UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
	:	
AVENTINE RENEWABLE ENERGY HOLDINGS, INC. *et al.,*	:	Case Number 09-11214 (KG)
	:	
	:	Jointly Administered
Debtors	:	**Hearing Date: 7/15/10 at 10:00 a.m.**
	:	**Objection Deadline: 4/5/10**
	:	**Extended by Agreement to May 26, 2010**

UNITED STATES TRUSTEE'S OBJECTION TO FINAL APPLICATION OF HOULIHAN LOKEY HOWARD & ZUKIN CAPITAL, INC. FOR COMPENSATION AND REIMBURSEMENT OF EXPENSES AS DEBTORS' FINANCIAL ADVISOR AND INVESTMENT BANKER (D.I. 859)

In support of her Objection to the Final Application of Houlihan Lokey Howard & Zukin Capital, Inc. for Compensation and Reimbursement of Expenses as the Debtors' Financial Advisor and Investment Banker (the "Application"), Roberta A. DeAngelis, Acting United States Trustee for Region 3 ("UST"), by undersigned counsel, avers as follows:

Introduction

1. This Court has jurisdiction to hear this Objection.

2. Pursuant to 28 U.S.C. § 586, the UST is charged with overseeing the administration of Chapter 11 cases filed in this judicial district, including reviewing and commenting on applications for compensation and reimbursement and objecting thereto when the UST considers it appropriate.

3. In furtherance of her case supervisory responsibilities, as well as pursuant to 11 U.S.C. § 307, the UST has standing to raise and be heard on issues of compensation and reimbursement of expenses.

4. The Debtors filed these jointly administered Chapter 11 cases on April 7, 2009.

5. The UST appointed an official committee of unsecured creditors on April 23, 2009.

6. On April 14, 2009, over the objection of the Debtors' existing pre-petition secured lenders who offered a different post-petition credit facility, and following a lengthy evidentiary hearing, the Court approved a priming $30 million debtor-in-possession credit facility offered by Brigade Leveraged Capital Structures Fund, Ltd. ("Brigade"), Nomura Corporate Research & Asset Management, Inc. (as Investment Manager for and behalf of certain lenders)("Nomura"), Whitebox Hedged High Yield Partners, L.P., Whitebox Combined Partners, L.P., and Pandora Select Partners, L.P.,[1] (Whitebox Hedged High Yield Partners, L.P., Whitebox Combined Partners, L.P., Pandora Select Partners, L.P. and Whitebox Advisors LLC collectively referred to as "Whitebox," and Brigade, Nomura and Whitebox referred to collectively as the "DIP Lenders"), with Whitebox Advisors LLC serving as the DIP Administrative and Collateral Agent, pursuant to the terms of an April 7, 2009 term sheet among the Debtors and the DIP Lenders.

7. At the contested hearing on April 14, 2009, Debtors' counsel represented that Brigade, Nomura and Whitebox collectively held 49% of the $300 million 10% fixed rate notes issued by the Debtors, and were members of a pre-petition *ad hoc* bondholders' committee.

8. In the course of the contested hearing on DIP financing, William Hardie III, a managing director of Houlihan Lokey Howard & Zukin Capital, Inc. ("HLHZ"), the Debtors'

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[1] The post-petition financing documents suggest that Whitebox Advisors is the general partner of Whitebox Hedged High Yield Partners, L.P. and Whitebox Combined Partners, L.P., and is also the general partner of Pandora Select Partners LLC, which is in turn the general partner of Pandora Select Partners, L.P.

financial advisor and investment banker, testified at length in support of the financing offered by the DIP Lenders.

9. On April 17, 2009, the Debtors filed an application to employ HLHZ as their financial advisor and investment banker pursuant to Section 327(a) of the Bankruptcy Code. The Debtors' application to employ HLHZ included the Declaration of William Hardie III, as required by FED.R.BANKR.P. 2014 (the "Hardie Declaration"), wherein Mr. Hardie represented that:

(a) HLHZ had reviewed its records to determine its relationships, if any, with parties in interest;

(b) HLHZ had disclosed in an exhibit to the Hardie Declaration its relationships with parties in interest to whom it had recently provided, or was currently providing, services "in matters unrelated to these chapter 11 cases;"

(c) HLHZ's conflicts review procedures were ongoing, and HLHZ would promptly file supplemental disclosures if it discovered additional relationships that should be disclosed;

(d) HLHZ did not and would not have any relationship with any party in interest which would interfere with or impair HLHZ's representation of the Debtors; and

(e) HLHZ was a "disinterested person" as that term is defined in Section 101(14) of the Bankruptcy Code.

