AMERICAN BANKRUPTCY INSTITUTE

2022 Annual Spring Meeting

Ethics: Who Is My Client, Anyway?

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CONCURRENT SESSION

2022

Presenters

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1

You Work For The Client

Rule 1.4 of the Rules of Professional Conduct provides:

"A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law."

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2

The General Ethical Obligations Apply In Bankruptcy

- The client **is** important!
- Basic concepts applicable to bankruptcy counsel – such as the duty of loyalty, independent judgment, and even who **the** client is – are drawn from the applicable non-bankruptcy law sources.

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Hypothetical 1 – Private Equity and its Portfolio Company

So, you get a call from Peter Parker of Stark Industries . . .

Avengers Corp.—a portfolio company of Stark Industries—needs restructuring help in the wake of the Infinity Wars.

Avengers Corp. is 100% owned by Stark Industries, and its three-person board includes Stark Industries principals: Pepper Potts, Peter Parker and Happy Hogan.

You run conflicts (no preliminary hits), send him an engagement letter. He sends back a letter signed by Sam Wilson, Avengers' interim CEO. He then wires you a hefty retainer, but you see that it was wired from a Stark Industries bank accounts.

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Diligence and Communications with the Client

- **Rule 1.3 of the Rules of Professional Conduct provides:**

"A lawyer shall act with reasonable diligence and promptness in representing a client."

- **Rule 1.4 of the Rules of Professional Conduct provides:**

"A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation"

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Diligence

- The alleged failure by attorneys to communicate with their client is the single most frequent complaint filed against lawyers.

Q: How many lawyers does it take to change a light bulb?
A: None, they'd rather keep their client in the dark.

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Fees

CONFIRM YOUR FEE ARRANGEMENT:

- **Rule 1.5 (b) of the Rules of Professional Conduct provides:**

"The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, *preferably in writing*, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client."

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Conflicts

- Under Rules 1.7, 1.8, 1.9 and 1.10 of the Rules of Professional Conduct, a lawyer has an obligation to avoid conflicts of interest.
- Representing a **small business** or the **owner of a small business** can create especially thorny conflict issues.

Conflicts

- Rule 1.8(f) – A lawyer shall not accept compensation for representing a client from one other than the client unless:
  1. the client gives informed consent;
  2. there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
  3. information relating to representation of a client is protected as required by Rule 1.6.

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Hypothetical 1(a) – Bank Conflict

After receiving the signed engagement letter, you meet the Avengers management team. Its interim CEO Sam Wilson is very new to the position. His right-hand man Bucky Barnes seems like an honest and capable COO who has been around longer than anyone else. Bruce Banner is the CFO, but he seems a bit "green."

They all rely heavily on Pepper Potts and her staff at Stark Industries, which provides substantially all back-office accounting and legal support pursuant to a management agreement that **no one seems to be able to find**.

You learn that the lender group includes Thanos National Bank, Ultron Credit Union and Loki Bank. Loki is the agent for the lender group, **and your firm has an ongoing (albeit unrelated) relationship with Loki**.

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Conflicts

- Conflicts between two or more current clients (Model Rule 1.7(b))
- Business conflicts

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Conflicts

Imputed Disqualification

- The Model Rules provide that **where an individual attorney is disqualified, the entire firm also is disqualified**, based upon the notion of shared confidences.
- All is not lost!
  - as the expansive reading of the Model Rule would be burdensome for attorneys at large firms, many courts have treated the rules as creating a rebuttable presumption.
- One way to rebut the presumption is by **using screening devices** to protect client confidences within a firm.

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Conflicts – Consent & Waivers

- Do it Right!
- One formulation:
  - disclose risks "in such detail that the person can understand the reasons why it might be reasonable to withhold consent"

"I'd like to level with you, Mrs. Ravenscroft, but there's no legal precedent."

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Conflicts – Disinterestedness under 11 U.S.C. § 327(a)

Counsel's compliance with the **disinterestedness** requirement, under Section 327(a) of the Bankruptcy Code, applies at the time of retention and throughout the case.

"Can't you ever relax?"

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Conflicts – Retention & Disclosure

While creditors and debtors may be ***adverse***, as they have differing economic interests regarding a debt obligation, in a bankruptcy case, their interests may be aligned – **the successful rehabilitation of the debtor**.

