Ethics & Professional Compensation/
Unsecured Trade Creditors

Beware of the Traps: Ethical and Fiduciary Issues for Committee Members and Professionals

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Beware the Traps: Ethical and Fiduciary Issues For Committee Members and Professionals

Jointly Presented by:

Ethics and Professional Responsibility Committee
Unsecured Trade Creditors Committee

Panel:

The Honorable Mary F. Walrath, United States Bankruptcy Judge (Delaware)
Melanie Cyganowski, Partner, Otterbourg P.C. (New York)
Jeffrey N. Pomerantz, Partner, Pachulski Stang Ziehl & Jones (Los Angeles)
Brent Weisenberg, Partner, Ballard Spahr (New York)

1. **The recurring issue of how far may a professional go in soliciting potential Committee members in advance of a Committee formation meeting will be explored by the panel.**

   A. A Committee member/top 20 creditor was on the Committee of a previous case where Prospective Committee counsel was counsel to the Committee. Can Prospective Committee counsel reach out to that Committee member to discuss the new case?

   B. Can Prospective Committee counsel reach out to a creditor through its in house counsel?

   C. Can Prospective Committee counsel reach out to a client/business contact and ask them to make an introduction to a Committee member/top 20 creditor?

   D. Can Prospective Committee counsel send materials to all top 20 creditors? Do the materials need to be labeled "advertising"?

   E. Can Prospective Committee counsel invite creditors to a conference call to discuss the case before the Committee is formed?

   F. What restrictions, if any, are there on financial advisors, in contacting potential creditors in light of the lack of statutory ethical codes affecting their conduct?

   See attached copy of *Universal Building Products* opinion in which Judge Walrath analyzes solicitation and disclosure issues and denies application to retain counsel for the Committee

   Also attached are Rules 7.2, 7.3 and 8.3 of the Model Rules of Professional Responsibility.

2. **What is the litmus test, if there is one, for determining that a professional's connections with interested parties are enough to disqualify the professional from representing the Committee?**

A. In *In re Caldor, Inc.*, 193 B.R. 165 (Bankr. S.D.N.Y. 1996), the Bankruptcy Court overruled an objection to a challenge to a Chapter 11 Committee's (Caldors) proposed retention of the same counsel[1] and financial advisers that another Chapter 11 Committee (Bradlees) had simultaneously retained. The Court overruled the contention that the retention was barred by 11 U.S.C. § 1103(b), despite the fact that the two bankruptcies involved competitors. In addressing the motion, the Court applied the same conflicts standard applied to the Chapter 11 Trustee's retention of a professional under 11 U.S.C. § 327, and also analyzed the issue under the then-operative rules of the Code of Professional Responsibility regulating multiple representations. For its part, Section 327 permits the retention of a professional "(i) who does not hold or represent an interest adverse to the estate and (ii) who is disinterested."

B. In *Exco Resources, Inc. v. Milbank Tweed Hadley & McCloy LLP (In re: Enron Corp.),* 2003 U.S. Dist. LEXIS 1442 (S.D.N.Y. February 3, 2003), the District Court affirmed the Bankruptcy Court's denial of a motion to disqualify Milbank as creditors' counsel. Both courts rejected the contention that Milbank failed to disclose substantial

[1] The Court permitted the Otterbourg firm to serve as Committee Counsel.

conflicts and the parties to the bankruptcy. The courts were persuaded by the absence of any actual conflict, as well as by the fact that Milbank's disclosures were both complete and ongoing. While declining to hold that Section 327 governs the appointment of creditors' counsel, the Court expressly relied upon *Caldor*, and determined that Milbank had satisfied the heightened retention standard contained in Section 327.

C. *In In re Universal Bldg. Prods.*, 486 B.R. 650 (Bankr. D. Del. 2010), the Bankruptcy Court rejected the Committee's application to retain two law firms on the grounds that the prospective counsel had violated the ethics rules by improperly using a third party to contact foreign creditors. The Court also found that the disclosures made by counsel were insufficient, but rejected the contention that professionals retained by a Committee were required to be disinterested. Rather, the Court concluded that Committee Counsel could not be adverse, stating:

> *Section 1103* specifically provides only that committee counsel shall not hold or represent an interest adverse to the committee. That section expressly states that the representation of a creditor in the case (which would make the attorney not disinterested) is not a per se disqualifying factor as suggested by the Debtors. See, e.g., *In re Firstmark Corp., 132 F.3d 1179, 1182-83 (7th*

> *Cir. 1997)* (finding no disqualification where counsel for committee represented former president of the debtor - who was a possible creditor and avoidance action defendant - in matters unrelated to the debtor); *In re Nat'l Century Fin. Enters., Inc., 298 B.R. 112, 118 (Bankr. S.D. Ohio 2003)* (finding firm not disqualified from representing committee although it concurrently represented two members of the committee).

D. *In re Martin*, 817 F.2d 175 (1st Cir. 1987), the First Circuit took a holistic view of determining the nature of the professional's relationship, and rejected the attempt by *debtors' counsel* to take a pre-filing mortgage interest in the debtors' house to secure payment of legal fees. The Court "telescoped" the "twin requirements of disinterestedness and lack of adversity" into a "single hallmark," and explained that the ultimate was not a single "objective" test. Rather, it was "whether a potential conflict, or the perception of one," which "render[ed] the lawyers interest materially adverse to the estate or the creditors."

E. In *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991), the Third Circuit examined the totality of circumstances when faced with the issue of a potential conflict involving *debtor's counsel*. There, a corporation and its principals filed for bankruptcy, and the corporate debtor's counsel had acted as trustee and counsel for the corporation and both principals of the corporation. Both the Bankruptcy and District Courts

concluded that the simultaneous representation of the corporate debtor's estate and the estates of the principals created a conflict of interest, requiring counsel's removal.

3. May a noteholder that is a Committee member participate in a plan mediation process in its individual capacity? What if institutional noteholder/Committee member has a trading arm to its business?

A. 11 U.S.C. § 1102 provides in pertinent part:

> (a)(1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.
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> ***
>
> (b)(1) A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee, or of the members of a committee organized by creditors before the commencement of the case under this chapter, if such committee was fairly chosen and is representative of the different kinds of claims to be represented.

B. A member of the Committee owes a fiduciary duty to all other creditors. *In re Fast Mart Convenience Stores, Inc.*, 265 B.R. 427, 432 (Bankr. E.D. Va. 2001) ("[i]f a creditor serving on the committee has an impermissible conflict of interest, it may give rise to a breach of fiduciary duty."); *In re FirstPlus Fin., Inc.*, 254 B.R. 888, 894 (Bankr. N.D. Tex. 2000) ("In a Chapter 11 case, an Unsecured

Creditors' Committee is appointed by the Office of the United States Trustee and owes a fiduciary duty to act on behalf of all unsecured creditors.").

C. 11 U.S.C. § 1102(c) provides in part:

1. A committee appointed under section 1102 of this title may—

(1) consult with the trustee or debtor in possession concerning the administration of the case;

(2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan

D. Who is an Insider?

1. Insiders may include temporary insiders who have entered into a special confidential relationship to a business, and are given access to information solely for corporate purposes. Accordingly, access to inside information may be sufficient to confer insider status even where there is no legal right or ability to exercise control over a corporate entity. *See In re Wash. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011), *vacated in part*, *In re Wash. Mut., Inc.*, 2012 Bankr. LEXIS 895 (Bankr. D. Del., Feb. 23, 2012).

2. In *Wash. Mut.*, the Bankruptcy Court initially found that the Equity Committee had stated a colorable claim that the Settlement Noteholders became temporary insiders of the Debtors when the Debtors gave them confidential information and allowed them to participate in negotiations with a bank for the shared goal of reaching a settlement that would form the basis of a consensual plan of reorganization. The Bankruptcy Court in *Wash. Mut.*, also initially found the Noteholders to be "insiders" for the purpose of the bankruptcy laws, and cited to the authorities below. The initial opinion was vacated in part in the context of a settlement and adoption of a reorganization plan.

3. *Luedke v. Delta Air Lines, Inc.*, 159 B.R. 385 (S.D.N.Y. 1993) (holding that plaintiff stated a claim that creditors' committee assumed a duty to all parties by becoming a joint sponsor and proponent of plan).

4. *In re Wash. Mut.*, Inc., 419 B.R. 271, 278 (Bankr. D. Del. 2009) (noting that "members of a class of creditors may, in fact, owe fiduciary duties to other members of the class" when they hold themselves out as representing that class).

5. *Official Comm. of Equity Sec. Holders of Mirant Corp. v. The Wilson Law Firm, P.C. (In re Mirant Corp.)*, 334 B.R. 787, 793 (Bankr. N.D. Tex. 2005) ("[W]hen a party purports to act for the benefit of a class, the party assumes a fiduciary role as to the class.").

6. *In re Winstar Commc'ns*, Inc., 554 F.3d 382, 396-97 (3d Cir. 2009) (holding that parties who do not fit the Bankruptcy Code definition of an insider may nonetheless be insiders if they have a sufficiently close relationship with the debtor to suggest that their transactions were not conducted at arm's length).

7. *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 298 (Bankr. W.D. Pa. 1990) (party who received "a great volume of information that was not available to other creditors, shareholders, and the general public" was a temporary insider).

8. Mark J. Krudys, Insider Trading by Members of Creditors' Committees - Actionable!, 44 *DePaul L. Rev.* 99, 142 (1994) (noting that "members of creditor steering committees, like official creditors' committees, appear to come within the temporary insider definition articulated in Dirks").

E. Possible Compliance Measures

1. At a minimum, one should erect internal barriers to prevent, for example, individual portfolio managers who are members of a creditors' committee of a distressed or bankrupt company (and who therefore have access to confidential information) from also trading such company's debt or equity.[2]

4. When is it appropriate to have multiple Creditors' Committees? What is the Court's role, if any, in policing the appointment of Creditors to a Committee?

A. Early cases held that § 1102 mandated separate committees for each debtor, absent substantive consolidation of the estates.

1. *In re White Motor Credit Corp*., 18 B.R. 720, 722 (Bankr. N.D. Ohio 1980) ("Absent a successful effort towards substantive consolidation, creditors of one debtor cannot be presumed to have a material or other qualifying interest in the assets or future of an affiliated debtor . . . As a matter of law, section 1102 indicates that each case should have a Court-appointed committee.").

[2] Hedge Fund Working Group, Hedge Fund Standards: Final Report (2008) http://www.efinancialnews.com/share/media/downloads/2008/01/2449616462.pdf

2. *Cf. In re Proof of the Pudding, Inc*., 3 B.R. 645 (Bankr. S.D.N.Y 1980). In refusing to allow the same counsel to represent three separate creditors' committees, the Court noted.

> The problems inherent in overlapping committees, in distinct but related cases, are clearly illustrated in the present cases. Those creditors serving n more than one committee will be called on to represent ofttimes competing interests. Their attempts to reconcile these competing interests could very well be to the detriment of other creditors and the respective debtors. Since ultimate decisions concerning litigation and scope of inquiry rest with the respective committees, this court is concerned with the composition of the committee as it is with the choice of committee's attorneys.