10. The list of names that HLHZ claimed (in the Hardie Declaration) to have used to search for connections with parties in interest did not include Nomura, Whitebox or Brigade.

11. The list of parties in interest with whom HLHZ acknowledged it had relationships (in the Hardie Declaration) did not include Nomura, Whitebox or Brigade.

12. This Court approved HLHZ's employment as the Debtors' financial advisor and investment banker by Order dated June 19, 2009 (D.I. 222).

13. At the time of HLHZ's employment, HLHZ had undisclosed connections with Whitebox and Brigade that were unknown to the UST, the Court, or other parties in interest. Those connections were not disclosed until HLHZ filed the February 15, 2010 Supplemental Declaration and Disclosure of William Hardie III (the "Supplemental Hardie Declaration") (D.I. 758).

14. The Supplemental Hardie Declaration disclosed, among other things, that:

(a) HLHZ served as the financial advisor and investment banker to the official committee of unsecured creditors in the Chapter 11 case of *VeraSun Energy Corp.*, No. 08-12606 BLS)(Bankr. D. Del.). Whitebox and Brigade were both *ex officio* members of the *VeraSun* creditors' committee.[2]

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[2] HLHZ claimed in the Supplemental Hardie Declaration that since the beginning of HLHZ's engagement in the instant cases, "out of an abundance of caution," HLHZ maintained an "ethical wall" between the professionals who provided services in the *VeraSun* engagement and the professionals providing services in the *Aventine* engagement, and that the respective teams were located in different HLHZ offices. Supplemental Hardie Declaration at 3.

As discussed in greater depth *infra*, if HLHZ knew enough at the beginning of its engagement in these cases to create an "ethical wall" between its *VeraSun* team and its *Aventine* team, then HLHZ knew enough about its connections with Whitebox and Brigade to disclose those connections pursuant to FED.R.BANKR.P. 2014(a) at the beginning of its engagement rather than ten months later. HLHZ's violation of its Rule 2014(a) disclosure obligation merits sanctions.

(b) HLHZ was engaged in January 2009 (and still serving as of February 15, 2010) as the financial advisor to the *Ad Hoc* Senior Secured Group in the Chapter 11 case of *Spansion, Inc.*, No. 09-10690 (KJC) (Bankr. D. Del.). Whitebox was a member of the *Spansion Ad Hoc* Senior Secured Group.

(c) The official committee of unsecured noteholders in the Chapter 11 case of *Energy Partners, Ltd.*, No. 09-32957-H4-11) (Bankr. S.D. Tex.), applied to retain HLHZ as its financial advisor in July 2009, but the application was denied. Whitebox was a member of the *Energy Partners* unsecured noteholders' committee.[3]

(d) In January 2009 and again in December 2009, Whitebox retained Houlihan Lokey Howard & Zukin Financial Advisors, Inc. ("HLHZ-FA"), an affiliate of HLHZ, to provide portfolio valuation services.[4]

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[3] The *Energy Partners* court denied the application to employ HLHZ because it found the proposed fees excessive. HLHZ and the *Energy Partners* noteholders' committee jointly moved to amend the Bankruptcy Court's memorandum opinion denying the application to employ HLHZ (D.I. 386 in that court's docket). In the motion, HLHZ stated that "the Noteholders' Committee so strongly believed that it needed Houlihan Lokey's services under the negotiated terms that after the Court denied the Houlihan Lokey Application pursuant to section 328(a), individual members of the Noteholders' Committee agreed to backstop Houlihan Lokey's fees on a pro-rata [sic.] if the Court denied any portion of them." Motion to Amend, ¶ 21. Earlier in that motion, HLHZ stated that it "Houlihan Lokey did agree to be retained by the Noteholders Committee under section 330 subsequent to the Court's oral ruling [denying HLHZ's application to be retained under Section 328(a)] . . . solely because *the Noteholders' Committee agreed it would backstop any fees that were not approved by the Court* under section 330." Motion to Amend, ¶ 18, n. 10 (emphasis added). Moreover, although the Bankruptcy Court denied the application to employ HLHZ, HLHZ had already "devoted a significant number of hours toward completing the valuation report." Motion to Amend, ¶ 20.

