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A Tale of Two Retentions

Lessons on Navigating Concurrent Representation of Parties-in-Interest in Large Chapter 11 Cases

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While the retention of professionals in large chapter 11 cases requires significant drafting, negotiating and lawyering behind the scenes, disputes about retention applications are generally settled and rarely publicly litigated. However, two recent proceedings departed from that norm, giving courts the opportunity to issue opinions on contested retention matters.

First, Hon. **Michael B. Kaplan** of the U.S. Bankruptcy Court for the District of New Jersey issued an opinion[1] on a retention issue in the bankruptcy of medical genetics company Invitae Corp. and certain of its affiliates. Specifically, the question before the court was whether Kirkland & Ellis International LLP could be retained as counsel to the Invitae debtors notwithstanding the fact that Kirkland was simultaneously representing one of the debtors' major creditors in an unrelated matter. Both the committee and U.S. Trustee objected to the retention on the grounds that Kirkland's representation is prohibited under 11 U.S.C. § 327(a). The court overruled both objections and approved Kirkland's retention.

Next, Hon. **Brian F. Kenney** of the U.S. Bankruptcy Court for the Eastern District of Virginia issued an opinion on a factually similar retention issue in the bankruptcy of industrial wood pellet producer Enviva Inc.[2] The question before the court was whether Vinson & Elkins LLP (V&E) could be retained to represent the Enviva debtors notwithstanding its concurrent representation of a major equityholder in an unrelated matter. The U.S. Trustee — but not the committee — objected to V&E's retention application. Unlike Judge Kaplan, Judge Kenney denied V&E's retention application and maintained that decision in the face of a reconsideration motion filed by Enviva.[3]

Given how common it is for law firms seeking to represent debtors in large chapter 11 cases to concurrently represent large banks, investment firms and other companies on unrelated matters despite the fact that they may be interested parties in such debtors' chapter 11 cases, these decisions provide helpful practice tips for practitioners.

Retention Basics

Section 327(a) of the Bankruptcy Code governs the retention of professionals and provides that a debtor may employ professionals "that do not hold or represent an interest adverse to the estate, and that are disinterested persons."[4] Section 327(c) provides further guidance on what disqualifies a professional from retention in the case of a concurrent representation of a creditor, and provides that "a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the [U.S. T]rustee, in which case the court shall disapprove such employment if there is an *actual conflict of interest*."[5] Because "actual conflict" is not defined in the Code, "courts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists 'in light of the particular facts of each case.'"[6]

1 *In re Invitae Corp.*, No. 24-11362 (MBK), 2024 WL 2230069 (Bankr. D.N.J. May 16, 2024).
2 *In re Enviva Inc.*, No. 24-10453-BFK, 2024 WL 2795274 (Bankr. E.D. Va. May 30, 2024).
3 *See* Mem.Op. and Order Denying Debtors' Motion to Reconsider Mem. Op. and Order Denying App. to Employ Vinson & Elkins LLP, Case No. 24-10453 (BKF) (D.I. 792, July 2, 2024) (the "Enviva Reconsideration Ruling").
4 11 U.S.C. § 327(a).
5 11 U.S.C. § 327(c) (emphasis added).
6 *In re BH & P Inc.*, 949 F.2d 1300, 1315 (3d Cir. 1991).

The *Invitae* Decision

As previously noted, the U.S. Bankruptcy Court for the District of New Jersey in a recent decision[7] considered whether § 327(a) prevented Kirkland from being retained as debtors' counsel given that Kirkland was concurrently representing Deerfield, a major creditor of the debtors. The court began by reciting the relevant procedural history. It recounted that prior to filing for bankruptcy, the debtors entered into a transaction with Deerfield whereby Deerfield became the debtors' senior secured noteholder and "largest secured creditor, holding approximately 79 percent of [the] Debtors' debt."[8]

The committee contended that the transaction "will likely be a 'central issue' in this bankruptcy proceeding, meaning that a successful challenge to the Transaction could result in 'hundreds of millions of dollars of additional recovery to unsecured creditors.'"[9] Since 2021, the debtors had represented Deerfield in matters unrelated to the *Invitae* bankruptcy; following the filing of the debtors' bankruptcy proceeding on Feb. 13, 2024, Kirkland filed a retention application seeking to be retained as debtors' counsel.[10]

The court then turned to the objectors, noting that while both the committee and the U.S. Trustee filed objections, they had asked the court for different relief.[11] The committee asked that the court limit Kirkland's retention to matters that do not involve Deerfield.[12] The U.S. Trustee, on the other hand, asked the court to deny the retention application altogether.[13]

The court's decision came down to its finding that the concurrent representation *did not* present an actual conflict of interest.[14] Given that no actual conflict existed and that § 327(c) instructed that "a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor ... unless there is an actual conflict of interest," the court found that Kirkland could not be disqualified absent an actual conflict just because of its concurrent representation.[15]

