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Who's My Client? The Importance of Engagement Letters

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In the context of a complex chapter 11 proceeding, it is common for an attorney to be tasked with representing multiple parties, often with similar interests in the outcome of the proceeding. Single counsel representing an organized group such as an unofficial or *ad hoc* committee of lenders or creditors is routine. In doing so, however, it is important for counsel to understand and anticipate the challenges that can stem from relationships among multiple clients. This article addresses the duties of an attorney representing the clients as a group, the potential duties that the clients may have to each other, what courts have said on the matter, and certain anticipatory actions that an attorney should consider taking in reconciling the members' potentially diverging interests.

Formation of "Group" Clients

Before undertaking joint representation of multiple clients — in a bankruptcy context or otherwise — counsel must be familiar with the Model Rules of Professional Conduct governing such representations. Understanding professional responsibility prior to undertaking such engagements is critical to the resulting consequences of representing multiple parties. Rule 1.6 of the Model Rules of Professional Conduct forbids, with few exceptions, a lawyer to reveal information relating to the representation of a client. Informed consent of the clients is one exception, and it requires adequate disclosure to enable a reasoned decision.[1]

Without clients' informed consent, among other things, Rule 1.7 forbids the representation of one client if doing so "creates direct adversity to another client," or if there is a "significant risk" that one client's representation will materially limit the lawyer's responsibilities to another.[2] In joint representations, the duty of confidentiality will likely present issues for the attorney that may implicate Rule 1.7. The concept of informed consent is crucial because the interests of the group members should be expected to diverge, and the attorney has an equal duty of loyalty to each member. According to comment 30 to Rule 1.7, the attorney/client privilege does not attach between commonly represented clients.[3]

Lenders often choose (or might be required) to navigate a complex bankruptcy proceeding of a common debtor in concert — and similarly situated nonlender creditors often choose to do the same. In some instances, the Bankruptcy Code provides for the appointment of an official statutory committee, granting such committees standing to be heard on any matter and vesting it with adversarial influence designed to facilitate a thoroughly vetted reorganization strategy that ensures that the interests of the official committee's constituents are protected.[4] These official committees bear fiduciary duties imposed for the benefit of each other and their constituencies, and are thus entitled to qualified immunity in the discharge of these duties.[5] Such appointments, however, are not the focus of this article.

Unofficial creditors' groups are not statutorily afforded the same standing. Absent an express intention to create a fiduciary relationship among such committee members, a fiduciary relationship is also generally not implied.[6] In some cases, courts have found that an implied fiduciary relationship existed where the agreement among the group members utilizes agency designations, such as "agent," "representative" or the like.[7] Yet, even in those circumstances, the presence of express language not intending to create a fiduciary relationship will prevail over those agency designations.[8] Under these arrangements, the group of lenders or the unofficial committee, as a whole, is the attorney's client. Actions taken in the bankruptcy proceeding with respect to the group's common interests are prioritized over any actions taken in pursuit of any member's individual interests.[9]

1 *See* Model Rules Prof'l Conduct 1.0(e).
2 *See id.* at R. 1.7, cmts. 18, 31 (conveying that "informed consent requires that each affected client be aware of relevant circumstances and of the material and reasonably foreseeable ways" that conflict could have adverse effects on attorney's representation of other group members).
3 *Id.* at cmt. 31.
4 11 U.S.C. §§ 1102, 1103.
5 11 U.S.C. § 1103(c)(5); *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3d Cir. 2000).
6 *See* Current Issues in Co-Lending Arrangements, SG002 ALI-ABA *219, *222-23; Daniel A. Fliman & Isaac S. Sasson, "Introduction to Ad Hoc Committees in Distressed Situations," 256-63 *N.Y.L.J. Corp. Update* (Sept. 29, 2016); *First Citizens Fed. Sav. & Loan Assoc. v. Worthen Bank & Tr. Co.*, 919 F.2d 510 (9th Cir. 1990) (stating that "fiduciary relationships should not be inferred absent unequivocal contractual language similar to that in *Women's Federal* [an earlier case in which the agreement expressly provided that one institution was to act 'as a trustee with fiduciary duties' toward the other]"). *Cf.*, *In re Wash. Mut. Inc.*, 419 B.R. 271, 278 (Bankr. D. Del. 2009) (suggesting that members of class of creditors might owe fiduciary duties to other members of class).
7 *See* Current Issues in Co-Lending Arrangements, at *223-24.
8 *Id.*
9 *See In re Nw. Airlines Corp.*, 363 B.R. 704, 708 (Bankr. S.D.N.Y. 2007) (noting entire shareholders' group, not individual financial advantage, should be basis of *ad hoc* committee's negotiating decisions).