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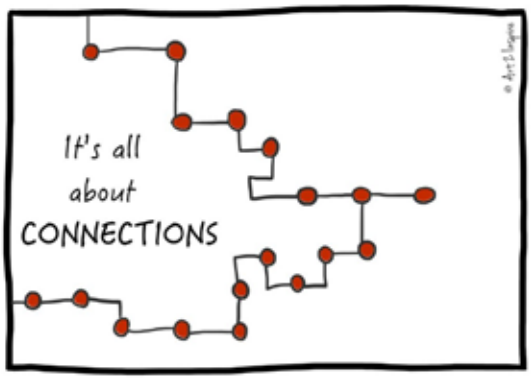
Conflicts – Retention & Disclosure



- Whether counsel's ***connections*** to a creditor give rise to sufficient ***adverseness*** to disqualify the professional from representing a debtor is fact specific.

Bankruptcy Code Requirements

- As analysis in this area of bankruptcy law is highly fact-specific, there exist many hundreds of reported decisions on the issue.

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Conflicts – Retention & Disclosure

Waivers

- Market practice regarding advance conflict waivers of adverse representation in unrelated litigation and bankruptcy proceedings.
- Effectiveness of "advance waivers."
- *Sheppard, Mullin v. J-M.*
- *In re Relativity Media LLC*
- Conflict waivers and disinterestedness.
- Practical considerations.
- Disclosure.
- Likelihood of objection to retention or disqualification motion.
- Ethical walls.
- Conflicts counsel.

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Hypothetical 1(b) – Restructuring Support Agreement

The RSA terms include the following:

(a) Stark will provide short term DIP facility, as needed (converted to equity under plan);
(b) The bank group will consent to use cash collateral;
(c) Plan of reorganization to be filed on petition date;
(d) Stark will fund the "Infinity War Victim Claim Settlement Trust";
(e) Trade debt will be paid under the plan;
(f) The bank group will support the plan, maturity extended, and Stark Industries will become a co-obligor under the modified loan documents;
(g) Stark will maintain 100% ownership of the reorganized Avengers Corp.;
(h) Exculpations for Avengers' officers and directors (including Stark Industries principals);
(i) Broad releases for Stark Industries, including direct and third-party releases.

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Inappropriate Client Demands

Clients may not demand unethical or unlawful conduct from their lawyers and expect compliance. In the hypothetical, *The Good Bank's* lawyers knew, or should have known, that the Bank had no reasonable or nonfrivolous basis to oppose setting aside the stipulation.

See In re Martinez 393 B.R. 27 (Bankr. D. Nev 2008).

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Questions???

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Ira Herman, a partner at Blank Rome, has been in practice for over 35 years and regularly advises lenders and other clients on the management of bankruptcy risk in their transactions; indenture trustees regarding defaulted public debt issues; and lenders regarding restructuring and bankruptcy, including distressed M&A transactions and inter-creditor issues. Additionally, he provides services on the debtors' side, counseling financially distressed entities and their management on restructuring challenges pertaining to corporate governance issues, and litigating corporate governance matters, such as breach of duty in good faith and dealing.

As a court appointed mediator for over 15 years, Ira has been able to facilitate the resolution of controversies involving U.S. and non-U.S. parties concerning bankruptcy and commercial law issues. He is on the Register of Mediators and Arbitrators for the U.S. Bankruptcy Courts for Delaware, E. Dist. New York, and S. Dist. New York, and the U.S. District Court, E. Dist. New York.

In addition to his restructuring and bankruptcy practice, Ira has been providing support to for-profit and nonprofit entities concerning data privacy and cybersecurity issues.

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Two "Closely-Held" Companies

Pizza Behemoth Corp.