[4] HLHZ claimed in the Supplemental Hardie Declaration that the valuation services that HLHZ-FA's Hedge Fund and Derivatives Valuation Services Group provided to Whitebox is unrelated to the services that HLHZ provided in the *Aventine* cases. HLHZ also asserted that through establishment of an "Information Wall," HLHZ had separated its employees in the Hedge Fund and Derivatives Valuation Services Group from the rest of its employees, including

(e) In October 2008, Brigade retained HLHZ-FA to provide portfolio valuation services, subject to the same type of Information Wall described with respect to Whitebox.

(f) HLHZ was engaged in December 2008 (and still serving as of February 15, 2010) as the financial advisor to an *ad hoc* group of secured note holders in the Chapter 11 case of *TCI 2 Holdings, LLC*, No. 09-13654 (JHW) (Bankr. D. N.J.)(the "Trump *Ad Hoc* Group"). Brigade was a member of the Trump *Ad Hoc* Group.

15. The disclosures made in the Supplemental Hardie Declaration were not made at the commencement of HLHZ's engagement in these cases, as they should have been, when the UST, the Court and other parties in interest wold have had a meaningful opportunity to scrutinize HLHZ's connections with parties in interest to ensure that HLHZ was a disinterested person as expressly required by Section 327(a).

16. When HLHZ filed the Supplemental Hardie Declaration, the Debtors had already filed their plan of reorganization, obtained approval of the disclosure statement in connection that plan, and transmitted the plan and disclosure statement to parties in interest to solicit acceptance of the plan.

17. Moreover, HLHZ did not file the Supplemental Hardie Declaration spontaneously as a result of its own continuing review of its connections. Instead, HLHZ filed the

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those who provided services in the *Aventine* cases. HLHZ claimed that the "Information Wall" includes physical and technological barriers, compliance mechanisms and policies and procedures designed to prevent improper sharing of confidential, non-public information and work product. The UST notes that regardless of any walls or barriers in place between HLHZ and HLHZ-FA, HLHZ, HLHZ-FA and other entities using the "Houlihan Lokey" trade name share a common internet website at www.houlihanlokey.com.

Supplemental Hardie Declaration in response to a February 3, 2010 inquiry by the UST to Debtors' counsel seeking, among other things, an explanation of HLHZ's previously undisclosed relationship with Whitebox. The UST's inquiry arose from a shareholder report to the UST that HLHZ had an undisclosed connection to Whitebox in the *Energy Partners* case.

18. Aventine's plan of reorganization was confirmed on February 24, 2010 and became effective on March 15, 2010. Under the terms of the confirmed plan, 80% of the equity of Reorganized Aventine was transferred to the holders of general unsecured claims, the vast majority of which were on account of bond debt, including the claims held by Whitebox and Brigade. The remaining 20% of the equity of Reorganized Aventine was transferred to the purchasers of $105 million of new 13% secured notes issued by Reorganized Aventine, which notes were first offered to Aventine bondholders and then to "backstop purchasers," which also included Whitebox and Brigade.

19. HLHZ has now applied for approval of its final compensation, in the amount of $4,903,790.33, together with reimbursement of expenses in the amount of $147,921.43.

Duty of Disclosure

20. Under FED.R.BANKR.P. 2014(a), a professional seeking to be employed pursuant to Sections 327, 1103 or 1114 of the Bankruptcy Code must disclose certain relationships: "The application 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." Under Del.Bankr.LR 2014-1(a), the duty of disclosure imposed by FED.R.BANKR.P. 2014(a) is a continuing duty:

> Promptly after learning any additional material information relating to such employment (such as potential or actual conflicts of interest), the professional employed or to be employed shall file and serve a supplemental affidavit setting forth the additional information.

Section 328(c) of the Bankruptcy Code provides a tool for enforcement of the continuing duty of disclosure. Thus, in *In re Leslie Fay Companies*, 175 B.R. 525, where the debtor's counsel failed to disclose to the court its ongoing representation of the Audit Committee and its members, the court reduced counsel's compensation, holding that:

> All facts that may have any bearing on the disinterestedness of a professional must be disclosed. Consistent with the duty placed on the professional, it is the responsibility of the professional, not of the court, to make sure that all relevant connections have been brought to light. [citations omitted]. So important is the duty of disclosure that the failure to disclose relevant connections is an independent basis for the disallowance of fees or even disqualification. [citations omitted].