Id. At 649.

B. Subsequent courts acknowledge the expense and administrative difficulties of having separate committees in large cases of inter-related debtors and permitted the appointment of one consolidated committee for all debtors, absent an actual conflict.

1. *In re McLean Indus., Inc*., 70 B.R. 852, 862 (Bankr. S.D. N.Y. 1987) (rejecting *White Motor* because "[t]here is no indication that Congress gave any thought to jointly administered cases and intended to require a committee for each case [and]]t]he cost could be extreme").

2. *In re Orfa Corp*., 121 B.R. 294, (Bankr. E.D. Pa. 1990) (court refused to appoint separate committee for one of three affiliated debtors "[i]n light of the apparently-selfish motivations of the supporters of the motion and the broad-based opposition to it; the delay that would result at a crucial juncture of the case [30 days before confirmation hearing] if we appointed an additional committee; and the added cost that would be attendant to [the] additional committee. . . . [T]he purported conflicts within the present Committee are not an uncommon or significant as to outweigh the foregoing conclusions.").

3. *In re Enron Corp*., 279 B.R. 671, 689, 693 (Bankr. S.D.N.Y. 2002) ("Conflicts among creditors and among the members of a creditors' committee are not uncommon. The question is whether such conflict hinders adequate representation. . . .

Creditors' Committee to function, no evidence of a debilitating division among its members.").

4. *In re Garden Ridge Corp*., No. 04-10324, 2005 WL 523129, at *4 (Bankr. D. Del. Mar. 2, 2005) ("Adequate representation is lacking only when . . . conflicts prevent an official committee from upholding its fiduciary obligations to all general unsecured creditors.").

C. Currently, the norm is to appoint only one joint committee for related debtors in large cases. For additional committees to be appointed, a party in interest must file a motion.

1. Section 1102 (a) (2) provides that a court may appoint an additional creditors' committee or equity security holders' committee "if necessary to assure adequate representation" of those constituencies. 11 U.S.C. §1102 (a) (2).

2. It is within the discretion of the court. *Enron*, 279 B.R. at 685.

3. It is an exception, not the rule. *Garden Ridge*, 2005 WL 523129, at *3 ("Many courts are reluctant to appoint an additional committee of creditors because it is an extraordinary remedy."). See also In re *Sharon Steel Corp*., 100 B.R. 767, 777-78 (Bankr. W.D. Pa. 1989) ("The legal principle to be

distilled from these cases is clear: adequate representation exists through a single committee as long as the diverse interests of the various creditor groups are represented on and have participated in that committee.").

4. The burden of proof is on the party moving for an additional committee. *In re Johns-Manville Corp*., 38 B.R. 331, 332 (S.D.N.Y. 1983) (denial of separate preferred equity committee upheld where appellants did not prove that their interests were prejudiced by appointment of single equity committee or conflict with general shareholders was so large as to create a conflict for committee counsel); *Garden Ridge*, 2005 WL 523129, at *3, *In re Agway, Inc,* 297 B.R. 371, 374 (Bankr. N.D.N.Y. 2003) (retirees failed to establish they were not adequate represented by creditors' committee).

5. Courts consider many factors in determining whether a party seeking an additional committee is already adequately represented by the existing committee, including: (a) the ability of the committee to function; (b) the nature of the case; and (c) the standing and desires of the various constituencies. *Enron*, 279 B.R. at 685.

6. Even if there is not adequate representation, courts still may deny the appointment of an additional committee. In determining whether to exercise their discretion, courts consider many additional factors such as: (1) the cost associated with the appointment; (2) the timing of the motion, whether early or late in the confirmation process; (3) the potential for added complexity; and (4) the presence of other avenues for creditor participation. *Enron*, 279 at 685 (citing *In re Dow Corning Corp.*, 194 B.R. 121, 143 (Bankr. E.D. Mich. 1996).

D. Originally, under the Bankruptcy Code, committees were appointed by the court. Kenneth N. Klee and K. John Shaffer, Creditors' Committees under Chapter 11 of the Bankruptcy Code, 44 S.C.L. Rev. 995, 1001-02 (1993). In 1986, when the national UST program was established, the power to appoint committees was given to the UST and court's authority was limited to directing the UST to appoint a committee. *In re Mercury Fin. Co*., 240 B.R. 270, 275 (N.D. Ill. 1999). In 2005, BAPCPA granted courts the express authority review a committee's membership and order its modification on request of a party in interest. 11 U.S.C. §1102 (a) (4).

1. It is unclear whether the court has the power to disband a commit.

   a. *In re Caesars Entm't Operating Co., Inc.*, 526 B.R. 265, 268 (Bankr. N.D. Ill. 2015) (holding that court does not have the authority to disband a UST-appointed creditors committee because "section 1102 (a) grants specific powers, and . . . the power to disband a committee is not one of them, the only fair reading of the statute is that there is no such power").

   b. *In re Dewey & Leboeuf LLP*, No. 12-12321, 2012 WL 5985325, *3-5 (Bankr. S.D.N.Y. Nov. 29, 2012) (court found that language of § 1102 authorizing UST to appoint additional committees as it "deems appropriate" suggests that the court does not have power to disband, but not deciding the issue because even if it had that power, it would not do so because the former partners' committee had a continuing critical role to serve).

   c. *In re City of Detroit, MI*, 519 B.R. 673, 680-81 (Bankr. E.D. Mich. 2014) (concluding that court had power under § 105 to disband the official unsecured creditors'

committee in chapter 9 case because it was not properly appointed under § 1102 (a) (2) and the committee added no value to the case having rejected mediation and threatening litigation). *Bus see Caesars*, 526 B.R. at 269 (concluding that § 105 does not authorize court to disband committee because it does not allow the court to contradict the Code).

2. The court has limited power to restrict the activities of a committee appointed by the UST. *Caesars*, 526 B.R. at 270 ("Limiting the Committee's activities is not an option either. Section 1103 of the Code addresses the powers and duties of committees appointed under section 1102. . . . Nothing in section 1103 authorizes a bankruptcy court to define those powers and duties in such a way as to place limits on a committee's activities beyond the limits in section 1103 itself.")

3. But the court does have the "power of the purse string" to control committees' activities. *See Caesars*, 526 B.R. at 270 (the court has the power to control what professionals are employed by the committees and what compensation those professionals can receive); *Dewey & Leboeuf*, 2012 WL

5985325, at *5 (though denying motion to disband committee, observing that "all professionals seeking compensation from the estate should be mindful of the fact that the standards for reviewing fee applications require the Court to consider whether services are necessary").

See In re City of Detroit, Michigan, 519 B.R. 673 (Bankr. E.D. Mich. 2014); *In re Dewey & LeBoeuf LLP*, 2012 WL 5985325 (Bankr. S.D.N.Y, Nov. 29, 2012); *In re JNL Funding Corp.*, 438 BR 356 (Bank E.D.N.Y. 2010). March 9, 2015 decision in *Caesars Entertainment Operating Co*. is attached to these materials.

5. Is it appropriate for a Committee to negotiate a plan that waives avoidance actions? Should it matter if one or more members received preferential transfers?

Time Permitting:

6. Under what conditions should the US Trustee refuse to appoint a creditor to a Committee, and when, if ever, should it take action to remove a creditor from the Committee?

A. When a creditor participates in pre-petition plan support discussions, should this creditor be disqualified from being appointed to the Committee?

B. What if the creditor signed a plan support agreement?

C. What if the creditor is a former professional for the Debtor?

D. What if the creditor is on list prepared by I-Banker of potential buyers in a case styled as 363 sale case?

E. What if the creditor later becomes a critical vendor, or substantial portion of claim is later deemed a 503(b)(9) claim?

Section 1102 of the Bankruptcy Code cedes authority to appoint a committee to the Office of the United States Trustee. The Code provides that the United States Trustee "shall" appoint a committee in chapter 11 cases, which "ordinarily" consists of the holders of the seven largest claims who are willing to serve. The use of the word "ordinarily" provides the United States Trustee with discretion to constitute a committee that is not comprised of the holders of the seven largest claims and more other than not committees are not comprised of the seven largest creditors willing to serve. If a committee was organized prior to the commencement of a case, the United States Trustee may appoint this committee as the official committee, provided that he/she determines that the members of the committee hold unsecured claims and fit with the definition of a "person" under the Code, and the committee is a fair representation of the different types of claims against the debtor.

There is nothing in the Bankruptcy Code that requires or prohibits the United States Trustee from reconstituting the committee after it is formed either by adding to or removing members from the committee. Further, pursuant to section 1102(a)(4) of the Code, the Court may on request of a

party in interest order the United States Trustee to change the composition of the committee if the Court determines that reconstituting the committee is necessary to ensure adequate representation of the unsecured creditor body. If the Court orders the reconstitution of the committee, it will not appoint new members, but will defer to the United States Trustee to make such new appointments.

The types of creditors that have presented consternation for the United States Trustee and Courts as potential committee members are as follows:

A. Insiders – *See, In re Glendale Woods Apts. Ltd.*, 25 B.R. 414 (Bankr. D. Md. 1982) (insiders were removed from committee due to confidentiality concerns).

B. Competitors – *See, In re Wilson Foods Corp*., 31 B.R. 272 (Bankr. W.D. Okla. 1983) (US Trustee did not appoint competitors due to confidentiality concerns).

C. Partially Secured Creditors – *See In re Walat Farms, Inc*., 64 B.R. 65 (Bankr. E.D. Mich. 1986) (partially secured creditors not per se disqualified by virtue of holding collateral).

D. Others – Holders of disputed claims; parties to prepetition plan support agreements; unions; indenture trustees; potential acquirers; former professionals; claim traders; and parties to executory contracts.

[Comment (CRule_7.1.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_7.1)][State Narratives (/ethics/comparative/index.htm#7.1)]

Rule 7.2 Advertising

(a) Subject to the requirements of Rules 7.1 and 7.3, a lawyer may advertise services through written, recorded or electronic communication, including public media.

(b) A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may

(1) pay the reasonable costs of advertisements or communications permitted by this Rule;

(2) pay the usual charges of a legal service plan or a not-for-profit or qualified lawyer referral service. A qualified lawyer referral service is a lawyer referral service that has been approved by an appropriate regulatory authority; and

(3) pay for a law practice in accordance with Rule 1.17; and

(4) refer clients to another lawyer or a nonlawyer professional pursuant to an agreement not otherwise prohibited under these Rules that provides for the other person to refer clients or customers to the lawyer, if

(i) the reciprocal referral agreement is not exclusive, and

(ii) the client is informed of the existence and nature of the agreement.

(c) Any communication made pursuant to this rule shall include the name and office address of at least one lawyer or law firm responsible for its content.

[Comment (CRule_7.2.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_7.2)][State Narratives (/ethics/comparative/index.htm#7.2)]

Rule 7.3 Direct Contact with Prospective Clients

(a) A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment from a prospective client when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted:

(1) is a lawyer; or

(2) has a family, close personal, or prior professional relationship with the lawyer.