There were three main reasons why the court found that no actual conflict of interest existed. First, the court accorded "weight to the extensive and detailed waivers present in this case."[16] Kirkland's engagement letters with both the debtors and Deerfield contained conflict waivers whereby "both parties expressly provided their informed consent and waived any such potential conflicts."[17] Further, the court was not convinced by the committee's argument that the engagement letter should have specifically referenced a potential conflict with Deerfield, finding that the waivers, coupled with disclosure of the potential Deerfield conflict in Kirkland's retention application, were sufficient.[18]

Second, the court considered the "competing economic interests" and found that because the revenue from Deerfield was $2.4 million in total (or 0.03 percent of Kirkland's annual revenue for the year), the "economics of the situation" did not create a conflict of interest.[19] Kirkland could zealously represent the debtors against Deerfield, as evidenced by the fact that Kirkland had already represented the debtors in an auction in which Deerfield was the stalking-horse bidder, but not the eventual successful bidder.[20]

Finally, the court's decision was guided by policy considerations, as "disqualification of [Kirkland] at this point in the bankruptcy would be detrimental both to the bankruptcy estate and the creditors," given that Kirkland had already put in significant time and effort and that there was likely to be very little, if any, recovery for unsecured creditors.[21] The court also considered and rejected the committee's suggestion that Kirkland only represent the debtors in matters unrelated to Deerfield. Since Deerfield was the major secured creditor in the case, "any attempt to limit [Kirkland]'s representation to work that does not impact Deerfield would be impractical, [be] difficult to police, and engender further debate and contest."[22]

The *Enviva* Decision

Although it reaches the diametrically opposite conclusion, the *Enviva* decision involves many similar facts to *Invitae*. Like Kirkland, V&E sought to be retained as debtors' counsel, despite the fact that they concurrently represented a major party-in-interest, Riverstone, which has a 43 percent interest[23] in the debtors' common stock in an unrelated matter.[24] Further, just as a major issue in *Invitae* would be investigating the transaction to which Deerfield (the concurrent client) was a beneficiary, in *Enviva* a major part of plan negotiations would be determining how much of the reorganized equity existing equityholders like Riverstone would retain.[25]

Also as in *Invitae*, the debtors had consented via a conflict waiver to V&E's continuing representation of Riverstone.[26] Unlike in *Invitae*, where Deerfield accounts for only 0.03 percent of Kirkland's annual revenue, Riverstone accounted for 1.4 percent of V&E's annual revenue.[27] Based on these facts, unlike the *Invitae* court, the *Enviva* court concluded that there was an actual conflict of interest that disqualified V&E under § 327(a) of the Bankruptcy Code from representing the debtors.[28] While the debtors' disclosures through their retention application of connections to parties-in-interest was sufficient, the court found that there was an actual conflict of interest for a few reasons:[29]

1. Unlike in *Invitae*, where the court afforded weight to the pre-petition waivers, the *Enviva* court found that the pre-petition conflict waivers were "not a substitute for disinterestedness under Section 327(a)."[30]

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7 *See In re Invitae Corp.*, 2024 WL 2230069.
8 *Id.* at *1.
9 *Id.* (citing Committee Objection, *In re Invitae Corp.*, No. 24-11362 (MBK) (Bankr. D.N.J. April 5, 2024), ECF No. 283).
10 *Id.* at *1.
11 *Id.* at *12.
12 *Id.* at *1.
13 *Id.* at *2.
14 *Id.*
15 *Id.*
16 *Id.* at *4.
17 *Id.*
18 *Id.*
19 *Id.* at *5.
20 *Id.*
21 *Id.* at *6.
22 *Id.*
23 *In re Enviva*, 2024 WL 2795274 at *7.
24 The U.S. Trustee also objected to V&E's retention on the grounds that other circumstances created conflicts of interest, including V&E's concurrent representation of the debtors' officers and directors in derivative lawsuits and V&E's potential preference claims for legal fees. The court rejected these arguments and found that these circumstances did not present a conflict.
25 *In re Enviva*, 2024 WL 2795274 at *8.
26 *Id.* at *7.
27 *Id.* at *9.
28 *See id.* at *4.
29 *Id.* at *6.

2. The court was troubled by the lack of — and impossibility of erecting — ethical walls between the V&E Enviva teams and V&E Riverstone teams, given that a number of V&E attorneys worked on both matters.[31]

3. Unlike in *Invitae*, where the court concluded that negotiating against Deerfield and zealously advocating for the debtors would not be an issue for Kirkland, the *Enviva* court concluded that the debtors' needing to negotiate against Riverstone to determine their equity allocation under a reorganization plan was problematic.[32]

4. The court expressed concern about the percentage of V&E's revenue attributable to Riverstone and distinguished *Invitae*, noting that "V&E's revenue from Riverstone amounts to 1.4 percent" or "46 times more than the percentage of annual revenue in *Invitae*."[33]

5. Like in *Invitae*, the court rejected the "middle-ground" option that V&E could represent the debtors, but not on matters related to Riverstone.

