  - The amendments are specific to ESI and deal with the sanctions for spoliation of ESI.

  - The Rule is divided into two subsections – (e)(1) and (e)(2) – and whether the loss of ESI is inadvertent or intentional will govern which subsection you fall under.

  - The amendments expressly eliminate the "absent exceptional circumstances" language from the rule as it resulted in differing standards being applied amongst the circuits (negligence and, gross negligence versus intentional conduct) as related to loss of ESI.

  - Now the rule authorizes and sets forth specific measures that a court may employ if information that should have been preserved is lost and specifies the finding necessary by the court to justify the imposition of the measures. The changes in the rules do not affect the validity of the independent tort claim for spoliation.

  - Rule 37(e)(1) applies only to ESI that was lost due to a party's failure to take reasonable steps to preserve it in anticipation or conduct of litigation.

  - The amendment does not create a new duty to preserve separate and distinct from the common law duty to preserve. In applying the rule, the court need not decide whether and when the duty to preserve arose.

  - Rule 37(e)(1) provides that:

    - if ESI is lost that should have been preserved,

    - the party failed to take reasonable steps to preserve it, and

    - it cannot be restored or replaced by additional discovery,

  - Then upon a finding of prejudice to the other party from the loss of information, the court may resort to certain measures delineated therein but no greater than necessary to cure the prejudice.

  - The burden of proving or disproving prejudice is not placed on any party based on the difficulty and unfair task of making the party who did not lose it to prove prejudice, but rather, is left to the discretion of the court to assess.

  - Perfection is not required under the rules – rather, the rules only require that "reasonable steps" be taken to preserve ESI.

  - The initial focus should be on:

- can the lost information be restored or replaced through other discovery, and

- how important is the lost information to a claim or defense in the litigation.

- Considerations by the court in ruling on motions brought under Rule 37(e)(1) include:

  (i) is the lost information relevant,

  (ii) is the lost information within the scope of what is discoverable,

  (iii) is the lost information subject to preservation from another source (*i.e.*, statutes, regulations and orders),

  (iv) the "good faith" operation of the ESI system and the party's familiarity therewith,

  (v) the party's sophistication,

  (vi) whether the loss was outside the party's control (*i.e.*, cloud failure, computer room flood, software attack), and

  (vii) proportionality, including a party's resources.

- Upon a finding under Rule 37(e)(1), the court can employ the following measures:

  (i) forbid the party that failed to preserve the information from putting on certain evidence,

  (ii) permit the party who is prejudiced from presenting evidence and argument to the jury regarding loss of the information, and/or

  (iii) giving jury instructions to assist in the evaluation of such evidence or argument.

- Rule 37(e)(2) only applies and authorizes the court to use specified severe measures or defer failures to preserve ESI on a finding that the party that lost the information acted with intent to deprive another party of the use of the information in the litigation.

- A finding of negligence or gross negligence is not sufficient to impose sanctions under this rule and, thus, the amendment now creates a new consistent federal standard for employing such severe measures.

- Moreover, once a finding of intentional conduct is determined, the rule does not require the court to make any further finding of prejudice.

- The measures that a court can employ under Rule 37(e)(2) include:

  (i) presume that the lost information was unfavorable to the party that lost it,

  (ii) a jury instruction that permits or requires the jury to presume or infer that the lost information was unfavorable to the party that lost it (*i.e.*, an "adverse inference ruling"), and

  (iii) dismiss the action or enter a default judgment.

- The Comments indicate, however, that court must exercise caution in using these measures to ensure that they only redress the loss at issue in the case.

- **Failure to meet and confer over discovery disputes in which sanctions awarded against attorney and client:**

  In *New Products Corporation. v. Tibble (In re Modern Plastics Corporation)*, 2015 WL 4498023 (Bankr. W.D. Mich. July 23, 2015), Judge Dales issued sanctions against plaintiff's counsel and plaintiff in an amount approximating $165,000.00 under Rules 37(a)(5) and 45(d)(2) of the Federal Rules of Civil Procedure (applicable in adversary proceedings) for failing to "meet and confer over discovery" issued by plaintiff after party subject to discovery asserted objections to the discovery as being overbroad. Counsel asked plaintiff's counsel to "meet and confer" to attempt to resolve the objections and limit the burdens imposed by the discovery. Plaintiff's counsel failed and refused to meet and, instead, issued additional discovery through subpoenas to third parties that involved, among other things, ESI and the retention of a third party ESI vendor to assess and assist in responding to the subject discovery.
  In describing the burdens associated with this discovery dispute, the Court indicated:

  > "Nevertheless, heedless of these obvious burdens, Mr. Demorest issued subpoenas, as an officer of the court, that required a global banking giant and a national law firm -- neither a party to the litigation – to produce documents involving their clients in thirty-six categories, covering a decade, within a fortnight – spanning the Labor Day holiday."

  The Court further stated:

> "Moreover, the court perceived not even a whiff of justification for the conduct of New Products or its counsel, in terms of avoiding undue burden resulting from the subpoenas, let alone a "substantial" justification, during the two hearings the court held in connection with the discovery dispute."

A motion for reconsideration and a stay was filed and denied on August 26, 2015. The decision is now on appeal.

The lesson of this case is: be reasonable and responsive, play nice and remember that the court may review your conduct.

- **Other Recent Sanctions Cases:**

  - *Cat 3, LLC v. Black Lineage, Inc.*, 2016 U.S. Dist. LEXIS 3618 (S.D.N.Y. 2016): Court issued sanctions under Rule 37(e)(2) for a party's intentional alteration and spoliation of an electronic document. In making this ruling, the Court noted that all of the threshold requirements of the rule were met: (i) the emails were electronically stored information, (ii) the party was obligated to preserve the ESI in connection with the litigation, (iii) the ESI was lost and could not be adequately restored or replaced, and (iv) the party's manipulation of the email addresses was not consistent with taking reasonable steps to preserver the evidence. The Court also noted that even if the requisites for imposing sanctions under new Rule 37(e)(2) had not be met, the Court, nevertheless, under the rubric of inherent powers could impose sanctions for spoliation to "redress conduct which abuses the judicial process" in order to preserve the integrity of the judicial process and to retain confidence that the process works to uncover the truth. Finally, the Court discussed the burden of proof and applicable standard for imposing sanctions for spoliation – preponderance of the evidence versus clear and convincing. Which standard is ultimately utilized, according to the Court, will depend, in large part, on the specific issue to be decided and the nature of the sanction requested – when a case-terminating or otherwise punitive in nature sanction is sought, a higher standard is merited.

  - *Nuvasive, Inc. v. Madsen Med., Inc.*, 2016 U.S. Dist. LEXIS 8997 (S.D. Cal. 2016): Court issued sanctions (*i.e.*, an adverse instruction to the jury) in connection with a failure to preserve and produce documents. As part of this ruling, the court did not find that the party had intentionally failed to preserve the subject documents. Thereafter, amended Rule 37(e) became effective on December 1, 2015. The party subject to the sanctions filed a motion for reconsideration under Rule 60(b) arguing, among other things, that the sanction issued was not appropriate under the amended rule. Trial of the matter had not

yet occurred. The Court granted the motion, thereby modifying the sanction to allow the parties to present evidence to the jury regarding the loss of the ESI and an instruction to the jury that the jury may consider such evidence along with all other evidence in the case in making its decision, consistent with the discretion provided to the Court under Rule 37(e)(1).

- *Leach Farms, Inc. v. Ryder Integrated Logistics, Inc.*, 2015 WL 348238 (E.D. Wis. 2015): Court refused to issue sanctions for counsel's refusal to agree to specific search terms for searching of database, particularly when multiple searches were necessitated to limit the scope and expanse of documents responsive to the discovery request.

- *Brown v. Tellermate Holdings Ltd.*, 2014 WL 2987051 (S.D. Ohio 2014): Court precluded defendant from using certain evidence and imposed sanctions against defendant and counsel, jointly, for failing to preserve and produce ESI and reiterated counsel's duty to cooperate in the discovery process, which includes know what information exists, how it is maintained, whether and how it can be retrieved and to exercise sufficient diligence to insure that all representations to the opposing parties and the Court are truthful based on a reasonable investigation of the facts.

- *Abadia-Peixoto v, US. Dept. of Homeland Sec.*, 2013 WL 4511925 (N.D. Cal. 2013): Court made clear that counsel has responsibility to ensure that client conduct a comprehensive and appropriate document search; counsel needs to be able to articulate how the search of ESI was conducted and the adequacy of the search done.

- *Qualcomm Inc. v. Broadcom Corp.*, 2008 WL 66932 (S.D. Cal. 2008): Magistrate judge referred six attorneys to the State Bar of California for investigation and possible imposition of sanctions in connection with (i) assisting their client to intentionally hide and recklessly ignore relevant documents, (ii) ignoring and rejecting numerous warning signs that the client's search was inadequate, and (iii) blindly accepting the client's unsupported assurance that the document search was adequate. Some of the problems encountered, according to the Court, were due to the lack of "meaningful communication" between the employees, in-house counsel, outside counsel and those responsible for document collection and production. Ultimately, the Court made clear that the attorney signing the discovery responses was not only responsible for the accuracy and propriety of them, but also for taking appropriate steps to learn the truth.

- *State v. Ratliff*, 849 N.W.2d 183 (N.D. 2014): Court reiterated that an attorney must understand the contours of ESI and, in particular, metadata; it is part of an attorney's ethical duties of competence and to maintain client confidences.

- *U.S. v. Hernandez*, 2014 WL 4510266 (S.D.N.Y. 2014): Court refused to appoint a Coordinating Discovery Attorney on behalf of 9 defendants in a criminal case because of ethical and legal issues that would be implicated and further noted that counsel of record is ultimately responsive for providing effective legal representation, including in the discovery process, to its client.

- *F.D.I.C. v. Horn*, 2015 WL 1529824 (E.D.N.Y. 2015): In the context of a malpractice case, the Court noted the importance of an attorney having policies and procedures for ensuring the preservation of ESI and such policy or lack thereof factoring into the Court's issuance of monetary sanctions. The Court also distinguished between those emails that one would reasonably expect to be preserved (*i.e.*, those to effectively represent a client versus a "casual email").

- *A PDX Pro Co. v. Dish Network Services, LLC*, 2015 WL 7717199 (D. Colo. 2015): Court stated that certification requirements under Federal Rule of Civil Procedure 26 implicate a counsel's duty of candor to the Court under the applicable ethical rules and further stated that: "As officers of the court, all attorneys conducting discovery owe the court a heightened duty of candor."

III. Metadata and Social Media:

- **Handling of metadata:**

(i) Generally:

- Metadata is "data about data" – *i.e.*, information describing the history, tracking, or management of an electronic document

- Poses 3 ethical issues:

  - Does sending attorney have a duty to delete or "scrub" metadata before producing it to an adverse party?

  - May the receiving attorney review or "mine" metadata?

  - Does the receiving attorney have a duty to notify the sender if metadata is found?

- ABA Formal Opinions 06-442 and 05-437 provide:

  -Do not impose an explicit duty with respect to metadata on the attorney sending the ESI, even though certain methods of eliminating metadata are suggested for attorneys concerned about producing it to opposing counsel

  -Mining data is not ethically permissible under MRP 4.4(b) and requires the recipient to notify the sender if metadata found and recipient knows or reasonably should know that transmission of metadata was inadvertent

MRP 4.4(b) provides:

"A lawyer who receives a document or electronically stored information relating to the representation of the lawyer's client and knows or reasonably should know that the document or electronically stored information was inadvertently sent shall promptly notify the sender."

- The Comments to MRP 4.4(b) also provide:

  [2]. . . "Whether the lawyer is required to take additional steps, such as returning the document or deleting electronically stored information, is a matter of law beyond the scope of these Rules, as is the question of whether the privileged status of a document or electronically stored information has been waived. Similarly, this Rule does not address the legal duties of a lawyer who receives a document or electronically stored information that the lawyer knows or reasonably should know may have been inappropriately obtained by the sending person. . . . Metadata in electronic documents creates an obligation under this Rule only if the receiving lawyer knows or reasonably should know that the metadata was inadvertently sent to the receiving attorney.

  [3] Some lawyers may choose to return a document or delete electronically stored information unread, for example, when the lawyer learns before receiving it that it was inadvertently sent. Where a lawyer is not required by applicable law to do so, the decision to voluntarily return such a document or delete electronically stored information is a matter of professional judgment ordinarily reserved to the lawyer. See. Rules 1.2 and 1.4.

- State Bar Ethical Opinions are not consistent

  -Most impose a duty to exercise "reasonable care" to prevent disclosure of metadata

  -Some provide that mining metadata is not an ethical violation

  -Most impose an obligation to notify the sender if metadata is found

(ii) In Michigan:

- There is no Michigan opinion governing how metadata must be dealt with and the Michigan Rules of Professional Responsibility do not currently address metadata.

- Scrubbing of documents before sent out electronically to remove all information in the metadata that could potentially reveal privileged materials.

- Of course, sometimes it is acceptable to allow such materials to go out, as when the documents going to a client and the client wants to see the changes; however, care must be taken and client must be advised not to circulate to others who may not have the protection of the attorney client privilege.

- **Social Media:**

  - Recent bar developments in Florida and New York

  - Professional Ethics of the Florida Bar Opinion 14-1 (June 25, 2015):

    - Provides that "social media information or date must be preserved if the information or data is known. . . or reasonably should be known. . . to be relevant to the reasonably foreseeable proceeding"

    - Cannot advise client to "clean-up" or remove information from social media pre-litigation if such removal would violate any substantive law regarding preservation and/or spoliation of evidence

    - General obligation of competence may also require attorney to advise client regarding removal of relevant information from client's social media pages, including whether removal would violate any legal duties regarding preservations of evidence, regardless of privacy settings

  - New York State Bar Association (Commercial and Federal Litigation Section) released updated Social Media Guidelines on June 9, 2015:

    - Ethical duty of competence requires lawyer to understand benefits, risks and ethical implications associated with social media (including the functionality of any social media served intended to be used)

    - Lawyer must advise client regarding the preservation of social media

IV. Other Ethical Issues:

- **Standard for Evaluating Fee Applications:** Two recent rulings by Texas bankruptcy courts in *In re Digerati Technologies, Inc.*, 2015 WL 5053555 (Bankr. S.D. Tex. August 21, 2015) and *Barron & Newburger PC v. Texas Skyline (In re Woerner)*, 783 F.3d 266

(5th Cir. 2015), in which the court rejected the 17-year-old, highly criticized holding of *Matter of Pro-Snax Distributors, Inc.*, 157 F.3d 414 (5th Cir. 1998), in terms of the approach that the courts should utilize in evaluating fee applications. Prior to this ruling, the Fifth Circuit had reviewed fees incurred by a professional retrospectively based on the actual benefits received from the services provided, as opposed to the reasonableness of the fees at the time that the fees were incurred. The law is the Fifth Circuit Court of Appeals in now a prospective approach, as opposed to the "identifiable, tangible, material benefit" retrospective standard, based on the plain language if Section 330 of the Bankruptcy Code. While these decisions were decided in the context of chapter 11 cases, the rulings of the court are equally applicable in chapter 13 cases.

In *In re Digerati Technologies, Inc.*, 2015 WL 5053555 (Bankr. S.D. Tex. August 21, 2015), in a case involving a 100% dividend to unsecured creditors, the bankruptcy court reduced counsel's fees by 26% based on such fees neither being necessary to the case administration nor reasonably likely to benefit the estate at the time that they were performed. The deductions made by the court related to unsuccessful motions seeking post-petition financing in which the court characterized applicant's courtroom performance at the hearing as being "woeful," or stated differently, "the attempt to obtain financing was not a good gamble given the poor preparation and paucity of relevant and convincing testimony that applicant adduced at the hearing." The court also reduced applicant's time associated with an emergency motion to extend deadline to provide proof of filing of its 2012 tax return as being unnecessary to the case administration and not likely to benefit the estate at the time the services were performed. The court specifically found that the applicant "did not do a good job" at the hearing to adduce testimony to establish cause existed to extend the deadline and, thus, it was not a "good gamble." The court also reduced time associated with attempting to confirm an unconfirmable plan that proposed the appointment of officers and directors of the reorganized debtor at "exorbitant compensation packages" (not even understood by the principals) as not being consistent with public policy. Finally, the court reduced fees of applicant based on its failure to disclose its prior attorney-client relationship with an investment bank and "counsel's 'slavish' regard for the interests of the officers of the debtor, as opposed to the debtor entity. This case also raises the question of who is the client and to whom do you owe your fiduciary duty, an issue addressed in the Final Report of the National Ethics Task Force.

In *Barron & Newburger PC v. Texas Skyline (In re Woerner)*, 783 F.3d 266 (5th Cir. 2015), the court disallowed certain fees based on the lack of likelihood of success of the legal strategy at the time the fees were incurred. In making this ruling, the court stated that Sections 327 through 330 of the Bankruptcy Code "explicitly contemplate[ ] compensation for attorneys where services were

> reasonable when rendered . . . but ultimately fail to produce an actual, material benefit." Moreover, the court found this interpretation to be consistent with the legislative history surrounding the adoption of the Bankruptcy Code. The court indicated that Congress had considered and rejected an "actual benefit" test at the time that the Code was enacted. Various fees had been incurred on discovery in connection with a motion to convert that was filed in the case. Because the court found that "there was not a reasonable likelihood of success in reaching confirmation or avoiding conversion to chapter 7 at the time that the services were rendered" based, among other things, lack of creditor support for a chapter 11 plan, the fees sought by applicant for such services were denied. The court also denied fees sought by applicant in connection with amending the schedules and statement of financial affairs associated with applicant's verification that all of debtor's assets had been accounted for, finding that "[n]either the creditors or the estate should have to bear the additional expense [attributable to Debtor's conduct]."
>
> *See also*, Hage, Paul R., *Benchnotes*, American Bankruptcy Institute Journal, Vol. XXXIV, No. 8, pg. 6 (August 2015).

These new decisions appear to represent a positive change in the Fifth Circuit as they bring the state of the law as relates to the standard governing review of fee applications of professionals in line with all the other circuits. The reversal of the *Pro-Snax* decision – which applied a retrospective, as opposed to a prospective, analysis – will result in less "second-guessing" of actions undertaken by counsel in a case that does not necessarily yield the anticipated and hoped-for results when counsel made the decision to proceed. Nevertheless, counsel must carefully assess and determine at the time that action is taken whether it is reasonable based on its belief then that the action can potentially confer a benefit on the estate.

Even if the client is insisting that counsel pursue a certain course of action and under circumstances where there is no issue of "informed consent," it does not excuse counsel's duty to determine whether the taking such action at that time is reasonable and likely to result in a benefit being obtained. *See also*, Rapoport, Nancy B., *"The Client Who Did Too Much,"* 47 Akron L.R. 121 (2014).

APPENDICES

Appendix 1: Complaint

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

IN RE: IH 1, et al.	:	**Case Number 09-10982 (PJW)**
George L. Miller, Chapter 7 Trustee,	:	**Adversary Case Number:**
Plaintiff,	:	
v.	:	
Kirkland & Ellis LLP **300 North LaSalle** **Chicago, IL 60654**	:	**JURY TRIAL DEMANDED**
Defendant.	:	

COMPLAINT

George L. Miller, in his capacity as the duly appointed Chapter 7 Trustee of IH 1, Inc., IH 2, Inc., IH 3, Inc., IH 4, Inc., and IH 5, Inc., by and through his undersigned counsel, brings this Complaint and alleges as follows:

INTRODUCTION

1. On February 2, 2006, Indalex Holding Corp. acquired all of the outstanding stock of Indalex Inc. and Indalex Limited from Honeywell in a highly leveraged buy-out (the "Acquisition" or "LBO").

2. As a result of the Acquisition, the consolidated operations of Indalex Inc. and Indalex Limited suddenly had an asset to debt ratio of slightly over 1 to 1 and the operations of Indalex Inc. and Indalex Limited became instantly financially precarious.

3. The Acquisition was followed by, among other things, an exorbitant dividend paid by Indalex Inc. on June 1, 2007 to, among others, two investment funds owned and

controlled by Sun Capital Partners, Inc. and/or its related entities (collectively hereinafter referred to as "Sun").

4. This dividend, which was not for reasonably equivalent value, caused Indalex Holdings Corp., its parent Indalex Holdings Finance, Inc. and its subsidiaries including, but not limited to, Indalex Inc. to be insolvent, insufficiently capitalized and/or unable to meet their debts when due.

5. As a result, on March 20, 2009 (the "Petition Date"), Indalex Holdings Finance, Inc., Indalex Holding Corp. and Indalex Inc., among others, filed for protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. (the "Court").[1]

JURISDICTION AND VENUE

6. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§157(c) and 1334.

7. Venue is proper in this Court pursuant to 28 U.S.C. §1409.

THE PARTIES

The Plaintiff

8. By Motion dated September 21, 2009, the Official Committee of Unsecured Creditors sought an Order converting the IH 1- IH 5 Chapter 11 cases to cases under Chapter 7.

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[1] On July 20, 2009, the Bankruptcy Court for the District of Delaware entered an Order approving the sale of substantially all of the assets of the Debtors to Sapa Holdings AB and its affiliates ("SAPA"). As part of the sale to SAPA, Debtors were to undertake to change their then existing names. On or about September 1, 2009, the following name changes became effective:

Indalex Holdings Finance, Inc. changed its name to IH 1, Inc.;
Indalex Holding Corp. changed its name to IH 3, Inc.; and
Indalex Inc. changed its name to IH 2, Inc.;
Caradon Lebanon, Inc. changed its name to IH 4, Inc.; and
Dolton Aluminum Company, Inc changed its name to IH 5, Inc..

By Order dated September 28, 2009 the Bankruptcy Court for the District of Delaware granted the request to change the caption of Debtors' cases to reflect the name changes.

9. Following a hearing, on October 15, 2009 the Court entered an Order converting the Chapter 11 cases to cases under Chapter 7.

10. By Notice dated October 30, 2009, George L. Miller ("Miller") was advised that he had been appointed as Interim Trustee/Trustee for IH 1, IH 2, IH 3, IH 4 and IH 5 (1H 1, 1H 2, IH 3, IH 4 and 1H 5 will, from time to time, be collectively called "Indalex").

11. The Plaintiff is the Chapter 7 Trustee of Indalex.

The Defendant

12. On information and belief, Kirkland & Ellis LLP is an Illinois limited liability partnership. On information and belief, Kirkland & Ellis is affiliated with Kirkland & Ellis International LLP, which is a Delaware limited liability partnership. Kirkland & Ellis LLP and Kirkland & Ellis International LLP will hereinafter collectively be referred to as "K&E."

13. K&E advertises itself as a firm providing service to clients around the world in, among other areas, corporate matters.

14. K&E lawyers regularly appear in the courts in Delaware including in the instant bankruptcy matter and, more particularly, in *Miller v. Sun Capital Partners, Inc. et al.,* Adversary No. 10-52279.

15. K&E lawyers regularly advise clients with respect to Delaware corporate law and Delaware fraudulent conveyance law including, but not limited to, Indalex.

16. A K&E paralegal was the sole incorporator of Indalex Holding Corp. in Delaware on September 12, 2005.

17. The same K&E paralegal was the sole incorporator of Indalex Holdings Finance, Inc. in Delaware on September 15, 2005.

18. At all times relevant hereto, K&E acted as outside general counsel to Indalex. Between August 2005 and March 2009, K&E charged Indalex more than $5 million for these services.

BACKGROUND

19. Indalex was a producer of soft alloy aluminum extrusion products in the United States and Canada.

20. At all times relevant hereto, Indalex's two largest markets were transportation (non-auto) and residential building and construction. These markets, combined, represented approximately 60% of Indalex's annual shipment volume.

21. On February 2, 2006, Indalex Inc.[2] and Indalex Limited were purchased by Indalex Holding Corp. in the LBO for approximately $425 million in cash, plus $23 million in transaction costs.

22. Indalex Holding Corp. is a wholly-owned direct subsidiary of Indalex Holdings Finance, Inc.

23. As of February 2, 2006, more than 90% of the stock of Indalex Holdings Finance, Inc. stock was owned by Sun Indalex, LLC.

24. On and after February 2, 2006, the stock of Sun Indalex, LLC was owned by three Sun controlled investment funds—Sun Capital Partners III, QP, LP, Sun Capital Partners III, LP and Sun Capital Partners IV, LP.[3]

25. As a result of the LBO, on and after February 2, 2006, Indalex was controlled by Sun.

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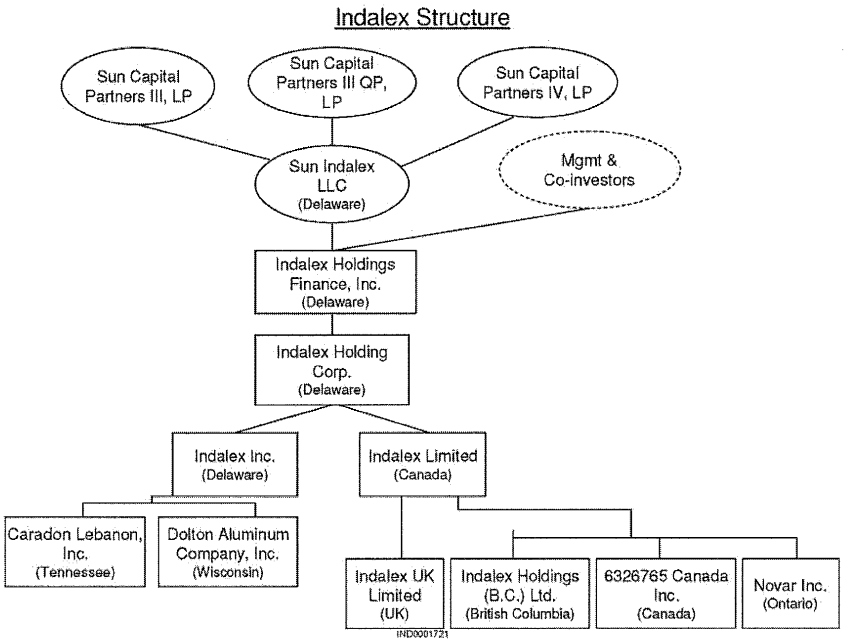
[2] Dolton Aluminum Company and Caradon Lebanon, Inc. were wholly-owned subsidiaries of Indalex Inc.

[3] K&E represents two of these three investment funds, among others, in *Miller v. Sun Capital Partners, Inc., et al.*, Adversary No. 10-52279.

26. After the LBO, Indalex was organized as follows:



27. Thereafter, from time to time, a few members of the Boards of Indalex Holdings Finance, Inc., Indalex Holding Corp. and Indalex Inc. changed but at all times from February 2, 2006 to the Petition Date, Sun controlled the Boards of Directors of Indalex as well as their business activities and policies.

The Retention Letter to Indalex

28. On February 2, 2006, K&E, through Douglas C. Gessner, Esquire, issued a retention letter to Indalex Holdings Finance, Inc. relating to legal services to be provided by K&E to Indalex ("Retention Letter").[4]

29. The Retention Letter recited, among other things, that Mr. Gessner would be primarily responsible for the Indalex engagement.

30. On information and belief, at the time Mr. Gessner issued the Retention Letter, two groups of K&E partners had already invested in one or more of the investment funds which owned Sun Indalex LLC.

31. On information and belief, the K&E partners invested through entities called Randolph Street Partners and K&E Investment Partners, LLC – 2003 PEF. The investments of Randolph Street Partners and K&E Investment Partners, LLP - 2003 PEF were not discovered until after discovery commenced in *Miller v. Sun Capital Partners, Inc., et al.,* Adversary No. 10-52279.