(b) A lawyer shall not solicit professional employment from a prospective client by written, recorded or electronic communication or by in-person, telephone or real-time electronic contact even when not otherwise prohibited by paragraph (a), if:

(1) the prospective client has made known to the lawyer a desire not to be solicited by the lawyer; or

(2) the solicitation involves coercion, duress or harassment.

(c) Every written, recorded or electronic communication from a lawyer soliciting professional employment from a prospective client known to be in need of legal services in a particular matter shall include the words "Advertising Material" on the outside envelope, if any, and at the beginning and ending of any recorded or electronic communication, unless the recipient of the communication is a person specified in paragraphs (a)(1) or (a)(2).

(d) Notwithstanding the prohibitions in paragraph (a), a lawyer may participate with a prepaid or group legal service plan operated by an organization not owned or directed by the lawyer that uses in-person or telephone contact to solicit memberships or subscriptions for the plan from persons who are not known to need legal services in a particular matter covered by the plan.

[Comment (CRule_7.3.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_7.3)][State Narratives (/ethics/comparative/index.htm#7.3)]

Rule 7.4 Communication of Fields of Practice and Specialization

(a) A lawyer may communicate the fact that the lawyer does or does not practice in particular fields of law.

(b) A lawyer admitted to engage in patent practice before the United States Patent and Trademark Office may use the designation "Patent Attorney" or a substantially similar designation.

(c) A lawyer engaged in Admiralty practice may use the designation "Admiralty," "Proctor in Admiralty" or a substantially similar designation.

(d) A lawyer shall not state or imply that a lawyer is certified as a specialist in a particular field of law, unless:

(1) the lawyer has been certified as a specialist by an organization that has been approved by an appropriate state authority or that has been accredited by the American Bar Association; and

(2) the name of the certifying organization is clearly identified in the communication.

[Comment (CRule_7.4.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_7.4)][State Narratives (/ethics/comparative/index.htm#7.4)]

Rule 7.5 Firm Names and Letterheads

(a) A lawyer shall not use a firm name, letterhead or other professional designation that violates Rule 7.1. A trade name may be used by a lawyer in private practice if it does not imply a connection with a government agency or with a public or charitable legal services organization and is not otherwise in violation of Rule 7.1.

(b) A lawyer who is a candidate for judicial office shall comply with the applicable provisions of the Code of Judicial Conduct.

[Comment (CRule_8.2.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_8.2)][State Narratives (/ethics/comparative/index.htm#8.2)]

Rule 8.3 Reporting Professional Misconduct

(a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority.

(b) A lawyer who knows that a judge has committed a violation of applicable rules of judicial conduct that raises a substantial question as to the judge's fitness for office shall inform the appropriate authority.

(c) This Rule does not require disclosure of information otherwise protected by Rule 1.6 or information gained by a lawyer or judge while participating in an approved lawyers assistance program.

[Comment (CRule_8.3.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_8.3)][State Narratives (/ethics/comparative/index.htm#8.3)]

Rule 8.4 Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law; or

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law.

[Comment (CRule_8.4.htm)][Pre-2002 version (../2001/ABA_CODE.HTM#Rule_8.4)][State Narratives (/ethics/comparative/index.htm#8.4)]

Rule 8.5 Disciplinary Authority; Choice of Law

486 B.R. 650
United States Bankruptcy Court,
D. Delaware.

In re UNIVERSAL BUILDING PRODUCTS,
Debtor.

No. 10–12453 (MFW).

Nov. 4, 2010.

Synopsis
Background: Official committee of unsecured creditors filed applications to retain two law firms as counsel. United States Trustee (UST) and Chapter 11 debtors opposed applications.

Holdings: The Bankruptcy Court, Mary F. Walrath, J., held that:

[1] debtors had standing to object to the committee retention applications;

[2] the law firms improperly solicited potential clients, in violation of the model rules and the Delaware rules of professional conduct;

[3] firms' conduct was sufficient reason to disqualify them from serving as committee counsel;

[4] even if law firm did provide legal advice to some creditors, through a particular individual, the firm was not disqualified from serving as committee counsel on the basis that it was not disinterested; and

[5] law firms' failure to provide complete and accurate disclosure at the outset of their connections with creditors and with individual who eventually served as one creditor's committee representative and as committee translator warranted denial of the applications.

Objections sustained and applications denied.

West Headnotes (15)

[1] **Attorney and Client**
Disqualification proceedings; standing
Bankruptcy
Reorganization cases; right to be heard
Bankruptcy
Creditors' and equity security holders' committees and meetings
Bankruptcy
Attorneys

Chapter 11 debtors had standing to object to applications to retain counsel that were filed by official committee of unsecured creditors; Bankruptcy Code expressly grants debtors the right to appear and be heard on any issue in their cases, and, under Delaware rules of professional conduct, any attorney with knowledge of a violation of applicable rules of professional conduct by another may be obligated to report that violation. 11 U.S.C.A. § 1109; Del.Rules of Prof.Conduct, Rule 8.3.

Cases that cite this headnote

[2] **Attorney and Client**
Advertising or soliciting

Under the Delaware rules of professional conduct, a lawyer is prohibited from soliciting prospective clients, both directly and indirectly through the use of an intermediary. Del.Rules of Prof.Conduct, Rule 7.3.

Cases that cite this headnote

[3] **Attorney and Client**
Advertising or soliciting

Prospective counsel for unsecured creditors committee improperly solicited potential clients, in violation of model rules and Delaware rules of professional conduct, where, once law firms learned that particular individual, who had served as committee translator or representative of foreign creditors in unrelated cases, did not represent any creditor on list of Chapter 11

debtors' 30 largest creditors, they actively encouraged and assisted him in his efforts to solicit creditors to get their proxies to attend committee formation meeting and vote in favor of firms as committee counsel, after which firms recommended that he be retained as committee translator; prospective clients who were solicited were foreign creditors unfamiliar with U.S. bankruptcy laws, particularly with system of forming creditors committees, such creditors were no less vulnerable to direct solicitation by someone on behalf of an attorney than an individual, and the practice at issue had long been criticized. Del.Rules of Prof.Conduct, Rules 7.3, 8.4.

Cases that cite this headnote

[4] **Attorney and Client**
Advertising or soliciting

Under the Delaware rules of professional conduct, prospective counsel for unsecured creditors committee in Chapter 11 case did not improperly solicit potential clients by sending a list of debtors' 30 largest creditors to their clients and to contacts with whom they had a professional relationship, or by sending a legal "analysis" of debtors' case to those same entities. Del.Rules of Prof.Conduct, Rule 7.3.

Cases that cite this headnote

[5] **Attorney and Client**
Bankruptcy

Conduct of prospective counsel for unsecured creditors committee, which improperly solicited potential clients in violation of the model rules and the Delaware rules of professional conduct, was sufficient to disqualify law firms from serving as committee counsel. 11 U.S.C.A. § 327; Del.Rules of Prof.Conduct, Rules 7.3, 8.4.

Cases that cite this headnote

[6] **Attorney and Client**
Bankruptcy

Committee counsel may not represent an entity with an interest adverse to the committee. 11 U.S.C.A. § 1103(b).

Cases that cite this headnote

[7] **Attorney and Client**
Bankruptcy

Even if prospective counsel for unsecured creditors committee did provide legal advice to some creditors, through a particular individual, and thereby "represented" the creditors, the law firm was not disqualified from serving as committee counsel on the basis that it was not disinterested; Bankruptcy Code expressly provides that committee counsel shall not hold or represent an interest adverse to the committee, and that the representation of a creditor in the case, which would make the attorney not disinterested, is not a per se disqualifying factor. 11 U.S.C.A. §§ 328(c), 1103(b).

Cases that cite this headnote

[8] **Attorney and Client**
Bankruptcy

Potential conflict of interest, alone, does not mandate disqualification of counsel for committee. 11 U.S.C.A. § 1103(b).

Cases that cite this headnote

[9] **Attorney and Client**
Bankruptcy

Time to evaluate whether prospective counsel

for committee is disqualified, because it represents an interest adverse to the committee, is at the time of retention. 11 U.S.C.A. § 1103(b).

Cases that cite this headnote

[10] **Attorney and Client**
Bankruptcy

Prior representations, even if adverse to the interests of the committee or unsecured creditors, do not disqualify committee counsel. 11 U.S.C.A. § 1103(b).

Cases that cite this headnote

[11] **Bankruptcy**
Professional Persons in General

Defective disclosure on the part of any professional person seeking retention by the debtor or committee is not a minor matter but, rather, goes to the heart of the integrity of the bankruptcy system. Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

Cases that cite this headnote

[12] **Bankruptcy**
Professional Persons in General

Under the bankruptcy rules, a professional must disclose all contacts, not pick and choose which to disclose and which to ignore or leave the court to search the record for such relationships. Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

Cases that cite this headnote

[13] **Attorney and Client**
Disclosure, waiver, or consent
Bankruptcy
Disclosure requirements

Failure to disclose connections itself is enough to warrant disqualification of counsel from employment. Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

Cases that cite this headnote

[14] **Attorney and Client**
Disclosure, waiver, or consent
Bankruptcy
Disclosure requirements

Failure of prospective counsel for unsecured creditors committee to provide complete and accurate disclosure at the outset of their connections with creditors and with individual who eventually served as one creditor's committee representative and as committee translator warranted denial of committee's applications to retain the law firms as committee counsel; although one firm at least disclosed that it had a prior relationship with individual, having served as committee counsel in cases where he represented a creditor or acted as a translator to the committee, both firms should have disclosed from the outset their efforts in support of individual's attempt to obtain proxies from creditors to attend committee formation meeting, as well as fact that one firm had provided legal advice to creditors, and subsequent disclosures, filed only after concerns about firms were raised and after discovery revealed extent of connections, were insufficient to cure original deficiencies. Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

Cases that cite this headnote

[15] **Bankruptcy**
Professional Persons in General
Bankruptcy

Disclosure requirements

Although a financial advisor and others are not bound by the same rules of professional responsibility that bind attorneys, because solicitation efforts go to the integrity of the process, all professionals, not just attorneys, should disclose any direct calls they made, or others made on their behalf, to creditors who were not their respective clients, in an effort to be employed in a bankruptcy case. Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION[1]

[1] This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052, which is made applicable to contested matters by Federal Rule of Bankruptcy Procedure 9014.

MARY F. WALRATH, Bankruptcy Judge.

Before the Court are the Applications of the Official Unsecured Creditors' Committee (the "Committee") to retain Arent Fox LLP ("AF") and Elliott Greenleaf & Siedzikowski, P.C. ("EG") as counsel (collectively the "Committee Retention Applications"). The Committee Retention Applications are opposed by the United States Trustee (the "UST") and the Debtors. For the reasons set forth below, the Committee Retention Applications will be denied.

I. *GENERAL CASE BACKGROUND*

On August 4, 2010, Universal Building Products, Inc., and several of its affiliates (collectively, the "Debtors") filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. At the same time the Debtors filed a motion to approve a sale of substantially all of their assets to their pre-petition lenders (the "Lenders") and a motion for approval of DIP financing to ***653** allow for the sale process to continue with a projected sale hearing date in early September. At the first day hearing held on August 5, 2010, the Court set a hearing for August 23, 2010, to consider the Debtors' request for bid procedures related to the sale motion.