- 52 retail and 2 regional commissary facilities located in 6 states in Midwest and Northwest US
- All equity (save for some management shares) owned by Pepperoni Equity Partners IV, LLC ("**PEEP**"), a wholly-owned subsidiary of Pepperoni Investment Enterprises Corp. ("**PIE**")
- $45M prepetition secured financing (term and revolver) provided by Pepperoni Omni Opportunity Financing, LLC ("**POOF**"), a wholly-owned subsidiary of PIE
  - Secured by first lien on substantially all debtor's assets
  - In default; currently operating under the *Sixth Amended and Restated Forbearance Agreement*—debtor has paid $360,000 in forbearance fees in last six months

Two "Closely-Held" Companies

Pizza Behemoth Corp. *(cont.)*

- Chapter 11 first-days include bid procedures for sale of all assets in 30 days and a $1.5M priming DIP loan provided by Pepperoni Loan-to-Own Partners, LLC ("**PLOP**"), a wholly owned subsidiary of PIE, which is also stalking-horse credit bidder at $38.5M under the bid procedures
- Unsecured creditors ($27M) are expected to be seriously out of the money and include all the landlords of the 52 retail locations and the landlord for the 2 commissaries, which is Pepperoni Oregon and Ohio Properties, LP ("**POOP**"), a wholly-owned subsidiary of PIE
- One month before the petition date, Teresa Ricotta, a senior VP and member of the credit committee at POOF, resigned from POOF and joined the Debtor's board as an "independent director" and chair of the restructuring committee
- 28 days before the petition date, the debtor hired Marionette Call of Beck & Call, LLP, a four-lawyer firm, as debtor's counsel, who prepared all the first-days and negotiated the DIP financing and bid procedures, and was, 20 years ago, the law-school roommate of Leslie Whiteshoe, the head of the restructuring practice at Garr Gantuine LLP, the 2,500-lawyer firm representing PIE, PEEP, POOF, PLOP, and POOP

Two "Closely-Held" Companies

Pizza Bros of Sheboygan, LLC

- One kosher pizza restaurant in a strip center
- LLC's sole members are Moishe and Tzippi Pupik, husband and wife
- $145,000 prepetition loan advanced by PPK Free Loans, LLC, which has two members—the Pupiks—to help smooth out cash flow after the other kosher-keeping Jewish family in Sheboygan moved to Boca Raton.
  - Secured by first lien on substantially all debtor's assets
  - Note is interest-only at 0% interest (because of the Torah), maturing the earlier of 2037 or when the Messiah comes

Two "Closely-Held" Companies

Pizza Bros of Sheboygan, LLC *(cont.)*

- Subchapter V Chapter 11 first-days include bid procedures for sale of all assets in 30 days and a $35,000 priming DIP loan (origination fee of 5%) provided by PPK Fresh Start Pizza, LLP, a newly-formed entity whose two members are (you guessed it) the Pupiks, which is also the stalking-horse credit bidder at exactly $180,000 under the bid procedures, which calls for the rejection of the lease and the moving of all pizza-making equipment to a de-commissioned school bus to become Wisconsin's first kosher pizza truck
- Unsecured creditors, including their mildly-enraged landlord with a rejection claim of $75,000, are expected to be out of the money unless another higher bidder can be found (yeah, right)
- The debtor is represented by Gary Garage, a sole practitioner who prepared all the first-days and negotiated the DIP financing and bid procedures, and is the nephew of Linda Laconic, one of the name partners in the regional firm of Reticent, Laconic & Terse, PC, the firm that has represented the Pupiks and their businesses for years

Two "Closely-Held" Companies

Same Issues:

- Concerns about **debtor's counsel**:
  - Independent? (Ethical rules)
  - Disinterested? (Bankruptcy Code § 327)
  - Too beholden to insider secured creditor or its counsel or both? To whom does debtor's counsel "owe" the gig to?
  - Is counsel even clear who the client is?
  - Who paid debtor's counsel's retainer? Does it matter?
  - Would disqualifying debtor's counsel accomplish anything? Could replacement counsel even be found without the ability to get a postpetition retainer in a case where administrative insolvency is avoided only by what is either a *de jure* or *de facto* surcharge of the secured creditor's collateral?