32. On April 17, 2012, Marc Leder, co-founder of Sun Capital Partners, Inc. revealed, for the first time, that Mr. Gessner is an investor in Randolph Street Partners.[5]

33. The Retention Letter did not disclose that K&E partners, including Mr. Gessner, owned interests in various Sun investment funds including the funds which owned Indalex through Sun Indalex, LLC.

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[4] The Retention Letter states, *inter alia*, that it "sets forth the terms of your retention of Kirkland & Ellis LLP (and an affiliated entity Kirkland & Ellis International LLP ...) to provide legal services and constitutes an agreement between us."

[5] These investments had not been discovered at the time the Trustee moved to disqualify K&E in *Miller v. Sun Capital Partners, Inc.* (Adversary No. 10-52279) in November 2010. Notably, although Mr. Gessner executed an affidavit in Opposition to the Trustee's Motion to Disqualify K&E in that matter, he did not reveal his personal investment interest in Indalex or in any Sun-affiliated fund. Mr. Gessner also failed to reveal that any K&E partners had a financial stake in the transactions on which K&E rendered advice.

34. On information and belief, the fact that K&E partners had a financial interest in Indalex was deliberately concealed from Indalex.

35. The Retention Letter between Indalex and K&E also included a provision by which Indalex authorized K&E to simultaneously represent (1) Indalex and (2) Sun and its affiliates.

36. Although permitted to simultaneously represent Indalex and Sun, K&E included a provision in the Retention Letter relating to the termination of Indalex's representation in the event K&E or Sun determined that a conflict of interest existed with respect to K&E's representation of Indalex.

37. Despite its duty to notify Indalex that the dividend transaction of June 1, 2007 represented a conflict of interest between Indalex, Sun and K&E, on information and belief, K&E never notified Indalex that a conflict of interest existed with respect to the June 1, 2007 dividend.

38. The conflict of interest was not discovered and could not be discovered by Indalex until after Plaintiff's appointment.[6]

The June 1, 2007 Dividend

39. Notwithstanding its duties to Indalex, K&E, including Mr. Gessner, provided legal advice with respect to the June 1, 2007 dividend which was adverse to Indalex but beneficial to K&E, Sun and various insiders.

40. In particular, while purporting to give Indalex legal advice with respect to the dividend transaction, and Indalex's legal obligations related thereto, and while charging Indalex for its counsel, K&E, among other things,

[6] K&E and Plaintiff are parties to a Tolling Agreement dated March 14, 2011.

- prepared for execution a patently false Board of Directors resolution for Indalex UK Limited so that the proceeds from the sale of an interest in Asia Aluminum Group ("AAG") could be utilized for a dividend paid to, *inter alia*, its client Sun;
- failed to advise Indalex as to the illegality of the June 1, 2007 dividend under all applicable laws, including the laws of the United Kingdom;
- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or should have known were patently false so that the dividend could be paid to, *inter alia*, its client Sun and so that each Board member could benefit financially;
- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or should have known were patently false so as to permit K&E partners to benefit financially;
- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or should have known were patently false in an effort to protect the controlling insiders, including Sun, from liability under Delaware corporate law;
- failed to ensure that FTI Capital Advisors ("FTI") had any professional competence, experience, reputation or prominence in the area of business solvency;

- insisted on the inclusion of language in a letter issued by FTI in an effort to protect the controlling insiders, including Sun, from liability under Delaware's fraudulent transfer statute;
- insisted on the inclusion of language in a letter issued by FTI which protected Sun, but not Indalex, in any potential cause of action involving FTI;
- failed to advise Indalex that a K&E partner was on the Board of Directors of FTI and that the K&E partner had a financial interest in FTI; and
- advised Indalex that one or more entities paying the dividend did not have to be covered by the letter issued by FTI.

41. K&E's action were taken in complicity with the controlling insiders, including Sun.

42. On information and belief, and unbeknownst to Indalex, K&E partners received proceeds from the dividend upon which K&E rendered legal advice.

43. Moreover, had Indalex been advised that Indalex UK Limited did not have a surplus sufficient to permit it to declare the June 1, 2007 dividend under UK law, millions of dollars would have been retained in Indalex UK Limited. On information and belief, at the time of the dividend, Indalex UK Limited was a party to a Credit Agreement dated February 2, 2006 with, among other parties, JP Morgan Chase Bank, N.A. ("JP Morgan") by way of a Joinder Agreement executed in May 2006. On information and belief, at the time of the dividend, Indalex UK Limited was also a party to a Security Debenture with JP Morgan and all of the shares in Indalex UK Limited were charged in favor of JP Morgan.

44. The close relationship between K&E and Sun, and the financial interest of K&E partners in Indalex, rendered K&E an insider of Indalex.

COUNT I

AIDING AND ABETTING BREACH OF FIDUCIARY DUTY

45. Plaintiff incorporates herein by reference paragraphs 1-44 of the Complaint as if set forth in full.

46. As controlling Indalex shareholder Sun Indalex LLC -- which was controlled by Sun Capital Partners, Inc., Marc Leder and Rodger Krouse -- had fiduciary duties to Indalex, their shareholders, employees and creditors at the time the June 1, 2007 dividend was paid.

47. As members of the Board of Directors of Indalex Inc., Indalex Holding Corp. and Indalex Holdings Finance in May and June 2007, Timothy R.K. Stubbs, Michael Alger, Clarence E. "Bud" Terry, M. Steven Liff and F. Dixon McElwee had fiduciary duties to Indalex, their shareholders, employees and creditors at the time the June 1, 2007 dividend was paid.

48. Sun Indalex LLC, Sun Capital Partners, Inc., Marc Leder, Rodger Krouse, Timothy R.K. Stubbs, Michael Alger, Clarence E. "Bud" Terry, M. Steven Liff and F. Dixon McElwee breached their fiduciary duties to Indalex, their employees and creditors by, among other things, declaring a dividend which benefitted them and rendered Indalex insolvent and/or was made at a time Indalex was already insolvent.

49. Sun Indalex LLC, Sun Capital Partners, Inc., Marc Leder, Rodger Krouse, Timothy R.K. Stubbs, Michael Alger, Clarence E. "Bud" Terry, M. Steven Liff and F. Dixon McElwee breached their fiduciary duties to Indalex, their employees and creditors by, among other things, declaring a dividend which benefitted them and rendered Indalex unable to pay

their debts when due and/or caused them to have unreasonably small capital for the business they operated.

50. K&E was well aware of the various duties of Sun Indalex LLC, Sun Capital Partners, Inc., Marc Leder, Rodger Krouse, Timothy R.K. Stubbs, Michael Alger, Clarence E. "Bud" Terry, M. Steven Liff and F. Dixon McElwee.

51. On information and belief, K&E knowingly assisted the above-referenced fiduciaries in violating their duties to Indalex, their employees and creditors as set forth *infra*. K&E's participation in these breaches of fiduciary duty was not discovered and could not be discovered by Indalex until after Plaintiff's appointment.

52. K&E's partners also received dividend proceeds as a result of K&E's complicity with Indalex's fiduciaries. The interest of these K&E partners was not discovered and could not be discovered by Indalex until after discovery commenced in *Miller v. Sun Capital Partners, et al.,* Adversary Case No. 10-52279.

53. Indalex was injured, and suffered damages, as a result of K&E's aid and assistance to Sun Indalex, LLC, Sun Capital Partners, Marc Leder, Rodger Krouse, Timothy R.K. Stubbs, Michael Alger, Clarence E. "Bud" Terry, M. Steven Liff and F. Dixon McElwee.

WHEREFORE, the Plaintiff respectfully requests that this Honorable Court enter judgment in his favor and against Kirkland & Ellis LLP, for an amount to be determined and for attorneys' fees and costs and other relief that this Honorable Court deems may be proper and just.

COUNT II

PROFESSIONAL NEGLIGENCE

54. Plaintiff incorporates herein by reference paragraphs 1-53 of the Complaint as if set forth in full.

55. K&E had an attorney-client relationship with Indalex. As such, K&E was in a position of trust and confidence with Indalex.

56. K&E was retained to advise Indalex on a number of legal issues including with respect to a dividend declared by Indalex Holding Corp. and Indalex Holdings Finance, Inc. in May 2007 and paid by Indalex Inc. on June 1, 2007.

57. In performing legal services for Indalex, K&E performed their services negligently and below the standard of reasonable care, skill and diligence expected of lawyers advising Delaware corporations on their obligations under applicable law including, but not limited to, Delaware law. K&E's failure was not discovered and could not be discovered by Indalex until, at the earliest, February 2009.

58. In performing legal services for Indalex, K&E failed to satisfy its duty to act in the highest degree of fidelity, loyalty and good faith towards Indalex. K&E's failure was not discovered and could not be discovered by Indalex until after Plaintiff's appointment.

59. In performing legal services for Indalex relating to the dividend, K&E failed to deal with Indalex honestly. K&E's failure was not discovered and could not be discovered by Indalex until after discovery commenced in *Miller v. Sun Capital Partners, Inc., et al.*, Adversary No. 10-52279.

60. In performing legal services for Indalex relating to the dividend, K&E failed to explain the existence of a conflict between K&E, Indalex and Sun so as to permit Indalex to

make an informed decision regarding the representation. K&E's failure was not discovered and could not be discovered by Indalex until after Plaintiff's appointment.

61. Rather, while charging Indalex for legal services, K&E performed services which benefitted K&E partners, Sun and other insiders of Indalex. K&E's failure was not discovered and could not be discovered by Indalex until after Plaintiff's appointment.

62. Indalex sustained damages as a result of K&E's professional negligence.

WHEREFORE, the Plaintiff respectfully requests that this Honorable Court enter judgment in his favor and against Kirkland & Ellis LLP, for an amount to be determined and for attorneys' fees and costs and other relief that this Honorable Court deems may be proper and just.

JURY TRIAL DEMAND

Plaintiff demands a trial by jury on those claims for which it is available.

Dated: May 14, 2012

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Counsel for Plaintiff

Appendix 2: Ruling on Motion to Dismiss

US.105994191.02

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE PETER J. WALSH

824 MARKET STREET
WILMINGTON, DE 19801
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October 2, 2012

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Counsel for Plaintiff
George L. Miller

Re: George L. Miller, Chapter 7 Trustee v. Kirkland & Ellis LLP
Adv. Proc. No. 12-50713 (PJW)

Dear Counsel:

This ruling is with respect to Kirkland & Ellis LLP's ("K&E") motion to dismiss the Trustee's Complaint (Doc. # 10). For the reasons briefly discussed below, I will deny the motion. I believe that the decision here is squarely within the Delaware Supreme Court's ruling in Laventhol, Krekstein, Horwath & Horwath v. Tuckman, 372 A.2d 168 (Del.Supr. 1976).

In order to juxtapose this matter with the Laventhol opinion, I note the following significant portions of the Trustee's Complaint:

> 28. On February 2, 2006, K&E, through Douglas C. Gessner, Esquire, issued a retention letter to Indalex Holdings Finance, Inc. relating to legal services to be provided by K&E to Indalex ("Retention Letter").
>
> 30. On information and belief, at the time Mr. Gessner issued the Retention Letter, two groups of K&E partners had already invested in one or more of the investment funds which owned Sun Indalex LLC.
>
> 31. On information and belief, the K&E partners invested through entities called Randolph Street Partners and K&E Investment Partners, LLC - 2003 PEF. The investments of Randolph Street Partners and K&E Investment Partners, LLP - 2003 PEF were not discovered until after discovery commenced in *Miller v. Sun Capital Partners, Inc., et al.*, Adversary No. 10-52279.
>
> 32. On April 17, 2012, Marc Leder, co-founder of Sun Capital Partners, Inc. revealed, for the first time, that Mr. Gessner is an investor in Randolph Street Partners.
>
> 33. The Retention Letter did not disclose that K&E partners, including Mr. Gessner, owned interests in various Sun investment funds including the funds which owned Indalex through Sun Indalex, LLC.

34. On information and belief, the fact that K&E partners had a financial interest in Indalex was deliberately concealed from Indalex.

37. Despite its duty to notify Indalex that the dividend transaction of June 1, 2007 represented a conflict of interest between Indalex, Sun and K&E, on information and belief, K&E never notified Indalex that a conflict of interest existed with respect to the June 1, 2007 dividend.

The Complaint accuses K&E of wrongdoing as follows:

39. Notwithstanding its duties to Indalex, K&E, including Mr. Gessner, provided legal advice with respect to the June 1, 2007 dividend which was adverse to Indalex but beneficial to K&E, Sun and various insiders.

40. In particular, while purporting to give Indalex legal advice with respect to the dividend transaction, and Indalex's legal obligations related thereto, and while charging Indalex for its counsel, K&E, among other things,

- prepared for execution a patently false Board of Directors resolution for Indalex UK Limited so that the proceeds from the sale of an interest in Asia Aluminum Group ("AAG") could be utilized for a dividend paid to, *inter alia*, its client Sun;
- failed to advise Indalex as to the illegality of the June 1, 2007 dividend under all applicable laws, including the laws of the United Kingdom;
- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or should have known were patently false so that the dividend could be paid to, *inter alia*, its client Sun and so that each Board member could benefit financially;
- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or

should have known were patently false so as to permit K&E partners to benefit financially;

- prepared for execution Board of Directors' Unanimous Consents for Indalex Holdings Finance, Inc. and Indalex Holding Corp. which it knew or should have known were patently false in an effort to protect the controlling insiders, including Sun, from liability under Delaware corporate law;

- failed to ensure that FTI Capital Advisors ("FTI") had any professional competence, experience, reputation or prominence in the area of business solvency;

- insisted on the inclusion of language in a letter issued by FTI in an effort to protect the controlling insiders, including Sun, from liability under Delaware's fraudulent transfer statute;

- insisted on the inclusion of language in a letter issued by FTI which protected Sun, but not Indalex, in any potential cause of action involving FTI;

- failed to advise Indalex that a K&E partner was on the Board of Directors of FTI and that the K&E partner had a financial interest in FTI; and

- advised Indalex that one or more entities paying the dividend did not have to be covered by the letter issued by FTI.

41. K&E's action [sic] were taken in complicity with the controlling insiders, including Sun.

42. On information and belief, and unbeknownst to Indalex, K&E partners received proceeds from the dividend upon which K&E rendered legal advice.

44. The close relationship between K&E and Sun, and the financial interest of K&E partners in Indalex, rendered K&E an insider of Indalex.

Pertinent parts of the Laventhol decision are as follows:

Plaintiffs are stockholders of Old A. Corp. On January 15, 1973 they filed a derivative and class action in the Court of Chancery against Frank and other present

and former directors of Old A. Corp., New A. Corp. and I.T.C. In brief, the complaint states a wide-ranging violation of fiduciary duties, centered around overvaluation of I.T.C.'s assets, owed to Old A. Corp. and its shareholders by Frank and the other individual defendants.

The complaint joins as parties defendant the firm of Laventhol, Krekstein, Horwath & Horwath, the certified public accountant for I.T.C., and Horwarth & Horwath, the certified public accountant for Old A. Corp. and charges that they conspired with the directors of the respective corporations to defraud the shareholders of Old A. Corp.; specifically, it is charged that they "knew that the Financial Statements included in the Proxy Statement failed adequately to disclose" facts stated elsewhere in the complaint and that they "knew, or should have known, that the Proxy Statement was materially deficient, . . . false and misleading . . .."

Id. at 169.

* * *

Generally speaking, an action in the Court of Chancery for damages or other relief which is legal in nature is subject to the statute of limitations rather than the equitable doctrine of laches. Bokat v. Getty Oil Company supra. There is, however, an established exception to this principle which denies its protection to those who owe a fiduciary duty to a corporation. In brief, the benefit of the statute of limitations will be denied to a corporate fiduciary who has engaged in fraudulent self-dealing. Bovay v. H.M. Byllesby & Co. supra; Halpern v. Barran, Del.Ch., 313 A.2d 139 (1973),

Id. at 169-170.

* * *

Here, the Trial Court enlarged the Bovay exception in ruling on the motion to dismiss; the Chancellor refused to apply the three-year statute of limitations for the benefit of certified public accountants who allegedly conspired with corporate fiduciaries to defraud the shareholders of Old A. Corp. The Court said:

> The question then becomes one of policy. Should those who conspire to defraud with self-dealing fiduciaries be bound by the same standard for statute of limitations purposes as the fiduciaries themselves? Compare Jackson v. Smith, 254 U.S. 586, 41 S.Ct. 200, 65 L.Ed. 418 (1921). The answer to the question is difficult in the relative vacuum of the bare pleadings. But, if outside experts, on whom many must depend for the integrity of corporate affairs, knowingly conspire with self-dealing fiduciaries to defraud those very persons who in practicality must rely on their advice, it is difficult, to see why the same principles of Bovay should not apply to statute of limitations purposes.
>
> Accordingly, as to the Fifth Cause of Action, I think the Bovay exception is applicable and the motion to dismiss on the bare plea of a Statute of Limitations should be denied."

Id. at 170.

* * *

The complaint alleges fraudulent self-dealing on the part of the directors of Old A. Corp. and of I.T.C. As to these defendants, of course, the minimum requirements of Bovay have been satisfied.

The complaint charges that the defendant-accountants conspired with the directors of those two corporations to defraud the stockholders of Old A. Corp. It is a fundamental principle of our jurisprudence that co-conspirators are jointly and severally liable for the acts of their confederates committed in furtherance of the conspiracy, Board of Education, Asbury Park v. Hoek, 38 N.J. 213, 183 A.2d 633 (1962); 15A C.J.S. Conspiracy (Several Liability) § 18, and cases cited therein. Further, persons who knowingly join a fiduciary in an enterprise which constitutes a breach of his fiduciary duty of trust are jointly and severally liable for any injury which results. Jackson v. Smith, 254 U.S. 586, 41 S.Ct. 200, 65 L.Ed. 418 (1921).

For present purposes, it appears that both classes of defendants, fiduciaries and accountants, stand in the same position under the principles of law governing the merits of the complaint and there is, therefore, no

> reason why the principles of law governing applicability of the statute of limitations should not apply in like manner. In short, enlargements of the Bovay exception was both logical and proper. We so hold.

Id. at 170-171.

According to the Complaint, the Trustee on April 17, 2012 first learned from a Sun Capital Partners insider that K&E had a conflicting interest in the dividend transaction. The Trustee's Complaint was filed 27 days later. I find that response time to be quite reasonable.

For the foregoing reasons, I deny the motion to dismiss.

So Ordered.

Very truly yours,

Peter J. Walsh

PJW:ipm

Appendix 3: Motion for Summary Judgment

US.105994191.02

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

IN RE: IH 1, Inc., *et al.*,	:	CASE NO. 09-10982-LSS
Debtors.	:	
GEORGE L. MILLER, Chapter 7 Trustee,	:	ADVERSARY NO. 12-50713-LSS
Plaintiff,	:	Redacted Pursuant to D.I. 34 and 66
v.	:	
KIRKLAND & ELLIS LLP,	:	
Defendant.	:	

MEMORANDUM OF LAW IN SUPPORT OF
KIRKLAND & ELLIS LLP's MOTION FOR SUMMARY JUDGMENT

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Attorneys for Defendant
Kirkland & Ellis LLP

Dated: June 19, 2015

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I. NATURE AND STAGE OF PROCEEDINGS

On March 20, 2009, in the midst of the Great Recession, Indalex, a US-based aluminum extrusion company heavily dependent upon the housing and credit markets, filed for bankruptcy protection before this Court. This adversary proceeding is the latter of two separate and independent lawsuits that the Chapter 7 trustee of Indalex filed years apart, both of which ignore the recent financial crisis and blame others for Indalex's demise. The trustee filed the first action against the private investment firm, Sun Capital Partners, Inc. and various affiliated entities and individuals on July 30, 2010. The trustee withdrew that case to the district court where it awaits pre-trial motion practice before Judge Andrews (No. 13-01996). Almost two years after he filed that lawsuit, on May 14, 2012, the trustee filed this adversary proceeding against Kirkland & Ellis LLP ("Kirkland"), claiming that Kirkland committed malpractice and knowingly assisted Indalex's directors in plundering the company, principally through their decision to declare a $76 million, publicly-disclosed, *pro rata* dividend, which Indalex paid to its shareholders on June 1, 2007.

II. SUMMARY OF ARGUMENT

1. This action is time-barred. Plaintiff's case is untimely and inexcusably so. Indeed, it is undisputed that plaintiff waited to file this suit until May 12, 2012, fifty-five days after the statute of limitations—which had been tolled by agreement—expired. To justify his delay and defeat Kirkland's motion to dismiss, plaintiff argued that Kirkland concealed certain of its partners' indirect investments in Indalex, which he argued created a conflict of interest that he could not have discovered until April 2012. But the undisputed facts disprove plaintiff's story. In reality, Indalex's bond offering memorandum published ***in January 2006*** makes clear that ***Indalex itself knew***

and disclosed that certain Kirkland partners indirectly invested in Indalex. That document, which Indalex shared with prospective public bondholders, their counsel, and Indalex's management, clearly stated: "[s]ome of the partners of Kirkland & Ellis LLP are partners in a partnership that is an investor in one or more of the investment funds affiliated with Sun Capital Partners that may purchase common stock of Indalex parent in connection with the Acquisition." Thus, Indalex and plaintiff, who stand in Indalex's shoes, knew in 2006 about the alleged conflict that plaintiff proffers to excuse his tardy filing of this lawsuit. Plaintiff's claims are thus time-barred and the Court should enter judgment for Kirkland on this basis.

Moreover, the alleged "conflict" underlying both of plaintiff's causes of action is no conflict at all. Kirkland partners did not invest in Indalex. Instead, much like a mutual fund, certain Kirkland partners made passive investments into a fund that invested in a fund, which, in turn, invested in Indalex. As a matter of law, these investments are too attenuated to create a conflict of interest and plaintiff has no authority to the contrary.

2. No evidence of aiding and abetting a fiduciary breach. Of equal importance, plaintiff seeks to hold Kirkland liable for the June 1, 2007 dividend, claiming that its payment rendered the company insolvent. Yet, plaintiff has no evidence that Indalex was actually insolvent when that transaction took place and, in fact, ignores overwhelming contemporaneous market and other evidence to the contrary. That Indalex was going to pay the June 1, 2007 dividend was widely known. Indeed, the formula for it was negotiated and then publicly disclosed in the bond indenture used to finance Sun Capital's February 2006 purchase of the company. Following the dividend, Indalex's bonds continued to trade above par and Indalex's stakeholders and professionals

(bondholders, secured lenders, analysts, ratings agencies, trade creditors, and auditors) believed the company to be solvent at the time. Indeed, Indalex continued to operate after the dividend was paid for a full 22 months, in an acutely distressed economy. In the face of this undisputed factual record, plaintiff asks the Court to accept his "say so" that Indalex was insolvent as of June 1, 2007. The law, however, does not allow plaintiff to prove insolvency simply by an *ipse dixit*. And a party seeking to prove insolvency cannot ignore what the market was saying about the company at the time. Plaintiff has proffered ***no*** expert opinion about Indalex's insolvency and willfully ignores what virtually everyone else was saying about Indalex at the time. Nor can plaintiff establish that Kirkland acted with knowledge to cause Indalex harm, since the factual record indicates that Kirkland, like nearly everyone at the time, reasonably believed, based on the input that Indalex's management and outside financial advisors provided, that the company was solvent when it paid the dividend. As a result of a complete lack of any evidence of insolvency, plaintiff's aiding and abetting claim fails.

3. No evidence of negligence. With the benefit of hindsight, plaintiff criticizes Kirkland's work for Indalex, yet plaintiff did not retain a corporate attorney with the necessary experience to opine on Kirkland's work for the company. Instead, plaintiff offers only the testimony of an ethicist, who admits he has never advised a board of directors about the payment of a dividend (much less one of the complexity and public nature in this case) and acknowledges that he is not qualified to opine on the corporate transactions at issue here. Because expert testimony is necessary to establish the standard against which plaintiff seeks to judge Kirkland's work and plaintiff lacks such proof, he cannot prove his negligence case and the Court should enter judgment for Kirkland.

III. STATEMENT OF UNDISPUTED FACTS

A. Some Kirkland Partners Passively Invest In Client-Operated Funds.

Beginning in the 1980's, a group of Kirkland partners formed investment funds to make personal investments alongside their private equity clients ("PE clients").[1] Since then, these investment vehicles have been funded solely with personal capital contributions from individual Kirkland partners.[2] The Firm itself has never invested in the funds, known as "PEFs," short for "Private Equity Funds," and each partner individually decides whether (and how much) to invest.[3] There is no requirement or expectation that a partner invest in the investment funds[4] and the PEFs only invest after a PE client invites them to do so.[5]

The PEFs are passive investments that a committee of Kirkland partners manages.[6] This committee has sole discretion to decide whether the PEFs will invest in a specific fund.[7] As such, when Kirkland partners commit capital to a PEF, they do not know how the management committee will invest the PEF's committed capital.[8] Likewise, when the management committee decides that a PEF will invest in a PE client's fund, it does not know how the PE fund will invest the PEF's money or what

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[1] Select pages of Transcript of Deposition of Jack Levin ("Levin Tr.") at 60:22-61:3, 52:23-53:2, Ex. 1.
[2] *Id.* at 61:9-21.
[3] *Id.*; *see also id.* at 61:6-63:12 (investment made by partners, not Kirkland).
[4] *Id.* at 68:4-24 (Kirkland partners were offered an opportunity to invest).
[5] *Id.* at 101:2-11 ("We only invested in funds that had invited us to invest...").
[6] *Id.* at 22:24-23:21; 25:16-23.
[7] *Id.* at 25:24-29:7.
[8] *Id.* at 65:9-67:1 (management committee decides how much of the PEFs' capital will be contributed to a PE fund).

portfolio companies the PE fund will acquire.[9] In fact, after the initial investment, the management committee does not consult with the PE funds in any way.[10]

In 2004, long before the Indalex bankruptcy and this litigation, the management committee circulated a memorandum explaining the need to obtain client consent before a PEF invested in a private equity fund formed by a firm client.[11] The memorandum provided examples of appropriate "Rule 1.8 investment letter[s]" and explained that the "PEFs will not disburse funds for a new investment" without first memorializing the client's consent to the investment.[12]

This case involves two PEFs in which Kirkland partners invested: (i) K&E Investment Partners, LLC – 2003 PEF (the "2003 PEF"), and (ii) K&E Investment Partners, LLC – 2005 PEF (the "2005 PEF" and collectively with the 2003 PEF, the "PEFs"). [redacted]

[9] *Id.* at 73:6-16, (management committee has "no ability to influence any decision-making that goes on within a private equity fund in which we invested."), 74:19-21 (same).
[10] *Id.*; *see also id.* at 76:20-77:19 (management committee does not investigate the PE funds possible acquisitions), 155:1-18 ("[N]one of us involved in the Kirkland investment fund had any ability to influence the activities of Sun or any other private equity fund in which we had invested . . . .").
[11] *Id.* at 122:8-14.
[12] 6/3/04 Memo From Levin to All Transactional Billers, Ex. 2.
[13] 12/20/02 Formation of 2003 Private Equity Fund Private Offering Memo, Ex. 3; *see also* 2003/2005 PEF Summary at KEADV00424860, Ex. 4. Exhibits 3 and 4 are filed under seal pursuant to D.I. 34 and 66.
[14] 12/20/02 Formation of 2003 Private Equity Fund Private Offering Memo at 23, Ex. 3.

