

A Chilling Decision for Creditor Work

A court ruling over use of an intermediary makes lawyers and advisers more careful about how they drum up clients

By *Danielle Fugazy*
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For borrowers, bankruptcy is all about restructuring and fresh starts, but representing their creditors is big business for lawyers and financial advisers.

Now these professionals face two new hurdles: An improving economy is making this work harder to find, and a November court ruling will force them to be more cautious about pursuing such clients.

Judge **Mary F. Walrath** of the U.S. Bankruptcy Court for the District of Delaware in Wilmington disqualified a Washington law firm, **Arent Fox**, and its Wilmington co-counsel, **Elliott Greenleaf & Siedzikowski**, from representing the official creditors committee in **Universal Building Products'** bankruptcy, saying the law firms had wrongly used an intermediary to help them win their appointment.

Though Walrath issued the ruling in Delaware, where the majority of U.S. companies are incorporated, "there will now be other courts looking into the matter, as well," **Robert J. Keach**, a shareholder at **Bernstein, Shur, Sawyer & Nelson**, said during a Web seminar hosted by **the Turnaround Management Association** last week on the case.

Arent Fox and Elliott Greenleaf engaged **Haishan Liu**, a Chinese translator, to persuade two of United Building Products' Chinese creditors, **Eastern Accessories Corp.** and **Shangahi Hualin Hardware**, to name him as their proxy. When Liu won a seat on the creditors committee, he voted to retain the two law firms as the panel's counsel. He then resigned from the committee, and Arent Fox recommended to the panel that it hire him as the official translator for the Chinese creditors.

The Delaware Lawyers' Rules of Professional Conduct bar lawyers from directly soliciting clients with whom they do not have a previous relationship, but these rules generally do not apply to nonlawyers.

Lawyers say it is not unusual for them to exchange information with nonlawyers before a creditors committee is formed. But they also said Walrath's ruling, which outlined the limits of this kind of collaboration, may have a big impact on how future committees select professionals, as well as how creditors are appointed to the committees.

The decision has already prompted several law firms to warn about erring on the side of caution.

"Transparency is a must. Disclosure — at the time of 'the pitch,' at the time of retention/application to the court, and continuing thereafter — is an unconditional requirement, though the nature and extent of disclosure will vary from case to case, depending upon the circumstances," **Richard M. Meth**, a partner with **Fox Rothschild** of Roseland, N.J., and **Jessica D. Gabel**, a professor at the **Georgia State University College of Law** in Atlanta, said in a March speech at the 35th annual **Judge Alexander L. Paskay Seminar on Bankruptcy Law and Practice**.

Panelists at last week's seminar also stressed the importance of caution.

"Before you pick up the phone, know the rules. Be transparent. Disclose things that can come back to you and hurt you," said **Mary Ellen Welch** Rogers, an attorney with **Goulston & Storrs** and the panel's moderator.

"A lot of the unsavoryness in the Building Products case was gleaned from innuendos, snarky statements and e-mails. Don't put anything in writing you wouldn't want your mother to see."

To be on the safe side, Keach recommended looking at a firm's home-state rules, as well as those of the potential client's state, and complying with the more difficult set of rules.

The methods Arent Fox and Elliott Greenleaf used were certainly seen as extreme. "There was an understanding or arrangement that, if you vote for me, I will **vote for you**," Timothy Dacey, a director with **Goulston & Storrs**, said during last week's seminar.

And Walrath was unimpressed by Arent Fox's argument that its arrangement with Liu is a widespread practice. She determined that the law firms had violated Rules 7.3 and 8.4 of the Delaware Lawyers' Rules of Professional Conduct.

Dacey said Rule 7.3 "prohibits a lawyer from direct solicitation of a client, in person, by live telephone or with real-time electronic contact, like through a chat room. In this case, the solicitation wasn't directly with the lawyers, but with Dr. Liu. However, 8.4(a) says you can't violate the Rules of Professional Conduct through the acts of another."

The judge also invoked Rule 8.3(a), commonly referred to as the "snitch rule." This requires a lawyer who has knowledge of another lawyer's rule violation that raises a substantial question about that lawyer's honesty, trustworthiness or fitness as an attorney to inform the appropriate professional authority.

The court suggested that other lawyers who know of a violation of the disclosure rules may have an obligation to report the violation under Rule 8.3(a).

However, as Dacey put it, "the rule is vague and unpopular. It deals mostly with things like bribery or misappropriation of client's funds. It's not usually applied to cases like this."

In addition, the court faulted Arent Fox and Elliot Greenleaf for failing to disclose their relationship with Liu, as Rule 2014(a) of the U.S. Bankruptcy Code requires.

Some lawyers are just as concerned about recommendations in Walrath's ruling that all professionals — not just law firms — be required to disclose whether they used intermediaries to solicit proxies, and that the U.S. trustee consider procedures to reduce undue influence on the decisions by creditor committees to hire professionals.

"This has the potential to put prospective committee members and prospective professionals **into a deep freeze**," **Evan Flaschen** and **Laura Venta**, who practice financial **restructuring law** at **Bracewell & Giuliani**, wrote in a Nov. 10 post on their **Basis Points Blog**.

They noted that the U.S. trustee has broad discretion in whom it appoints to a committee.

"One could easily see the U.S. trustee taking it a step further in particular cases by deciding not to appoint to the committee any creditor who had been solicited by any professional prior to the committee formation," the lawyers wrote. "We suggest that professionals only call clients and do not solicit proxies even from creditors who are clients. When in doubt, caution should be the rule."

"Since the decision, professionals seem to be more conservative in seeking creditor support and in **exchanging introductions**," **Michael Lastowski**, **a member** of law firm **Duane Morris** and the head of its Wilmington, Del., office, and **Christopher Winter**, a partner at the firm, said in an article published on the firm's website in March.

"The Office of the United States Trustee's committee questionnaire does not ask potential committee members whether they have been solicited. However, at committee formation meetings, potential members of committees are asked to identify any professionals who have contacted them in anticipation of the meeting."