175 B.R. at 533.

21. The court and parties in interest police conflicts through mandatory disclosure of relationships under FED.R.BANKR.P. 2014(a). The scope of disclosure is broader than the question of disqualification; the applicant and the professional must disclose, without exception, all connections and not merely those that rise to the level of conflicts. *In re Granite Partners, L.P.*, 219 B.R. 22, 35 (Bankr. S.D.N.Y. 1998).

22. "Disclosure 'goes to the heart of the integrity of the bankruptcy system.'" *In re eToys, Inc.*, 331 B.R. 176, 189 (Bankr. D.Del. 2005), *quoting In re B.E.S. Concrete Prods., Inc.*, 93 B.R. 228, 236 (Bankr. E.D.Cal. 1988).

23. In *In re Enron Corp.,* 2003 WL 223455 (S.D.N.Y. 2003), the court observed: "The purpose of Rule 2014(a) is to provide the court and the United States trustee with

information to determine whether the professional's employment is in the best interests of the estate." For that reason, the duty disclosure is not merely critical, it is sacrosanct. *eToys, supra*, 331 B.R. at 189.

24. The professional must disclose all connections; he may not pick and choose which connections to disclose and which to ignore as unimportant or trivial. *In re Jore Corporation*, 2003 WL 22048517, *20 (Bankr. D. Mont. July 28, 2003). The reason is simple: "[t]he decision as to what facts may be relevant should not be left up to the professional, 'whose judgment may be clouded by the benefits of potential employment.'" *In re Fibermark, Inc.*, 2006 WL 723495at *8 (Bankr. D.Vt. March 11, 2006), *quoting In re Lee*, 94 B.R. 172, 177 (Bankr. C.D.Cal. 1988). The professional may not leave the court or other parties in interest to search the record for such relationships or otherwise to ferret them out. *In re BH & P, Inc.*, 949 F.2d 1300, 1317-18 (3d Cir. 1991).

25. The court may find a disclosure violation even where it would not have found a professional not disinterested had there been timely and complete disclosure of a connection. *Matter of Olsen Indus., Inc.*, 222 B.R. 49, 60 (Bankr. Del. 1997). Indeed, a disclosure violation, even one that is merely negligent rather than willful, and even one that causes no harm, may nonetheless result in sanctions that include disqualification and/or disallowance of fees. *BH&P, supra*, 949 F.2d at 1318; *see also Jore, supra*, at *20. In *In re A C and S, Inc.*, 297 B.R. 395 (Bankr. D. Del. 2003), the court noted that "[n]ot every violation of the disclosure requirements of the Code and Rules requires disgorgement [of fees], but '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.'" *Id.* at 405, *quoting In re Crivello*, 134 F.3d 831, 836-37 (7th Cir.

1998). In *Olsen Indus., supra*, the court held that because it had found a law firm's disclosure violation to be intentional and serious, it was not necessary for the court to rule on the disinterestedness issue. 225 B.R. at 60.

26. Regardless of whether such connections affected its disinterestedness, HLHZ was obligated to disclose all of its connections with Whitebox and Brigade, and it was obligated to do so as soon as the Debtors sought to employ HLHZ – not ten (10) months later, when the UST asked a direct question about such connections. *See Matter of CF Holding Corp.*, 164 B.R. 799, 806 -07 (Bankr. D. Conn. 1994)(debtor's financial advisor denied over $795,000 in fees and expenses for failure to timely disclose investment in entity whose controlling principal sought to purchase majority interest in reorganized debtors; fees of debtor's counsel reduced by $250,000 for failure to bring matter to court's attention after acquiring actual knowledge of financial advisor's actions).

27. That HLHZ was serving as the financial advisor to committees in *VeraSun, Energy Partners, Spansion* and *TCI 2 Holdings* rather than to individual members of those committees, does not reduce HLHZ's obligation of disclosure, nor excuse its failure to disclose. In each of the above-described cases, HLHZ has a connection the individual members of each committee. Indeed, professionals serving a committee are *selected* for employment by the individual committee members, and are beholden to the individual committee members for such employment.