[redacted]

B. 2003-2005: The PEFs Invest In Sun Capital Funds.

Kirkland started representing Sun Capital in 2000.[17] [redacted]

In June 2004, Kirkland partner Doug Gessner sent a letter to Sun Capital's General Counsel to confirm that Sun Capital consented to the PEFs' investments in Sun Capital-sponsored funds and to Kirkland's continued representation of Sun Capital and its affiliates.[20] The letter attached the relevant excerpts from Rule 1.7 and Rule 1.8 of the Rules of Professional Conduct and explained that:

- Sun Capital's "invitation to invest is not a condition to [Kirkland's] willingness to provide legal services;" and
- Kirkland did "not believe that [its] judgment will be compromised by virtue of the investment."[21]

[15] 1/4/05 Formation of 2005 Private Equity Fund – Private Offering Memo, Ex. 5; 2003/2005 PEF Summary at KEADV00424860, Ex. 4. Exhibit 5 is filed under seal pursuant to D.I. 34 and 66.
[16] 5/10/05 05 PEF Reopening –Private Offering Memo at p. 4, Ex. 6. Exhibit 6 is filed under seal pursuant to D.I. 34 and 66.
[17] 12/8/10 Declaration of Douglas C. Gessner, P.C. at ¶ 1, Ex. 7.
[18] Sun Capital Partners III QP, LP Subscription Agreement; Ex. 8; 1/22/03 Memorandum to Limited Partners in Sun Capital Partners III QP, LP at 2, Ex. 4; Levin Tr. 115:16-117:2, Ex. 9; 2003/2005 PEF Summary at KEADV00424860, Ex. 1. Exhibits 8 and 9 are filed under seal pursuant to D.I. 34 and 66.
[19] 2003/2005 PEF Summary at KEADV00424860, Ex. 4.
[20] 6/8/04 Letter from Gessner to Couch at Sun Capital, Ex. 10.
[21] *See id.* at 1 and 2.

Sun Capital signed and returned the letter, acknowledging Sun's consent to the PEFs' investments in Sun Capital funds.[22]

[redacted]

C. **January-March 2006: The PEFs' Passive Investments In The Sun Funds Is Disclosed.**

In July 2005 (after the PEFs had already committed to Sun III and Sun IV), Sun Capital started to analyze whether to acquire Indalex, an aluminum extrusion company.[27] Kirkland provided a variety of legal services to Sun Capital in connection with the Indalex acquisition, including assistance with drafting a Bond Offering Memorandum

[22] *See id.* at 2.
[23] Sun Capital Partners IV LP Subscription Booklet, Ex. 11; 2003/2005 PEF Summary at KEADV00424860, Ex. 4. Exhibit 11 is filed under seal pursuant to D.I. 34 and 66.
[24] 2003/2005 PEF Summary at KEADV00424860, Ex. 4.
[25] *See supra* n. 10.
[26] Levin Tr. at 76:20-77:19; 155:1-18, Ex. 1.
[27] 7/20/05 Indalex Aluminum Solutions Group Mem., Ex. 12.

that would eventually be issued to raise debt financing for the acquisition.[28] On January 11, 2006, as Kirkland worked to finalize the Bond Offering Memorandum, Kirkland partner Carol Anne Huff—who was an investor in the PEFs—added language to the "Legal Matters" section of the Bond Offering Memorandum that specifically identified the PEFs' investments in funds affiliated with Sun Capital.[29] The "Legal Matters" section is typically used to describe relationships with advisors; in this case, it specifically identified the investments that plaintiff claims Kirkland "deliberately concealed" from Indalex and its debtholders:

> Certain legal matters with regard to the validity of the notes and other legal matters will be passed upon for us by Kirkland & Ellis LLP .... The initial purchasers have been represented by [Cravath, Swaine & Moore]. Kirkland & Ellis LLP has from time to time represented, and may continue to represent, Sun Capital Partners and some of its affiliate in connection with carious legal matters. ***Some of the partners of Kirkland & Ellis LLP are partners in a partnership that is an investor in one or more of the investment funds affiliated with Sun Capital Partners that may purchase common stock of Indalex parent in connection with the Acquisition***.[30]

Thereafter, all versions—including the final January 30, 2006 version—of the Bond Offering Memorandum included the Legal Matters Disclosure.[31] The document was

[28] Select pages of Transcript of Deposition of Carol Anne Huff dated 5/28/14 ("5/28/14 Huff Tr.") at 19:10-14 (participated in drafting sessions with the company and the underwriters, and their counsel), Ex. 13.

[29] Select pages of Transcript of Deposition of Carol Anne Huff dated 10/9/14 ("10/9/14 Huff Tr.") at 27:10-29:11 (Huff added the legal matters language in the January 11, 2006 draft of the Bond Offering Memorandum; she made the change at the printer; Mike Alger was also at the printer and he received a copy of the revised Bond Offering Memorandum with the legal matters language), Ex. 14; Select pages of Transcript of Deposition of Elizabeth Martin ("Martin Tr.") at 20 (Mike Alger and Tim Stubbs were at the printer when Bond Offering Memorandum was being finalized), Ex. 15.

[30] 1/12/06 email from CHI Customer Service with attachment at 192, Ex. 16.

[31] *Id.; see also* 1/14/06 email from CHI Customer Service, Ex. 17; 1/17/06 email from CHI Customer Service, Ex. 18; 1/17/06 email from CHI Customer Service, Ex. 19; 1/23/06 email from CHI Customer Service, Ex. 20; 1/31/06 email from CHI Customer Service, Ex. 21; 2/1/06 email from CHI Customer Service, Ex. 22. For the Court's convenience, the drafts of the Bond Offering Memorandum that accompany these emails have been omitted. Each omitted draft contains the Legal Matters Disclosure and is substantially similar to Exhibit 16 attached hereto.

provided to prospective bondholders and their attorneys at Cravath, Swaine & Moore LLP ("Cravath"), who were charged with protecting the bondholders' interests in the transaction.[32] In January 2006, prospective bondholders and/or their counsel, Cravath, received at least seven drafts containing the Legal Matters Disclosure.[33] Some or all of those distributions were sent to J.P. Morgan and Harris Nesbitt (co-lead managers of the bond offering),[34] Morgan Joseph, Credit Suisse First Boston, and Piper Jaffray (additional co-managers of the bond offering), and Crowe Chizek and Deloitte (Indalex's accountants).[35] On January 30, 2006, prospective bondholders (many of whom later became actual bondholders) received the final Bond Offering Memorandum, which, like the earlier drafts, included the disclosure about the PEFs' investments in funds affiliated with Sun Capital.[36] No creditor, debtor, or investor in Indalex ever raised any concerns about the alleged "investment conflict" upon which plaintiff's case is built.

After the final Bond Offering Memorandum was circulated to prospective investors, a Sun affiliate acquired Indalex on February 2, 2006 for $425 million (plus fees and expenses).[37] Sun Capital financed the purchase through a $111.3 million equity contribution (from Sun III, Sun IV and co-investors), $69.8 million in borrowings on a revolving bank loan, and $270 million in senior subordinated notes (*i.e.*, the bonds that Indalex issued pursuant to the Bond Offering Memorandum).[38]

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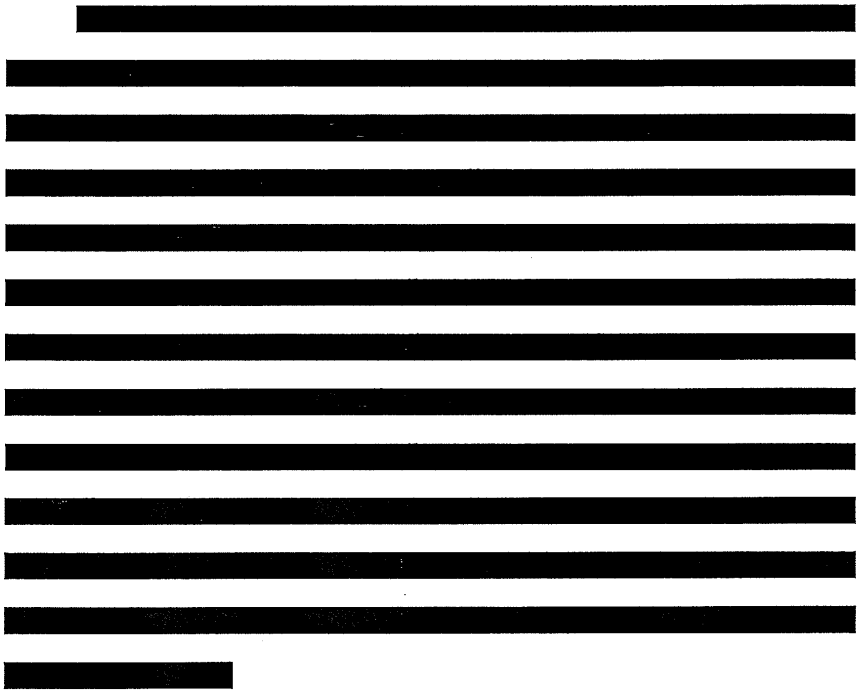
[32] 5/28/14 Huff Tr. at 66:8-10 (Cravath represented the initial purchasers of the bonds and negotiated the bond indenture), Ex. 13.
[33] *See supra* n. 30, 31.
[34] *Id.*
[35] *Id.*
[36] 1/30/06 Bond Offering Memorandum at 210, Ex. 23.
[37] Compl., D.I. 1 at ¶¶ 21-25.
[38] Acquisition Summary Indalex Holding Corporation at 2, Ex. 24.



A short time after the acquisition, Indalex provided its management-level employees with an opportunity to purchase equity in the company (the "Management Equity Offering"). On March 7, 2006, Kirkland attorney Ted Frankel sent two e-mails to Indalex's Chief Compliance Officer Bill Corley attaching a number of relevant documents, including the Bond Offering Memorandum, asking Mr. Corley to "distribute these documents to each [U.S./Canadian] resident who has indicated an interest in

[39] *Id.*; *see also* 2003/2005 PEF Summary at KEADV00424860, Ex. 4.
[40] Complaint in *Miller v. Sun Capital Partners, Inc., et al.,* Adv. No. 10-52279 Bankr. D. Del. ("Sun Adversary Compl."), at ¶ 181, Ex. 25.
[41] 2003/2005 PEF Summary at KEADV00424860, Ex. 4.
[42] *Id.*
[43] *Id.*
[44] *Id.*

participating in the [Management Equity Offering]."[45] Mr. Frankel copied Indalex CEO Tim Stubbs and CFO Mike Alger on both e-mails.[46] That same day, Mr. Corley forwarded the information—including the Bond Offering Memorandum with the Legal Matters Disclosure—to 23 Indalex managers; the distribution included two senior vice presidents, numerous vice presidents, and the director of investor relations, among other high level managers at Indalex.[47] Although a number of Indalex managers participated in the Management Equity Offering, no Indalex employee ever raised any concerns about the PEFs' investments.

D. February 2006: Indalex Retains Kirkland And Executes A Conflict Waiver.

When a Sun Capital affiliate acquired Indalex in February 2006, Indalex retained Kirkland to render legal services, as is customary in the industry.[48] Indalex signed a written engagement letter with Kirkland, which outlined the relationship between Kirkland, Indalex, and Sun Capital (the "Engagement Letter").[49] The Engagement Letter specifically advised Indalex that Kirkland had represented Sun Capital "on a variety of matters, including Sun's investment in [Indalex]" and anticipated that the Firm would continue to represent Sun Capital in the future:

> As you know we have represented and represent Sun Capital Partners, Inc. and its affiliated investment funds and management companies (together "Sun") on a variety of matters, including Sun's investment in you and anticipate that we will represent Sun in future matters. ***You are a portfolio***

[45] 3/7/06 Email from Frankel to Corley and others re U.S. Residents, Ex. 26; 3/7/06 Email from Frankel to Corley and others re Canadian Residents, Ex. 27.
[46] *Id.*
[47] 3/7/06 Email from Corley Indalex managers re U.S. Residents, Ex. 28; 3/7/06 Email from Corley Indalex managers re Canadian Residents, Ex. 29.
[48] Compl., D.I. 1 at ¶ 28; 1/7/15 Report from William H. Coquillette at 2 ("Kirkland & Ellis acted appropriately and consistent with customary practice in corporate transactions (including private equity transactions) when it undertook to represent Indalex"), Ex. 30.
[49] 2/2/06 Engagement Letter, Ex. 31.

> ***company of Sun. This confirms that K&E LLP has informed you of its representation of Sun on a variety of matters, including Sun's investment in you*** ...[50]

The Engagement Letter also included an explicit waiver provision that encompassed past, present, and future conflicts arising from Kirkland's representation of Sun Capital:

> ***[Y]ou consent to, and waive any conflict or other objection with respect to K&E LLP's representation of Sun, its affiliates or portfolio companies*** in connection with any and all (i) matters in which K&E LLP currently represents Sun, its affiliates or portfolio companies, including the Indalex matters, (ii) past matters in which K&E LLP represented you, Sun, Sun's affiliates or Sun's portfolio companies (or any combination thereof) and (iii) future matters in which K&E LLP might represent Sun (whether or not such matter is related to the Indalex Matters).[51]

Mike Alger, Indalex's Chief Financial Officer at the time, read the Engagement Letter and understood its contents—including that Kirkland could continue to represent Sun Capital in the event of a conflict with Indalex—before he signed it.[52]

E. May-June 2007: Indalex Sells Its Interest In AAG, Repays Debt, And Pays A Dividend.

As part of the acquisition, Sun Capital disclosed in February 2006 to Indalex's creditors and bondholders that Indalex might sell its interest in Asia Aluminum Group ("AAG"), a Chinese aluminum extruder, and declare a dividend in the future.[53] Indeed, both the credit agreement, which provided the terms for the revolving bank loan used to finance the acquisition, and the bond indenture, which set forth the terms under which Indalex sold the bonds, included a detailed formula that governed the precise amount of the AAG sale proceeds Indalex could use to declare a dividend.[54]

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[50] *Id.* at 4.
[51] *Id.*
[52] 12/9/10 Declaration of Michael E. Alger at ¶¶ 22, 28, Ex. 32.
[53] Sun Adv. Compl., at ¶¶ 112-115, Ex. 25.
[54] *Id.;* 1/30/06 Bond Offering Memorandum at 14, Ex. 23.

In May 2007, Indalex UK, a non-operating subsidiary of Indalex Limited, sold its sole asset—the 25.1% interest in AAG—for approximately $152.2 million.[55] Afterwards, Goldman Sachs Credit Research issued an "outperform" rating for the Indalex bonds, recommending that investors invest in the Indalex bonds even though the bonds were trading above par (*i.e.,* were relatively more expensive than when they were issued) despite also noting that it expected that Indalex would soon issue a dividend along the lines permitted by the formula in the bond indenture.[56] Subsequently, Indalex UK declared an intracompany dividend (the "UK Intracompany Dividend") to upstream the proceeds of the AAG sale to its parent company for use in the long-anticipated dividend.[57] Kirkland drafted the Indalex UK board meeting minutes approving the UK Intracompany Dividend.[58]

After it sold its interest in AAG but before it declared a dividend, Indalex retained FTI Capital Advisors, LLC ("FTI"), a subsidiary of global advisory firm FTI Consulting, Inc.,[59] to review Indalex's financials and confirm that Indalex had sufficient resources to declare the dividend (*i.e.*, that declaring a dividend would not render Indalex insolvent).[60]

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[55] Select pages of Transcript of Deposition of Michael Alger Tr. - Vol. 1 at 41:13-18 (AAG was held by Indalex UK, which was held by Indalex Limited), Ex. 33; 5/15/07 Press Release (Indalex divested its interest in AAG), Ex. 34; 6/1/07 Final FTI Report at 1, Ex. 35.

[56] 5/21/07 Goldman Sachs Credit Research, Company Update at 1, Ex 36.

[57] Select pages of Transcript of Deposition of Ted Frankel dated 10/8/14 at 21:5-9; 23:17-19 (Indalex UK wired proceeds of AAG sale to Indalex), Ex. 37.

[58] Compl. D.I. at ¶ 40; select pages of the Deposition of Michael Alger - Vol. 2 at 199:10-17, Ex. 38. In his Complaint, plaintiff alleges that the UK Intracompany Dividend failed to satisfy a technical requirement of UK law. Plaintiff does not, however, represent Indalex UK, and the UK Intracompany Dividend did not adversely affect the creditors he purports to represent. In any event, the Company corrected the technical oversight before Indalex filed bankruptcy. More than eight years later, no creditor of Indalex UK has claimed any injury from the UK Intracompany Dividend.

[59] Select pages of Transcript of Deposition of Kevin Shultz ("Shultz Tr.") at 128:16-20, Ex. 39.

[60] 5/14/07 FTI Engagement Letter, Ex. 40; select pages of Transcript of Deposition of Dixon McElwee at 118:14-118:24, Ex. 41; select pages of Transcript of Deposition of Steven Liff at 11:24-12:11, Ex. 42.

FTI met with management to discuss the company's financial condition and reviewed Indalex's projections.[61] After FTI completed its work, it determined that, in its professional opinion, Indalex would pass the three relevant solvency tests under Delaware law if it paid a $114.4 million dividend from the proceeds of the AAG sale.[62] After FTI circulated a draft of its report, attorneys from Kirkland reviewed the language of the report and suggested revisions to track the language of the relevant Delaware statutes.[63] Under oath, the leader of FTI's engagement team described Kirkland's changes as legal "wordsmithing," and confirmed that the revisions had no effect on FTI's fundamental conclusion that Indalex would remain solvent after it paid the dividend.[64] Thereafter, on June 1, 2007, in accordance with the formula set forth in the bond indenture and the revolving credit agreement, Indalex paid a $76 million *pro rata* dividend to its shareholders.[65] Kirkland drafted the unanimous consents that Indalex's board of directors used to declare the June 2007 Dividend.[66]

In June 2007, the PEFs held very small interests in the Sun Capital funds and an even more modest investment in Indalex. [redacted]

[61] 5/14/07 E-mail from Shultz to Alger, Ex. 43; select pages of Transcript of Deposition of Richard Braun ("Braun Tr.") at 73:20-75:18, Ex. 44; 5/10/07 E-mail from Williams to FTI, Ex. 45; 5/22/07 E-mail from Williams to FTI, Ex. 46.
[62] 6/1/07 Final FTI Report at 1, Ex. 35.
[63] Select pages of Transcript of Deposition of Jeremy Liss at 23:2-24:11 ("We asked them to make changes to that the opinion conformed to Delaware law and statutes with respect to fraudulent conveyance"), Ex. 47; 5/30/07 Email from Brandon Smith re K&E Comments to FTI Solvency Opinion (Indalex), Ex. 48.
[64] Braun Tr. at 207:12-209:5, Ex. 44.
[65] Compl., D.I. 1 at ¶¶ 3-5; Sun Adversary Compl., at ¶¶ 112-115, Ex. 25.
[66] 5/31/07 Email from Ted Frankel to Tim Stubbs and others (attaching draft board consents), Ex. 49.

[redacted]

Later that month, as part of the June 1, 2007 dividend transaction, Kirkland assisted Indalex with a tender offer that resulted in the retirement of $71.9 million of bonds at 105% of principal—a significant de-levering event that resulted in $8.3 million in annual interest savings for Indalex.[68] The second priority Indalex bonds continued to trade above par after the June 1, 2007 dividend and near par well into 2008.[69] Indalex received clean audit opinions from its auditors both before (April 2007) and after (March 2008) the June 2007 Dividend.[70] Additionally, at the time of the dividend, independent analysts noted that Indalex seemed primed for solid performance over the coming years.[71]

F. As The U.S. Economy Weakens, Indalex Faces Liquidity Challenges.

In 2008, as a result of the weakening U.S. economy and tightening credit markets, the aluminum extrusion market saw demand decline and volatile prices.[72] This volatility had a negative effect on Indalex's liquidity.[73] As a result, availability under its revolver tightened more than expected.[74] To combat these challenges, Indalex sought to inject additional cash into the business.[75] In May 2008, almost a year after Indalex declared the

[67] 2003/2005 PEF Summary at KEADV00424860, Ex. 4.
[68] Indalex Holdings Finance, Inc. 10-Q for the period ended July 1, 2007 at 20, Ex. 50; 7/11/07 Mgmt. Update Meeting, Ex. 51.
[69] 1/9/15 Expert Report of John D. Finnerty, Ph.D ("Finnerty Report") at ¶¶ 171-86 and Exhibit 50 thereto, Ex. 52; Bond Trade Activity for Indalex Holding Corp, Ex. 53.
[70] Indalex Finance Annual Report on Form 10-K for the Year Ended December 31, 2006 at F-2 Ex. 54; Indalex Finance Annual Report on Form 10-K for the Year Ended December 31, 2007 at F-2, Ex. 55.
[71] 5/21/07 Goldman Sachs Credit Research, Company Update at 1 (commenting that the Notes were trading above their face value and recommending an investment in the Notes, giving the Notes a favorable "Outperform" evaluation), Ex. 36.
[72] 3/14/08 Mgmt. Presentation, Ex. 56.
[73] *Id.*
[74] March 2008 Situation Presentation, Ex. 57.
[75] *Id.*; select pages of the Transcript of the Deposition of Timothy Stubbs at 235:9-236:19, Ex. 58.

June 1, 2007, Indalex received a $15 million term loan from Sun Capital.[76] As 2008 progressed, demand for extruded aluminum products continued to fall rapidly.[77] In the fall of 2008, massive losses spread throughout the financial system that impacted all aspects of the U.S. economy, including the aluminum extrusion market.[78] Accordingly, on the heels of the Lehman Brothers bankruptcy, Indalex required additional financing and Sun Capital agreed to make an additional loan of $15 million, which was funded in late November 2008.[79]

On March 20, 2009, nearly two years after Indalex declared the June 1, 2007 dividend and, in the worst economic crisis since the Great Depression, Indalex filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code.[80] On October 15, 2009, the Indalex bankruptcy was converted to a Chapter 7 case and George L. Miller was appointed trustee.[81]

G. After An Extensive Investigation, Plaintiff Sues Sun Capital And Certain Former Indalex Officers And Directors.

Nine months after his appointment, plaintiff filed the Sun Adversary on July 30, 2010.[82] There, plaintiff alleged that the June 1, 2007 dividend rendered Indalex insolvent and that the Indalex directors breached their duties in approving it.[83] Despite knowing

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[76] Sun Adversary Compl., at ¶ 181, Ex. 25.
[77] November 2008 Indalex Availability, at 2, Ex. 59.
[78] Norbert J. Michel, Ph.D., "Lehman Brothers Bankruptcy and the Financial Crisis: Lessons Learned," Sept. 12, 2013, http://www.heritage.org/research/reports/2013/09/lehman-brothers-bankruptcy-and-the-financial-crisis-lessons-learned#_ftnref1, last visited on May 8, 2014 (citation omitted), Ex. 60; Martin Neil Baily and Douglas J. Elliott, "The US Financial and Economic Crisis: Where Does It Stand and Where Do We Go From Here?," June 2009, http://www.brookings.edu/~/media/research/files/papers/2009/6/15-economic-crisis-baily elliott/0615_economic_crisis_baily_elliott.pdf, Ex. 61.
[79] Sun Adversary Compl., at ¶ 181, Ex. 25.
[80] Compl., D. I. 1 at ¶¶ 3, 5.
[81] *Id.* at ¶¶ 8-9.
[82] Sun Adversary Compl. at 1, Ex. 25.
[83] *Id.* at ¶¶ 179, 193, 197, 248, 260.

that Kirkland provided legal advice to the Indalex board, plaintiff did not name Kirkland as a defendant in that case and never sought to depose any Kirkland attorneys during discovery. The Sun Adversary is pending in the District Court where the District Court has taken defendants' motion to exclude plaintiff's sole expert under advisement.[84]

H. March 14, 2011: Plaintiff And Kirkland Enter Into A One-Year Tolling Agreement.

Eight months after initiating the Sun Adversary, plaintiff asked Kirkland to enter into a Tolling and Standstill Agreement (the "Tolling Agreement").[85] In that agreement, plaintiff acknowledged that ***"the statute of limitations with respect to one or more of Plaintiff's claims against Kirkland may expire on March 20, 2011."***[86] On March 14, 2011, six days before the statute of limitations expired, Kirkland agreed to toll all statutes of limitations from March 14, 2011 "through and including ***the earlier of*** (a) one year from [March 14, 2011] (subject to renewal as and when agreed by the parties) or (b) sixty (60) days following the termination of [the Tolling] Agreement in accordance with the provisions of paragraph 4 below."[87] Neither plaintiff nor Kirkland terminated the Tolling Agreement pursuant to paragraph 4 and, thus, it expired on March 14, 2012. Thereafter, the six days remaining on the statute of limitations began to run again. Plaintiff did not sue Kirkland during the six days after the Tolling Agreement expired.

I. May 14, 2012: Plaintiff Files His Untimely Claims Against Kirkland.

On May 14, 2012, nearly five years after Indalex declared the June 1, 2007 dividend, more than three years after Indalex filed bankruptcy, and 55 days after the statute of limitations expired, plaintiff filed this two-count complaint against Kirkland.

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[84] *Miller v. Sun Capital Partners, Inc., et al.*, C.A. No. 13-01996-RGA (D. Del.), D.I. 24 and 43.
[85] Compl., D.I. 1 at ¶ 38, n. 6.
[86] 3/14/11 Tolling Agreement at Recital F (emphasis added), Ex. 62.
[87] *Id.* at ¶ 1 (emphasis added).

Recognizing that his suit required a tolling theory to survive, plaintiff alleged that Kirkland had "deliberately concealed from Indalex" the fact that certain Kirkland partners had an indirect financial interest in Indalex through the PEFs.[88] Plaintiff asserted, moreover, that the PEFs' investments were "revealed, for the first time" during the April 17, 2012 deposition of Sun Capital co-founder Marc Leder in the Sun Adversary.[89] Accordingly, plaintiff claimed that Kirkland's alleged "conflict of interest was not discovered and could not be discovered by Indalex until after Plaintiff's appointment."[90]

In Count I, plaintiff claims that Kirkland "knowingly assisted [various Indalex] fiduciaries in violating their duties to Indalex" by "declaring a dividend which benefited them and rendered Indalex insolvent and/or was made at a time Indalex was already insolvent".[91] In search of a tolling theory, plaintiff alleges that "K&E's partners also received dividend proceeds as a result of K&E's complicity with Indalex's fiduciaries . . . The interest of these K&E partners was not discovered and could not be discovered by Indalex until after discovery commenced in [the Sun Adversary.]"[92]

In Count II, plaintiff claims that Kirkland committed professional negligence. More specifically:

- plaintiff alleges that Kirkland failed to ensure that the UK Intracompany Dividend complied with the laws of the United Kingdom;

[88] Compl., D.I. 1 at ¶ 34.
[89] *Id.* at ¶ 32.
[90] *Id.* at ¶ 38.
[91] *Id.* at ¶¶ 48-49, 51.
[92] *Id.* at ¶ 52.

- plaintiff claims that the unanimous consents that Kirkland lawyers prepared and Indalex used to declare the June 2007 dividend contained false statements;
- plaintiff asserts that Kirkland failed to ensure that FTI was qualified to perform the solvency analysis that it prepared for Indalex in connection with the June 2007 dividend;
- plaintiff challenges Kirkland's suggested edits to FTI's solvency opinion; and
- plaintiff claims that Kirkland should have advised Indalex that one of Kirkland's Washington, D.C. partners sits on the board of FTI's parent company and that Kirkland partners had an indirect ownership interest in Indalex through the PEFs.[93]

Kirkland moved to dismiss plaintiff's untimely complaint arguing that the Sun-affiliated members of the Indalex board knew about the PEFs' investments from the outset and, therefore, plaintiff's claims, both of which are premised on an alleged "investment conflict," were time-barred.[94] In response, plaintiff sought protection under the "self-dealing fiduciary exception," which tolls the statute of limitations when the only parties with knowledge of the key facts are self-dealing fiduciaries and their conspirators. Deferring to the allegations in plaintiff's complaint, Judge Peter J. Walsh denied Kirkland's motion and allowed the case to proceed to discovery.[95]

Discovery has revealed that Indalex itself knew about the investments because it disclosed them in the Bond Offering Memorandum and that the Bond Offering

[93] Plaintiff did not depose the Kirkland partner who sits on the Board of the parent company of FTI and, during discovery, plaintiff did not develop a single connection between that partner and Indalex.
[94] Motion to Dismiss, D.I. 10 and 11.
[95] 10/2/12 Letter Ruling and Order on Motion to Dismiss, D.I. 20 at 2.