On August 13, 2010, the UST held an organizational meeting to determine whether there was sufficient creditor interest to form a Committee. At that time a Committee was formed and it selected AF and EG as counsel. The Committee Retention Applications were filed on August 24 and 30, 2010.

In the interim, on August 19, 2010, the Committee filed preliminary objections to the motions for approval of the sale procedures and the final DIP financing. The Committee also filed an emergency motion seeking to prohibit the Lenders from credit bidding at the proposed sale. At the August 23 hearing on the DIP financing and sale procedures motions, a global settlement among the Debtors, the Committee and the Lenders was announced pursuant to which the sale to the Lenders would proceed, with a sale hearing scheduled for September 7, 2010. (Tr. 8/23/10 at 5–6.)[2] In exchange, the Lenders would allow any excess funds from the DIP budget and the avoidance actions to be transferred to a liquidating trust for the benefit of the unsecured creditors pursuant to an agreed plan of reorganization. (*Id.*) After additional notice and hearing, the Court approved the proposed procedure and ultimately the sale was approved on September 7, 2010.

[2] References to the record are as follows: "Tr. [date] at" refers to the transcript of the hearing held on the referenced date; "Liu Dep." refers to the transcript of the deposition of Dr. Haishan Liu held on September 17, 2010; "Ex. L-[#]" refers to the Liu deposition exhibits; "Ex. [letter]" and "Ex. [#]" refer to the exhibits of the Committee and the Debtors,

respectively, admitted into evidence at the October 7, 2010, hearing.

On September 3, 2010, the Debtors filed an emergency motion to compel discovery related to the Committee Retention Applications. The Debtors sought discovery, inter alia, of the relationship between proposed counsel for the Committee and Dr. Haishan Liu whom the Committee had retained as a translator.[3] The Court did not grant the Debtors' motion to expedite the hearing on the emergency motion but noted at the sale hearing held on September 7, 2010, that the motion appeared to be premature because no discovery had even been served. (Tr. 9/7/10 at 8.)

[3] No separate application was filed with respect to Dr. Liu's retention. Rather, in the application to retain AF, the Committee sought approval of Dr. Liu's retention and payment of his fees subject to section 503(b)(3)(F). (*See* proposed form of order attached to AF retention application.)

In the interim, the global settlement apparently fell apart. When the Committee filed an objection to the Debtors' emergency motion to compel discovery on September 6, 2010, it also filed an emergency motion for the appointment of a chapter 11 trustee and to terminate the Debtors' exclusivity contending that the Debtors had filed a plan and disclosure statement on August 31, 2010, which did not comply with the parties' agreement. On September 30, 2010, the Committee filed an objection to the Debtors' disclosure statement. Most recently, on October 27, 2010, the Committee filed an emergency motion to convert these cases to chapter 7, inter alia, because the Lenders have now taken the position that the Debtors are in default of the DIP financing budget and Order and the Lenders, therefore, are under no obligation to fund a plan of liquidation.

***654** On September 16 and 30, 2010, the UST filed an objection and supplemental objection to the Committee Retention Applications contending that counsel's disclosures under Rule 2014 were incomplete. On September 30, 2010, the Debtors filed an omnibus objection to the Committee Retention Applications contending that proposed counsel had (1) violated the applicable Codes of Professional Conduct by having Dr. Liu solicit creditors to serve on the Committee and give him their proxy so that he could vote for counsel in exchange for being retained as a translator by the Committee and (2) violated the applicable provisions of the Bankruptcy Code and Rules by failing to disclose adequately their relationship with Dr. Liu.

A hearing was held on October 7, 2010, to consider the Committee Retention Applications and objections. After hearing evidence, the Court took the matter under advisement.[4] The parties filed post-trial briefs on October 21, 2010. The matter is now ripe for decision.

[4] At the hearing on the Committee Retention Applications in this case, the Debtors moved into evidence pleadings filed in bankruptcy cases in Texas in which it was alleged that AF had a financial advisor, with which it had a relationship, solicit creditors for proxies to serve on the creditors' committee for the purpose of supporting AF as counsel to the committee. The Committee filed a motion to strike the Debtors' references in their pleadings to those unrelated cases and opposed the admission of those pleadings into evidence in this case on numerous grounds. The Court took that issue under advisement as well. (Tr. 10/7/10 at 105–08.) Because the Court finds that it is not necessary to consider those pleadings to sustain the Debtors' objection, the Court finds it unnecessary to consider whether those pleadings are admissible.

II. *FACTUAL BACKGROUND RELEVANT TO RETENTION MOTIONS*

As a result of the evidence presented, including the deposition of Dr. Liu and testimony of representatives of the respective firms proposed to be retained by the Committee, the Court finds that the following occurred between the filing of the Debtors' petition on August 4, 2010, and the Committee formation meeting on August 13, 2010.

On the day the Debtors filed their bankruptcy petitions, attorneys at both AF and EG faxed copies of the petitions and the list of the thirty largest creditors to Dr. Liu.[5] (Liu Dep. at 51–52; Exs. L–2, L–23.) Dr. Liu testified that he received the same information from three other law firms that same day. (*Id.*) Dr. Liu's main business is as an authorized distributor for Fujifilm, but he also consults with Asian creditors who may have a collection problem in the United States. (*Id.* at 11–12.) Each of the firms who sent the information to Dr. Liu had a prior relationship with him, representing him or his Asian clients in collection or preference cases. (*Id.* at 115–20; Tr. 10/7/10 at 69.) Several had worked with him in cases where they served as Committee counsel while he acted as a translator or a representative of an Asian creditor. (Liu Dep. at 115–20.)

5 EG sent additional information about its analysis of the case to Dr. Liu and to several other clients and contacts known to have relationships with foreign entities. (Tr. 10/7/10 at 68–69, 96.)

Dr. Liu understood that counsel were sending him the information because they were interested in making a pitch for the Committee representation in this case. (Liu Dep. at 50–51, 58, 70, 134.) AF emailed Dr. Liu "[w]e are definitely interested in pursuing this case." (Ex. L–19; Tr. 10/7/10 at 45–46.) The attorney at EG emailed "I am sending this to you first in order to get your support early. I would like to pitch this as lead or co-counsel—no more local." (Ex. L–23.)

*655 At the time of the bankruptcy filing, neither AF nor EG had any prior relationship with any of the Asian creditors. (Tr. 10/7/10 at 39–40, 84–85.) Nor did AF or EG have any knowledge that Dr. Liu had a relationship with any of those creditors. (*Id.* at 40, 85–87.) In fact, Dr. Liu did not represent any of the creditors on the creditor list at the time it was sent to him. (Liu Dep. at 46–51, 83, 155.)

In response to the information sent to him by AF and EG on August 4, 2010, Dr. Liu responded by email "As usual, at this probing stage, let's find out what those Asian creditors are going to respond and their representation status in the USA prior to the petition." (Ex. L–2.) Dr. Liu further noted that AF and EG "desire me to get a certain support from Asian Chinese exporters who might recommend [Dr. Liu] as a pending committee member in the case.... Before recommending you, I need some one and some groups to commend me to one or more of those prospective committee participants." (Ex. L–27.) Dr. Liu noted that "the grand cultivation of a support base from Chinese exporters" was "an invaluable asset." (*Id.*)

Notwithstanding having no relationship with the Asian creditors on the list, Dr. Liu made extensive efforts to contact them to educate them about the intricacies of the United States Bankruptcy Code and to see if they would give him a proxy to represent them at the Committee formation meeting. (*Id.* at 42–43, 46–51, 71–72, 74–78, 83–85.) Throughout this process, Dr. Liu sent almost daily emails to AF and EG reporting on his efforts to locate creditors on the list and get their proxies. (Ex. L–3, L–7, L–8, L–9, L–18; Tr. 10/7/10 at 89–90.) The AF partner involved in this process emailed Dr. Liu "Let me know if you need any assistance." (Ex. A at HL–391.) In fact, AF did assist Dr. Liu in his efforts to find contact information for the creditors.[6]

6 Dr. Liu asked AF to contact the Debtors' counsel or the UST to obtain contact information for the fourth largest creditor, but AF advised him that neither would give an attorney that information. Instead, AF recommended that Liu call them directly and gave him their phone numbers. (Tr. 10/7/10 at 41–42; Ex. L–4, L–5, L–6.) In addition, an attorney at AF forwarded to Dr. Liu an address for one of the creditors that he had obtained through an internet search. (Ex. L–11.)

While seeking to persuade the creditors to give him their proxies, Dr. Liu asked AF and EG for legal advice regarding the creditors noting that "getting a proxy is a two way traffic." (Liu Dep. at 78–81, 210–18; Ex. L–17, L–18.) The questions related specifically to how the creditors could improve their chances of getting paid for product in transit. (Liu dep. at 213, 216–18; Tr. 10/7/10 at 50–51.) AF advised Dr. Liu that the creditors could claim administrative status for that product under section 503(b)(9). (Liu Dep. at 213, 216–18; Ex. L–17.)

Ultimately, Dr. Liu was "rewarded" for his efforts when two of the creditors, Eastern Accessories Corporation ("EAC") and Shanghai Hualin Hardware ("SHH"), agreed to give him their proxies. (Liu Dep. at 83, 227–28; Exs. L–8, L–22.) When Dr. Liu reported that he had secured the representation of SHH, AF responded "Excellent. That is great. Thanks." (Ex. L–10.) Dr. Liu reported to AF and EG that "I'll hold the proxy [for the larger creditor, EAC] to cheer everyone up. I strongly suggest [AF] may co-pitch with his colleagues." (Ex. L–22.)

Because he felt that the UST would not allow him to act as a proxy for both creditors, Dr. Liu decided to act as proxy only for the larger creditor, EAC, because he felt it was more likely to get on the Committee. (*Id.* at 74, 86, 227–28.) Dr. Liu *656 asked AF and EG to get him a "reliable" person to hold the proxy for SHH. (Liu Dep. at 164–65; Ex. L–12.) EG responded that it could "call in a favor" and recommended a person to whom EG had recently referred business and noted that the person was not interested in making a pitch for business from the Committee (as a financial advisor) and that he "knows the rules and will serve us well." (Tr. 10/7/10 at 90, 93–94; Ex. L–14.) AF was aware of the recommendation and approved it. (Liu Dep. at 171–72; Exs. L–13 & L–15; Tr. 10/7/10 at 44.) EG also sent Dr. Liu a form of proxy that it said complied with the UST's requirements. (Exs. L–30, L–35; Tr. 10/7/10 at 79, 92.)

EG advised Dr. Liu that the UST would ask the proxy holder questions about how it was obtained and would disqualify the holder if he had not actually communicated with the creditor before the committee formation meeting.

(Exs. L–14, L–28.) This comported with Dr. Liu's experience. (Liu Dep. at 182.) As a result, a conference call was arranged among SHH, Dr. Liu, AF, EG, and the proxy holder to discuss whether the creditor wished to give its proxy. (Liu Dep. at 200–03; Tr. 10/7/10 at 45, 78, 90–91.)