28. When the Debtors employed HLHZ at the commencement of these cases, HLHZ's relationships with Whitebox and Brigade became facts bearing on HLHZ's disinterestedness. HLHZ therefore had an affirmative duty to disclose its relationships with Whitebox and Brigade

– even if only to explain away potential conflicts of interest. *Fibermark, supra*, 2006 WL 723495 at *10, *citing In re eToys, Inc.*, 331 B.R. 176 (Bankr. D.Del. 2005). Such disclosure would permit the UST, the Court and other parties in interest to assess whether HLHZ would "bite the hand that feeds it quite as hard as the circumstances warranted." *In re Granite Partners,*219 B.R. 22, 38 (Bankr. S.D.N.Y. 1998). HLHZ breached that duty.

29. When HLHZ undertook to represent the noteholders' committee in *Energy Partners*, in July 2009, with Whitebox a member of that committee, and especially given the noteholders' committee members' undertaking to "backstop" HLHZ's fees, HLHZ had an affirmative duty to supplement its disclosures in these cases. HLHZ breached that duty.

30. When Whitebox engaged HLHZ-FA for a second time in December 2009 to provide additional portfolio valuation services, HLHZ had a duty to supplement its disclosures in these cases. HLHZ breached that duty.

31. By remaining silent about its connections with Whitebox and Brigade – both at the commencement of these cases and as HLHZ undertook new engagements serving those entities or committees of which they were members, HLHZ precluded any inquiry – by the UST, by the Court, and by other parties in interest – regarding whether HLHZ was qualified, and remained qualified, to be employed under Section 327(a). Had HLHZ made appropriate and timely disclosures, the UST, the Court and other parties in interest would have been able to evaluate HLHZ's disinterestedness and its ability to continue providing impartial and detached advice to the Debtors and, if appropriate, to seek disqualification, as well as denial of compensation under 11 U.S.C. § 328(c).

32. HLHZ has not explained its failure to disclose its connections to Whitebox and Brigade until confronted by the UST ten months into these cases, even as it expanded its connections with Whitebox. In the context of HLHZ's considerable experience as a financial advisor and investment banker in bankruptcy cases in this judicial district and elsewhere, it is difficult to understand HLHZ'S failure to disclose its multiple connections with Whitebox and Brigade as inadvertent rather than willful. HLHZ and its numerous managing directors are highly experienced bankruptcy practitioners; they have filed retention applications in dozens of cases in Delaware and other judicial districts. They are not strangers to the Court or to the retention process, nor are they strangers to the comprehensive and ongoing relationships analysis that any professional must perform when it seeks to be employed by a debtor in possession under Section 327(a).

33. Indeed, when the Debtors engaged HLHZ at the commencement of these cases, HLHZ knew enough to set up an "ethical wall" between the HLHZ professionals advising the *VeraSun* creditors' committee team and the HLHZ professionals advising the Debtors. Thus, HLHZ's failure to make timely disclosure of its connections with Whitebox and Brigade cannot be attributed to a simple error in running a database check. Query how HLHZ could be so concerned about its connections arising from the *VeraSun* case that it erected an ethical barrier between its *VeraSun* and *Aventine* teams, yet somehow unaware of its obligation to disclose those connections in these cases.

34. HLHZ's failure to disclose its connections to Whitebox and Brigade seriously affected the integrity of the judicial process, precluding a determination of whether any of

HLHZ's connections with Whitebox and/or Brigade was a disqualifying one that made HLHZ's continued employment under Section 327(a) inappropriate.

35. HLHZ's failure to disclose its connections with Whitebox and Brigade is compounded by the fact that HLHZ was not merely on the same side of the negotiating table as Whitebox and Brigade, serving another party whose economic interests were aligned with those of Whitebox and Brigade; instead, HLHZ was on the same side of the negotiating table with Whitebox and Brigade in order to hold the hands of the members of the official or *ad hoc* committee. In contrast, in these cases, HLHZ was engaged to sit on the other side of the negotiating table from Whitebox and Brigade, and to negotiate against them for the best outcome for the Debtors' estates.