Memorandum was widely circulated to Indalex's creditors and senior managers in 2006. For that reason, Kirkland renews its statute of limitations defense and, in addition, seeks summary judgment on the additional grounds set forth below.

III. ARGUMENT

Plaintiff's claims that Kirkland aided and abetted Indalex's board of directors to breach their fiduciary duties and committed professional negligence must fail for two reasons. First, without justification, plaintiff did not file this lawsuit within the applicable limitations periods. Second, there is no genuine issue of material fact that would allow plaintiff to proceed past summary judgment.

A. Plaintiff's Claims Are Time-Barred.

Although the parties agree that Delaware's three-year statute of limitations applies to plaintiff's aiding and abetting claim, they disagree as to whether Delaware's (three years) or Illinois' statute (two years) applies to his professional negligence claims.[96] Because his claims are time-barred under either statute, for purposes of this motion only, defendant assumes that Delaware's three-year statute applies to both claims.

1. Plaintiff Missed The Deadline For Bringing This Lawsuit.

Plaintiff's claims accrued on June 1, 2007 when Indalex paid the dividend. In Delaware, "the statute of limitations begins to run, *i.e.*, the cause of action accrues, at the time of the alleged wrongful act, even if the plaintiff is ignorant of the cause of action." *In re Dean Witter P'ship Litig.*, C.A. No. 14816, 1998 WL 442456, at *4 (Del. Ch. July

[96] *See Shea v. Delcollo & Werb, P.A.*, 977 A.2d 899 (Del. 2009) (citing 10 Del. C. § 8106 ("No action to recover damages caused by an injury unaccompanied with force or resulting indirectly from the act of the defendant shall be brought after the expiration of three years from the accruing of the cause of such action.")); *Gale v. Williams*, 701 N.E.2d 808, 811 (Ill. App. Ct. 1998) (citing 735 ILCS 5/13-214.3(b)) (noting that a two-year statute of limitations "govern[s] personal actions against attorneys" and "[a]n action for damages . . . must be commenced within 2 years from the time the person bringing the action knew or reasonably should have known of the injury for which damages are sought").

17, 1998) *aff'd*, 725 A.2d 441 (Del. 1999) (holding plaintiffs' breach of fiduciary duty claims accrued when they purchased certain partnership interests causing injury); *HealthTrio, Inc. v. Margules*, C.A. No. 06C-04-196, 2007 WL 544156, at *7 (Del. Super. Ct. Jan. 16, 2007) (holding statute of limitations accrued on date attorney provided legal advice).

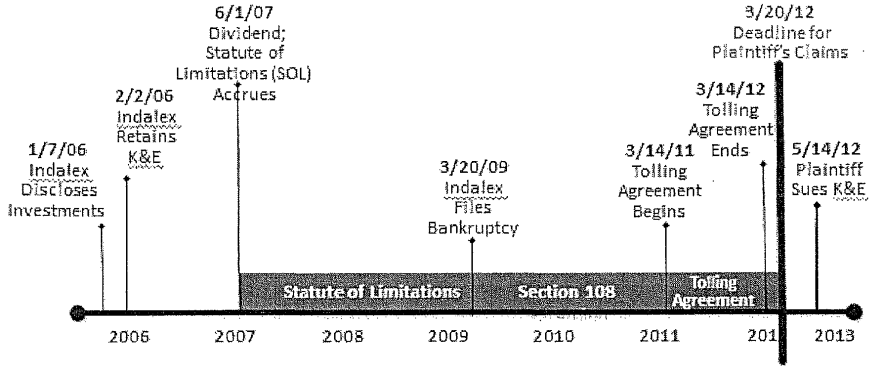
Here, plaintiff's entire aiding and abetting claim derives from his belief that Kirkland knowingly assisted Indalex's directors to breach their fiduciary duties when they declared the dividend on June 1, 2007.[97] Similarly, plaintiff's professional negligence claim derives from the legal services Kirkland performed "relating to the dividend."[98] Because plaintiff's claims center on advice Kirkland provided "relating to the dividend," which Indalex declared on June 1, 2007, plaintiff's claims accrued—and the statute of limitations began to run—on June 1, 2007.

Although the statute of limitations would have expired three years later, on June 1, 2010, Section 108 of the Bankruptcy Code afforded plaintiff an additional two years from the date of the bankruptcy to file his claims against Kirkland. *See* 11 U.S.C. § 108(a) (2012). Indalex filed for bankruptcy on March 20, 2009; accordingly, Section 108 extended the time for plaintiff to file this lawsuit until March 20, 2011.

Instead of filing his complaint by that date, however, plaintiff asked Kirkland to agree to the Tolling Agreement, which "stopped the clock" for one year beginning on March 14, 2011.[99] But as March 14, 2012 approached, plaintiff did nothing. As a result, the Tolling Agreement terminated and the "clock" resumed on March 14, 2012. From that point, plaintiff had six days (the time remaining before the Section 108 extension

[97] Compl., D.I. 1 at ¶¶ 46-53.
[98] *Id.* at ¶¶ 55-61.
[99] 3/14/11 Tolling Agreement at 1, Ex. 62.

expired)—or until March 20, 2012—to file his complaint. Yet still he did nothing and instead, plaintiff waited until May 14, 2012—***55 days after the statute of limitations expired***—to file this lawsuit.[100] The following timeline is illustrative:



2. **The Discovery Rule Cannot Save Plaintiff's Claims.**

Aware that he inexcusably missed his deadline, plaintiff claims that Indalex could not have discovered that it had potential claims against Kirkland until April 2012 when plaintiff allegedly first learned about the PEFs' investments or until he became Indalex's trustee.[101] Plaintiff is wrong on the law and the facts.

[100] The fact that plaintiff filed his complaint 61 days after the Tolling Agreement expired suggests that plaintiff erroneously believed that the Tolling Agreement afforded him an additional 60 days in which to file his claim. The Tolling Agreement tolled the period from March 14, 2011 "through and including ***the earlier of*** (a) one year from [March 14, 2011] (subject to renewal as and when agreed by the parties) or (b) sixty (60) days following the termination of this Agreement in accordance with the provisions of paragraph 4 below". *See* 3/14/11 Tolling Agreement at 2, Ex. 62. Paragraph 4 makes clear that the 60-day period only applies if one of the parties elects in writing to terminate the agreement. *Id.* at 2-3. Because neither party elected to terminate the Tolling Agreement, plaintiff's deadline for filing his claim was March 20, 2012. Nevertheless, even if plaintiff had an additional 60 days to file (which he did not), plaintiff failed to file in time.

[101] Compl., D.I. 1 at ¶¶ 51, 57.

a. Plaintiff Stands In Indalex's Shoes.

At the threshold, plaintiff incorrectly claims that he should be exempt from the statute of limitations because he was not appointed until October 30, 2009 and therefore could not have discovered the facts that give rise to his claims until then.[102] In other words, plaintiff argues that his knowledge—as opposed to Indalex's—is determinative. He is wrong. Although the trustee, as successor to the debtor's interest, has standing to assert claims belonging to the debtor, he is "subject to the same defenses as could have been asserted by the defendant had the action been instituted by the debtor." *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356 (3d Cir. 2001) (quoting *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1154 (3d Cir. 1989)). In other words, the "trustee stands in the shoes of the debtor." *Id.*

Thus, as Indalex's trustee, plaintiff stands in the shoes of the company and Indalex's knowledge—including the fact that it knew, in 2006, about the investments and, in 2007, that Kirkland provided legal services to Indalex in connection with the dividend—is imputed to plaintiff. *See id.* at 356 (quoting Senate Report to the Bankruptcy Reform Act of 1978: "[I]f the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations, then the trustee would not be able to pursue that claim, because he too would be barred. He could take no greater rights than the debtor himself had.").

[102] *Id.* at ¶¶ 10, 38.

b. Indalex Knew About The PEFs' Investments And The Alleged Injury In June 2007.

Moreover, to the extent plaintiff claims that the statute of limitations should be tolled because Indalex was allegedly unaware of the facts underlying plaintiff's claims until April 2012, plaintiff is wrong.

"[A]ny possible tolling exception to the strict application of the statute of limitations [including the discovery rule] tolls the statute '*only until* the plaintiff discovers (or [by] exercising reasonable diligence should have discovered) his injury.'" *Pomeranz v. Museum Partners, L.P.*, C.A. No. 20211, 2005 WL 217039, at *3 (Del. Ch. Jan. 24, 2005) (citing *Dean Witter*, 1998 WL 442456 at *6) (emphasis in original). To toll the limitations period, "there must have been no observable or objective factors to put a party on notice of an injury, and plaintiffs must show that they were blamelessly ignorant of the act or omission and the injury." *Dean Witter*, 1998 WL 442456 at *5. "Once a plaintiff is on notice of facts that ought to make her suspect wrongdoing, she is obliged to diligently investigate and to file within the limitations period as measured from that time." *Pomeranz*, 2005 WL 217039 at *13. "Inquiry notice does not require actual discovery of the reason for the injury. Nor does it require plaintiffs' awareness of all of the aspects of the alleged wrongful conduct." *Dean Witter*, 1998 WL 442456 at *7.

Pomeranz is instructive. In that case, certain partners in an investment vehicle sued other partners claiming that they aided and abetted a breach of fiduciary duty when they withdrew from the partnership. *See Pomeranz*, 2005 WL 217039 at *8. Plaintiffs argued that the discovery rule tolled the statute of limitations because they were not aware of their injury until they received the terms of the withdrawal agreement. *Id.* at *10. The court disagreed and held that the clock started as soon as they received

financial schedules that "should have raised their eyebrows regarding what was happening to the financial strength of the partnership" because a "rational investor should have been suspicious that the reported withdrawal of 66% of the Partnership's capital in mid-February 2000—or over $12 million had injured the Partnership." *Id.* at *10, *13. The court dismissed plaintiffs' claims as untimely noting that plaintiffs' ignorance of the "full economic impact of the wrong" and the precise cause of the wrong was irrelevant and the discovery rule only tolled the statute of limitations until plaintiffs were on notice of the general financial impact of defendants' actions. *Id.* at *12.

Here, as in *Pomeranz*, Indalex was not blamelessly ignorant that its payment of the dividend allegedly injured the company. Indeed, plaintiff himself claims "***Indalex knew or should have known that the payment of [the] dividend did or would render Indalex insolvent.***"[103] Even absent this "admission," the undisputed facts show that, as of June 1, 2007, Indalex knew:

- Kirkland represented both Sun and Indalex;
- Kirkland provided legal advice to Indalex regarding the dividend;
- Kirkland prepared the draft board resolutions related to the dividend for Indalex's board of directors to review; and
- Indalex paid a dividend of approximately $76 million to its shareholders.[104]

Because, Indalex knew or should have known that the payment of the dividend would (according to plaintiff) harm Indalex, and Indalex knew that Kirkland provided advice to Indalex regarding the dividend, at a minimum, Indalex was on inquiry notice of its claims.

[103] Sun Adversary Compl. at ¶ 197 (emphasis added), Ex. 25.
[104] Compl., D.I. 1 at ¶¶ 3, 35, 40.

Nevertheless, throughout his complaint, plaintiff repeatedly claims that the statute of limitations should be tolled because Indalex was unaware of the alleged "investment conflict" Kirkland "deliberately concealed."[105] But this allegation also cannot save plaintiff's claims because the undisputed facts show that Indalex knew about the PEFs' investments in early 2006—well before the June 2007 Dividend.[106] Indalex's own Bond Offering Memorandum expressly disclosed the Kirkland partners' investments.[107] Indalex shared the document with its creditors and also sent the Bond Offering Memorandum to 23 of its senior executives in early 2006.[108] Plaintiff has nothing to refute this evidence.

Furthermore, now that plaintiff must support his allegations with evidence, he cannot argue, as he did in opposition to Kirkland's motion to dismiss, that the only people at Indalex who knew that certain Kirkland partners invested in funds that invested in funds that invested in Indalex were allegedly self-dealing fiduciaries on Indalex's

[105] *Id.* at ¶ 34.

[106] Even if the PEFs' investments had not been disclosed to Indalex and its creditors, the discovery rule still would not save plaintiff's tardy claims because Indalex was aware of its alleged injury upon the payment of the dividend. "It is ***not notice of the negligence or cause of the injury***, but rather ***notice of the injury***, which triggers the running of the statute of limitations". *Estate of Buonamici v. Morici*, C.A. No. 08C-10-231, 2010 WL 2185966, at *3 (Del. Super. Ct. June 1, 2010) (emphasis added); *see also Pomeranz*, 2005 WL 217039 at *11 (noting that the operation of the discovery rule ceases "[o]nce a plaintiff is on notice of facts that ought to make [plaintiff] suspect wrongdoing"); *Dean Witter*, 1998 WL 442456 at *6 (noting that the "statute of limitations ceases to be tolled when the plaintiff is put on inquiry notice of the alleged wrongs").

[107] 1/30/06 Bond Offering Memorandum at 210, Ex. 23.

[108] *See supra* n. 47. Plaintiff also cannot claim that it was unaware of the investments because it never read the Bond Offering Memorandum because, "one who assents to a writing is presumed to know its contents and cannot escape being bound by its terms merely by contending that he did not read them." *See In re Stock Bldg. Supply, LLC*, 433 B.R. 460, 467 (Bankr. D. Del. 2010) (internal citations omitted).

board of directors.[109] *See Bovay v. H.H. Byllesby & Co.*, 38 A.2d 808 (Del. 1944) (applying self-dealing fiduciary exception to toll statute of limitation). The undisputed facts confirm that the PEFs' investments were known to non-insider employees and executives of Indalex long before Indalex declared the dividend. No one—not a bondholder, not Cravath (counsel for the bondholders), and not a single Indalex employee—ever complained about the PEFs' investments. Indalex knew of the facts comprising all of his claims against Kirkland immediately after the dividend. Therefore, plaintiff cannot rely on tolling principles to save his untimely claims and the Court should enter judgment for Kirkland because plaintiff failed to timely file this action.

B. Plaintiff Cannot Establish Essential Elements Of Either Of His Claims.

1. Kirkland Did Not Have An Undisclosed Conflict Of Interest.

The gravamen of plaintiff's entire case is his claim that Kirkland had an undisclosed conflict of interest because some Kirkland lawyers invested in funds that invested in funds that invested in Indalex. But the undisputed evidence confirms that Kirkland disclosed the investments to Indalex and its creditors and that the *de minimis*, passive investments did not create a conflict in any event. Because there was no conflict, the Court should enter summary judgment on all claims for Kirkland.

First, as discussed in detail above, the PEFs' investments were disclosed to Indalex and its creditors at the time of the Indalex acquisition.

Second, plaintiff's conflict argument is contrary to established authority. When evaluating whether a lawyer's personal interest could give rise to a conflict, "[t]he

[109] Plaintiff's Opposition to Kirkland & Ellis LLP's Motion to Dismiss, D.I. 17, at 11; *see also* 10/2/12 Order on Motion to Dismiss, D.I. 20 at 2 (quoting *Laventhol, Krekstein, Horwath & Horwath v. Tuckman*, 372 A.2d 168 (Del. Supr. 1976)).

circumstances of each potential conflict must be analyzed, taking into account such factors as the extent and value of the lawyer's ownership interest relative to [his or] her overall income and assets and the client's capitalization, the type of legal service being provided, and the possible effect of the lawyer's ownership stake upon the lawyer's actions and recommendations." *Lawyer's Interests Adverse to Client*, ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:407 (2012); *see also Acquiring Ownership in a Client in Connection with Performing Legal Services*, ABA COMM. ON ETHICS AND PROF 1 RESPONSIBILITY, Formal Op. 00-418 at 7 (July 7, 2000) ("ABA Comm., Formal Op. 00-418") ("A lawyer's representation of a corporation in which she owns stock creates no inherent conflict of interest....").

A conflict of interest exists under Rule 1.7 only if there is a "significant risk" that a lawyer's "personal interest[s]" will "materially limit[]" the representation of one or more clients.[110] Numerous commentators have confirmed that small ownership interests in clients do not give rise to a conflict and need not be disclosed. *See Lawyer's Interests Adverse to Client*, ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:407 (2012); *see also id.* at 51:405 ("Slight interests that would be unlikely to have much if any impact on a representation do not even need to be disclosed to the client."); MALLEN & SMITH, LEGAL MALPRACTICE § 16.8 (2014 ed.) (recognizing that conflicts may be avoided by limiting ownership in a client to a nonmaterial sum, such as less than 5%). This issue often arises in the analogous context where a lawyer invests in a mutual fund

[110] A "significant risk" is a risk that is "significant and plausible" and requires "more than a mere possibility of adverse effect." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 cmt. c.(iii) (2014). And, "materially limited" concerns the lawyer's "ability to consider, recommend or carry out an appropriate course of action for the client" while exercising "independent professional judgment." Del. Prof. Cond. R. 1.7(a) cmt. [8]; *see also* Ill. Prof. Cond. R. 1.7(a) cmt. [8] (same).

which invests in the lawyer's client or adversary.[111] In such instances, the lawyer is not conflicted when either representing, or adverse to, one of the mutual fund's portfolio investments. *See* ABA COMM., Formal Op. 00-418 at 2, n.7 (citing authorities that permit lawyers to acquire client stock in an open market).

Here, the PEFs' investments, individually and collectively, represented a *de minimis* indirect interest in Indalex. Moreover, similar to a mutual fund, the Kirkland lawyers did not have any control over the management committee's decision to invest in the Sun Capital funds.[112] Likewise, when the management committee committed to the Sun Capital funds, it relinquished all control over how the Sun Capital funds invested the PEFs' capital.[113] In short, the Kirkland lawyers' held *de minimis* indirect interests in Indalex and had no control over those indirect interests. As such, the indirect investments did not present a conflict under Rule 1.7.

Nor did the indirect investments violate Rule 1.8. Rule 1.8(a) prohibits lawyers from entering into business transactions or knowingly acquiring an interest adverse to a client. *See id.* However, "Rule 1.8(a) does not . . . apply when the lawyer acquires stock in an open market purchase or in other circumstances not involving direct intervention by the client." ABA COMM., Formal Op. 00-418 at n.7 (unlike where a lawyer accepts an interest in a client in connection with a fee for legal services). As plaintiff's own expert admits the"[Kirkland's partners] were not entering into a business transaction [with Indalex]."[114] Nor did the Kirkland partners acquire an interest adverse to the client. As

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[111] 1/12/15 Expert Report of P. Clarkson Collins, Jr., Esquire at ¶ 33, Ex. 63.
[112] *See supra* n. 8.
[113] Levin Tr. at 76:20-77:19; 155:1-18, Ex. 1.
[114] Select pages of the Transcript of the Deposition of Lawrence Fox ("Fox Tr.") at 196:6-13 ("[Kirkland's partners] were not entering into a business transaction [with Indalex]"), 196:23-200:5 (admitting to the underlying factual predicate), Ex. 64

investors, their interest was to see the Sun Capital funds, and their portfolio companies, like Indalex, succeed.

Because Kirkland disclosed the PEFs' investments and they do not create a conflict of interest in any event, plaintiff cannot present any evidence to support the underlying predicate for all of his claims.

2. **Plaintiff Cannot Establish Essential Elements Of His Aiding And Abetting Claim.**

Even assuming this case was timely (it is not), plaintiff's aiding and abetting claim also fails because plaintiff cannot establish that Indalex's directors breached their fiduciary duties or that Kirkland knowingly helped them to do so. *See Houseman v. Sagerman*, C.A. No. 8897-VCG, 2014 WL 1600724, at *9 (Del. Ch. Apr. 16, 2014) ("[K]nowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach." (quoting *Malpiede v. Townson*, 780 A.2d 1075, 1097 (Del. 2001)).

a. **Plaintiff Cannot Establish An Underlying Breach.**

Plaintiff claims that Kirkland aided and abetted Indalex's directors in breaching their fiduciary duties when they declared the June 1, 2007 dividend that allegedly rendered Indalex insolvent.[115] But plaintiff has no evidence that the June 1, 2007 dividend actually rendered Indalex insolvent, and, therefore, cannot demonstrate a breach, causation, or damages.[116] To prove insolvency, a trustee "must establish a reasonable estimate of cash conversion based upon balance sheets, financial statements, appraisals, expert testimony and other affirmative evidence." *In re Thomas Farm Sys.,*

[115] Compl., D.I. at ¶ 48.
[116] *See Houseman*, 2014 WL 1600724 at *9 (plaintiff must establish underlying breach of fiduciary duty).

Inc., 18 B.R. 541, 543 (Bankr. E.D. Pa. 1982) (finding statement of the debtor's president not sufficient to satisfy the balance-sheet test and establish insolvency) (citing *Constructora Maza Inc. v. Banco de Ponce*, 616 F.2d 573 (1st Cir. 1980); *In re Fulghum Construction Co.*, 7 B.R. 629 (Bankr. M. D. Tenn. 1980)). Courts typically rely on expert testimony in determining whether a company is insolvent. *See e.g., Brandt v. Samuel, Son & Co., Ltd. (In re Longview Aluminum, L.L.C.),* C.A. No. 03 B 12184, 2005 Bankr. LEXIS 1312, at *17 (Bankr. N.D. Ill. July 14, 2005) ("It is generally accepted that whenever possible, ***a determination of insolvency should be based on seasonable appraisals or expert testimony***.") (emphasis added); *Miller & Rhoads, Inc. Secured Creditors' Trust v. Robert Abbey, Inc. (In re Miller & Rhoads, Inc.),* 146 B.R. 950, 956 (Bankr. E.D. Va. 1992) ("Numerous cases have held that the schedules are not dispositive or controlling and that courts should rely upon more accurate evidence, such as current appraisals, opinion testimony or actual sales of the assets in determining insolvency.") (citation omitted); *see also In re Am. Classic Voyages Co.*, 367 B.R. 500, 508 (Bankr. D. Del. 2007), *aff'd sub nom.*, 384 B.R. 62 (D. Del. 2008) (considering expert testimony in determining insolvency).

Here, plaintiff did not identify a solvency expert and his only expert, Lawrence Fox, admits that he is not qualified to opine on issues of solvency.[117] Mr. Fox's, opinion was limited to the alleged conflicts of interest and he specifically disavowed any opinion

[117] Pursuant to the Court's Order Approving Stipulation Regarding Sixth Amended Scheduling Order ("Order"), plaintiff was required to "designate his expert(s) and serve copies of all initial expert report(s) on November 13, 2014." Order, D.I. 55; *see also* Stipulation Regarding Sixth Amended Scheduling Order, D.I. 54-2 (emphasis added); Fox Tr. 14:24-15:2 ("I am not an expert on solvency issues"), Ex. 64.

on solvency as irrelevant to his analysis.[118] Without a qualified expert,[119] plaintiff cannot rebut the testimony of Kirkland's expert who concluded that Indalex was solvent.[120]

In fact, the overwhelming undisputed evidence in this case confirms that the June 1, 2007 dividend did not render Indalex insolvent. ***First,*** Kirkland's expert John Finnerty reviewed Indalex's records and determined that the payment of the June 1, 2007 dividend would not render the company insolvent. ***Second,*** Indalex's bonds continued to trade ***above par*** well after the Indalex paid the June 1, 2007 dividend and Indalex's first lien creditors under the company's revolver permitted the dividend to be paid.[121] *See VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 623-33 (3d Cir. 2007) (reviewing contemporaneous market valuations, including price of bonds, as "strong evidence that VFI was solvent at the time of" transfer); *In re Old CarCo LLC*, 435 B.R. 169, 193 (Bankr. S.D.N.Y. 2010). ***Third,*** Indalex's auditors' determined that Indalex had "sufficient availability of borrowings and sufficient ability to generate cash flow and will be able to continue as a going concern ***through 2008.***"[122] *See In re AbitibiBowater Inc.*, C. A. No. 09-11296, 2010 WL 4823839, at *6 (Bankr. D. Del. Nov. 22, 2010) ("The Debtors' public filings substantiate that Bowater was solvent at the time. For example, in rendering its opinion on Bowater's Form 10-K for 2007, the Company's outside auditors, Pricewaterhouse Coopers, did not express any going concern qualification.").

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[118] 11/13/14 Expert Report of Lawrence Fox, Ex. 65.

[119] Plaintiff cannot rely on the opinion of his solvency expert in the Sun Adversary because plaintiff did not disclose him in this case. Although the parties entered into an agreement that discovery from the Sun Adversary case would be admissible in this case, there is no such agreement with respect to expert reports or opinions. Accordingly, under Rule 26, plaintiff had to disclose his experts on November 13, 2014 but plaintiff did not do so

[120] Finnerty Report at ¶ 10, Ex. 52.

[121] Finnerty Report at ¶¶ 171-86 and Exhibit 50 thereto, Ex. 52; Bond Trade Activity for Indalex Holding Corp, Ex. 53.

[122] 3/30/08 Crowe Horwath Workpaper, at 11 (emphasis supplied), Ex. 66; select pages of Transcript of Deposition of Alexander Wodka at 111:13-118:6, Ex. 67.

Fourth, independent market analysts, including Standard & Poor's, Moody's, and Goldman Sachs, affirmed this view.[123] These contemporaneous opinions of independent analysts, free of litigation bias, are compelling evidence of Indalex's solvency, which plaintiff cannot rebut. *See VFB LLC v. Campbell Soup Co.*, C.A. No. 02-137, 2005 WL 2234606, at *13 (D. Del. Sept. 13, 2005) (noting that assessments of value by investment analysts and other "contemporaneous evidence of fair market value has the advantage of being untainted by hindsight or *post-hoc* litigation interests"); *In re Iridium Operating LLC*, 373 B.R. 283, 349 (Bankr. S.D.N.Y. 2007).

Fifth, Indalex continued to operate for ***more than 22 months*** after it paid the June 1, 2007 dividend, failing only after aluminum demand dropped to its lowest levels in 20 years.[124] It strains credibility to think that Indalex's stakeholders sat on their hands for almost two years if Indalex was insolvent in June of 2007. *See In re Prime Realty, Inc.*, 380 B.R. 529, 537 (8th Cir. 2007) (finding fact that debtor "continued to operate as a going concern for almost a year after it remitted the Transfers" supported conclusion that debtor was solvent at time of transfer); *In re Iridium*, 373 B.R. at 348 (contemporaneous actions of stakeholders are powerful evidence of solvency).

Sixth, Indalex management concluded that Indalex would remain solvent following the payment of a much larger dividend.[125] And Indalex hired FTI to evaluate

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[123] Bloomberg Bond Rating for Indalex Holding Corp., Ex. 68; 6/6/07 E-mail from Alger to Stubbs, Williams, and Kavanaugh ("S&P is raising our bank rating up one notch due to collateral quality b from b-."), Ex. 70; 8/24/07 Goldman Sachs Analyst Report for Indalex Holding Corp., Ex. 69; 11/16/07 Goldman Sachs Analyst Report for Indalex Holding Corp., Ex. 71.

[124] 3/20/09 Stubbs Decl. in Supp. of Ch. 11 Petitions ¶¶ 26-28, Ex. 72.