The proxies that Dr. Liu obtained included the right to vote on the creditors' behalf for counsel for the Committee. (Liu Dep. at 84–85; Ex. L–14.) Dr. Liu did not discuss with the creditors which professionals he would support; the proxies gave him the discretion to decide. (*Id.* at 86, 313.)

At the Committee formation meeting, EAC (whose proxy Dr. Liu held) was chosen by the UST to serve on the Committee. (Tr. 10/7/10 at 79.) After it was formed, the Committee interviewed attorneys and financial advisors. Ten law firms, including AF and EG, gave presentations seeking to be retained as counsel for the Committee. (*Id.* at 80; Liu Dep. at 311–12.) Liu told the other Committee members that he had had dealings in other cases with AF and EG and the other law firm that was a finalist. (Tr. 10/7/10 at 11.) However, Dr. Liu did not advise the other members of the Committee of the email and other communications he had had with AF and EG leading to the formation meeting. (*Id.* at 16.) AF and EG were ultimately chosen as counsel by unanimous vote. (*Id.* at 15–16.)

Thereafter, on AF's recommendation, the Committee decided to hire Dr. Liu as a translator so that EAC could participate in Committee meetings. (*Id.* at 14.) Dr. Liu advised EAC that, in light of his retention as a translator, he could no longer act as its representative on the Committee and referred it to another attorney he knew. (Liu Dep. at 87–88.) However, no one advised the Co–Chair of the Committee that Dr. Liu was no longer acting as EAC's representative on the Committee. (Tr. 10/7/10 at 14–16.)

On August 30, 2010, the Committee filed the Committee Retention Applications. In its retention application, AF filed a declaration disclosing that (1) at AF's recommendation, Dr. Liu had been selected by the Committee to serve as a translator for the Committee and (2) AF had been involved in many cases where Dr. Liu served as a translator for the creditors' committee or acted as a representative of a creditor on the committee. (Ex. D at ¶ 11.) The declaration also disclosed that Dr. Liu had held a proxy for a creditor in that case. (*Id.*) On September 13, 2010, AF filed a Supplemental Declaration identifying two additional cases in which it was involved where Dr. Liu was the committee translator or a creditor representative, one of which had happened very recently. (Tr. 10/7/10 at 37; Ex. E.) On September 22, 2010, AF filed a Second Supplemental Declaration advising that it had "contacts" ***657** with EAC and SHH through Dr. Liu and that those creditors had "inquiries relating to the Debtors." (Tr. 10/7/10 at 38; Ex. F.) There was no revelation, however, as to the content of those communications.[7]

7 On September 29, 2010, AF filed a Third Supplemental Declaration regarding an unrelated connection with the Debtors' CRO. (Ex. G; Tr. 10/7/10 at 38.)

Attached to its retention application, EG's original Affidavit did not reveal any connection with Dr. Liu, EAC or SHH. (Ex. O; Tr. 10/7/10 at 97–98.) In a Supplemental Affidavit filed on September 15, 2010, EG revealed it had been involved in a number of cases in which Dr. Liu was involved as a translator or creditor representative. (Ex. P.) In a Second Supplemental Affidavit, filed on September 23, 2010, EG revealed that it had had contacts with Dr. Liu and EAC and SHH prior to the formation meeting, including providing a proxy and introducing a proxy holder for SHH. (Ex. 52.)

At the hearing, the Committee offered a declaration which contained a chart of all seventeen bankruptcy cases in which Liu had been involved. (Exs. J & K.) AF had been counsel to the Committee in six of those cases, Lowenstein Sandler had been counsel in five, and six different firms had been counsel in the other six cases. (Tr. 10/7/10 at 16–19; Ex. K.) A second chart detailed the seventy bankruptcy cases in which AF had been counsel to the committee since 2003. (Ex. M.) Dr. Liu was involved in only six of them. (*Id.*) If one considers only the cases since June 4, 2008, when Dr. Liu apparently first became involved in bankruptcy matters with AF, however, there are twenty-seven cases in which AF served as committee counsel including three in which Liu served as translator for the committee and three in which Liu acted as a representative of committee members. (Exs. K, M.)

III. *JURISDICTION*

The Court has jurisdiction over this matter which is a core proceeding pursuant to 28 U.S.C. §§ 1334 & 157(b)(2)(A) & (O).

IV. *DISCUSSION*

A. *Standing*

[1] As a preliminary matter, EG asserts that the Debtors have no standing to object to the Committee Retention Applications because they have no interest in whom the Committee chooses to represent them. Specifically, EG argues that to have standing to be heard on the issue presented in this case the Debtors must show that resolution of the issue will diminish the Debtors' property, increase their burdens, or impair their rights. *See, e.g., In re ANC Rental Corp.*, 2003 U.S.App. LEXIS 2159, at *7 (3d Cir. Dec. 13, 2002); *Newspaper & Mail Deliverers' Union*, 1991 WL 243458, 1991 U.S. Dist. LEXIS 16337 (S.D.N.Y. Nov. 12, 1991).

The Court rejects this argument. Section 1109 expressly grants the Debtors the right to appear and be heard on any issue in their cases. 11 U.S.C. § 1109. In addition, any attorney with knowledge of a violation of applicable rules of professional conduct by another may be obligated to report that violation.[8] Therefore, the Court finds that the Debtors do have standing to object to the Committee Retention Applications.

[8] Rule 8.3 Reporting Professional Misconduct provides that: (a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority.

658 B. *Violation of Rules of Professional Conduct

[2] The Debtors contend that the Committee Retention Applications should be denied because proposed Committee counsel violated the applicable rules governing attorney conduct. Specifically, the Debtors cite Rule 7.3 of Delaware's Rules of Professional Responsibility which provides:

> A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment from a prospective client when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted: (1) is a lawyer; or (2) has a family, close personal, or prior professional relationship with the lawyer.

Del. Lawyers' R. of Prof. Cond. 7.3. This rule is identical to Rule 7.3 of the Model Rules of Professional Conduct. Rule 7.3 of the New York Rules of Professional Conduct is similar: "[a] lawyer shall not engage in solicitation by in-person or telephone contact, or by real-time or interactive computer-accessed communication unless the recipient is a close friend, relative, former client or existing client...."

The comments to Rule 7.3 make it clear that a lawyer is also prohibited from using another as an intermediary to solicit prospective clients. The Annotations to Model Rule 7.3 provide:

> Lawyers may not use other people to solicit for them, and Rule 7.3 is sometimes invoked along with either Rule 7.2(b) (prohibiting paid recommendations) or Rule 8.4 (prohibiting use of third parties to violate Rules) to prohibit the practice. *See, e.g., In re O'Keefe*, 877 So.2d 79 (La.2004) (lawyer disbarred for paying "runners" to find and refer personal injury cases); *Miss. Bar v. Turnage*, 919 So.2d 36 (Miss.2005) (lawyer suspended for hiring former insurance salesperson to solicit clients for potential class suit against insurer); Md. Ethics Op. 98–30 (1988) (lawyer may not have bail bondsman pass out bondsman's business cards with lawyer's contact information printed on back); *see also Cincinnati Bar Ass'n v. Rinderknecht* [79 Ohio St.3d 30], 679 N.E.2d 669 (Ohio 1997) (lawyer indefinitely suspended for setting up direct marketing service to solicit accident victims as clients for himself and chiropractor; decided under Ohio Code); *cf. Crook v. State*, No. 08–02–000382–CR, 2005 WL 1539187 (Tex.App. June 30, 2005) (lawyer convicted of felony barratry for hiring chiropractor's assistant to solicit auto accident victims; court invokes Rules 7.3 and 8.4 in analyzing offense).

Annotations to ABA–AMRPC Rule 7.3. *See also* Thomas

E. Ray, *Solicitation of Clients: Are There Any Guidelines?*, 21 NOV Am. Bankr.Inst. J. 12 (2002) (suggesting that direct solicitation by phone or in person of creditors on the debtor's schedules by counsel hoping to be retained as counsel to the committee was unethical).

[3] AF and EG argue that the Rule cannot be constitutionally applied to them to prohibit their activities in this case. They argue that, because committee members are often sophisticated business entities, restricting attorney solicitations to them runs afoul of the First Amendment. *See, e.g., Edenfield v. Fane*, 507 U.S. 761, 774–75, 113 S.Ct. 1792, 123 L.Ed.2d 543 (1993) (striking Florida statute which prohibited CPAs from directly soliciting accounting clients and noting that business clients are different from the "unsophisticated, injured or distressed lay person" often targeted by attorney's solicitations). *See also* Samuel L. Bufford, *Attorney Solicitation of Legal Work in Business Settings*, County Bar Update, Vol. 26, No. 4 (April 2006) (arguing that California's disciplinary rule prohibiting direct solicitation of prospective unrelated clients by attorneys ***659** in the business context is unconstitutional).

[4] The Court disagrees. The issue in this case is not the propriety of written "advertising" issued by AF and EG. In fact, the Court finds nothing wrong with AF and EG sending the list of creditors to their clients and contacts with whom they have a professional relationship. Nor does the Court object to EG's sending its "analysis" of the Debtors' case to those same entities. *See generally* Michael P. Richman, *Chasing Committees: the Ethics of Entertainment Solicitation*, 22 OCT Am. Bankr.Inst. J. 18 (2003) (noting that written solicitation of prospective clients—giving counsel's qualifications—is permissible but that entertainment solicitation—wining and dining prospective committee members before the formation meeting—was unethical).

What the Court finds improper in this case is that once AF and EG learned that Dr. Liu did not represent any creditor on the list, they actively encouraged and assisted him in his efforts to solicit creditors to get their proxies to attend the formation meeting and vote for counsel. The Supreme Court has expressly held that state bar associations may prohibit direct oral communications with prospective clients by an attorney or by someone on his behalf. *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 464–66, 98 S.Ct. 1912, 56 L.Ed.2d 444 (1978) (upholding states' right to prohibit direct solicitation by attorneys given states' compelling interest in preventing abuses and significant potential for harm to prospective clients by attorneys "trained in the art of persuasion"). That precedent has not been changed in the business context. Further, the Court finds it particularly unwise to change it in the context of this case. In this case the prospective clients who were solicited were foreign creditors unfamiliar with our bankruptcy laws and particularly with the system of forming creditors' committees. They are no less vulnerable to direct solicitation by someone on behalf of an attorney than an individual.[9]

[9] In fact, Dr. Liu himself (a sophisticated businessman who is familiar with our bankruptcy laws and procedures) said he felt uncomfortable when attorneys sent him emails and approached him at formation meetings asking for his support. (Liu Dep. at 205–09, 271.) Dr. Liu also complained that many proxy holders only showed up at the formation meeting (ostensibly to vote for professionals) and then never participated in the case again. (*Id.* at 208.) Ironically, that is exactly what Dr. Liu himself did; he directly solicited EAC and SHH for their support with the intention of only representing them at the formation meeting and not thereafter.