As in *Invitae*, the court found this proposal impractical and that a reorganization plan "is like a machine in which all of the parts depend on all of the other parts," and the court "does not see how V&E can delegate this core function ... to its co-counsel."[34] While the Enviva debtors subsequently moved for reconsideration of the court's decision, the court declined to consider their acceptance of the need for an ethical wall as well as their proposal to create an independent "plan evaluation committee," as that did not constitute newly discovered evidence. Instead, it reviewed their motion under the "clear error of law" standard, finding that such proposals failed to adequately remedy the disinterestedness issues in its original opinion.[35]

Takeaways for Practitioners

While the opposite outcomes in the cases could arguably be attributed to the differing percentage of firm revenues for which the concurrent clients accounted, given the generally similar factual scenarios and the fact that even the Enviva revenue number (1.4 percent) was lower than what many courts routinely had approved, there is no easy way to reconcile these cases. Nevertheless, the cases, even if difficult to reconcile, provide important lessons for counsel seeking retention:

1. *Take disclosure obligations in retention applications seriously*. Despite the differing outcomes in these cases, both judges mentioned disclosure of relationships with parties-in-interest as important.[36] Although the *Enviva* decision did not go V&E's way, the outcome would have been much worse if they had failed to disclose the Riverstone relationship and thus were accused of trying to hide a disqualifying conflict.[37]

2. *Include robust conflict waivers in engagement letters*. In *Invitae*, the detailed conflict waivers were key to the court's finding that there was no disqualifying conflict.[38] Even if the conflict waivers could not save V&E from disqualification, there is a clear benefit to including them in engagement letters, and their inclusion is often sufficient to avoid objections in the first place. Further, although the *Invitae* court did not find that mentioning Deerfield by name in the debtors' conflict waiver was required, to the extent that a law firm knows that one of its current clients is a major creditor of the debtor it seeks to represent, it would likely make the waiver more iron-clad to include that major creditor by name in a conflict waiver.[39]

3. *Consider carefully the percentage of the firm's revenue received from the concurrent client, and be prepared for pushback if the concurrent client is a major contributor to firm revenue*. The distinguishing factor, at least according to the *Enviva* court, between the *Invitae* and *Enviva* outcomes was the revenue percentage from the concurrent client. While it is difficult to precisely determine what percentage of revenue will invite increased court scrutiny, courts generally seem to be more comfortable with concurrent representation when the concurrent client accounts for less than 1 percent of the firm's revenue.[40]

4. *Do not count on being able to use conflicts' counsel to get around a conflict issue if a court finds an actual conflict, particularly where the conflict-generating creditor will have a role in plan negotiations*. One thing that both courts agreed on is that it is impractical for debtors' counsel to delegate a major part of their function, such as plan negotiations or negotiations with a major party-in-interest, to conflicts counsel. Courts want debtors' counsel to be able to handle major case negotiations and do not want to be called in to police frequent disputes about the functions that conflicts counsel vs. debtors' counsel must handle. That being said, it likely remains easier to justify conflicts counsel as a solution where the disputes with the creditor are more discrete and divorced from key structuring and economics points on the terms of a plan of reorganization (*i.e.*, a counterparty to an executory contract).

5. *If concerned about potential retention roadblocks, consider carefully where to file the case*. The differing outcomes here suggest that New Jersey is taking a much more debtor-friendly and lenient approach to concurrent conflicts, while Virginia is taking a stricter approach.

Given the relative dearth of law on these issues, the *Invitae* and *Enviva* decisions are likely to have significant persuasive authority. Practitioners who want an *Invitae* outcome may be wise to file somewhere other than Virginia. abi

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30 *Id.* at *7.
31 *Id.* at *8.
32 *Id.* at *8.
33 *Id.* at *9 (citing *In re Invitae*, 2024 WL 2230069 at *5).
34 *Id.* at *8.
35 Enviva Reconsideration Ruling at 9-10.
36 *In re Invitae*, 2024 WL 2230069 at *5 (that "information in the disclosure schedules ... withstands careful scrutiny and satisfies the Court").
37 *In re Enviva*, 2024 WL 2795274 at *6 ("This is not a case where an undisclosed conflict is discovered deep into the case.").
38 *In re Invitae*, 2024 WL 2230069 at *5.
39 *Id.* at *4.
40 *See In re Art Van Furniture LLC*, 617 B.R. 509, 519 (Bankr. D. Del. 2020) (approving retention application where concurrent client's revenue "stood at approximately one-tenth of 1 percent of total firm revenue"); *In re Project Orange Assocs. LLC*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010) (denying retention application where concurrent client's revenue accounted for "0.92 percent of revenue in 2008, 1.6 percent of revenue in 2009, and has accounted for 0.90 percent of revenues to date in 2010").