[125] 4/19/07 E-mail from Alger to Garff ("Net, net, the numbers suggest that we should not have an availability/liquidity issue if the maximum RPs are made."), Ex. 73.

Indalex's solvency.[126] After a thorough analysis, FTI determined that Indalex's assets (debt free) would exceed its liabilities by over $60 million, even if Indalex paid a $114 million—rather than $76 million—dividend.[127] During his deposition, Rick Braun of FTI testified that the solvency opinion was conservative.[128]

Because the undisputed evidence confirms that Indalex was solvent in June 2007, plaintiff cannot establish that the Indalex directors breached their fiduciary duties to Indalex and therefore his aiding and abetting claim against Kirkland fails.

b. Plaintiff Cannot Demonstrate That Kirkland Knowingly Assisted The Directors To Breach Their Fiduciary Duties.

Even if plaintiff could prove that the directors breached their fiduciary duties (and he cannot), he cannot demonstrate that Kirkland "acted with knowledge" that the June 1, 2007 dividend violated Delaware law. "[K]nowing participation in a board's fiduciary breach requires that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach." *Houseman*, 2014 WL 1600724 at *9. (quoting *Malpiede v. Townson*, 780 A.2d 1075, 1097 (Del. 2001)). A third party knowingly participates in a breach of the duty of care if it "knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum," or otherwise "purposely induce[s] the breach of the duty of care." *Id.* (quoting *In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54 (Del. Ch. Mar. 7, 2014)).

[126] 5/14/07 FTI Engagement Letter, Ex. 40;
[127] 6/1/07 Final FTI Report at 1, Ex. 35.
[128] Braun Tr. at 163:11-24; 171:5; 199:24; 200:2-24; 224:23-225:65 (noting "conservative" assumptions made by FTI); 209:21-210:6 ("I've since reviewed what we did, standing here now five years later I still feel that what we did was a reasonable and professional job and that the conclusions we reached were supportive."), Ex. 44.

Here, the undisputed evidence shows that Kirkland had no knowledge, and no reason to believe, that the payment of the June 1, 2007 dividend would render Indalex insolvent. Kirkland appropriately and reasonably relied on the business judgment of Indalex management, FTI, and external factors in the marketplace,[129] all of which indicated that Indalex could pay the June 1, 2007 dividend.[130] The possible payment of the June 1, 2007 dividend was anticipated at the time of the acquisition and calculated in accordance with the formula set forth in the bond indenture and credit agreement.[131] Indalex retained FTI to prepare a solvency report to confirm that it could lawfully proceed. After weeks of inquiry and analysis, FTI confirmed Indalex was solvent.[132] Both management's and FTI's conclusions were supported by information in the marketplace and audit reports.[133] Plaintiff has no evidence that Kirkland knowingly assisted Indalex in declaring an unlawful dividend and, as a result, plaintiff cannot prove that Kirkland aided and abetted the Indalex directors' alleged breach of fiduciary duty.

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[129] 1/12/15 Expert Report of Richard M. Leisner at 22 ("As a general rule, outside corporate counsel in a transaction is entitled to rely on information provided by the client and other responsible third parties."), Ex. 74.

[130] *See In re Iridium*, 373 B.R. at 350 ("Without a firm basis to replace management's cost projections with those developed for litigation, the starting point for a solvency analysis should be management's projections.") (citing *In re Longview Aluminum, L.L.C.*, 2005 WL 3021173, at *9); *see also In re Plassein*, C.A. No. 03-11489, 2008 WL 1990315, at *8 (Bankr. D. Del. May 5, 2008) ("When there is substantial evidence presented to show that the business plan was prepared in a reasonable manner, using supportable assumptions and logically consistent computations, the plan constitutes a fair, reasonable projection of future operations and alternative projections of future operations should be rejected.").

[131] 5/21/07 Goldman Sachs Credit Research, Company Update at 1 ("not surprised to see a large dividend"), Ex. 36; Compl., D.I. 1 at ¶ 3.

[132] *See* Shultz Tr. at 126:9-13 (as the engagement partner who signed the FTI final report Shultz stands behind FTI's work); 124:23-125:19 (having no reservations about FTI's conclusions that following the consummation of the pay down of Indalex debt and the payment of the any AAG-related divided), Ex. 39.

[133] *See e.g.* Indalex Finance Annual Report on Form 10-K for the Year Ended December 31, 2006 (no indication of insolvency or financial difficulties), Ex. 54; *see also* 5/21/07 Goldman Sachs Credit Research, Company Update at 1, Ex. 36; 11/20/06 Goldman Sachs Analyst Report for Indalex Holding Corp., Ex. 75.

3. **Plaintiff Cannot Establish Essential Elements Of His Professional Negligence Claim.**

Similarly, plaintiff's professional negligence claim fails because he cannot establish that Kirkland's advice with respect to the June 1, 2007 dividend fell below the standard of care. It is well settled that expert testimony is required to establish the standard of care.[134] *See Pinckney v. Tigani*, C.A. No. 02C-08-129, 2004 WL 2827896, at *3 (Del. Super. Nov. 30, 2004) ("It is well settled under Delaware law that claims of legal malpractice must be supported by expert testimony.") (citation omitted).

Plaintiff's expert, Mr. Fox, is an ethicist and litigator not a transactional lawyer.[135] His experience is in the field of ethics and professional responsibility, and not in the payment of publicly disclosed dividends.[136] And he admits that he is not qualified to opine on corporate transactions, private equity transactions, valuations, or solvency issues.[137] Without this expertise, Mr. Fox cannot establish the standard of care that a "reasonably prudent" attorney should have exercised "under the circumstances."[138] *See*

[134] To prove a legal malpractice/professional negligence claim, a plaintiff must establish: "(1) the employment of an attorney; (2) the attorney's neglect of a professional obligation; and (3) resultant loss." *Ashby & Geddes, P.A. v. Brandt*, 806 F. Supp. 2d 752, 757 (D. Del. 2011) (quoting *Edelstein v. Goldstein*, C.A. No. 09C-034, 2011 WL 721490, at *6 (Del. Super. Mar. 1, 2011)). Thus, a plaintiff "must establish the applicable standard of care through the presentation of expert testimony, a breach of that standard of care, and a causal link between the breach and the injury." *Phillips v. Wilks, Lukoff & Bracegirdle, LLC*, C.A. No. 671-2013, 2014 WL 4930693, at *3 (Del. Supr. Oct. 1, 2014) (citing *Middlebrook v. Ayres*, C.A. No. 02C-07-203, 2004 WL 1284207, at *5 (Del. June 9, 2004) (quoting *Weaver v. Lukoff*, 511 A.2d 1044, 1 (Del. 1986)).

[135] Fox Tr. at 13:16-21 (Fox is a trial attorney), Ex. 64.

[136] *Id.* at 13:22-14:6 (Fox teaches legal ethics and consults with law firms about professional responsibility).

[137] *Id.* at 14:14-15 ("I am not an expert in corporate transactions"); 14:16-20 ("I am not an expert on private equity transactions"); 14:21-22 ("I am not an expert valuations"); 14:24-15:2 ("I am not an expert on solvency issues").

[138] *See supra* n. 133; *see also Ruthenberg v. Kimmel & Spiller, P.A.*, C.A. No. 79C-DE-17, 1981 WL 383091, at *2 (Del. Super. Mar. 17, 1981) (finding expert opinion insufficient where expert provides "conclusory opinion as to the ultimate fact in issue without setting forth the standard the facts are being measured against").

Waldorf v. Shuta, 142 F.3d 601, 625 (3d Cir. 1998) (holding expert witness must have specialized knowledge regarding the area of testimony based on practical experience, academic training, and/or credentials).

In contrast, the admissible evidence confirms that Kirkland met the appropriate standard of care with respect to the work it performed on behalf of Indalex. Kirkland's three experts have testified that Kirkland's professional services in connection with the preparation of the written consents approving the June 1, 2007 dividend satisfied the applicable standards of skill, care and diligence for competent counsel in similar circumstances,[139] Kirkland acted consistent with customary practice in private equity transactions when it undertook to represent Indalex, and when it negotiated the wording of the solvency opinion with FTI,[140] and Indalex's Board of Directors was well-informed, thoughtful, and acted in accordance with good corporate governance practices when it declared the June 1, 2007 dividend.[141] Because plaintiff has nothing other than his own bald assertion that Kirkland violated the standard of care and the undisputed evidence demonstrates otherwise, plaintiff's professional negligence claim fails.

IV. CONCLUSION

For the reasons set forth above, the Court should enter summary judgment for Kirkland on plaintiff's untimely claims.

[139] 1/12/15 Expert Report of Richard M. Leisner at 9, Ex. 74.
[140] 1/7/15 Report from William H. Coquillette at 2-3, Ex. 30.
[141] 1/9/15 Expert Report of Jonathan Macey at 3, Ex. 76.

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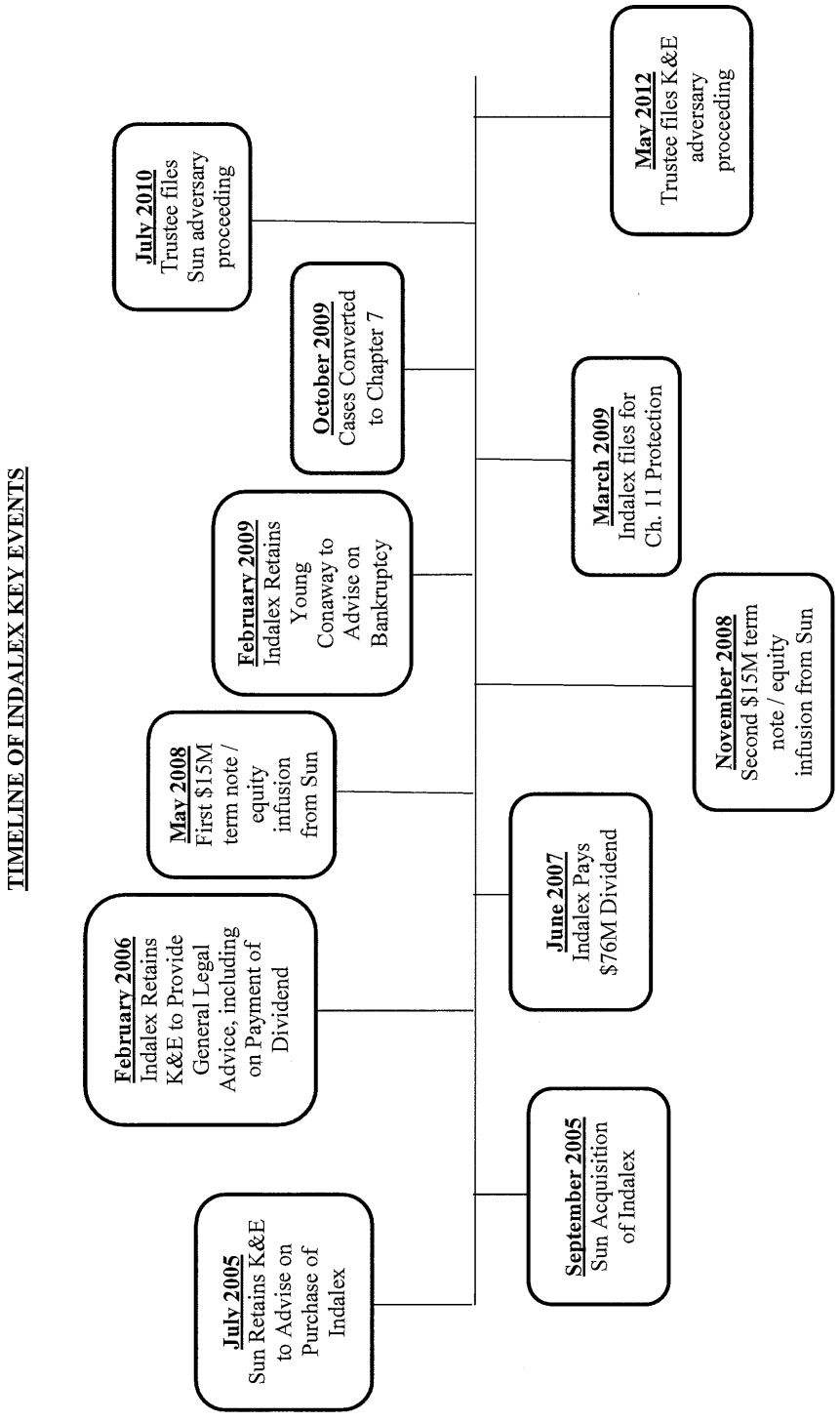
Dated: June 19, 2015

Appendix 4: Timeline

US.105994191.02


TIMELINE OF INDALEX KEY EVENTS
July 2005
Sun Retains K&E to Advise on Purchase of Indalex
February 2006
Indalex Retains K&E to Provide General Legal Advice, including on Payment of Dividend
September 2005
Sun Acquisition of Indalex
May 2008
First $15M term note / equity infusion from Sun
June 2007
Indalex Pays $76M Dividend
February 2009
Indalex Retains Young Conaway to Advise on Bankruptcy
November 2008
Second $15M term note / equity infusion from Sun
October 2009
Cases Converted to Chapter 7
March 2009
Indalex files for Ch. 11 Protection
July 2010
Trustee files Sun adversary proceeding
May 2012
Trustee files K&E adversary proceeding

APPENDIX 5 – *Best Practices Report on Electronic Discovery (ESI) Issues in Bankruptcy Cases*

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Best Practices Report on Electronic Discovery (ESI) Issues in Bankruptcy Cases*

By ABA Electronic Discovery (ESI) in Bankruptcy Working Group

The ABA Electronic Discovery (ESI) in Bankruptcy Working Group is part of the ABA Business Law Section's Committee on Bankruptcy Court Structure and the Insolvency Process. The Electronic Discovery (ESI) in Bankruptcy Working Group was formed to study and prepare guidelines or a best practices report on the scope and timing of a party's obligation to preserve electronically stored information ("ESI") in bankruptcy cases. The issues studied by the Working Group include the scope and timing of a Chapter 11 debtor-in-possession's obligation to preserve ESI not only in connection with adversary proceedings, but also in connection with contested matters and the bankruptcy case filing itself, and the obligations of non-debtor parties to preserve ESI in connection with adversary proceedings and contested matters in a bankruptcy case. Because to date there appears to have been only very limited study and reported case authority on ESI-related issues in bankruptcy, it seemed to be an appropriate time to provide more focused guidance on this subject.

The Electronic Discovery (ESI) in Bankruptcy Working Group is comprised of judges, former judges, bankruptcy practitioners, litigation attorneys experienced in bankruptcy and general civil litigation, representatives of the Executive Office for United States Trustees, and law professors knowledgeable in the field of bankruptcy law. The Working Group includes persons with experience in business and consumer bankruptcy cases, large and small Chapter 7, Chapter 11, and Chapter 13 cases, and e-discovery matters in litigation. The goal in forming the Working Group was to provide a broad range of perspectives and experience.

The general subject of electronic discovery (ESI) issues in litigation has engendered much commentary, discussion, and debate in recent years and a significant number of legal opinions. This Report and the guidelines set forth herein are intended to provide a framework for consideration of ESI issues in bankruptcy cases. In drafting the guidelines, it was thought important to include certain guiding principles that need to be considered when addressing ESI issues in bankruptcy cases. Those principles are discussed in the Report. It should be

* This Best Practices Report is not, and should not be construed as, the official policy or position of the American Bar Association.

noted that while this has been a collaborative and interactive process, not all Working Group members agree on all points in the Report.

The Working Group wishes to acknowledge the excellent work done by others who have studied and written on the issues relating to electronic discovery (ESI) in civil litigation. In particular, the Working Group wishes to acknowledge the extensive work of The Sedona Conference on electronic discovery issues. The principles and guidelines appearing as part of this Report are not intended to replace other valuable sources of guidance on ESI issues such as *The Sedona Principles (Second Edition): Best Practices Recommendations & Principles for Addressing Electronic Document Production.*[1] Interested parties are encouraged to consult the Sedona Principles for background materials and very instructive general principles and guidelines with respect to ESI issues in civil litigation. This Report is intended to supplement those principles and guidelines and provide more particularized guidance on issues concerning ESI in connection with bankruptcy cases.

This Best Practices Report is divided into six sections. Those sections are (i) ESI Principles and Guidelines in Large Chapter 11 Cases; (ii) ESI Principles and Guidelines in Middle Market and Smaller Chapter 11 Cases; (iii) ESI Principles and Guidelines in Chapter 7 and Chapter 13 Cases; (iv) ESI Principles and Guidelines in Connection with Filing Proofs of Claim and Objections to Claims in Bankruptcy Cases; (v) ESI Principles and Guidelines for Creditors in Bankruptcy Cases; and (vi) Rules and Procedures with Respect to ESI in Adversary Proceedings and Contested Matters in Bankruptcy Cases. Although an in-depth analysis of ESI principles and guidelines in Chapter 9, Chapter 12, and Chapter 15 cases is beyond the scope of this Report, a brief discussion of ESI with respect to each of those chapters is found in note 6 below. In addition, it was thought that it would be helpful to include a short bibliography of useful electronic discovery resources. That bibliography appears at the end of this Report.

Comments on this Report may be submitted to Richard L. Wasserman, the Chair of the Working Group, whose address is Venable LLP, 750 East Pratt Street, Suite 900, Baltimore, Maryland 21202; e-mail address: rlwasserman@venable.com; telephone number: 410-244-7505. The names of the members of the Working Group are set forth below.

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1. *See* SEDONA CONF., THE SEDONA PRINCIPLES (SECOND EDITION): BEST PRACTICES RECOMMENDATIONS & PRINCIPLES FOR ADDRESSING ELECTRONIC DOCUMENT PRODUCTION (June 2007) [hereinafter Sedona Principles], *available at* https://thesedonaconference.org/download-pub/81.

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SECTION I

ELECTRONIC DISCOVERY (ESI) PRINCIPLES AND GUIDELINES IN LARGE CHAPTER 11 CASES

I. PRINCIPLES APPLICABLE TO ESI ISSUES IN BANKRUPTCY CASES

The principles set forth below are not meant to be exclusive or to replace other valuable sources of guidance, such as the Sedona Principles. Rather, they are intended to provide more particularized guidance on issues concerning electronic discovery (ESI) that may arise in the bankruptcy context.

Principle 1: The duty to preserve ESI and other evidence applies in the bankruptcy context. A person or entity preparing to file a bankruptcy case should consider appropriate steps to preserve ESI and other evidence. In addition, potential debtors and non-debtor parties have an obligation to preserve ESI and other evidence related to the filing of a contested matter, adversary proceeding, or other disputed issue in a bankruptcy case. This duty to preserve may arise prior to the formal filing of the bankruptcy case or other litigated matter, generally when the case filing or other potential litigation matter becomes reasonably anticipated. This duty to preserve is also consistent with and supplemental to the obligation of debtors, debtors-in-possession, and other fiduciaries to take reasonable steps to preserve books and records in order to facilitate the just and efficient administration of the bankruptcy estate and resolution of disputed matters arising in or in connection with the bankruptcy case. A debtor's preservation efforts should extend to representatives and affiliates of the debtor, and the debtor should consider appropriate instructions to such third parties regarding preservation of ESI relating to the debtor.

Principle 2: The actual or anticipated filing of a bankruptcy petition does not require a debtor to preserve every piece of information in its possession. A person or entity preparing to file a bankruptcy petition should take reasonable steps to preserve ESI and other evidence that the person or entity reasonably anticipates may be needed in connection with administration of the bankruptcy case or proceedings therein or operation of the business or affairs of the debtor or otherwise relevant to a legitimate subject of dispute in the bankruptcy case or potential litigation therein. This obligation does not require a debtor to preserve all ESI and other information in its possession merely because a bankruptcy petition is filed or shortly anticipated. It would generally not be inappropriate for debtors to continue following routine document retention programs and to continue the good-faith operation of electronic information systems that may automatically delete ESI, so long as the application of such programs and systems is suspended with respect to specific ESI and other evidence to which a duty to preserve has attached.

Principle 3: Proportionality considerations regarding the preservation and production of ESI are particularly important in the bankruptcy context. A party's obligations with respect to the preservation and production of ESI should be proportional to the significance, financial and otherwise, of the matter

in dispute and the need for production of ESI in the matter. Proportionality considerations are especially important in the bankruptcy context. Debtors will be operating within constraints and generally have limited assets. Creditors often face the prospect of less than a full recovery, frequently a significantly reduced one, on claims against the bankruptcy estate. Parties should not be forced to spend a disproportionate amount of already limited resources on the preservation and production of ESI.

Principle 4: Interested parties in a bankruptcy case are encouraged to confer regarding issues related to the preservation and production of ESI. The value of direct discussions regarding ESI is not a novel concept and is well-recognized, for example, in Sedona Principle No. 3. Indeed, in matters and proceedings where Federal Rule of Bankruptcy Procedure 7026 applies, conferring with opposing counsel is required. Even where it is not required, however, the potential benefit of conferring is heightened in bankruptcy cases. Bankruptcy courts are courts of equity. The stakeholders in a bankruptcy case are tasked with resolving disputes quickly and efficiently in order to avoid dissipating assets of the bankruptcy estate. This means that disputed matters in bankruptcy cases are often heard and decided in an expedited manner. In these circumstances, it is particularly important for parties to confer regarding ESI obligations and requests for production of ESI in order to avoid unnecessary disputes. The development of a proposed ESI protocol by the debtor and interested parties is a suggested best practice to consider in large chapter 11 cases.

II. ESI Guidelines and Suggested Best Practices for Debtor's Counsel in Large Chapter 11 Cases

The following are guidelines and suggested best practices with respect to ESI in large chapter 11 cases. It is recognized that the guidelines and recommendations set forth herein may not be appropriate in each and every case. There may be good reasons in a chapter 11 case, large or small, for taking a different approach to ESI issues. The following are intended as suggested guidelines for counsel and courts to consider.

1. Pre-filing

- Counsel's pre-filing planning checklist for a chapter 11 case should include a discussion of ESI-related matters with the client.
- Counsel should gain an understanding of the client's electronic information systems, including the types of ESI the client maintains and the locations where it is used and stored. This should include discussion of the client's existing policies and procedures regarding ESI, including any data retention program that calls for the automatic deletion or culling of ESI. It should also include identification of sources of ESI that are likely to be identified as not reasonably accessible because of undue burden or cost.

- Counsel should explain to the client its obligation to preserve ESI, consistent with the principles outlined above. This should include identification and discussion of issues that are reasonably anticipated to be disputed in the bankruptcy case and the sources and locations of ESI likely to be relevant to such disputes (including key custodians and storage systems or media that are likely to contain such ESI).
- Because first-day motions are contested matters, debtor's counsel should, if reasonably practicable, put appropriate preservation measures in place regarding the subjects of the various first-day motions to be filed on behalf of a chapter 11 debtor-in-possession. The same is true of any adversary proceedings to be filed as part of the first-day filings.
- In order to plan and implement appropriate preservation efforts, the parties may wish to designate a liaison or primary point of contact for ESI issues at both the client and its outside counsel. Discussions of the client's electronic information systems and ESI obligations should include participation by the client's IT department. If an outside vendor or consultant is retained to assist with ESI matters, a lead person in that organization may also be identified and the vendor or consultant's scope of work and reporting obligations should be clearly identified.
- A debtor's preservation plan and instructions should be communicated in writing within the debtor's organization (in the nature of a litigation hold). The debtor's preservation plan should include a mechanism for periodic updates and reminders as issues are identified and refined during the bankruptcy case.
- The review and discussion of the client's ESI obligations should consider any specialized data privacy considerations (e.g., specific regulatory requirements in the client's industry, statutes applicable to the client, confidentiality or non-disclosure agreements with third parties, and obligations imposed under foreign legal systems for clients with operations or affiliates in jurisdictions outside of the United States).

2. At Time of Filing of Chapter 11 Case

- Debtor's counsel should consider whether, at the outset of the case, there is a need for bankruptcy court approval of an interim ESI protocol addressing any pertinent ESI issues, including preservation efforts. Debtor's counsel may also want to consider including in the debtor's first-day affidavit a description of the debtor's prepetition preservation efforts and any changes to the debtor's preservation practices made prior to the bankruptcy filing. Final decisions regarding preservation and other ESI-related issues should be reserved, if possible and if not unduly burdensome to the debtor, until a later date when a Creditors' Committee has been appointed and the debtor can confer with it and other stakeholders in the case.

- If any of the professionals to be employed by the debtor are working on ESI preservation programs, the scope of their work should be identified in the employment application for such professionals.

3. Within 45 to 60 Days of Petition Date or at or Before Final Hearing on Bankruptcy Rule 4001 Matters

- As soon as reasonably practicable in the case, allowing for consultation with the Creditors' Committee, the United States Trustee, and any other interested parties (which could include secured lenders, indenture trustees, or other significant creditor constituencies), the debtor should consider formulating and proposing an ESI protocol for approval by the Bankruptcy Court after notice and opportunity for objection by other parties. An ESI protocol may not be necessary or desirable in every large chapter 11 case.
- The ESI protocol should address preservation efforts implemented by the debtor, document databases or repositories established by the debtor, issues related to the intended form or forms of production of ESI by the debtor, any sources of ESI that the debtor deems not reasonably accessible because of undue burden or cost, any categories of ESI that the debtor specifically identifies as not warranting the expense of preservation, document retention programs or policies that remain in effect, and any other significant ESI-related issues. The ESI protocol should identify a point of contact at debtor's counsel to which third parties can address inquiries or concerns regarding ESI-related issues. The ESI protocol may also identify the parties and subject matters as to which the debtor expects to request production of ESI (but any such provision does not relieve the debtor of any obligation otherwise existing to confer directly with those parties, including regarding any requested preservation of ESI).
- The timing for seeking approval of an ESI protocol will vary depending upon the circumstances of each case. Depending upon how long it takes to appoint a Creditors' Committee and how long the consultation process with interested parties lasts, it may be appropriate to file the motion seeking approval of the ESI protocol within the applicable time period to provide sufficient notice and be calendared for a date within forty-five to sixty days after the Petition Date or for the date of the final hearing on Bankruptcy Rule 4001 matters. Because of its importance, it should be a goal to have the ESI protocol approval order entered early in the debtor's bankruptcy case. Adequate notice of any motion seeking approval of a proposed ESI protocol should be provided to creditors and other parties in interest.
- Among the provisions to consider including in an ESI protocol approval order from the Bankruptcy Court is a provision, in accordance with

Federal Rule of Evidence 502(d), addressing the non-waiver of attorney-client privilege and work-product protection when ESI is disclosed.

- Approval of the ESI protocol should not preclude the debtor or other parties from seeking additional or different treatment of ESI in appropriate circumstances. Any issues regarding requests for deviation from the protocol should be addressed in direct communications between the affected parties before any relief is sought from the Court. The order approving the ESI protocol should include a provision that the terms of the protocol are subject to further order of the Court and can be amended for cause. Although adequate notice to potentially affected creditors and interested parties should be a prerequisite to approval of any ESI protocol, approval of such protocol is not intended to preclude parties engaged in current or future litigation with a debtor, including the debtor, from seeking ESI-related relief particularized to such litigated matter.[2]

4. Other ESI Considerations

- In addition to ESI obligations in connection with adversary proceedings and contested matters, other ESI issues may arise during the case. For example, special considerations may apply with respect to personally identifiable information and patient records and other patient care information.[3] In addition, if there is a sale or other transfer of property of the estate, consideration should be given to preserving ESI and other data and documents, or providing for continued access by the estate to such ESI and other data and documents, following such sale or other transfer.
- If a preservation obligation arises and appropriate documents and ESI are not preserved, under the applicable rules and case law there is a real possibility of a claim of spoliation of evidence and a request for sanctions. With respect to the wide range of potential sanctions, see Section VI below.