Further, the practice at issue here has been a matter of criticism under the Act and the Bankruptcy Code was enacted to change some of those practices (or at least to shed some light on them by requiring disclosures). *See, e.g.*, H.R. No. 595, 95th Cong., 2d Sess. 93, *reprinted in* 1978 U.S.Code Cong. & Ad. News 6054 (criticizing the practice of "creditors' attorneys with proxies participat[ing] actively in the election of the members of the committee in order that they may be selected as counsel to the committee" which "is a lucrative position."). *Cf. In re ABC Auto. Prods. Corp.*, 210 B.R. 437, 443 (Bankr.E.D.Pa.1997) (criticizing committee counsel for using members' proxies to conduct committee business without any input from committee members).

AF and EG argue further, however, that their activity did not violate any ethical rule. At the hearing on the instant motion, the partner at AF leading the engagement testified that he never asked Dr. Liu to solicit clients for AF or creditors to serve on a creditors' committee "on behalf of AF." (Tr. 10/7/10 at 23.) He explained the language in his emails thanking Dr. Liu for his efforts and asking if he needed ***660** any assistance as simple common courtesy. (*Id.* at 27–28.) He further denied having any discussion with EG regarding what they expected Dr. Liu to do for them, other than to allow them to demonstrate that they were the best firm for the Committee to hire. (*Id.* at 28–29.) The partner in charge of the EG engagement also denied that he asked Dr. Liu to solicit any clients on its behalf and also stated that he was just hoping for a recommendation and "a fair shot to go in and present our case as to why we should be Committee counsel." (*Id.* at

72, 81–82.) EG also denied offering Dr. Liu or the proxy chosen for SHH anything of value for voting for them. (*Id.* at 82.) Both firms vehemently denied asking Dr. Liu to solicit creditors for them.

The Court finds that the evidence proves otherwise and finds that, in fact, AF, EG and Dr. Liu were acting in concert to cold-call creditors that Dr. Liu did not represent for the purpose of being retained by them to attend the Committee formation meeting and to cast a proxy in favor of AF and EG for counsel. This is demonstrated by the following facts: (1) as a result of the communications between Dr. Liu, AF and EG, it was clear to counsel that Dr. Liu did not represent any of the creditors at the time he first endeavored to contact them; (2) Dr. Liu kept AF and EG apprised (on at least a daily basis) of his efforts to locate and obtain proxies from the creditors and noted that he would act "as usual" in doing so; (3) Dr. Liu asked for assistance in locating the creditors and AF provided advice and some assistance; (4) Dr. Liu expressly stated that he understood that counsel wanted him to get "support" from the creditors and that they were interested in serving as Committee counsel; (5) to persuade the creditors to provide proxies, Dr. Liu asked for (and AF provided) legal advice relevant to those creditors' rights as part of the "two way traffic;" (6) Dr. Liu asked for a nominee to serve as a proxy for one of the creditors and EG made a recommendation (approved by AF) of someone who "will serve us well;" (7) when Dr. Liu got EAC's proxy he said he would serve as the proxy which would "cheer everyone up" and that AF and EG should definitely make a pitch for the Committee now; (8) both AF and EG were on the conference call with one of the creditors, SHH, to discuss the case and persuade it to execute a proxy; (9) Dr. Liu did vote the EAC proxy in favor of AF and EG at the committee formation meeting; and (10) AF immediately recommended that the Committee retain Dr. Liu as a translator.

AF and EG note, however, that they were not the only attorneys seeking Dr. Liu's assistance or asking him to vote any proxies he held for them as counsel. Rather than excusing the behavior of AF or EG, however, it simply evidences that others may not be complying with the rules either.[10] The Court is only able to address the issue before it: the conduct of AF and EG. The Court would caution other counsel who observe violations of the Rules of Professional Responsibility or Model Rules of Professional Conduct in other cases to bring it to the Court's attention for proper action. *See* Rule 8.3 of the Model Rules of Professional Conduct. *See generally* Thomas E. Ray, *Solicitation of Clients: Are There Any Guidelines?*, 21 NOV Am. Bankr.Inst. J. 12 (2002) (noting that attorneys who are aware of ethical violations are obligated by Model Rule 8.3(a) to report such violations).

[10] In fact, Dr. Liu testified that counsel for the Debtors had approached him at an organizational meeting of creditors in another case ostensibly to get his support when he made a pitch. (Liu Dep. at 314.)

[5] Therefore, the Court concludes that there are sufficient facts to suggest ***661** that AF and EG did violate Rule 7.3 and Rule 8.4 of the Model Rules of Professional Conduct and of Delaware's Rules of Professional Responsibility. The Court finds this conduct sufficient reason to disqualify AF and EG from serving as counsel to the Committee in this case. *See, e.g., In re Vanderbilt Assocs., Ltd.*, 117 B.R. 678, 680 (D.Utah 1990) (noting that ethical rules apply to question of whether an attorney can be employed pursuant to § 327 of the Bankruptcy Code); *Berger McGill, Inc. v. Capozzoli (In re Berger McGill, Inc.)*, 242 B.R. 413, 423 (Bankr.S.D.Ohio 1999) (disqualifying law firm from representing debtor in action against creditor/former client where creditor had previously consulted and provided confidential information to counsel about the subject of the law suit); *In re Soulisak*, 227 B.R. 77, 80 (Bankr.E.D.Va.1998) ("Attorneys who practice before a bankruptcy court must not only concern themselves with the obligations set forth in the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, but also with the application of state ethical rules."); *In re RKC Dev. Corp.*, 205 B.R. 869, 873 (Bankr.S.D.Ohio 1997) (concluding that appointment under § 327 should be refused where retention is at variance with ethical and disciplinary rules); *In re Sauer*, 191 B.R. 402, 407 (Bankr.D.Neb.1995) (disqualifying counsel for failure to observe applicable state ethics code).

C. *Failure to be Disinterested*

[6] [7] The Debtors also contend that AF's Retention Application should be denied because AF is not disinterested. While section 1103(b) of the Bankruptcy Code provides only that Committee counsel may not represent an entity with an interest adverse to the Committee,[11] the Debtors contend that section 328 imposes the additional requirement that Committee counsel be disinterested.[12] In this case, the Debtors contend that AF is not disinterested because it provided legal advice to several creditors that they could assert administrative claims for goods in transit, which is contrary to the interests of the general unsecured creditors represented by the Committee.

[11] "An attorney ... employed to represent a committee ... may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case." 11 U.S.C. § 1103(b).

[12] Section 328(c) provides that the Court may disallow counsel fees "if, at any time during such professional person's employment ... such 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." 11 U.S.C. § 328(c).

At the hearing the AF partner admitted that he responded to Dr. Liu's email regarding the question of what creditors' rights were with respect to in-transit goods. (Tr. 10/7/10 at 29.) He denied, however, that he was providing legal advice to the creditors, stating that Dr. Liu often asked counsel who were interested in pitching for Committee representation "hypothetical" questions to see who was the most knowledgeable. (*Id.* at 29.) Further, he noted that he gave the "advice" to Dr. Liu not to the creditors and that there was no attorney/client relationship ever established between AF and the creditors. (*Id.* at 31.) He stated that it was no different from the hundreds of questions he gets from acquaintances at cocktail parties and in the hall. (*Id.* at 31, 53.)

The Court disagrees. The emails were far from hypothetical cocktail party conversation; they expressly referenced the names of the creditors and amounts of ***662** their claims in the "re" lines and in the text. (Tr. 10/7/10 at 53–58; Ex. L–17, L–18.) Further, the legal advice was given in the context of AF's effort to win Dr. Liu's support for its pitch to become Committee counsel. Even if AF did provide legal advice to the creditors (through Dr. Liu), however, the Court concludes that AF is not disqualified from serving as Committee counsel on the basis that it is not disinterested.

The Court disagrees with the Debtors' argument that committee counsel generally cannot be retained if they are not disinterested. Section 1103 specifically provides only that committee counsel shall not hold or represent an interest adverse to the committee. That section expressly states that the representation of a creditor in the case (which would make the attorney not disinterested[13]) is not a per se disqualifying factor as suggested by the Debtors.[14] *See, e.g., In re Firstmark Corp.*, 132 F.3d 1179, 1182–83 (7th Cir.1997) (finding no disqualification where counsel for committee represented former president of the debtor—who was a possible creditor and avoidance action defendant—in matters unrelated to the debtor); *In re Nat'l Century Fin. Enters., Inc.*, 298 B.R. 112, 118 (Bankr.S.D.Ohio 2003) (finding firm not disqualified from representing committee although it concurrently represented two members of the committee).

[13] Disinterested is defined in the Code to include "a creditor" or anyone with "an interest materially adverse to the interest of the estate." 11 U.S.C. § 101(14).

[14] *Cf.* 11 U.S.C. § 327(c) (counsel is not per se disqualified from representing the trustee simply because of its prior representation of a creditor).

The fact that committee counsel also represents an individual creditor has been found to be at most a potential conflict.

> Congress implicitly determined that the inherent tension between a committee and one of its creditors, standing alone, was immaterial and any conflict too theoretical to warrant being classified as an adverse interest. That is, merely the remote potential for dispute, strife, discord, or difference between a committee and one of its creditors does not give rise to any conflict of interest or appearance of impropriety that would bar an attorney from representing both parties.

In re Nat'l Liquidators, 182 B.R. 186, 192–93 (S.D.Ohio 1995) (concluding that only when "evidence suggest[s] the existence of possible challenges to a creditor's claim, the existence of a possible recovery action against the creditor, or the existence of any possible dispute between a committee and one of its constituents or members" would counsel be disqualified under § 1103).

[8] A potential conflict alone does not mandate disqualification of counsel for the Committee. *See, e.g., In re First Jersey Secs., Inc.*, 180 F.3d 504, 509 (3d Cir.1999) (stating that the Bankruptcy Code "mandates disqualification when there is an actual conflict, allows for it when there is a potential conflict, and precludes it based solely on an appearance of a conflict.").

[9] [10] Furthermore, the time to evaluate whether AF is

disqualified, because it represents an interest adverse to the Committee, is at the time of retention. Prior representations, even if adverse to the interests of the committee or unsecured creditors, do not disqualify committee counsel. *See, e.g., In re Enron Corp.*, No. 02 Civ. 5638(BSJ), 2003 WL 223455, *6–7 (S.D.N.Y. Feb. 3, 2003) (finding committee counsel did not hold an adverse interest because it had previously represented debtor-related entities and stating that the "argument under § 1103 fails because [counsel's] alleged adverse interests ... predated [counsel's] representation of the committee"); *In re Diva Jewelry Design,* ***663** *Inc.*, 367 B.R. 463, 473–74 (Bankr.S.D.N.Y.2007) (finding that discussions that proposed trustee's counsel had with creditors regarding their possible consignment claims prior to retention by trustee did not disqualify counsel from employment); *Nat'l Century Fin.*, 298 B.R. at 118 (finding firm not disqualified from representing committee although it had previously represented the debtor in a discreet matter that ended before bankruptcy).

Therefore, even if AF "represented" EAC and SHH as a result of the legal advice given to Dr. Liu on their behalf, that is insufficient to disqualify it per se. Further, the Court finds that there is no evidence that AF actually entered into an attorney/client relationship with either EAC or SHH or that that legal representation continued to the time of AF's retention by the Committee.