Two "Closely-Held" Companies

Same Issues:

- Concerns for **general unsecured creditors / Committee**:
  - Who investigates prepetition lender's claims (perfection of liens, equitable subordination, recharacterization)—does independent director cleanse anything?
  - What protections should the insider DIP lender be given?
  - Is debtor's management an adequate fiduciary? Is a Chapter 11 trustee warranted?
  - How aggressive must Committee or individual GUC counsel be with "nothing to lose"? Can counsel be obstreperous enough to win a "nuisance-value" tip from the secured creditor without running afoul of ethical rules (conduct, interests of client) or Bankruptcy Rule 9011?
  - What if some members of the Committee are essential vendors getting paid or are happy to do business with the reorganized business and write off old debt? How can Committee counsel advance those trade creditors' interests while also advancing the competing interests of GUCs like landlords whose leases are being rejected and have no chance to recover with future business?
  - Who *really* is/are Committee counsel's client(s)?
  - Should there be two committees—one for trade and one for everyone else like landlords?

Two "Closely-Held" Companies

Same Issues:

- Concerns for **secured creditor counsel**:
  - How much of counsel's fingerprints are on everything? Does it matter?
  - Are fees conditioned on results of sale—that is, does counsel do better if secured creditor/stalking horse is the prevailing buyer? Does it matter?
  - With no disclosure requirements, can counsel keep such an incentivized fee structure confidential? Can counsel even agree to such a fee structure?
  - Even if not, how motivated is counsel going to be to help the secured creditor obtain an (unfair? predetermined?) result in this deal to ensure they get hired in the next deal? How much room is there in the ethical rules for this?
  - Does counsel have a countervailing obligation to the bankruptcy process or as an officer of the bankruptcy court?

Two "Closely-Held" Companies

Same Issues:

- Concerns for the **Bankruptcy Court**:
  - When a case looks like a *fait accompli* from the outset, how much should the externalities involved in the proposed deal (or its alternatives—dismissal, conversion, trustee, or just disapproval of the DIP financing) weigh on the judge's discretion?
    - Interests of non-creditor parties-in-interests—employees, neighboring businesses, customers who love *this specific pizza*
    - How specialized is the business?
    - How can "the market" (whatever that is) be harmed if the business fails
  - What interests in the "integrity of the bankruptcy system" are really at stake? Does it depend on the size of the case?
  - How much evidence do you need to give the insider buyer the protections under Bankruptcy Code § 363(m)? Is it even possible to grant them under these circumstances? Is it possible *not* to grant them?
  - How badly does the court want to see a plan confirmed post-sale? (*See* Delaware Local Rule 3017-2)

Faculty

Jamie L. Edmonson is a partner with Robinson & Cole LLP in Wilmington, Del., and a member of its Bankruptcy + Reorganizations Group. She also spends significant time in the firm's Los Angeles office. Ms. Edmonson has more than two decades of experience representing public and nonpublic debtor corporations, secured and unsecured creditors, official committees, trustees and asset-purchasers in bankruptcy and restructuring matters. Her practice is focused on guiding clients through commercial bankruptcy cases, restructurings, creditors' rights issues, insolvencies and liquidations, in which she represents a wide range of clients, including debtors, creditor and equity statutory committees, lenders, asset-purchasers, landlords and lessees. In addition to her bankruptcy work, she works in the areas of finance, real estate, energy and corporate law. Ms. Edmonson regularly serves as Delaware and lead counsel in large chapter 11 filings and has experience in all aspects of the chapter 11 restructuring process involving many industries, including information technology, retail, food, energy, construction, real estate, telecommunications and manufacturing. She was elected to the 2017 Global Network of Women Committee for the Turnaround Management Association, and her *pro bono* work includes serving as a judge for the National Appellate Advocacy Competition (NAAC) for the American Bar Association and joining efforts with the Lawyers' Committee for Civil Rights to serve as a nonpartisan poll monitor on Election Day 2018 and 2020. Before joining Robinson+Cole, Ms. Edmonson was the managing partner of the Wilmington office for an AmLaw 100 firm. She also utilized her finance background as a managing director with a nationally renowned financial advisory firm for several years. Ms. Edmonson received her B.S./B.A. from American University and her J.D. from Loyola Law School Los Angeles.