2. A model template for an ESI Protocol is attached as Appendix 1 to this Report. Also attached as Appendix 2 is a form of ESI Protocol Approval Order, including Federal Rule of Evidence 502(d) provisions. Whether to propose an ESI Protocol and what to include in an ESI Protocol will depend upon the facts and circumstances of each case. As will be noted, a number of the items covered in the attached ESI Protocol template are presented in brackets for "consideration" by the debtor and its counsel, with a view toward customizing the provisions based upon the facts and circumstances applicable to the debtor and its case. Even with respect to matters not presented in brackets, such matters may not be appropriate in every case, and additional matters not set forth in the template may need to be addressed. The same case-by-case approach would also apply to drafting a proposed ESI Protocol Approval Order.

3. *See* 11 U.S.C. §§ 363(b)(1), 332, 333 (2012).

SECTION II

ELECTRONIC DISCOVERY (ESI) PRINCIPLES AND GUIDELINES IN MIDDLE MARKET AND SMALLER CHAPTER 11 CASES

I. PRINCIPLES APPLICABLE TO ESI ISSUES IN BANKRUPTCY CASES

The principles set forth below are not meant to be exclusive or to replace other valuable sources of guidance, such as the Sedona Principles. Rather, they are intended to provide more particularized guidance on issues concerning electronic discovery (ESI) that may arise in the bankruptcy context.

Principle 1: The duty to preserve ESI and other evidence applies in the bankruptcy context. A person or entity preparing to file a bankruptcy case should consider appropriate steps to preserve ESI and other evidence. In addition, potential debtors and non-debtor parties have an obligation to preserve ESI and other evidence related to the filing of a contested matter, adversary proceeding, or other disputed issue in a bankruptcy case. This duty to preserve may arise prior to the formal filing of the bankruptcy case or other litigated matter, generally when the case filing or other potential litigation matter becomes reasonably anticipated. This duty to preserve is also consistent with and supplemental to the obligation of debtors, debtors-in-possession, and other fiduciaries to take reasonable steps to preserve books and records in order to facilitate the just and efficient administration of the bankruptcy estate and resolution of disputed matters arising in or in connection with the bankruptcy case. A debtor's preservation efforts should extend to representatives and affiliates of the debtor, and the debtor should consider appropriate instructions to such third parties regarding preservation of ESI relating to the debtor.

Principle 2: The actual or anticipated filing of a bankruptcy petition does not require a debtor to preserve every piece of information in its possession. A person or entity preparing to file a bankruptcy petition should take reasonable steps to preserve ESI and other evidence that the person or entity reasonably anticipates may be needed in connection with administration of the bankruptcy case or proceedings therein or operation of the business or affairs of the debtor or otherwise relevant to a legitimate subject of dispute in the bankruptcy case or potential litigation therein. This obligation does not require a debtor to preserve all ESI and other information in its possession merely because a bankruptcy petition is filed or shortly anticipated. If in doubt, a debtor should err on the side of preserving its data. Depending on the size of the debtor, the complexity of its ESI systems, and the resources available in advance of the filing of a bankruptcy petition, the most prudent and least burdensome approach may be to suspend even routine data destruction in the period leading up to a bankruptcy filing (as opposed to expending resources identifying more specifically the ESI to which a duty to preserve may have attached).

Principle 3: Proportionality considerations regarding the preservation and production of ESI are particularly important in the bankruptcy context. A party's obligations with respect to the preservation and production of ESI should

be proportional to the significance, financial and otherwise, of the matter in dispute and the need for production of ESI in the matter. Proportionality considerations are especially important in the bankruptcy context. Debtors will be operating within constraints and generally have limited assets. Creditors often face the prospect of less than a full recovery, frequently a significantly reduced one, on claims against the bankruptcy estate. Parties should not be forced to spend a disproportionate amount of already limited resources on the preservation and production of ESI.

Principle 4: Interested parties in a bankruptcy case are encouraged to confer regarding issues related to the preservation and production of ESI. The value of direct discussions regarding ESI is not a novel concept and is well-recognized, for example, in Sedona Principle No. 3. Indeed, in matters and proceedings where Federal Rule of Bankruptcy Procedure 7026 applies, conferring with opposing counsel is required. Even where it is not required, however, the potential benefit of conferring is heightened in bankruptcy cases. Bankruptcy courts are courts of equity. The stakeholders in a bankruptcy case are tasked with resolving disputes quickly and efficiently in order to avoid dissipating assets of the bankruptcy estate. This means that disputed matters in bankruptcy cases are often heard and decided in an expedited manner. In these circumstances, it is particularly important for parties to confer regarding ESI obligations and requests for production of ESI in order to avoid unnecessary disputes. The development of a proposed ESI protocol by the debtor and interested parties may be a useful step to be considered in middle market and even possibly in smaller chapter 11 cases.

II. ESI Guidelines and Considerations for Debtor's Counsel in Middle Market and Smaller Chapter 11 Cases

The following are guidelines and considerations with respect to ESI issues in middle market and smaller chapter 11 cases. It is recognized that the guidelines and recommendations set forth herein may not be appropriate in each and every case. There may be good reasons in a chapter 11 case, large or small, for taking a different approach to ESI issues. The following are intended as suggested guidelines for counsel and courts to consider.

1. Pre-filing

- Counsel's pre-filing planning checklist for a chapter 11 case should include a discussion of ESI-related matters with the client. The proportionality principle (Principle 3 above) may take on added significance in middle market and smaller chapter 11 cases. The following suggested guidelines should be read with that principle in mind.
- Counsel should gain an understanding of the client's electronic information systems, including the types of ESI the client maintains and the locations where it is used and stored. This should include discussion of the

client's existing policies and procedures regarding ESI, including any data retention program that calls for the automatic deletion or culling of ESI. It should also include identification of sources of ESI that are likely to be identified as not reasonably accessible because of undue burden or cost.

- Counsel should explain to the client its obligation to preserve ESI, consistent with the principles outlined above. This should include identification and discussion of issues that are reasonably anticipated to be disputed in the bankruptcy case and the sources and locations of ESI likely to be relevant to such disputes (including key custodians and storage systems or media that are likely to contain such ESI).
- If first-day motions are to be filed in the case, because such motions are contested matters, debtor's counsel should, if reasonably practicable, put appropriate preservation measures in place regarding the subjects of the various first-day motions to be filed on behalf of a chapter 11 debtor-in-possession. The same is true of any adversary proceedings to be filed as part of the first-day filings.
- In order to plan and implement appropriate preservation efforts, the parties may wish to designate a liaison or primary point of contact for ESI issues at both the client and its outside counsel. Discussions of the client's electronic information systems and ESI obligations should include participation by knowledgeable persons including, if applicable, the client's IT department. If an outside vendor or consultant is retained to assist with ESI matters, a lead person in that organization may also be identified and the vendor or consultant's scope of work and reporting obligations should be clearly identified.
- A debtor's preservation plan and instructions should be communicated in writing within the debtor's organization (in the nature of a litigation hold). The debtor's preservation plan should include a mechanism for periodic updates and reminders as issues are identified and refined during the bankruptcy case.
- The review and discussion of the client's ESI obligations should consider, to the extent reasonably practicable, any specialized data privacy considerations (e.g., specific regulatory requirements in the client's industry, statutes applicable to the client, confidentiality or non-disclosure agreements with third parties, and obligations imposed under foreign legal systems for clients with operations or affiliates in jurisdictions outside of the United States).

2. At Time of Filing of Chapter 11 Case

- Debtor's counsel may want to consider whether, at the outset of the case, it may be appropriate under the circumstances of the case to seek bankruptcy court approval of an interim ESI protocol addressing any pertinent

ESI issues, including preservation efforts. Debtor's counsel may also want to consider including in the debtor's first-day affidavit (if there is one in the case) a description of the debtor's prepetition preservation efforts and any changes to the debtor's preservation practices made prior to the bankruptcy filing. It may be appropriate in a given case to reserve decisions regarding preservation and other ESI-related issues until a later date in the case when disputed issues become identified and when the United States Trustee and other interested parties, including particularly a Creditors' Committee if it is organized in the case, can participate in discussions and consideration of ESI-related issues.

- If any of the professionals to be employed by the debtor are working on ESI preservation programs, the scope of their work should be identified in the employment application for such professionals.

3. Consideration of an ESI Protocol if Appropriate in the Case

- Subject to the specific circumstances of each case including the proportionality principle referenced above, a debtor may want to consider the possibility of formulating and proposing a protocol addressing pertinent ESI issues, including preservation efforts. An ESI protocol will not be warranted or appropriate in every chapter 11 case.
- If appropriate, among the issues that may be addressed in an ESI protocol are the following: preservation efforts implemented by the debtor, document databases or repositories established by the debtor, issues related to the intended form or forms of production of ESI by the debtor, any sources of ESI that the debtor deems not reasonably accessible because of undue burden or cost, any categories of ESI that the debtor specifically identifies as not warranting the expense of preservation, document retention programs or policies that remain in effect, and any other significant ESI-related issues. If there is an ESI protocol to be proposed in the case, it should identify a point of contact at debtor's counsel to which third parties can address inquiries or concerns regarding ESI-related issues. Any such ESI protocol may also identify the parties and subject matters as to which the debtor expects to request production of ESI (but any such provision does not relieve the debtor of any obligation otherwise existing to confer directly with those parties, including regarding any requested preservation of ESI).
- The timing for seeking approval of an ESI protocol (if applicable) will vary depending upon the circumstances of each case. Consultation with the United States Trustee and other interested parties (including the Creditors' Committee if there is one organized in the case) with respect to a proposed ESI protocol is important and should precede the filing of any motion seeking court approval of such ESI protocol. If an ESI protocol is to be pursued by the debtor, adequate notice of any motion seeking approval of

the proposed ESI protocol should be provided to creditors and other parties in interest.

- Among the provisions to consider including in an ESI protocol approval order from the Bankruptcy Court is a provision, in accordance with Federal Rule of Evidence 502(d), addressing the non-waiver of attorney-client privilege and work-product protection when ESI is disclosed.
- Approval of an ESI protocol in a particular case should not preclude the debtor or other parties from seeking additional or different treatment of ESI in appropriate circumstances. Any issues regarding requests for deviation from the protocol should be addressed in direct communications between the affected parties before any relief is sought from the Court. The order approving an ESI protocol should include a provision that the terms of the protocol are subject to further order of the Court and can be amended for cause. Although adequate notice to potentially affected creditors and interested parties should be a prerequisite to approval of any ESI protocol, approval of any such protocol is not intended to preclude parties engaged in current or future litigation with a debtor, including the debtor, from seeking ESI-related relief particularized to such litigated matter.[4]

4. ESI Considerations During the Case

- In addition to ESI obligations in connection with adversary proceedings and contested matters, other ESI issues may arise during the case. For example, special considerations may apply with respect to personally identifiable information and patient records and other patient care information.[5] In addition, if there is a sale or other transfer of property of the estate, consideration should be given to preserving ESI and other data and documents, or providing for continued access by the estate to such ESI and other data and documents, following such sale or other transfer.
- If a preservation obligation arises and appropriate documents and ESI are not preserved, under the applicable rules and case law there is a real possibility of a claim of spoliation of evidence and a request for sanctions. With respect to the wide range of potential sanctions, see Section VI below.[6]

4. With respect to the ESI Protocol and the ESI Protocol Approval Order, see *supra* note 2.

5. *See* 11 U.S.C. §§ 363(b)(1), 332, 333 (2012).

6. Although chapter 12 cases are different in many respects from chapter 11 cases, the ESI principles and guidelines set forth herein with respect to smaller chapter 11 cases may be useful to parties (including debtors-in-possession and trustees) and their counsel in chapter 12 cases. In a small chapter 12 case, the principles and guidelines in Section III of this Report discussing chapter 13 may also be instructive.

This Report does not address ESI issues in chapter 9 cases. Such cases may present unique circumstances and issues. For example, public disclosure laws such as any applicable freedom of

SECTION III

ELECTRONIC DISCOVERY (ESI) PRINCIPLES AND GUIDELINES IN CHAPTER 7 AND CHAPTER 13 CASES

- Consistent with the principles underlying sections 521(a)(3) and (4) and 727(a)(3) of the Bankruptcy Code, Chapter 7 and Chapter 13 debtors should, unless otherwise justified under the circumstances of the case, not destroy information, including electronically stored information (ESI), relating to their bankruptcy case. Counsel should discuss this with their clients.
- In chapter 7 and chapter 13 cases, a guiding principle is that a debtor's obligation with respect to the preservation and production of ESI should be proportional to the resources and sophistication of the debtor, the significance of the matter to which the ESI relates, and the amount or value of the property at issue. Whether a debtor is represented by counsel is a further factor to be considered. The foregoing is hereinafter referred to as the "proportionality principle."
- The "proportionality principle" is a very important factor to keep in mind in Chapter 7 cases. In many Chapter 7 cases, ESI will not be an issue unless it is raised by the Chapter 7 trustee or another party in interest, including the Office of the United States Trustee. If debtor's counsel determines that a case is an asset case, counsel should discuss with the debtor what, if any, ESI there is relating to property of the estate. If the debtor is or was a business entity or sole proprietorship, debtor's counsel should discuss with the debtor what, if any, ESI exists that relates to property of the estate.
- A chapter 7 trustee may request a debtor to preserve ESI within the possession or control of the debtor. The chapter 7 trustee or another party in interest, including the Office of the United States Trustee, may seek an

information act and state sunshine and open meeting laws may need to be considered. Additionally, considerations and limitations imposed by section 904 of the Bankruptcy Code may come into play in chapter 9 cases. Such topics are beyond the scope of this Report.

Similarly, this Report does not address the subject of electronic discovery (ESI) issues in Chapter 15 cases. Some of the ESI principles and guidelines discussed in this Report may apply in Chapter 15 cases, but issues of foreign law, comity, and United States public policy, all of which are beyond the scope of this Report, may also need to be considered. *See, e.g., In re* Toft, 453 B.R. 186 (Bankr. S.D.N.Y. 2011) (refusing to allow foreign representative's request on an ex parte basis to access emails of debtor stored on two internet service providers located in the United States based on 11 U.S.C. § 1506, which allows a court to refuse to take an action "if the action would be manifestly contrary to public policy of the United States"). Issues relating to international discovery considerations in the federal courts have been addressed in numerous cases. *See, e.g.*, Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Court, 482 U.S. 522 (1987). Those issues may also be implicated in Chapter 15 cases. In addition, as a helpful resource and guide with respect to ESI discovery issues in cross-border disputes, see SEDONA CONF., INTERNATIONAL PRINCIPLES ON DISCOVERY, DISCLOSURE & DATA PROTECTION: BEST PRACTICES, RECOMMENDATIONS & PRINCIPLES FOR ADDRESSING THE PRESERVATION & DISCOVERY OF PROTECTED DATA IN U.S. LITIGATION (2011).

order from the Bankruptcy Court, as part of a request for a Bankruptcy Rule 2004 examination or otherwise, to preserve and/or turn over ESI. Relevance, reasonableness, and proportionality should be applied to any such request, depending upon the circumstances of each case.

- With respect to chapter 13 cases, in addition to documentary materials needed for purposes of complying with the debtor's duties in connection with the case, a chapter 13 debtor should, subject to the proportionality principle and reasonableness and relevance, preserve ESI concerning the same subject matter as the documentary materials required to be retained by the debtor.
- A chapter 13 trustee may request a chapter 13 debtor to preserve ESI within the possession or control of the debtor. The chapter 13 trustee or another party in interest, including the Office of the United States Trustee, may seek an order from the Bankruptcy Court to preserve and/or turn over ESI. Relevance, reasonableness, and proportionality should be applied to any such request, depending upon the circumstances of each case.
- If adversary proceedings are filed in a chapter 7 or chapter 13 case, the ESI preservation and production obligations set forth in Bankruptcy Rules 7026, 7033, 7034, and 7037 apply. If the filing of an adversary proceeding by, on behalf of, or against a chapter 7 or chapter 13 debtor is reasonably likely, counsel for the debtor should discuss with the debtor whether there is any ESI that should be preserved by the debtor in connection with such adversary proceeding. Similarly, if there is a significant contested matter to be filed by or on behalf of a chapter 7 or chapter 13 debtor or likely to be filed against or involving the debtor seeking relief for or with respect to the debtor from the Bankruptcy Court, counsel for the debtor should discuss with the debtor whether there is any ESI that should be preserved by the debtor in connection with such contested matter. In addition, debtors in chapter 7 and chapter 13 cases should understand that the chapter 7 trustee or the chapter 13 trustee (as applicable) may need identification of and access to ESI and the debtor's assistance in connection with litigation by or against the estate.
- Counsel for creditors involved in chapter 7 and chapter 13 adversary proceedings and significant contested matters should discuss with their clients whether they have in their possession ESI that should be preserved in connection with such adversary proceedings or contested matters.
- If the nature of a creditor's claim makes it foreseeable that access to documents including original documents will be needed to support or challenge the claim in litigation, the creditor should take appropriate steps to preserve such documents.

- Nothing set forth in these guidelines is intended to alter or affect any applicable privilege, including the attorney-client privilege, or the work-product protection of communications, documents, or ESI, as such doctrines exist under otherwise applicable law.

Section IV

Electronic Discovery (ESI) Principles and Guidelines in Connection with Filing Proofs of Claim and Objections to Claims in Bankruptcy Cases

The following are principles, guidelines, and suggested best practices with respect to ESI issues in connection with proofs of claim and objections to claims in bankruptcy cases. The guidelines and recommendations set forth herein may not be appropriate in each and every case, and there may be good reasons for taking a different approach with respect to ESI issues in a given case. These principles and guidelines are a suggested starting point for counsel and judges to consider as they assess what is appropriate under the circumstances of their particular case.

I. ESI Principles Applicable to Proofs of Claim and Objections to Claims

Principle 1: The filing of a proof of claim is not a "per se" trigger of a debtor's duty to preserve documents and electronically stored information (ESI). This principle is directly reflected in cases such as *In re Kmart Corp.*, 371 B.R. 823 (Bankr. N.D. Ill. 2007). The Working Group directly borrows from and endorses the *Kmart* court's conclusion on this point. In larger cases, there may be hundreds or thousands of proofs of claim. Treating each of them as an independent trigger of a duty to preserve could overwhelm a debtor and lead to a conclusion that every document and every piece of ESI relating to the claim should be preserved, which is not necessary or appropriate. (See Principle 2.)

Principle 2: The duty to preserve arises when litigation regarding a proof of claim is reasonably anticipated. Factors to be considered in this analysis include the size of the claim, the nature of the claim (including whether it is a prepetition or an administrative claim), the specificity of the basis for the claim, and the nature and extent of the debtor's opposition. As the court observed in *Kmart*, "the 'duty to preserve documents in the face of pending litigation is not a passive obligation,' but must be 'discharged actively.'"[7]

Principle 3: The scope of the duty to preserve should be proportional to the reasonably anticipated scope of the litigation regarding the proof of claim. As with other types of disputes, the amount of a claim is an important but not de-

7. 371 B.R. at 846 (citations omitted).

terminative factor to consider regarding the appropriate scope of preservation. Even an exceedingly large claim may not require extensive preservation efforts if the debtor or trustee disputes only some minor aspect of the claim. With respect to a creditor filing a proof of claim, the creditor should take steps to preserve a reasonable and proportional scope of documents and ESI relating to the claim, including documents and ESI that form the basis of the claim. As the possibility of an objection or other litigation with respect to the claim becomes reasonably anticipated, the creditor's preservation obligation attaches and extends to the issues raised by the objection or litigation. A creditor's preservation efforts should be reasonable in light of the nature of the dispute and proportional to the amount at issue. The scope of that obligation will vary depending upon the facts and circumstances of each case, the nature of the creditor's claim, and the nature of any actual or reasonably anticipated objection or dispute regarding the claim.

II. ESI Guidelines and Suggested Best Practices Regarding Proofs of Claim and Objections to Claims

1. The Obligation of Debtors-in-Possession and Trustees to Preserve Documents and Electronically Stored Information Relating to Claims in Chapter 11 Cases

- In the period leading up to the filing of a chapter 11 case, a debtor should preserve documents and ESI regarding reasonably anticipated subjects of claim objections and litigation with respect to claims. Those preservation efforts should be reasonable in light of the nature of the dispute and proportional to the amount at issue. If a particular issue or dispute (or type of issue or dispute) precipitated the debtor's filing, then the debtor should preserve documents and ESI reasonably likely to be relevant to litigation concerning the issue or dispute.
- The filing of a proof of claim has in a number of cases been analogized to the filing of a complaint in civil litigation.[8] Similarly, the filing of an objection to a claim has been analogized to the filing of an answer.[9] The Advisory Committee Note to Bankruptcy Rule 3007 makes it clear that the filing of an objection to a claim initiates a contested matter governed by Bankruptcy Rule 9014, unless a counterclaim is joined with the objection to the claim, in which event ordinarily an adversary proceeding subject to Part VII of the Federal Rules of Bankruptcy Procedure is commenced.

8. *See, e.g.*, Smith v. Dowden, 47 F.3d 940, 943 (8th Cir. 1995); Simmons v. Savell, 765 F.2d 547, 552 (5th Cir. 1985); *In re* Barker, 306 B.R. 339, 347 (Bankr. E.D. Cal. 2004); *In re* Lomas Fin. Corp., 212 B.R. 46, 55 (Bankr. D. Del. 1997); *In re* 20/20 Sport, Inc., 200 B.R. 972, 978 (Bankr. S.D.N.Y. 1996).

9. *See supra* note 8.

- As the term is used by the Bankruptcy Court in the *Kmart* case, the "trigger date" is the date on which the obligation to preserve documents relating to the claim at issue in the case arose.[10] In general, "the duty to preserve documents arises when a party is on notice of the potential relevance of the documents to pending or impending litigation, and [in general civil litigation] a party may be on notice even prior to the filing of a complaint."[11]
- Accordingly, the duty of a debtor-in-possession or chapter 11 trustee to preserve documents and ESI would ordinarily arise no later than the date of the filing of an objection to a claim and often would arise earlier when the objection becomes reasonably anticipated. As a debtor-in-possession or trustee begins to evaluate potential objections to claims, it should also evaluate whether there are any corresponding preservation efforts that should be implemented.
- By way of example, in the context of the administrative claim at issue in the *Kmart* case, the Bankruptcy Court determined that the debtor-in-possession's duty to preserve, under the facts and circumstances of that case, arose shortly after the administrative claim was filed. As the court in *Kmart* stated, "the particular administrative claim filed in this case contained sufficient information to put Kmart on notice that litigation was likely."[12]
- Because in many chapter 11 cases proofs of claim are not filed directly with the debtor or chapter 11 trustee (if applicable), and because in many cases it is unclear at the time of the filing of the proof of claim whether an objection will be filed or litigation will ensue, a general rule that the duty to preserve documents and ESI arises at the time of filing a proof of claim or shortly thereafter seems neither prudent nor practical. A debtor has a duty to preserve where it or its counsel anticipates or reasonably should anticipate that litigation about a particular claim is likely. The debtor may have a duty to preserve even before the filing of a proof of claim if the debtor believes litigation about the claim is likely. The reasonableness of beliefs about the likelihood of litigation should be evaluated based not only on the content of a proof of claim but on all pertinent circumstances. If counsel for a particular creditor believes that document preservation is important with respect to litigation of its claim, counsel may expressly notify the debtor by separate written communication at the time of filing such creditor's proof of claim and may do so even before filing its proof of claim. Such a notice from a creditor or its counsel will then need to be evaluated by counsel for the debtor-in-possession

10. 371 B.R. at 843.
11. *Id.*
12. *Id.* at 844.

or chapter 11 trustee and appropriate steps taken depending upon whether the debtor reasonably expects objections to the proof of claim to be filed, either by the debtor or other parties in interest.

2. Creditor/Claimant Obligation to Preserve Documents and Electronically Stored Information Relating to Claims in Chapter 11 Cases

- A creditor should consider preserving documents and ESI, including at a minimum documents and ESI that form the basis for the claim, as the creditor is preparing to file its proof of claim or otherwise to assert a claim in the bankruptcy case. When preparing to file a claim, ordinarily the creditor should preserve documents relating to such claim, particularly if it is likely or expected that litigation concerning such claim will result in the bankruptcy case. Among the matters to consider in assessing whether it is reasonable to anticipate an objection is the treatment of the creditor's claim on the debtor's schedules (and any amendments thereto), including the amount of the claim as scheduled by the debtor and whether the claim is listed as disputed, contingent, or unliquidated. The scope of the creditor's preservation should correspond to any anticipated objection or actual objection to the claim. The preservation efforts should be reasonable in light of the nature of the dispute and proportional to the amount at issue. As a general guideline and subject to the principles set forth above, if a proof of claim is filed, documents required to be attached to the proof of claim in accordance with Bankruptcy Rule 3001 and documents and ESI that would be needed to prove the claim affirmatively should be preserved, and if an objection to the claim is filed or reasonably anticipated by the creditor, documents and ESI relevant to the filed objection or anticipated objection should also be preserved. Each situation should be considered by the creditor's counsel based upon the facts and circumstances relating to the particular claim and the likely or expected response to such claim by the debtor-in-possession or trustee.
- A creditor has a preservation obligation with respect to documents and ESI relating to its claim that arises no later than when an objection to the claim is filed and served on the creditor. A creditor should evaluate and refine its preservation obligation based on any objection that is filed to the claim. As noted above, in many instances a creditor's preservation obligation will be triggered when a claim is filed but a debtor's preservation obligation, even for the same claim, will not be triggered until an objection is reasonably anticipated. The Working Group does not consider this temporal variation unfair. An earlier "trigger date" for a bankruptcy claimant's duty to preserve is analogous to the earlier duty, outside bankruptcy, of a prospective plaintiff who may reasonably anticipate litigation before the potential defendant.

3. The Obligation to Preserve Documents and Electronically Stored Information in Connection with Proofs of Claim and Objections to Claims in Chapter 7 and Chapter 13 Cases

- To the extent that a chapter 7 or chapter 13 trustee is contemplating an objection to a claim and is in possession of documents and ESI relating to the claim, the trustee should preserve such documents and ESI. In such a circumstance, the trustee should, to the extent that he or she has not already done so, request the debtor to preserve any documents and ESI relating to the claim in question and to turn over such documents and ESI to the trustee. If a chapter 7 or chapter 13 debtor or other party in interest is contemplating filing an objection to a proof of claim, the debtor or other party in interest should preserve all documents and ESI relating to such claim. If a chapter 7 trustee needs to request the debtor to preserve and turn over documents and ESI relating to a claim in the bankruptcy case and the debtor in such case is not an individual debtor, the trustee should determine which individuals at the debtor or formerly with the debtor likely would have pertinent materials and should request that they preserve and turn over such documents and ESI. The timing and scope of such request will vary depending upon the facts and circumstances of each case and the claim in question.
- A creditor in a chapter 7 or chapter 13 case who has filed a proof of claim should consider taking steps to preserve documents and ESI relating to such claim no later than when such creditor reasonably anticipates that an objection may be raised to the claim. In addition, a creditor who files a proof of claim in a chapter 7 or chapter 13 case should preserve documents required to be attached to the proof of claim in accordance with Bankruptcy Rule 3001 and, subject to the principles set forth above, documents and ESI that would be needed to prove the claim affirmatively and documents and ESI relevant to any filed objection or reasonably anticipated objection to such creditor's claim. A creditor's preservation obligation with respect to documents and ESI relating to its claim arises no later than when an objection to the claim is filed and served on the creditor. Even before filing a proof of claim, a creditor having reason to believe that litigation will arise concerning its claim should take steps to preserve documents and ESI relating to its claim. For example, if a creditor is preparing to file a motion to lift the stay, that creditor should take steps to preserve documents and ESI relating to its claim, whether or not it has filed a proof of claim in the bankruptcy case. As another example, the debtor's listing of a mortgage arrearage amount in a chapter 13 plan may trigger a preservation obligation on the part of the mortgage creditor if the amount listed is going to be contested by the creditor. The exact timing of a creditor's obligation to preserve documents and ESI may vary depending upon the facts and circumstances of

the case and the nature of the creditor's claim (e.g., asset case v. no-asset case, secured claim v. unsecured claim, administrative or priority claim v. prepetition general unsecured claim).