D. *Failure to Disclose*

The Debtors (and the UST) argue, however, that the Committee Retention Applications should be denied because proposed counsel failed to disclose adequately their connections with Dr. Liu and with EAC and SHH in their original retention applications. Rule 2014(a) requires that

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

Fed. R. Bankr.P.2014(a). Delaware Local Rule 2014–1(a) also requires that additional disclosures be made "[p]romptly after learning any additional material information relating to such employment (such as potential or actual conflicts)."

[11] [12] "Defective disclosure is not a minor matter. It goes to the heart of the integrity of the bankruptcy system...." *In re B.E.S. Concrete Prods., Inc.*, 93 B.R. 228, 236–38 (Bankr.E.D.Cal.1988) (disqualifying special counsel who failed to disclose that it represented co-defendants in litigation it was handling for debtor). The professional must disclose all contacts, not pick and choose which to disclose and which to ignore or leave the court to search the record for such relationships. *In re BH & P, Inc.*, 949 F.2d 1300, 1317–18 (3d Cir.1991) (finding failure to disclose potential conflict which counsel had discussed with UST was inadvertent but violative of Rule 2014 nonetheless); *In re Jore Corp.*, 298 B.R. 703, 732 (Bankr.D.Mont.2003) (disqualifying counsel for debtor for failure to disclose that conflicts waiver obtained from DIP lender prohibited debtor's counsel from undertaking litigation adverse to it); *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr.S.D.N.Y.1998) (noting that "professional's duty to disclose is self-policing .... [and court] should not have to 'rummage through files or conduct independent factfinding investigations' to determine if the professional is disqualified") (quoting *In re Rusty Jones, Inc.*, 134 B.R. 321, 345 (Bankr.N.D.Ill.1991)).

[13] Failure to disclose connections itself is enough to warrant disqualification of counsel from employment. *See, e.g., In re Crivello*, 134 F.3d 831, 839 (7th Cir.1998) (stating that "a bankruptcy court should punish a willful failure to disclose connections under Fed. R. Bankr.P.2014 as severely as an attempt to put forth a fraud on the court."); *Rome v. Braunstein*, 19 F.3d 54, 59 (1st Cir.1994) (warning that "[a]bsent the spontaneous, timely and complete disclosure required by section 327(a) and Fed. R. Bankr.P.2014(a), court-appointed counsel proceed *at their own* ***664** *risk.*") (emphasis in original); *In re Filene's Basement, Inc.*, 239 B.R. 845 (Bankr.D.Mass.1999) (disqualifying counsel because of false 2014 disclosures alone without deciding whether counsel was disinterested); *In re Tinley Plaza Assocs., L.P.*, 142 B.R. 272, 280 (Bankr.N.D.Ill.1992) (firm disqualified from representing debtor where original retention application failed to disclose that "of counsel" to firm was president of investment banking firm providing services for debtor). *But see In re Leslie Fay Cos., Inc.*, 175 B.R. 525, 539 (Bankr.S.D.N.Y.1994) (finding that failure of counsel to disclose potential conflicts did not warrant disqualification but did warrant sanction requiring counsel to pay the substantial fees incurred in having an

examiner investigate its potential conflicts).

[14] [15] In this case the Court finds that the evidence supports disqualification of both AF and EG from representing the Committee. Although AF at least disclosed that it had a prior relationship with Dr. Liu, having served as committee counsel in cases where he represented a creditor or acted as a translator to the committee, the Court finds that disclosure deficient. AF argues that complete disclosures were ultimately made, before the hearing on consideration of the Committee Retention Applications. The Court agrees with the UST, however, that the subsequent disclosures by AF and EG (filed only after concerns about them were expressed by the Debtors and the UST and after discovery revealed what had occurred) were not enough to cure the original deficiencies.[15] AF (and EG) should have fully disclosed at the outset their efforts in support of Dr. Liu's attempt to obtain proxies from creditors to attend the Committee formation meeting. Further, while it was not a disqualifying factor, the fact that AF had provided legal advice to two creditors on their right to seek administrative claims is a fact that should have been revealed to the Committee and to the Court. Because AF and EG did not make sufficient disclosures in their original retention applications, the Debtors and the UST were obligated to engage in discovery to garner the facts and bring them to the Court's attention. The failure to provide complete and accurate disclosure at the outset warrants denial of the Committee Retention Applications.[16]

15 Although AF did disclose it had communications regarding two of the creditors, it did not provide details about those communications or provide any details about other communications it had with Dr. Liu in an effort to obtain creditor proxies.

16 The Court finds that this disclosure requirement applies to all professionals under Rule 2014. Although a financial advisor and others are not bound by the same Rules of Professional Responsibility that attorneys are, the Court concludes that, because solicitation efforts go to the integrity of the process, all professionals should disclose any direct calls they made (or others made on their behalf) to creditors (who were not their respective clients) in an effort to be employed in a bankruptcy case.

F. Further Recommendations

The Court hopes that by requiring disclosure of the practice of using others to solicit proxies to act at a committee formation meeting will go a long way to discourage that improper practice. The Court would also urge the UST to consider implementing procedures to reduce the likelihood of undue influence on the decision of a committee to hire professionals. Specifically, the Court recommends that the UST adopt the suggestion by Dr. Liu that the creditors be kept in a separate room from prospective professionals (who do not represent a client eligible to serve on the Committee) before the committee formation meeting. Further, the UST might *665 consider amending the questionnaire it sends to prospective committee members to include questions regarding whether they were solicited by anyone in connection with the case.

V. *CONCLUSION*

For the reasons set forth above, the Court will deny the Committee Retention Applications.

An appropriate order is attached.

ORDER

AND NOW, this **4th** day of **NOVEMBER, 2010,** upon consideration of the Applications of the Official Unsecured Creditors' Committee (the "Committee") to retain counsel, the opposition thereto and for the reasons set forth in the accompanying Opinion, it is hereby

ORDERED that the Applications are **DENIED.**

All Citations

486 B.R. 650, 53 Bankr.Ct.Dec. 259

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 11
	)	
CAESARS ENTERTAINMENT,	)	No. 15 B 1145
OPERATING CO., INC., *et al.*,	)	(Jointly administered)
	)	
Debtors.	)	Judge Goldgar

MEMORANDUM OPINION

This matter is before the court for ruling on the motion of debtors Caesars Entertainment Operating Company, Inc., and certain subsidiaries (collectively "Caesars") to disband the Official Committee of Second Priority Noteholders (the "Noteholders Committee"). (Dkt. No. 384). The Noteholders Committee is one of two committees that the United States trustee ("U.S. Trustee") appointed under section 1102(a)(1) of the Bankruptcy Code, 11 U.S.C. § 1102(a)(1), at the beginning of these cases. Because a bankruptcy court has no power to disband a committee that the U.S. Trustee has appointed under section 1102(a)(1), the motion will be denied.

1. Jurisdiction

The court has subject matter jurisdiction over this case pursuant to 28 U.S.C. § 1334(a) and the district court's Internal Operating Procedure 15(a). This is a core proceeding under 28 U.S.C. § 157(b)(2)(A).

2. Background

The few relevant facts are drawn from the motion and responses, from other papers in the bankruptcy cases, and from the court's docket. No facts are in dispute.

The debtors in these cases describe themselves as the primary operating units of the

"Caesars gaming enterprise." The debtor named in the caption, Caesars Entertainment Operating Company, Inc. ("CEOC"), is a subsidiary of non-debtor Caesars Entertainment Corporation. The rest of the debtors are subsidiaries of CEOC.

On January 12, 2015, three creditors filed an involuntary bankruptcy petition against CEOC in the District of Delaware. Three days later, on January 15, 2015, CEOC and the other debtors filed voluntary chapter 11 petitions in this district. After initially staying the voluntary cases, the bankruptcy court in Delaware determined under Rule 1014(b), Fed. R. Bankr. P. 1014(b), that all of cases should proceed in this district. The Delaware court lifted the stay and transferred the involuntary case here. The cases are pending.[1/]

On January 28, 2015, the U.S. Trustee issued a notice that on February 4, 2015, he would hold a meeting to form a committee of unsecured creditors. Before the February 4 meeting, counsel for Caesars sent the U.S. Trustee a letter arguing at length that holders and trustees of Caesars' second lien notes and subsidiary guaranteed notes were not suitable to serve on an official unsecured creditors committee. Among the holders of second lien notes are the petitioning creditors in the involuntary case.

The February 4 meeting must have taken place, because the next day the U.S. Trustee filed not one but two notices with the court. The first was a notice of the appointment of an unsecured creditors committee (the "Unsecured Creditors' Committee"). The second was a notice of the appointment of an "official committee of second priority noteholders."

1/ Caesars has since moved to suspend proceedings in the involuntary case. The petitioning creditors in the involuntary case have responded by moving for consolidation of the involuntary and voluntary cases and have requested a determination that the earlier order for relief in the involuntary case serves as the order for relief for all the cases. The two motions are a problem for another day.

Nothing in the record explains why the U.S. Trustee chose to appoint the Noteholders Committee in addition to the Unsecured Creditors' Committee. The U.S. Trustee gave no reasons for doing so. He did not have to give reasons. *See In re ShoreBank Corp.*, 467 B.R. 156, 162 (Bankr. N.D. Ill. 2012) ("The U.S. Trustee did not provide a rationale or make a record [in appointing a committee] for the simple reason that the Code did not require him to.").

Unhappy with this state of affairs, Caesars now moves for an order disbanding the Noteholders Committee. Caesars argues that (1) an intercreditor agreement to which each Committee member is a party would prevent the Committee from performing many of its statutory functions, *see* 11 U.S.C. § 1103(c); (2) the noteholders are sophisticated business entities who do not need a committee to represent their interests; and (3) a second committee in the case will dramatically increase administrative costs with no corresponding benefit to the estates. Alternatively, if the Committee is not disbanded, Caesars asks to have the two committees merged ("reconstituted" is Caesars' term) or at a minimum to limit the Noteholders Committee's activities so as not to duplicate the work of the Unsecured Creditors' Committee.

Other parties have weighed in. UMB Bank, the first lien notes indenture trustee, joins Caesars' motion, as do the Ad Hoc Committee of First Lien Noteholders and the Ad Hoc Committee of First Lien Bank Lenders. The Noteholders Committee not surprisingly objects to the motion, as do the U.S. Trustee and the Unsecured Creditors' Committee. BOKF, N.A., a member of the Noteholders Committee, joins that Committee's objection. So does the Ad Hoc Committee of Holders of 12.75% Second Priority Senior Secured Notes due 2018. Wilmington Trust, N.A., an indenture trustee for certain senior unsecured notes, joins the Unsecured Creditors' Committee's objection.

3. Discussion

When the Bankruptcy Code was enacted in 1978, bankruptcy courts had authority to appoint creditors committees in chapter 11 cases. Kenneth N. Klee & K. John Shaffer, *Creditors' Committees under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. Rev. 995, 1001-02 (1993). With the expansion of the U.S. Trustee program in 1986, however, Congress transferred that authority to the U.S. Trustee. *Id.* at 1002; *In re Mercury Fin. Co.*, 240 B.R. 270, 275 (N.D. Ill. 1999). The U.S. Trustee's role is now described in section 1102(a)(1). That section provides that the U.S. Trustee "shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." 11 U.S.C. § 1102(a)(1).