Ira L. Herman is a partner with Blank Rome LLP in its New York office, where he concentrates his practice on distressed public debt issues, insolvency matters involving upstream and midstream oil and gas companies, and distressed M&A. He regularly counsels lenders and other constituencies regarding bankruptcy risk, including with regard to intercreditor issues. Additionally, he advises financially distressed entities and their management on restructuring and bankruptcy issues, in and out of court, including corporate governance issues. Mr. Herman is a court-appointed mediator, and he has facilitated the resolution of controversies involving U.S. and non-U.S. parties concerning bankruptcy and commercial law issues. In 2017, he was appointed to the *Bankruptcy Law360* editorial advisory board. He also authored "Anticipating and Managing Bankruptcy Risk," a series of articles prepared for the Financial Restructuring & Bankruptcy module of *Lexis Practice Advisor*, and chapter 28, titled "Bankruptcy," in the treatise *Negotiating and Drafting Office Leases* (2017 Law Journal Press). Mr. Herman received his B.A. in political science *cum laude* from Yeshiva University in 1979, where he served as editor-in-chief of *The Polis*, a political science journal, and his J.D. *cum laude* with distinction from Boston University School of Law in 1982, where he served as an editor of the *Boston University International Law Journal*.

Aaron M. Kaufman is a partner with Gray Reed & McGraw LLP in Dallas and has resolved high-profile cases in numerous industries, including energy, health care, retail, construction, real estate, technology, fitness and many others. His bankruptcy experience includes representing debtors, trustees and lenders to committees, investors and other parties with a stake in the outcome. He also assists investors in acquiring distressed assets and represents clients in all other aspects of commercial

bankruptcy cases. Mr. Kaufman has resolved bankruptcy-related litigation and other commercial disputes concerning a number of issues, including fraudulent transfers, preference actions, breach of fiduciary duties and contract claims. He is often called on by media to provide insights on legal issues impacting distressed businesses across the country, and he is a frequent author and speaker on a variety of bankruptcy and litigation topics. Mr. Kaufman has been listed in *The Best Lawyers in America* in the fields of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law and Bankruptcy Litigation (2020-22), recognized as a leading bankruptcy/restructuring lawyer in Texas by *Chambers & Partners USA* (2021), named in Texas *Super Lawyers* (a Thomson Reuters company) as published in *Texas Monthly* (2018-21), and named a "Rising Star" by *Texas Super Lawyers* (2016-17). He is a contributor to ABI's VOLO Circuit Court First Responder project, has been a coordinating editor for the *ABI Journal*, and is a member of the American and Dallas Bar Associations and the Hon. John C. Ford American Inn of Court. Mr. Kaufman received his B.S. from the University of Texas at Austin in 2002 and his J.D. with honors from the University of Houston Law Center in 2007.

Jordan A. Kroop is a corporate bankruptcy, restructuring, and reorganization attorney with Perkins Coie LLP in Phoenix, where he represents debtors, official committees, acquirers and significant creditors in chapter 11 matters involving publicly traded and privately held companies throughout the U.S. He is a Fellow of the American College of Bankruptcy and represents clients in such diverse industries as manufacturing, real estate development, construction, hospitality, food and beverage, gaming, health care and technology. Mr. Kroop has represented the Boston Celtics, the Milwaukee Bucks, the Phoenix Coyotes and the Russian Tea Room, debtor-sellers, and strategic acquirers in chapter 11 asset sales throughout the country in transactions totaling more than $1 billion. He is a long-time adjunct professor of law at Sandra Day O'Connor College of Law at Arizona State University. He also has been an instructor at ABI's Litigation Skills Symposium and has taught international commercial arbitration at the University of the Pacific's McGeorge School of Law in Salzburg, Austria. Since 1998, Mr. Kroop has co-authored and regularly updated the two-volume treatise *Bankruptcy Litigation and Practice: A Practitioner's Guide*, now in its fourth edition. He also co-authored a chapter on chapter 11 and sports franchises in the *Collier Guide to Chapter 11* (LexisNexis 2011, rev'd 2012, 2013) and co-authored *The Executive Guide to Corporate Bankruptcy* (Beard Books). In addition, he has authored dozens of articles in national publications and augments his writing with frequent panel and seminar presentations across the nation. He also co-chairs ABI's Southwest Bankruptcy Conference. Mr. Kroop has been recognized for more than 10 years in *Southwest Super Lawyers* and *The Best Lawyers in America*, including as Lawyer of the Year in 2017. He also has been listed in *Lawdragon*'s "500 Leading Global Restructuring & Insolvency Lawyers" since 2020. Mr. Kroop received his A.B. *magna cum laude* from Brown University and his J.D. from the University of Virginia.