SECTION V

ELECTRONIC DISCOVERY (ESI) PRINCIPLES AND GUIDELINES FOR CREDITORS IN BANKRUPTCY CASES

A bankruptcy case has been filed. What obligation, if any, does a creditor have to preserve documents and electronically stored information (ESI) relating to its dealings with the debtor and its claims against the debtor? The following are principles, guidelines, and suggested best practices with respect to electronic discovery issues for creditors in bankruptcy cases. The guidelines and recommendations set forth herein may not be appropriate in each and every case, and there may be good reasons for taking a different approach with respect to ESI issues in a given case. Hopefully, the following principles and guidelines will provide a helpful starting point for creditors and their counsel to consider.

I. ESI PRINCIPLES FOR CREDITORS WHEN CONFRONTED WITH A BANKRUPTCY FILING BY A DEBTOR

Principle 1: The duty to preserve ESI and other evidence applies in connection with bankruptcy cases. The timing and scope of such duty will vary from case to case. Creditors and other non-debtor parties in interest have an obligation to preserve ESI and other evidence relating to contested matters, adversary proceedings, and other disputed matters that are, or are likely to be, the subject of litigation in or in connection with the bankruptcy case. With respect to documents and ESI relating to a creditor's claim against a debtor who has filed bankruptcy, the creditor should, if it decides to file a claim or it reasonably believes that its claim is likely to be the subject of a dispute, take steps to preserve a reasonable and proportional scope of such documents and ESI, including documents and ESI that form the basis of its claim.

Principle 2: The filing of a bankruptcy case does not require a creditor to preserve every document or piece of information in its possession relating to the debtor or its dealings with the debtor. The mere filing of the bankruptcy case will not ordinarily by itself trigger a creditor's duty to preserve documents and ESI regarding its various dealings with the debtor. However, if the creditor reasonably anticipates litigation with the debtor, a duty of the creditor to preserve documents and ESI relating to such litigation or potential litigation arises.

Principle 3: Proportionality considerations should apply with respect to a creditor's obligation to preserve documents and ESI in connection with bankruptcy cases. The scope of a creditor's preservation obligation, if and when it arises, does not automatically include every document or piece of information in the creditor's possession, custody, or control concerning the debtor.

A rule of reasonableness should apply. The scope of the duty to preserve should be proportional to the reasonably anticipated scope of the matters at issue or expected to be at issue. A creditor's obligation with respect to preservation of documents and ESI should be proportional to the significance, financial and otherwise, of the creditor's claim or the matter in dispute and the need for production of such documents and ESI in the matter. A creditor's preservation efforts should be reasonable in light of the facts and circumstances in each particular case.

II. ESI Guidelines and Suggested Best Practices for Creditors and Their Counsel When a Debtor Files a Bankruptcy Case

- The filing of a bankruptcy case by a debtor is not by itself the commencement of litigation against a creditor. Therefore, a creditor is not obligated to institute a litigation hold with respect to its documents and ESI relating to the debtor based solely upon a bankruptcy petition being filed by the debtor. However, upon the filing of a bankruptcy petition, the creditor should assess whether it reasonably anticipates adversary proceedings, contested matters, or other disputed matters that are likely to be the subject of litigation with the debtor. The creditor should consider consulting with legal counsel regarding such issues, including implementing a litigation hold to preserve a reasonable and proportional scope of documents and ESI if the duty to preserve is triggered.
- The scope of a creditor's preservation obligation when it arises extends to matters at issue or in dispute, or reasonably anticipated to be at issue or in dispute, in or in connection with the debtor's bankruptcy case. The scope of a creditor's preservation obligation may change during the course of the bankruptcy case as new issues arise.
- Once an adversary proceeding, contested matter, or other litigated matter is reasonably anticipated by a creditor or commenced against a creditor, a duty of the creditor to preserve documents and ESI relating to such matter arises. The scope of that obligation is subject to reasonableness and proportionality considerations, which will vary depending upon the specific circumstances of each particular matter.
- A creditor's preservation efforts should be reasonable in light of the nature of the dispute and proportional to the amount at issue. Principle 3 above provides additional guidance with respect to the concept of proportionality. Once an adversary proceeding or contested matter is filed, the obligations set out in the applicable Bankruptcy Rules and Federal Rules of Civil Procedure with respect to ESI apply.[13] The parties to any such contested matter or adversary proceeding are encouraged to

13. See Bankruptcy Rules 7026, 7033, 7034, 7037, 9014, and 9016 and the corresponding Federal Rules of Civil Procedure incorporated thereby.

work cooperatively on document and ESI preservation and production efforts.

- With respect to proofs of claim and claims litigation, a creditor should consider preserving documents and ESI, including at a minimum documents and ESI that form the basis for its claim, as the creditor is preparing to file a proof of claim or otherwise assert its claim in the bankruptcy case. A creditor has a preservation obligation with respect to documents and ESI relating to its claim that arises no later than when an objection to the claim is filed and served on the creditor. A creditor should evaluate and refine its preservation obligation based on the objection that is actually filed to the claim. When preparing to file a claim in a bankruptcy case, a creditor should consider taking steps to preserve documents and ESI relating to the claim if such creditor reasonably anticipates that an objection may be raised to the claim. Among the matters to consider in assessing whether it is reasonable to anticipate an objection is the treatment of the creditor's claim on the debtor's schedules (and any amendments thereto), including the amount of the claim as scheduled by the debtor and whether the claim is listed as disputed, contingent, or unliquidated. A creditor's preservation efforts should be reasonable in light of the nature of the objection that is filed or reasonably anticipated and should be proportional to the amount at issue. If a proof of claim is filed, documents required to be attached to the proof of claim in accordance with Bankruptcy Rule 3001 and documents and ESI that would be needed to prove the claim affirmatively should be preserved, and if an objection to the claim is filed or reasonably anticipated by the creditor, documents and ESI relevant to the filed objection or anticipated objection should also be preserved.
- If a creditor is put on notice of a potential dispute or litigation by a trustee or debtor-in-possession, such creditor should consult with counsel about such notice and how to respond, including whether a document and ESI preservation obligation arises and, if so, what steps should be taken to implement it. Similarly, if a creditor is put on notice that certain documents and other information including ESI should be preserved, the creditor should again consult counsel with respect to its response thereto including any potential preservation obligation. It is important that a creditor take appropriate steps to preserve documents and ESI if a preservation obligation arises.
- Other procedural settings in which a preservation obligation may arise include a Bankruptcy Rule 2004 examination or the receipt of a nonparty subpoena. If a creditor is the target of a Rule 2004 examination or otherwise receives a subpoena, the creditor should consult counsel about its obligations in response thereto, including a document and ESI preservation obligation.

- If a preservation obligation arises and appropriate documents and ESI are not preserved, under the applicable rules and case law there is a real possibility of a claim of spoliation of evidence and a request for sanctions. With respect to the wide range of potential sanctions, see Section VI below.

SECTION VI

RULES AND PROCEDURES WITH RESPECT TO ELECTRONICALLY STORED INFORMATION (ESI) IN ADVERSARY PROCEEDINGS AND CONTESTED MATTERS IN BANKRUPTCY CASES

The Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") contain a number of rules relating to ESI in adversary proceedings and contested matters in bankruptcy cases. These rules incorporate by reference provisions from the Federal Rules of Civil Procedure relating to the discovery and production of ESI, the failure to comply with such discovery requirements, and associated sanctions. In addition, the federal rule of civil procedure relating to subpoenas, Rule 45, including its ESI provisions, is also incorporated into bankruptcy practice through Bankruptcy Rule 9016. Supplementing the Federal Rules of Civil Procedure incorporated into bankruptcy practice through the applicable Bankruptcy Rules in adversary proceedings and contested matters, there are also various Bankruptcy Court local rules applicable to ESI that need to be consulted.

Part VII of the Bankruptcy Rules applies to adversary proceedings brought in bankruptcy cases. A number of the Part VII Bankruptcy Rules incorporate by reference and make applicable to adversary proceedings specific federal rules of civil procedure. Such rules include those federal rules of civil procedure relating to discovery and production of ESI and sanctions relating to the failure to produce required information. With respect to the ESI obligations of parties in adversary proceedings, the following rules are applicable:

- Bankruptcy Rule 7026 incorporating Federal Rule of Civil Procedure 26, including, specifically with respect to ESI, Rule 26(a)(1)(A)(ii), Rule 26(b)(2)(B), and Rule 26(f)(3)(C).
- Bankruptcy Rule 7033 incorporating Federal Rule of Civil Procedure 33, including, specifically with respect to ESI, Rule 33(d).
- Bankruptcy Rule 7034 incorporating Federal Rule of Civil Procedure 34, including, specifically with respect to ESI, Rule 34(a)(1)(A) and Rule 34(b)(1)(C) and (2)(D) and (E).
- Bankruptcy Rule 7037 incorporating Federal Rule of Civil Procedure 37, including, specifically with respect to ESI, Rule 37(e).

With respect to contested matters in bankruptcy cases, certain Part VII Bankruptcy Rules are incorporated and apply in such matters.[14] Included among the

14. *See* FED. R. BANKR. P. 9014(c).

rules that apply in contested matters are Bankruptcy Rules 7026, 7033, 7034, and 7037, all referenced above. Accordingly, unless the Bankruptcy Court otherwise directs, the same ESI discovery rules and sanction rules with respect to ESI and other document discovery apply in contested matters in bankruptcy cases.[15]

Bankruptcy Rule 9016 incorporates Federal Rule of Civil Procedure 45, the federal rule with respect to subpoenas, into bankruptcy practice. Rule 45 applies in both adversary proceedings and contested matters. It also applies in connection with Bankruptcy Rule 2004 examinations.[16] Rule 45 specifically addresses ESI in several places.[17]

Counsel will also need to consult local rules of procedure with respect to electronic discovery and other issues relating to ESI. For example, in the District of Delaware, the Bankruptcy Court for the District of Delaware has adopted a rule noting that court's "expect[ation] that parties to a case will cooperatively reach agreement on how to conduct e-discovery," and detailing "default standards" by which any e-discovery will be conducted if by the Federal Rule of Civil Procedure 16 scheduling conference agreement has not been reached about the conduct of such discovery.[18] The local rules of each jurisdiction need to be consulted as to whether they have any local rules applicable to ESI issues in cases pending in that jurisdiction.

General federal civil litigators will be familiar with the ESI provisions contained in the Federal Rules of Civil Procedure and the case law interpreting those rules. Bankruptcy lawyers will need to become familiar with those rules to the extent that ESI issues arise in bankruptcy cases and in particular in adversary proceedings and contested matters.

A number of bankruptcy courts have addressed ESI issues and spoliation and sanction claims related thereto in bankruptcy cases. Each case presents its own unique set of facts, but they illustrate that sanctions may be imposed in appropriate circumstances. A sampling of those cases appears below.[19]

15. Note should be made that, as set forth in Bankruptcy Rule 9014(c), certain subparts of Federal Rule of Civil Procedure 26 do not apply in contested matters unless the Bankruptcy Court otherwise directs.

16. *See* FED. R. BANKR. P. 2004(c).

17. *See* FED. R. CIV. P. 45(a)(1)(A)(iii), (C), and (D), 45(b)(1), 45(c)(2)(A) and (B), 45(d)(1).

18. DEL. BANKR. CT. LOCAL RULE 7026-3, "Discovery of Electronic Documents (E-Discovery)."

19. *See, e.g.*, Herzog v. Zyen, LLC (*In re* Xyience Inc.), No. BK-S-08-10474, Adv. No. 09-1402, 2011 Bankr. LEXIS 4251 (Bankr. D. Nev. Oct. 28, 2011) (imposing monetary sanctions to reimburse plaintiff-trustee's expenses, costs, and reasonable attorney's fees); Harmon v. Lighthouse Capital Funding, Inc. (*In re* Harmon), No. 10-33789, Adv. No. 10-03207, 2011 Bankr. LEXIS 323 (Bankr. S.D. Tex. Jan. 26, 2011) (sanction deeming a particular fact established in plaintiff's favor awarded against defendant in adversary proceeding); *In re* Global Technovations, Inc., 431 B.R. 739 (Bankr. E.D. Mich. 2010) (court declined to grant terminating sanctions, adverse inference instruction, or monetary sanctions; sanctions found to be inappropriate under facts of this case); GFI Acquisition, LLC v. Am. Federated Title Corp. (*In re* A&M Fla. Props. II, LLC), No. 09-15173, Adv. No. 09-01162, 2010 Bankr. LEXIS 1217 (Bankr. S.D.N.Y. Apr. 7, 2010) (court declined to order dismissal or grant adverse inference instruction; monetary sanctions awarded); Sabertooth, LLC v. Simons (*In re* Venom, Inc.), No. 09-10445, Adv. No. 09-0006, 2010 Bankr. LEXIS 723 (Bankr. E.D. Pa. Mar. 9, 2010) (attorneys' fees awarded as sanction; request to preclude evidence

Conclusion

It has been the goal of the Working Group to present a Best Practices Report and a set of principles and guidelines with respect to electronic discovery and ESI issues in bankruptcy cases. Because electronic discovery is a rapidly developing area of the law, and one unfamiliar to many bankruptcy attorneys and their clients, it is hoped that these materials will provide a helpful resource guide. It is further hoped that this Report will engender further discussion and thoughtful analysis and commentary on the matters addressed in the Report and other ESI-related issues in bankruptcy cases. Undoubtedly new court rules and case law will be forthcoming addressing ESI-related issues in bankruptcy cases. The Working Group has prepared this Report to serve as a starting point for judges, attorneys, and academics when considering and addressing issues related to electronic discovery and ESI in bankruptcy cases.

denied); Chrysler Fin. Servs. Ams. LLC v. Hecker (*In re* Hecker), 430 B.R. 189 (Bankr. D. Minn. 2010) (entry of judgment that debtor's debt to plaintiff was not dischargeable imposed as sanction); Grochocinski v. Schlossberg (*In re* Eckert), 402 B.R. 825 (N.D. Ill. 2009) (facts alleged by trustee taken as proof against defendant and defendant precluded from offering testimony or other evidence in opposition; monetary sanctions also awarded); Springel v. Prosser (*In re* Prosser), No. 06-30009, 2009 Bankr. LEXIS 3209 (Bankr. D.V.I. Oct. 9, 2009) (court disallowed all of debtor's claimed exemptions); *In re* Riverside Healthcare, Inc., 393 B.R. 422 (Bankr. M.D. La. 2008) (sanction for alleged spoliation held to be inappropriate); *In re* Kmart Corp., 371 B.R. 823 (Bankr. N.D. Ill. 2007) (request for default judgment or adverse inference instruction denied but attorneys' fees awarded as sanction); United States v. Krause (*In re* Krause), 367 B.R. 740 (Bankr. D. Kan. 2007) (partial default judgment entered as sanction in adversary proceeding); Shaw Grp., Inc. v. Next Factors, Inc. (*In re* Stone & Webster, Inc.), 359 B.R. 102 (Bankr. D. Del. 2007) (request for sanctions denied); Quintus Corp. v. Avaya, Inc. (*In re* Quintus Corp.), 353 B.R. 77 (Bankr. D. Del. 2006) (entry of judgment against defendant imposed as sanction in adversary proceeding); Oscher v. Solomon Tropp Law Group P.A. (*In re* Atl. Int'l Mortg. Co.), 352 B.R. 503 (Bankr. M.D. Fla. 2006) (entry of default judgment in adversary proceeding was too drastic a sanction; monetary sanctions imposed).

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Appendix 1
*** TEMPLATE FOR ESI PROTOCOL ***

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF [STATE]

In re:	)
[DEBTOR(S)]	)
Debtors.	)

ELECTRONICALLY STORED INFORMATION PROTOCOL

Following consultation with the Official Committee of Unsecured Creditors, the Office of the United States Trustee, and other parties in interest [including _____], the Debtors have agreed to this protocol with respect to the preservation of electronically stored information ("ESI"). This protocol (the "ESI Protocol") is intended to provide information and identify a general framework regarding the Debtors' plans for the preservation and handling of ESI. The Debtors intend to present this ESI Protocol to the Bankruptcy Court for approval.

I. General Provisions

This ESI Protocol is intended to provide general information to parties in interest in order to minimize requests and demands to the Debtors regarding issues related to ESI. This ESI Protocol is not an agreement by the Debtors to produce any particular type or scope of ESI in an adversary proceeding, contested matter, or other dispute. Nothing in this ESI Protocol waives any of the Debtors' rights concerning ESI or otherwise under applicable law or rules, including the Bankruptcy Rules, incorporated Federal Rules of Civil Procedure, or local rules. The Debtors will use reasonable and good faith efforts to preserve and produce a reasonable and proportional scope of ESI in appropriate matters. The Debtors and other parties shall be expected to use reasonable and good faith efforts to limit requests for ESI to a reasonable and proportional scope, which may include limits on the number of custodians, date limits, file type limits, and other limits or agreements that are appropriate under the circumstances.

II. Overview of Debtors' Electronic Information Systems and Preservation Efforts

A. The Debtors maintain the following electronic information systems:
[In this section, *consider* disclosing information regarding:

- General information regarding operating systems
- What email system the Debtors use (e.g., Outlook or Lotus Notes)
- Whether there is automatic overwriting or deletion of user mailboxes based on date or size limitations
- Whether the Debtors maintain a general email archive or repository and, if yes, what are the parameters
- Typical organization/storage of non-email documents–e.g., is there a document management system, do users have a dedicated/portioned network directory location, shared locations/etc.
- What database information the Debtors maintain–e.g., ERP/finance/accounting/inventory/HR/etc.
- Any proprietary/industry specific/custom systems]

B. The Debtors' preservations efforts to date include:
[In this section, *consider* disclosing information regarding:

- Any specific preservation efforts requested by the Committee/U.S. Trustee/etc. to which the Debtors have agreed
- Any other general preservation efforts that the Debtors may have implemented, which *might* include
  - Snapshots/copies of servers or systems
  - Mailbox snapshots for individual custodians, which might include senior management or other employees, that the Debtors know will be relevant to particular matters in the case
  - Any collection/snapshot of non-email documents for custodians (e.g., copies of network directory locations for individual custodians)
  - Preservation/collection from non-custodian-based sources such as database systems
  - Whether the Debtors have taken backup tapes out of rotation and, if so, the nature and date
- Any large collections/databases the Debtors maintain–e.g., if there is a large litigation-related database, the Debtors might consider disclosing the custodians and collection time periods related to that

- Any preservation efforts the Debtors have implemented for significant litigation/anticipated litigation (but unless there is a small number, not every single matter for which they have implemented a litigation hold)]

C. The Debtors consider the following data sources to be not reasonably accessible because of undue burden or cost and do not intend to preserve or produce from the following:
[In this section, the following, based largely on the Delaware default standard, might be considered:

- Deleted, slack, fragmented, or other data only accessible by forensics
- Random access memory (RAM), temporary files, or other ephemeral data that are difficult to preserve without disabling the operating system
- On-line access data such as temporary Internet files, history, cache, cookies, and the like
- Metadata other than as provided in Section III below, specifically including data in metadata fields that are frequently updated automatically, such as last-opened dates
- Backup data that are substantially duplicative of data that are more accessible elsewhere
- Voicemail and other voice messages (except as may be routinely generated as attachments to emails that are themselves preserved)
- Instant messages that are not ordinarily printed or maintained in a server dedicated to instant messaging
- Text messages
- Electronic mail or pin-to-pin messages sent to or from mobile devices (e.g., iPhone and Blackberry devices), provided that a copy of such mail is routinely saved elsewhere
- Other electronic data stored on a mobile device, such as calendar or contact data or notes, provided that a copy of such information is routinely saved elsewhere
- Logs of calls made from mobile devices
- Server, system, or network logs
- Electronic data temporarily stored by laboratory equipment or attached electronic equipment, provided that such data is not ordinarily preserved as part of a laboratory report
- Data remaining from systems no longer in use that is unreadable or unusable on the systems in use]

The Debtors reserve the right to supplement or amend the foregoing and to identify other sources of not reasonably accessible data in individual matters.

III. Intended Standard Form of Production

For matters requiring production of any significant volume of ESI, unless otherwise agreed to by the parties or ordered by the court, the Debtors intend to produce in the following format and to request production in the following format:

- **General format** - Subject to the exceptions below, ESI will be provided as single-page TIFF format utilizing Group 4 compression with at least 300 dots per inch resolution. Images shall be reduced by up to 10% to allow for a dedicated space for Bates numbering and any other electronic stamping or document designations (such as those pertaining to confidentiality).
- **General Metadata Load File Format** - All produced ESI documents shall be accompanied by metadata load files that shall be delimited with the following data fields:
  - Beginning Document Number;
  - Ending Document Number;
  - BegAttach (the Beginning Document Number of the parent document);
  - EndAttach (the Ending Document Number of the last attachment);
  - Custodian;
  - Page Count;
  - MD5; and
  - Extracted Text.
- **Non-email Metadata Load File** - In addition to the general metadata fields contained above, the metadata load file for all non-email ESI (including attachments to emails and loose files) shall, where available, also contain the following data fields:
  - FileExt (the extension of the filename, e.g., "DOC" for an MS Word document);
  - Filename (the original filename);
  - Filepath;
  - Date Created;
  - Date Last Modified;

- Author; and
- Native Path (relative path to the native version of the ESI when a native version is delivered (e.g., Excel/PowerPoint files)).

- **Email Metadata Load File** - In addition to the general metadata fields contained above, the metadata load file for all email ESI shall, where available, also contain the following data fields:
  - PST or NSF File Name;
  - To;
  - From;
  - Cc;
  - Bcc;
  - Date Sent;
  - Date Received; and
  - Subject Line.
- **Exceptions** - Because Microsoft Excel and PowerPoint files are not amenable to production in the formats above, the Debtors will produce Microsoft Excel files in native format. A placeholder image will be included with the TIFF files indicating the Bates number of the document and that the document was produced in native format. Certain other file types (e.g., program, video, database, sound files, etc.) are also not amenable to conversion into TIFF format. In general, these types of files will not be collected or processed. When present in a collection, however, such documents will be represented in the form of a placeholder TIFF image and will be produced in a reasonably usable form upon a showing of need. Debtors will use reasonable and good faith efforts to address production of any other types of documents that reasonably should be produced in a particular matter but that might not be amenable to production in the foregoing format (e.g., oversized documents).

The Debtors reserve the right to supplement or modify the intended or requested form of production in individual matters. For smaller matters and/or those with lower volumes of ESI, the Debtors may produce in any reasonably useable format, which could include native production or searchable .pdfs. In addition, the Debtors will consider and discuss in good faith any requests for production in formats other than as set forth above.

IV. Designation of ESI Liaisons

Any questions or issues regarding the Debtors' handling of ESI should be directed to:

[identification and contact information for Debtors' ESI liaison, which can be a client representative and/or an attorney at the law firm serving as Debtors' counsel] ("Debtors' ESI Liaison").

Any party directing any such question or issue to the Debtors or requesting the preservation or production of ESI by the Debtors, or from whom the Debtors request preservation or production of ESI, should designate their own ESI liaison in a writing directed to Debtors' ESI Liaison. Absent agreement to the contrary by the Debtors and the other party, all requests and communications regarding ESI should ordinarily be accomplished through the ESI Liaisons.

V. Miscellaneous Provisions

A. The "safe harbor" provisions of Federal Rule of Civil Procedure 37(e), Federal Rule of Bankruptcy Procedure 7037, and the Advisory Committee Notes to Rule 37(e) shall be applicable to this ESI Protocol and the Debtors' preservation efforts. Consistent with the foregoing, the Debtors shall not be in violation of this ESI Protocol, or the Order of the Bankruptcy Court approving the ESI Protocol (the "Protocol Approval Order"), if, despite the Debtors' good faith efforts to comply with their preservation undertakings in this ESI Protocol, any documents or ESI are altered, lost, overwritten, or destroyed as a result of the Debtors' routine, good faith operation of their information or computer systems. This includes, but is not limited to:

   (1) good faith upgrading, loading, reprograming, customizing, or migrating software;

   (2) good faith inputting, accessing, updating, or modifying data in an accounting or other business database maintained on an individual transaction, invoice, or purchase order basis in an accounting or other business database; and

   (3) good faith editing, modifying, updating, or removal of an internet site.

B. The Debtors may use any reasonable method to preserve documents and ESI consistent with the Debtors' record management systems, routine computer operation, ordinary business practices, and the scope of preservation set forth in this ESI Protocol. Ordinarily, the Debtors will preserve in native format or some other reasonably useable format that preserves available metadata of the type specified in Section III above. The Debtors will act in good faith and may not transfer documents and ESI to another form solely for the purpose of increasing the burden of discovery for creditors or other interested parties.

C. This ESI Protocol does not obligate the Debtors to segregate specific documents or ESI from other documents or ESI where they presently

reside. This ESI Protocol does not obligate the Debtors to mirror image any media or to image documents maintained in paper form.

D. Nothing in this ESI Protocol shall constitute a waiver by the Debtors or any other interested party of any claim of privilege or other protection from discovery. In particular, no inadvertent production of any document or ESI that the producing party contends is privileged shall constitute a waiver of that privilege. It is intended that the Protocol Approval Order will contain clawback and non-waiver provisions pursuant to Rule 502 of the Federal Rules of Evidence.

E. This ESI Protocol and the Protocol Approval Order do not address, limit, or determine the relevance, discoverability, or admissibility of any document or ESI, regardless of whether any such document or ESI is intended to be preserved pursuant to the terms of this ESI Protocol. Neither the Debtors nor any party in interest waive any objections as to the production, discoverability, or confidentiality of documents and ESI preserved pursuant to this ESI Protocol.

F. As stated above, it is intended that this ESI Protocol will be presented to the Bankruptcy Court for approval. This ESI Protocol and the Protocol Approval Order may be modified, amended, or supplemented by further order of the Bankruptcy Court after proper notice of any request therefor. Nothing herein or in the Protocol Approval Order shall limit or otherwise affect the right (to the extent that any such right may otherwise exist under applicable law) to obtain or otherwise seek production of documents and ESI from the Debtors under applicable law. Nothing contained herein or in the Protocol Approval Order shall limit, preclude, or otherwise affect the entry of, or the terms and provisions of, stipulations and orders entered in adversary proceedings, contested matters, or other litigation involving the Debtors, or other agreements between the parties thereto, regarding document and ESI preservation, production, and/or discovery procedures. In the event of any conflicting terms, the terms of any such stipulations, orders, or agreements shall govern in such adversary proceedings, contested matters, or other litigation.