The rest of section 1102(a) spells out the powers left to the bankruptcy court. Section 1102(a)(2) says the court "may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation . . . ." 11 U.S.C. § 1102(a)(2). Section 1102(a)(3) says that in a small business case the court "may order that a committee of creditors not be appointed." 11 U.S.C. § 1102(a)(3). And section 1102(a)(4) says the court can order the U.S. Trustee "to change the membership of a committee" if a change is "necessary to ensure adequate representation of creditors or equity security holders." 11 U.S.C. § 1102(a)(4).

Those are the only powers over committees the Code gives the court. There are no others. In particular, nothing in section 1102(a) confers on the court the power to disband a committee the U.S. Trustee has appointed under section 1102(a)(1). *See In re Dewey & LeBoeuf LLP*, No. 12-12321 MG, 2012 WL 5985325, at *3 (Bankr. S.D.N.Y. Nov. 29, 2012); *In re Pacific Ave., LLC*, 467 B.R. 868, 870 (Bankr. W.D.N.C. 2012) ("There is no specific statutory

provision for disbanding a creditors' committee."); *In re JNL Funding Corp.*, 438 B.R. 356, 361 (Bankr. E.D.N.Y. 2010) ("Section 1102 is silent as to this Court having power to order a committee to be disbanded . . . ."); *In re Texaco, Inc.*, 79 B.R. 560, 565 (Bankr. S.D.N.Y. 1987); *see also* 1 Robert E. Ginsberg & Robert D. Martin, *Ginsberg & Martin on Bankruptcy* § 4.02[B][1] at 4-46 to 47 (Susan V. Kelley, ed. 2013-1 Supp.) ("There is no statutory authority to disband a committee . . . .").[2/]

Because section 1102(a) grants specific powers, and because the power to disband a committee is not one of them, the only fair reading of the statute is that there is no such power. As the U.S. Trustee observes, this is a straightforward application of the interpretive doctrine *expressio unius est exclusio alterius* – the expression of one thing is the exclusion of another. *See, e.g., POM Wonderful LLC v. Coca Cola Co.*, ___ U.S. ___, 134 S. Ct. 2228, 2238 (2014). When a statute expressly grants courts the authority to take certain actions, that express grant implies the prohibition of other actions. *Gomez v. United States*, 490 U.S. 858, 872 (1989); *Continental Casualty Co. v. United States*, 314 U.S. 527, 533 (1942) ("Generally speaking, a 'legislative affirmative description' implies denial of the nondescribed powers.").

Whether Caesars' concerns about the Noteholders Committee are well-taken, then, is beside the point. Even if they are, section 1102(a) does not authorize the court to disband the Committee. *In re New Life Fellowship, Inc.*, 202 B.R. 994, 996 (Bankr. W.D. Okla. 1996)

[2/] The Bankruptcy Rules likewise do not empower a court to disband a committee appointed under section 1102(a)(1). The lone exception is Rule 2007(c). On motion of a party in interest, and after notice and a hearing, Rule 2007(c) not only permits but requires the court to "direct the United States trustee to vacate the appointment" of a committee if its members were members of a committee "organized by creditors before the commencement of [the] case" and if the appointment "failed to satisfy requirements of section 1102(b)(1) . . . ." Fed. R. Bankr. P. 2007(c). There is no such committee in this case.

(finding "the specific language . . . of section 1102(a)(1) compel[s] the conclusion that the court . . . is without power to abolish the committee"); *see also Dewey*, 2012 WL 5985325, at *3 (suggesting in dictum that the language of section 1102(a)(1) "would seem to leave little or no role" for the court). Caesars' motion to disband the Noteholders Committee must be denied.

Caesars concedes that section 1102(a) does not itself empower a bankruptcy court to disband a committee appointed under section 1102(a)(1). Caesars contends the power resides instead in section 105(a) of the Code, which allows the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Some courts have agreed with this contention. *See, e.g., In re City of Detroit*, 519 B.R. 673, 680 (Bankr. E.D. Mich. 2014) (dictum); *JNL Funding*, 438 B.R. at 360; *cf. Pacific Ave.*, 467 B.R. at 870 (relying on section 105(d)).

Section 105(a) confers no such power. That section gives bankruptcy courts the power only to implement existing Code provisions. *Courtney v. Halleran*, 485 F.3d 942, 948 (7th Cir. 2007); *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir. 2004). It is neither an "independent source of rights," *Village of Rosemont v. Jaffe*, 482 F.3d 926, 935 (7th Cir. 2007), nor a source of "substantive authority," *In re UAL Corp.*, 412 F.3d 775, 778 (7th Cir. 2005). Because it is neither, section 105(a) does not allow bankruptcy courts to contradict the Code, *Law v. Siegel*, ___ U.S. ___, 134 S. Ct. 1188, 1194 (2014) – such as by exercising powers the Code does not confer, *Petro v. Mishler*, 276 F.3d 375, 378 (7th Cir. 2002); *In re Lloyd*, 37 F.3d 271, 275 (7th Cir. 1994) (declaring that section 105(a) does not allow courts to "create rights outside the Code"); *see also In re Fesco Plastics Corp.*, 996 F.2d 152, 154 (7th Cir. 1993) (stating that "when a specific Code section addresses an issue," section 105(a) cannot be employed "to achieve a result not contemplated by the Code").

Section 105(a) thus is not a vehicle for reading into section 1102(a)(1) a power to do away with statutory committees when section 1102(a)(1) itself grants no such power – and especially when section 1102(a)(1) grants other powers but not that one. *New Life Fellowship*, 202 B.R. at 997. The approach suggested in *City of Detroit* – that section 105(a) authorizes the exercise of that power because the Code does not "explicitly prohibit" it, *City of Detroit*, 519 B.R. at 680 – is consequently incorrect. Had Congress wanted to give bankruptcy courts the power to abolish committees appointed under section 1102(a)(1), it could have done so. It chose not to. That choice must be respected. *New Life Fellowship*, 202 B.R. at 997; *see In re New Energy Corp.*, 739 F.3d 1077, 1079 (7th Cir. 2014) (noting that judges must "implement the Bankruptcy Code as written, rather than make changes that they see as improvements").[3/]

For the same reasons, Caesars' alternative requests – to "reconstitute" the Noteholders Committee by merging it with the Unsecured Creditors' Committee or limit the scope of the Noteholders Committee's activities – must be rejected. Usually, "reconstituting" a committee means adjusting its membership. *See, e.g., In re Dow Corning Corp.*, 212 B.R. 258, 264 (E.D. Mich. 1997); *ShoreBank*, 467 B.R. at 160; *Mercury Fin. Co.*, 224 B.R. at 383; 7 *Collier on Bankruptcy* ¶ 1102.05 at 1102-25 to -26 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014). As the Noteholders Committee rightly observes, merging it with another committee

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[3/] Other decisions Caesars cites involved questions of committee membership and are therefore distinguishable on their facts. *See, e.g., In re Mercury Fin. Co.*, 224 B.R. 380, 383 (Bankr. N.D. Ill. 1998) (ordering committee disbanded as an exercise of the court's power to "reconstitute" committee), *aff'd*, 240 B.R. 270 (N.D. Ill. 1999). Since 2005, moreover, bankruptcy courts have had express statutory authority to order changes to the membership of committees (though only to ensure adequate representation). *See* 11 U.S.C. § 1102(a)(4); *ShoreBank*, 467 B.R. at 160 (discussing the history of the judicial power to regulate committee membership). To the extent *Mercury* and other pre-2005 decisions relied on section 105(a) as the source for that authority, *see ShoreBank*, 467 B.R. at 160 (noting that between 1986 and 2005 courts invoked section 105(a)), they were incorrect.

would not so much adjust its membership as eliminate the Committee altogether. Eliminating the Noteholders Committee is not an option.[4/]

Limiting the Committee's activities is not an option either. Section 1103 of the Code addresses the powers and duties of committees appointed under section 1102. *See* 11 U.S.C. § 1103. Nothing in section 1103 authorizes a bankruptcy court to define those powers and duties in such a way as to place limits on a committee's activities beyond the limits in section 1103 itself. Neither Caesars nor any of its allies has cited any authority supporting the existence of such a power. Needless to say, it cannot be located in section 105(a). *See Petro*, 276 F.3d at 378; *Lloyd*, 37 F.3d at 275.

None of this means, of course, that the concerns Caesars raises as reasons to disband the Noteholders Committee or restrict what it can do are illegitimate. In its objection to Caesars' motion, the U.S. Trustee actually shares those concerns. It appears a central issue in this case will be several prepetition transactions the Noteholders Committee describes as insider deals that "denuded [the] chapter 11 estates of billions of dollars." (Noteholders Comm. Obj. at 1). These transactions will now be the subject of investigations by not one but two official committees, as well by an examiner who even Caesars agrees should be appointed. The estates will pay for all of these investigations, and Caesars is right to be worried that the costs of needlessly duplicative work will take a hefty bite out of the estates.

4/ *Texaco*, which Caesars cites, ordered the merger of two committees of unsecured creditors, *Texaco*, 79 B.R. at 565-67, but the decision is wholly unconvincing. *Texaco* treats the question as one of adequate representation, not recognizing that merging one committee with another "adjusts" the membership of the first committee right out of existence. *Id.* at 566. *Texaco* (a decision issued after the 1986 amendment to section 1102 deprived bankruptcy courts of the power to regulate committee membership) also supplies no authority for any judicial power to merge committees – except legislative history stating that courts retained their authority post-amendment to appoint additional committees, a different matter entirely. *Id.*

But there are other ways to avoid those costs that do not violate the Code. The U.S. Trustee correctly observes that the court can control the two official Committees' employment of professionals, including the terms on which they are employed. *See* 11 U.S.C. § 328(a). The court can also control the compensation of those professionals. *See* 11 U.S.C. § 330(a). And the court can control the scope of the examiner's investigation, *see* 11 U.S.C. § 1104(c), as well as the examiner's compensation, *see* 11 U.S.C. § 330(a). Compensation of Committee professionals and the examiner is something all parties, including Caesars and the U.S. Trustee, will have a chance to address before a single cent is awarded on a final basis.[2/]

Caesars' concerns are best addressed through these Code provisions, not by the unauthorized disbanding or hamstringing of a committee the U.S. Trustee has appointed under section 1102(a)(1).

4. Conclusion

The motion of debtors Caesars Entertainment Operating Company, Inc., and certain subsidiaries to disband the Official Committee of Second Priority Noteholders is denied. A separate order will be entered consistent with this opinion.

Dated: March 9, 2015

A. Benjamin Goldgar
United States Bankruptcy Judge

2/ It may be that the Committees (and perhaps the examiner, too) will coordinate their investigations to avoid needless duplication. Indeed, the Unsecured Creditors' Committee says in its objection to Caesars' motion that discussions to that end have already begun.