What the Courts Say

Courts have taken note of complications appurtenant to the Model Rules of Professional Conduct in a bankruptcy context, even calling into question whether the rules were intended to be followed as strictly as the language suggests.[10] In addition, courts have issued warnings to advise that inconsistent acts are not always materially adverse acts that would constitute a violation of fiduciary duties in instances where they are owed among committee members.[11] Some courts have also cautioned others to be wary of construing them as such in light of the duality that those members possess by way of membership in the group.

An important provision in engagement letters relating to waiving future conflicts draws differing opinions from the courts.[12] The likelihood of an advance waiver surviving scrutiny is higher as the waiving party's sophistication increases and that party is given an opportunity for other counsel to review the waiver prior to granting it.[13]

An Attorney's Actions in Light of Duties and Potential Conflicts

What is an attorney to do when one or more of the group members take actions inconsistent with the group's common interests? Know that the Model Rules of Professional Conduct are a primary source of instruction and are helpful in resolving this dilemma. However, not all deviations from the common plan will rise to the level of material adversity. While the group members are acting in concert with each other as the attorney's singular client, the members simultaneously remain individual entities with unique and parochial interests. A member's pursuit of individual interests apart from the group's interests is not a conflict if it does not substantially undermine the group's efforts.[14] Deviations are to be expected because of the dual nature that the group members retain as individual entities comprising a unit.[15]

One of the most helpful things that the attorney can do is to execute a well-drafted engagement letter at the onset of the representation and make certain that the group members understand its provisions. Doing so should alleviate much of the headache and confusion that may arise when group members develop differing interests. The letter should also include provisions that plainly state the group members' mutual understandings of the relationship and expectations of each other and of the attorney.

A good engagement letter reinforces the principles embodied in the Model Rules of Professional Conduct and communicates them to the group members. It should be clear in the letter that the attorney's only client is the group — not the individual members. Making this distinction known from the onset assists in having easier conversations when the attorney has to remind members that the pursuit of the group's common interests are the attorney's obligation.

Another essential provision in the engagement letter would address confidentiality and the attorney's duty to maintain it. While the members must understand that there will be no confidentiality among them for matters concerning the entire group, confidential information obtained by way of group membership should not be used to disadvantage the other members.[16] As previously noted, the members can disclaim fiduciary duties to each other, and the members generally hold no fiduciary duty to other creditors outside of the group. Since the Bankruptcy Code does not stringently regulate *ad hoc* committees (as compared to statutory committees), the engagement letter should provide structure for the group members to understand this elastic construct.

In spite of the members' differing views, as long as a group remains, the attorney is obligated to keep all members apprised of material developments so that each member is equipped with adequate knowledge to make informed decisions, including whether severance from the group is necessary.[17] Initially, the attorney's approach should be to have an open discussion with all of the group members. A resolution decided by all of the members is the ideal outcome, as it would be improper for the divergent member to be disregarded by mere account of its changed interest.

If tension persists, the engagement letter will be useful. Where a group member's interests deviate so far from the interests of the rest of the group, clauses in the engagement letter pertaining to current conflicts and disqualification will guide the separation. The letter can include covenants regarding which members will and will not continue to be represented by the attorney, and the members should have agreed that the attorney's knowledge of confidential infor-

10 *In re Flanigan's Enters. Inc.*, 70 B.R. 248, 250 (Bankr. S.D. Fla. 1987) (comparing unclear concepts concerning conflicts in bankruptcy forums to clearly drawn lines of conflicts in other forums); *see also* Model Rules Prof'l Conduct 1.7, cmt. 3 (stating that "simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients").

11 *See In re Rickel & Assoc's. Inc.*, 272 B.R. 74, 100 (stating that official committee members burdened with "fiduciary duties ... are hybrids who serve more than one master. Every member of the Committee is, by definition, a creditor. Thus, he is [in] competition with every other creditor for a piece of a shrinking pie. He may assert his rights as a creditor to the detriment of the creditor body as a whole without running afoul of his fiduciary obligations"); *see also Krafsur v. UOP (In re El Paso Refinery LP)*, 196 B.R. 58, 74 (Bankr. W.D. Tex. 1996).