Dated: _____ [Debtors]

by: _____

Appendix 2
*** MODEL FORM OF ESI PROTOCOL APPROVAL ORDER ***

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF [STATE]

In re:	)
[DEBTOR(S)]	)
Debtors.	)

ORDER APPROVING ELECTRONICALLY STORED INFORMATION (ESI) PROTOCOL AND ADDRESSING NON-WAIVER OF ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT PROTECTION PURSUANT TO RULE 502(d) OF THE FEDERAL RULES OF EVIDENCE

Upon the Debtors' Motion for Order Approving Electronically Stored Information (ESI) Protocol (the "Motion") and the other pleadings and proceedings herein; due and adequate notice of the Motion having been provided and a hearing having been held before this Court on _____; it appearing that the relief requested in the Motion is in the best interests of the Debtors' estates, their creditors, and all other parties in interest; after due deliberation and sufficient cause appearing therefor, it is, by the United States Bankruptcy Court for the District of _____, HEREBY ORDERED THAT:

1. The Electronically Stored Information (ESI) Protocol, a copy of which is attached hereto as Exhibit 1 (the "ESI Protocol"), is approved.
2. Pursuant to Fed. R. Evid. 502(d) and (e), the disclosure during discovery or other voluntary production of any communication or information including electronically stored information (hereinafter "Document") by any of the Debtors or any other party in this case that is protected by the attorney-client privilege ("Privilege" or "Privileged," as the case may be) or work-product protection ("Protection" or "Protected," as the case may be), as defined by Fed. R. Evid. 502(g), shall not waive the Privilege or Protection for either that Document or the subject matter of that Document, unless there is an intentional waiver under Fed. R. Evid. 502(a)(1), in which event the scope of any such waiver shall be

determined by Fed. R. Evid. 502(a)(2) and (3). Unless otherwise ordered by this Court, this provision shall displace the provisions of Fed. R. Evid. 502(b)(1) and (2) in this case.

3. Except when the requesting party contests the validity of the underlying claim of Privilege or Protection, any Document the party producing the Document claims as Privileged or Protected shall, upon written request, promptly be returned to the producing party and/or destroyed, at the producing party's option. If the underlying claim of Privilege or Protection is contested, the requesting party and the producing party shall comply with, and may promptly seek a judicial determination of the matter pursuant to, Fed. R. Civ. P. 26(b)(5)(B). In assessing the validity of any claim of Privilege or Protection, this Court shall not consider the provisions of Fed. R. Evid. 502(b)(1) and (2), but shall consider whether timely and otherwise reasonable steps were taken by the producing party to request the return or destruction of the Document once the producing party had actual knowledge of (i) the circumstances giving rise to the claim of Privilege or Protection and (ii) the production of the Document in question. For purposes of this paragraph, "destroyed" shall mean that the paper versions are shredded, that active electronic versions are deleted, and that no effort shall be made to recover versions that are not readily accessible, such as those on backup media or only recoverable through forensic means. For purposes of this paragraph, "actual knowledge" refers to the actual knowledge of an attorney with lead responsibilities in this case or in the adversary proceeding or contested matter if applicable.
4. The ESI Protocol and the terms of this Order may be modified, amended, or supplemented for cause by further order of this Court after due and proper notice. In addition, the entry of this Order shall not preclude the entry of case- or matter-specific ESI-related orders in future litigated matters.
5. This Court retains jurisdiction with respect to all matters arising from or related to this Order.

Dated: _____ _____

UNITED STATES BANKRUPTCY JUDGE
FOR THE DISTRICT OF _____

APPENDIX 6 – California Ethics Opinion on duty and responsibility of counsel to deal with ESI Formal Opinion No. 2015-193 (June 2015)

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION NO. 2015-193

ISSUE: What are an attorney's ethical duties in the handling of discovery of electronically stored information?

DIGEST: An attorney's obligations under the ethical duty of competence evolve as new technologies develop and become integrated with the practice of law. Attorney competence related to litigation generally requires, among other things, and at a minimum, a basic understanding of, and facility with, issues relating to e-discovery, including the discovery of electronically stored information ("ESI"). On a case-by-case basis, the duty of competence may require a higher level of technical knowledge and ability, depending on the e-discovery issues involved in a matter, and the nature of the ESI. Competency may require even a highly experienced attorney to seek assistance in some litigation matters involving ESI. An attorney lacking the required competence for e-discovery issues has three options: (1) acquire sufficient learning and skill before performance is required; (2) associate with or consult technical consultants or competent counsel; or (3) decline the client representation. Lack of competence in e-discovery issues also may lead to an ethical violation of an attorney's duty of confidentiality.

AUTHORITIES INTERPRETED: Rules 3-100 and 3-110 of the Rules of Professional Conduct of the State Bar of California.[1/]

Business and Professions Code section 6068(e).

Evidence Code sections 952, 954 and 955.

STATEMENT OF FACTS

Attorney defends Client in litigation brought by Client's Chief Competitor in a judicial district that mandates consideration of e-discovery[2/] issues in its formal case management order, which is consistent with California Rules of Court, rule 3.728. Opposing Counsel demands e-discovery; Attorney refuses. They are unable to reach an agreement by the time of the initial case management conference. At that conference, an annoyed Judge informs both attorneys they have had ample prior notice that e-discovery would be addressed at the conference and tells them to return in two hours with a joint proposal.

In the ensuing meeting between the two lawyers, Opposing Counsel suggests a joint search of Client's network, using Opposing Counsel's chosen vendor, based upon a jointly agreed search term list. She offers a clawback agreement that would permit Client to claw back any inadvertently produced ESI that is protected by the attorney-client privilege and/or the work product doctrine ("Privileged ESI").

[1/] Unless otherwise indicated, all references to rules in this opinion will be to the Rules of Professional Conduct of the State Bar of California.

[2/] Electronically stored information ("ESI") is information that is stored in technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities (e.g., Code Civ. Proc., § 2016.020, sub. (d) – (e)). Electronic Discovery, also known as e-discovery, is the use of legal means to obtain ESI in the course of litigation for evidentiary purposes.

Attorney believes the clawback agreement will allow him to pull back anything he "inadvertently" produces. Attorney concludes that Opposing Counsel's proposal is acceptable and, after advising Client about the terms and obtaining Client's authority, agrees to Opposing Counsel's proposal. Judge thereafter approves the attorneys' joint agreement and incorporates it into a Case Management Order, including the provision for the clawback of Privileged ESI. The Court sets a deadline three months later for the network search to occur.

Back in his office, Attorney prepares a list of keywords he thinks would be relevant to the case, and provides them to Opposing Counsel as Client's agreed upon search terms. Attorney reviews Opposing Counsel's additional proposed search terms, which on their face appear to be neutral and not advantageous to one party or the other, and agrees that they may be included.

Attorney has represented Client before, and knows Client is a large company with an information technology ("IT") department. Client's CEO tells Attorney there is no electronic information it has not already provided to Attorney in hard copy form. Attorney assumes that the IT department understands network searches better than he does and, relying on that assumption and the information provided by CEO, concludes it is unnecessary to do anything further beyond instructing Client to provide Vendor direct access to its network on the agreed upon search date. Attorney takes no further action to review the available data or to instruct Client or its IT staff about the search or discovery. As directed by Attorney, Client gives Vendor unsupervised direct access to its network to run the search using the search terms.

Subsequently, Attorney receives an electronic copy of the data retrieved by Vendor's search and, busy with other matters, saves it in an electronic file without review. He believes that the data will match the hard copy documents provided by Client that he already has reviewed, based on Client's CEO's representation that all information has already been provided to Attorney.

A few weeks later, Attorney receives a letter from Opposing Counsel accusing Client of destroying evidence and/or spoliation. Opposing Counsel threatens motions for monetary and evidentiary sanctions. After Attorney receives this letter, he unsuccessfully attempts to open his electronic copy of the data retrieved by Vendor's search. Attorney hires an e-discovery expert ("Expert"), who accesses the data, conducts a forensic search, and tells Attorney potentially responsive ESI has been routinely deleted from Client's computers as part of Client's normal document retention policy, resulting in gaps in the document production. Expert also advises Attorney that, due to the breadth of Vendor's execution of the jointly agreed search terms, both privileged information and irrelevant but highly proprietary information about Client's upcoming revolutionary product were provided to Chief Competitor in the data retrieval. Expert advises Attorney that an IT professional with litigation experience likely would have recognized the overbreadth of the search and prevented the retrieval of the proprietary information.

What ethical issues face Attorney relating to the e-discovery issues in this hypothetical?

DISCUSSION

I. Duty of Competence

A. Did Attorney Violate The Duty of Competence Arising From His Own Acts/Omissions?

While e-discovery may be relatively new to the legal profession, an attorney's core ethical duty of competence remains constant. Rule 3-110(A) provides: "A member shall not intentionally, recklessly, or repeatedly fail to perform legal services with competence." Under subdivision (B) of that rule, "competence" in legal services shall mean to apply the diligence, learning and skill, and mental, emotional, and physical ability reasonably necessary for the performance of such service. Read together, a mere failure to act competently does not trigger discipline under rule 3-110. Rather, it is the failure to do so in a manner that is intentional, reckless or repeated that would result in a disciplinable rule 3-110 violation. (See *In the Matter of Torres* (Reviwe Dept. 2000) 4 Cal. State Bar Ct. Rptr. 138, 149 ("We have repeatedly held that negligent legal representation, even that amounting to legal malpractice, does not establish a [competence] rule 3-110(A) violation."); see also, *In the Matter of Gadda* (Review Dept. 2002) 4 Cal. State Bar Ct. Rptr. 416 (reckless and repeated acts); *In the Matter of Riordan* (Review Dept. 2007) 5 Cal. State Bar Ct. Rptr. 41 (reckless and repeated acts).)

Legal rules and procedures, when placed alongside ever-changing technology, produce professional challenges that attorneys must meet to remain competent. Maintaining learning and skill consistent with an attorney's duty of competence includes keeping "abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, . . ." ABA Model Rule 1.1, Comment [8].[3/] Rule 3-110(C) provides: "If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate, professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required." Another permissible choice would be to decline the representation. When e-discovery is at issue, association or consultation may be with a non-lawyer technical expert, if appropriate in the circumstances. Cal. State Bar Formal Opn. No. 2010-179.

Not every litigated case involves e-discovery. Yet, in today's technological world, almost every litigation matter *potentially* does. The chances are significant that a party or a witness has used email or other electronic communication, stores information digitally, and/or has other forms of ESI related to the dispute. The law governing e-discovery is still evolving. In 2009, the California Legislature passed California's Electronic Discovery Act adding or amending several California discovery statutes to make provisions for electronic discovery. See, e.g., Code of Civil Procedure section 2031.010, paragraph (a) (expressly providing for "copying, testing, or sampling" of "electronically stored information in the possession, custody, or control of any other party to the action.")[4/] However, there is little California case law interpreting the Electronic Discovery Act, and much of the development of e-discovery law continues to occur in the federal arena. Thus, to analyze a California attorney's current ethical obligations relating to e-discovery, we look to the federal jurisprudence for guidance, as well as applicable Model Rules, and apply those principles based upon California's ethical rules and existing discovery law.[5/]

We start with the premise that "competent" handling of e-discovery has many dimensions, depending upon the complexity of e-discovery in a particular case. The ethical duty of competence requires an attorney to assess at the outset of each case what electronic discovery issues might arise during the litigation, including the likelihood that e-discovery will or should be sought by either side. If e-discovery will probably be sought, the duty of competence requires an attorney to assess his or her own e-discovery skills and resources as part of the attorney's duty to provide the client with competent representation. If an attorney lacks such skills and/or resources, the attorney must try to acquire sufficient learning and skill, or associate or consult with someone with expertise to assist. Rule 3-110(C). Attorneys handling e-discovery should be able to perform (either by themselves or in association with competent co-counsel or expert consultants) the following:

- initially assess e-discovery needs and issues, if any;
- implement/cause to implement appropriate ESI preservation procedures;[6/]

[3/] Although not binding, opinions of ethics committees in California should be consulted by members for guidance on proper professional conduct. Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered. Rule 1-100(A).

[4/] In 2006, revisions were made to the Federal Rules of Civil Procedure, rules 16, 26, 33, 34, 37 and 45, to address e-discovery issues in federal litigation. California modeled its Electronic Discovery Act to conform with mostly-parallel provisions in those 2006 federal rules amendments. (See Evans, *Analysis of the Assembly Committee on Judiciary regarding AB 5* (2009). (http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_0001-0050/ab_5_cfa_20090302_114942_asm_comm.html).)

[5/] Federal decisions are compelling where the California law is based upon a federal statute or the federal rules. (See *Toshiba America Electronic Components, Inc. v. Superior Court (Lexar Media, Inc.)* (2004) 124 Cal.App.4th 762, 770 [21 Cal.Rptr.3d 532]; *Vasquez v. Cal. School of Culinary Arts, Inc.* (2014) 230 Cal.App.4th 35 [178 Cal.Rptr.3d 10]; see also footnote 4, *supra.*)

[6/] This opinion does not directly address ethical obligations relating to litigation holds. A litigation hold is a directive issued to, by, or on behalf of a client to persons or entities associated with the client who may possess potentially relevant documents (including ESI) that directs those custodians to preserve such documents, pending further direction. See generally Redgrave, *Sedona Conference ® Commentary on Legal Holds: The Trigger and The Process* (Fall 2010) The Sedona Conference Journal, Vol. 11 at pp. 260 – 270, 277 – 279. Prompt issuance of a litigation hold may prevent spoliation of evidence, and the duty to do so falls on both the party and outside counsel working on the matter. See

- analyze and understand a client's ESI systems and storage;
- advise the client on available options for collection and preservation of ESI;
- identify custodians of potentially relevant ESI;
- engage in competent and meaningful meet and confer with opposing counsel concerning an e-discovery plan;
- perform data searches;
- collect responsive ESI in a manner that preserves the integrity of that ESI; and
- produce responsive non-privileged ESI in a recognized and appropriate manner.[7]

See, e.g., *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC* (S.D.N.Y. 2010) 685 F.Supp.2d 456, 462 – 465 (defining gross negligence in the preservation of ESI), (abrogated on other grounds in *Chin v. Port Authority* (2nd Cir. 2012) 685 F.3d 135 (failure to institute litigation hold did not constitute gross negligence per se)).

In our hypothetical, Attorney had a general obligation to make an e-discovery evaluation early, prior to the initial case management conference. The fact that it was the standard practice of the judicial district in which the case was pending to address e-discovery issues in formal case management highlighted Attorney's obligation to conduct an early initial e-discovery evaluation.

Notwithstanding this obligation, Attorney made *no* assessment of the case's e-discovery needs or of his own capabilities. Attorney exacerbated the situation by not consulting with another attorney or an e-discovery expert prior to agreeing to an e-discovery plan at the initial case management conference. He then allowed that proposal to become a court order, again with no expert consultation, although he lacked sufficient expertise. Attorney participated in preparing joint e-discovery search terms without experience or expert consultation, and he did not fully understand the danger of overbreadth in the agreed upon search terms.

Even after Attorney stipulated to a court order directing a search of Client's network, Attorney took no action other than to instruct Client to allow Vendor to have access to Client's network. Attorney did not instruct or supervise Client regarding the direct network search or discovery, nor did he try to pre-test the agreed upon search terms or otherwise review the data before the network search, relying on his assumption that Client's IT department would know what to do, and on the parties' clawback agreement.

After the search, busy with other matters and under the impression the data matched the hard copy documents he had already seen, Attorney took no action to review the gathered data until after Opposing Counsel asserted spoliation and threatened sanctions. Attorney then unsuccessfully attempted to review the search results. It was only then, at the end of this long line of events, that Attorney finally consulted an e-discovery expert and learned of the e-discovery problems facing Client. By this point, the potential prejudice facing Client was significant, and much of the damage already had been done.

At the least, Attorney risked breaching his duty of competence when he failed at the outset of the case to perform a timely e-discovery evaluation. Once Opposing Counsel insisted on the exchange of e-discovery, it became certain that e-discovery would be implicated, and the risk of a breach of the duty of competence grew considerably; this should have prompted Attorney to take additional steps to obtain competence, as contemplated under rule 3-110(C), such as consulting an e-discovery expert.

[Footnote Continued...]

Zubulake v. UBS Warburg LLC (S.D.N.Y. 2003) 220 F.R.D. 212, 218 and *Zubulake v. UBS Warburg LLC* (S.D.N.Y. 2004) 229 F.R.D. 422, 432. Spoliation of evidence can result in significant sanctions, including monetary and/or evidentiary sanctions, which may impact a client's case significantly.

[7] This opinion focuses on an attorney's ethical obligations relating to his own client's ESI and, therefore, this list focuses on those issues. This opinion does not address the scope of an attorney's duty of competence relating to obtaining an opposing party's ESI.

Had the e-discovery expert been consulted at the beginning, or at the latest once Attorney realized e-discovery would be required, the expert could have taken various steps to protect Client's interest, including possibly helping to structure the search differently, or drafting search terms less likely to turn over privileged and/or irrelevant but highly proprietary material. An expert also could have assisted Attorney in his duty to counsel Client of the significant risks in allowing a third party unsupervised direct access to Client's system due to the high risks and how to mitigate those risks. An expert also could have supervised the data collection by Vendor.[8/]

Whether Attorney's acts/omissions in this single case amount to a disciplinable offense under the "intentionally, recklessly, or repeatedly" standard of rule 3-110 is beyond this opinion, yet such a finding could be implicated by these facts.[9/] See, e.g., *In the Matter of Respondent G.* (Review Dept. 1992) 2 Cal. State Bar Ct. Rptr. 175, 179 (respondent did not perform competently where he was reminded on repeated occasions of inheritance taxes owed and repeatedly failed to advise his clients of them); *In re Matter of Copren* (Review Dept. 2005) 4 Cal. State Bar Ct. Rptr. 861, 864 (respondent did not perform competently when he failed to take several acts in single bankruptcy matter); *In re Matter of Layton* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 366, 377 – 378 (respondent did not perform competently where he "recklessly" exceeded time to administer estate, failed to diligently sell/distribute real property, untimely settled supplemental accounting and did not notify beneficiaries of intentions not to sell/lease property).

B. Did Attorney Violate The Duty of Competence By Failing To Supervise?

The duty of competence in rule 3-110 includes the duty to supervise the work of subordinate attorneys and non-attorney employees or agents. See Discussion to rule 3-110. This duty to supervise can extend to outside vendors or contractors, and even to the client itself. See California State Bar Formal Opn. No. 2004-165 (duty to supervise outside contract lawyers); San Diego County Bar Association Formal Opn. No. 2012-1 (duty to supervise clients relating to ESI, citing *Cardenas v. Dorel Juvenile Group, Inc.* (D. Kan. 2006) 2006 WL 1537394).

Rule 3-110(C) permits an attorney to meet the duty of competence through association with another lawyer or consultation with an expert. See California State Bar Formal Opn. No. 2010-179. Such expert may be an outside vendor, a subordinate attorney, or even the client, if they possess the necessary expertise. This consultation or association, however, does not absolve an attorney's obligation to supervise the work of the expert under rule 3-110, which is a non-delegable duty belonging to the attorney who is counsel in the litigation, and who remains the one primarily answerable to the court. An attorney must maintain overall responsibility for the work of the expert he or she chooses, even if that expert is the client or someone employed by the client. The attorney must do so by remaining regularly engaged in the expert's work, by educating everyone involved in the e-discovery workup about the legal issues in the case, the factual matters impacting discovery, including witnesses and key evidentiary issues, the obligations around discovery imposed by the law or by the court, and of any relevant risks associated with the e-discovery tasks at hand. The attorney should issue appropriate instructions and guidance and, ultimately, conduct appropriate tests until satisfied that the attorney is meeting his ethical obligations prior to releasing ESI.

Here, relying on his familiarity with Client's IT department, Attorney assumed the department understood network searches better than he did. He gave them no further instructions other than to allow Vendor access on the date of the network search. He provided them with no information regarding how discovery works in litigation, differences

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[8/] See Advisory Committee Notes to the 2006 Amendments to the Federal Rules of Civil Procedure, rule 34 ("Inspection or testing of certain types of electronically stored information or of a responding party's electronic information system may raise issues of confidentiality or privacy. The addition of testing and sampling to Rule 34(a) . . . is not meant to create a routine right of direct access to a party's electronic information system, although such access might be justified in some circumstances. Courts should guard against undue intrusiveness resulting from inspecting or testing such systems."). See also The Sedona Principles Addressing Electronic Document Production (2nd Ed. 2007), Comment 10(b) ("Special issues may arise with any request to secure direct access to electronically stored information or to computer devices or systems on which it resides. Protective orders should be in place to guard against any release of proprietary, confidential, or personal electronically stored information accessible to the adversary or its expert.").

[9/] This opinion does not intend to set or define a standard of care of attorneys for liability purposes, as standards of care can be highly dependent on the factual scenario and other factors not applicable to our analysis herein.

between a party affiliated vendor and a neutral vendor, what could constitute waiver under the law, what case-specific issues were involved, or the applicable search terms. Client allowed Vendor direct access to its entire network, without the presence of any Client representative to observe or monitor Vendor's actions. Vendor retrieved proprietary trade secret and privileged information, a result Expert advised Attorney could have been prevented had a trained IT individual been involved from the outset. In addition, Attorney failed to warn Client of the potential significant legal effect of not suspending its routine document deletion protocol under its document retention program.

Here, as with Attorney's own actions/inactions, whether Attorney's reliance on Client was reasonable and sufficient to satisfy the duty to supervise in this setting is a question for a trier of fact. Again, however, a potential finding of a competence violation is implicated by the fact pattern. See, e.g., *Palomo v. State Bar* (1984) 36 Cal.3d 785, 796 [205 Cal.Rptr. 834] (evidence demonstrated lawyer's pervasive carelessness in failing to give the office manager any supervision, or instruction on trust account requirements and procedures).

II. Duty of Confidentiality

A fundamental duty of an attorney is "[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." (Bus. & Prof. Code, § 6068 (e)(1).) "Secrets" includes "information, other than that protected by the attorney-client privilege, that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client." (Cal. State Bar Formal Opinion No. 1988-96.) "A member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1), without the informed consent of the client, or as provided in paragraph (B) of this rule." (Rule 3-100(A).)

Similarly, an attorney has a duty to assert the attorney-client privilege to protect confidential communications between the attorney and client. (Evid. Code, §§ 952, 954, 955.) In civil discovery, the attorney-client privilege will protect confidential communications between the attorney and client in cases of inadvertent disclosure *only if* the attorney and client act reasonably to protect that privilege. See *Regents of University of California v. Superior Court (Aquila Merchant Services, Inc.)* (2008) 165 Cal.App.4th 672, 683 [81 Cal.Rptr.3d 186]. This approach also echoes federal law. [10/] A lack of reasonable care to protect against disclosing privileged and protected information when producing ESI can be deemed a waiver of the attorney-client privilege. See *Kilopass Tech. Inc. v. Sidense Corp.* (N.D. Cal. 2012) 2012 WL 1534065 at 2 – 3 (attorney-client privilege deemed waived as to privileged documents released through e-discovery because screening procedures employed were unreasonable).

In our hypothetical, because of the actions taken by Attorney prior to consulting with any e-discovery expert, Client's privileged information has been disclosed. Due to Attorney's actions, Chief Competitor can argue that such disclosures were not "inadvertent" and that any privileges were waived. Further, non-privileged, but highly confidential proprietary information about Client's upcoming revolutionary new product has been released into the hands of Chief Competitor. Even absent any indication that Opposing Counsel did anything to engineer the overbroad disclosure, it remains true that the disclosure occurred because Attorney participated in creating overbroad search terms. All of this happened unbeknownst to Attorney, and only came to light after Chief Competitor accused Client of evidence spoliation. Absent Chief Competitor's accusation, it is not clear when any of this would have come to Attorney's attention, if ever.

The clawback agreement on which Attorney heavily relied may not work to retrieve the information from the other side. By its terms, the clawback agreement was limited to inadvertently produced Privileged ESI. Both privileged information, and non-privileged, but confidential and proprietary information, have been released to Chief Competitor.

[10/] See Federal Rules of Evidence, rule 502(b): "Inadvertent Disclosure. When made in a federal proceeding or to a federal office or agency, the disclosure does not operate as a waiver in a federal or state proceeding if: (1) the disclosure is inadvertent; (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and (3) the holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B)."

Under these facts, Client may have to litigate whether Client (through Attorney) acted diligently enough to protect its attorney-client privileged communications. Attorney took no action to review Client's network prior to allowing the network search, did not instruct or supervise Client prior to or during Vendor's search, participated in drafting the overbroad search terms, and waited until after Client was accused of evidence spoliation before reviewing the data – all of which could permit Opposing Counsel viably to argue Client failed to exercise due care to protect the privilege, and the disclosure was not inadvertent.[11/]

Client also may have to litigate its right to the return of non-privileged but confidential proprietary information, which was not addressed in the clawback agreement.

Whether a waiver has occurred under these circumstances, and what Client's rights are to return of its non-privileged/confidential proprietary information, again are legal questions beyond this opinion. Attorney did not reasonably try to minimize the risks. Even if Client can retrieve the information, Client may never "un-ring the bell."

The State Bar Court Review Department has stated, "Section 6068, subdivision (e) is the most strongly worded duty binding on a California attorney. It requires the attorney to maintain 'inviolate' the confidence and 'at every peril to himself or herself' preserve the client's secrets." (See *Matter of Johnson* (Rev. Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179.) While the law does not require perfection by attorneys in acting to protect privileged or confidential information, it requires the exercise of reasonable care. Cal. State Bar Formal Opn. No. 2010-179. Here, Attorney took only minimal steps to protect Client's ESI, or to instruct/supervise Client in the gathering and production of that ESI, and instead released everything without prior review, inappropriately relying on a clawback agreement. Client's secrets are now in Chief Competitor's hands, and further, Chief Competitor may claim that Client has waived the attorney-client privilege. Client has been exposed to that potential dispute as the direct result of Attorney's actions. Attorney may have breached his duty of confidentiality to Client.

CONCLUSION

Electronic document creation and/or storage, and electronic communications, have become commonplace in modern life, and discovery of ESI is now a frequent part of almost any litigated matter. Attorneys who handle litigation may not ignore the requirements and obligations of electronic discovery. Depending on the factual circumstances, a lack of technological knowledge in handling e-discovery may render an attorney ethically incompetent to handle certain litigation matters involving e-discovery, absent curative assistance under rule 3-110(C), even where the attorney may otherwise be highly experienced. It also may result in violations of the duty of confidentiality, notwithstanding a lack of bad faith conduct.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Trustees, any persons or tribunals charged with regulatory responsibilities, or any member of the State Bar.

*[**Publisher's Note**: Internet resources cited in this opinion were last accessed by staff on June 30, 2015. Copies of these resources are on file with the State Bar's Office of Professional Competence.]*

[11/] Although statute, rules, and/or case law provide some limited authority for the legal claw back of certain inadvertently produced materials, even in the absence of an express agreement, those provisions may not work to mitigate the damage caused by the production in this hypothetical. These "default" claw back provisions typically only apply to privilege and work product information, and require both that the disclosure at issue has been truly inadvertent, and that the holder of the privilege has taken reasonable steps to prevent disclosure in the first instance. See Federal Rules of Evidence, rule 502; see also generally *State Compensation Insurance Fund v. WPS, Inc.* (1999) 70 Cal.App.4th 644 [82 Cal.Rptr.2d 799]; *Rico v. Mitsubishi Motors Corp.* (2007) 42 Cal.4th 807, 817 – 818 [68 Cal.Rptr.3d 758]. As noted above, whether the disclosures at issue in our hypothetical truly were "inadvertent" under either the parties' agreement or the relevant law is an open question. Indeed, Attorney will find even less assistance from California's discovery clawback statute than he will from the federal equivalent, as the California statute merely addresses the procedure for litigating a dispute on a claim of inadvertent production, and not the legal issue of waiver at all. (See Code Civ. Proc., § 2031.285.)