12 *Compare Sheppard, Mullin, Richter & Hampton LLP v. J-M Mfg. Co. Inc.*, 425 P.3d 1 (Cal. 2018) (ruling against enforcement of advance-conflict waiver); *Lennar Mare Island LLC v. Steadfast Ins. Co.*, 105 F. Supp. 3d 1100 (E.D. Cal. 2015) (same); *Worldspan LP v. Sabre Grp. Holdings Inc.*, 5 F. Supp. 2d 1356 (N.D. Ga. 1998) (same); *with Galderma Labs. LP v. Actavis Mid Atl. LLC*, 927 F. Supp. 2d 390 (N.D. Tex. 2013) (finding advance-conflict waiver enforceable); *St. Barnabas Hosp. v. New York City Health & Hosps. Corp.*, 775 N.Y.S.2d 9 (N.Y. App. 2004) (same).

13 *See Galderma*, 927 F. Supp. 2d 390; *Macy's Inc. v. J.C. Penney Corp.*, 968 N.Y.S.2d 64 (N.Y. App. Div. 2013); *see also Restatement (Third) of the Law Governing Lawyers* § 122 (2000) ("A client's open-ended agreement to consent to all conflicts normally should be ineffective unless the client possesses sophistication in the matter in question and has had the opportunity to receive independent legal advice about the consent.").

14 *M/A-Com Sec. Corp. v. Galesi*, 904 F.2d 134, 136 (2d Cir. 1990) ("[T]he implied covenant does not extend so far as to undermine a party's general right to act on its own interests in a way that may incidentally lessen the other party's anticipated fruits from the contract.").

15 Evan D. Flaschen & Kurt A. Mayr, "Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds," XXVI *ABI Journal* 7, 16, 46-49, September 2007, *available at* abi.org/abi-journal (explaining that "individual [*ad hoc* committee] members are always free to file separate pleadings advocating different positions") (unless otherwise specified, all links in this article were last visited on March 22, 2021).

16 *See* Henry C. Kevane, Jeffrey T. Kucera & Matthew J. Ochs, "No More Ad Lib: The Nuts & Bolts of *Ad Hoc* Bankruptcy Committees," *Bus. Law Today*, at 3 (December 2014) ("[T]he application of the [attorney/client] privilege is relatively straightforward, following attorney/client privilege principles applicable in the corporate context."); Model Rules Prof'l Conduct 1.7, cmt. 31 ("As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the lawyer not to disclose to the other client information relevant to the common representation. This is so because the lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interest and the right to expect that the lawyer will use that information to that client's benefit."); *Restatement (Third) of the Law Governing Lawyers* § 122, cmt. h (2000) ("When a lawyer undertakes representation despite a conflict and after required disclosure and informed consent ... the lawyer must not regard informed consent as a basis for limiting the scope of the representation or favoring the interests of one client over the interests of another, except as expressly agreed under the informed consent.").

17 Model Rules Prof'l Conduct 1.4 (Am. Bar Ass'n 2020).

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mation will not serve as the basis for a claim of disqualification by any member.

The attorney should also educate group members concerning any waiver of future conflicts because courts in and outside of the bankruptcy setting have varied opinions on the efficacy of advance waivers.[18] Reviewing the consequences of such a waiver with each group member would bolster any necessary arguments that the waiver is effective. Ultimately, the attorney should confirm whether case law in the relevant jurisdiction supports the use of an advance waiver prior to the execution of one, and the attorney should follow through with providing sufficient information for the members' full understanding.[19]

18 *Supra*, n.5; *see also* William Freivogel, *Freivogel on Conflicts: A Guide to Conflicts of Interest for Lawyers*, *available at* freivogelonconflicts.com/waiversconsents.html (identifying instances of courts favoring and not favoring advance waivers).

19 *Id.*

Conclusion

A well-drafted engagement letter is of great utility to an attorney representing groups of lenders or unofficial committees of creditors. Rely on the Model Rules of Professional Conduct and case law in drafting it, then rely on the letter in the event of internal conflicts. The letter establishes the covenants, or lack thereof, among those group or committee members that steer the direction of the ship when group dynamics cause a shift in the tide. In many respects, the representation of a group of lenders or an unofficial committee of creditors takes on the form of a traditional joint representation of multiple clients. A skilled attorney will capture in mind and address in writing the scenarios that could result during the course of group representation, bearing in mind the significance of ensuring that the group members appreciate the gravity of the joint engagement. abi