36. As one court wrote, "the jaundiced eye and scowling mien of counsel for the debtor should fall upon all who have done business with the debtor recently enough to be potential targets for the recovery of assets of the estate. *In re McKinney Ranch Associates*, 62 B.R. 249 (Bankr. C.D. Cal. 1986). Similarly, the jaundiced eye and scowling mien of the debtor's financial advisor should fall upon all creditors and potential lenders with whom they must negotiate on behalf of the debtors. Query, then, how HLHZ could cast its jaundiced eye and scowling mien on Whitebox and on Brigade, when Whitebox and Brigade are its masters in other engagements.

37. The purpose of disclosure under FED.R.BANKR.P. 2014(a) is to allow the UST, the Court and other parties in interest to test a professional person's disinterestedness. Even if an investigation of HLHZ's connections with Whitebox and Brigade would not compel an ultimate finding that HLHZ was *per se* disqualified, the UST, the Court, and other parties in interest were

deprived of the opportunity to explore HLHZ's connections, to follow the facts wherever they might lead, and to fully test HLHZ's disinterestedness. The loss of this opportunity, engendered by HLHZ's failure to make timely and accurate disclosures under Rule 2014(a), impaired the integrity of the retention process and, in turn, harmed the integrity of the bankruptcy system as well as public confidence in the integrity of that system.

Remedies for HLHZ's Nondisclosure of Its Connections With Whitebox and Brigade

The Court's Continuing Authority to Impose Remedies

38. A court may disqualify a professional, deny compensation in whole or in part, or even order disgorgement of compensation, doing so under its inherent power to supervise the professionals who appear before the court. *In re Kaiser Group Intern., Inc.*, 272 B.R. 846, 850 (Bankr. D. Del. 2002).

39. As discussed above, a professional's failure to disclose connections with parties in interest may result in disallowance of fees or disqualification, even if the failure was negligent and not willful. *eToys, supra*, 331 B.R. at 197, *citing BH & P, supra*. If the failure to disclose is willful, disallowance of fees is almost a certainty. *eToys, supra*, 331 B.R. at 197, *citing In re ACandS, Inc.*, 297 B.R. 395, 405). Indeed, willful nondisclosure of relationships in connection with the retention of professionals may rise to the level of a fraud upon the court. *See Pearson v. First NH Mort. Corp.*, 200 F.3d 30, 35-41 (1st Cir. 1999); *In re R&R Associates of Hampton*, 2003 WL 1233047 (Bankr. D. N.H. January 31, 2003).

40. In *R&R Associates, supra*, a Chapter 11 debtor partnership applied to employ Thomas, a member of Thomas & Utell, as its counsel. The retention application and Thomas's

Rule 2014 statement both asserted that neither Thomas nor his firm had any connections with the debtor, its creditors or any parties in interest, and that Thomas and his firm were "disinterested."

(a) In fact, as the bankruptcy court later found, Thomas and his firm represented one of the debtor's partners, Gaudette, and Gaudette's wife individually, and also represented several other entities controlled by the Gaudettes. Thomas & Utell had assisted the Gaudettes with the formation of three family limited partnerships and the transfer of assets into those partnerships which might otherwise have been used to satisfy the debtor's obligations. Thomas & Utell also represented the Gaudettes in various state court litigation matters. They therefore had relationships that "may have been adverse" to the debtor and its creditors and should have been disclosed. 2003 WL 1233047 at *4.

(b) After the case was converted to Chapter 7, Thomas and his firm were awarded $18,887 in fees and expenses of $221.30. More than a year after entry of the fee award, the Chapter 7 trustee filed suit against Thomas and his firm, asserting that counsel misrepresented or failed to disclose their relationships to the Gaudettes and the Gaudette entities when applying for employment as counsel to the Chapter 11 debtor, and that they had negligently failed to pursue actions against the debtor's partners for the debts of the partnership, both of which constituted fraud upon the court.

(c) Because the Chapter 7 trustee had not demonstrated that counsels' failure to disclose their connections with the debtor and the debtor's general partners "was the result of some corrupt intent on the part of the Law Firm Defendants," the court found that the trustee failed to prove fraud upon the court. *Id.* at *6. Indeed, the court appeared to accept the attorney's defense that the disclosure violation arose not from corrupt intent

but from his novice's misunderstanding of Rule 2014; the case was his first Chapter 11 case and he had borrowed a Rule 2014 disclosure form from another attorney in his firm. *Id.* at *5.

(d) Nonetheless, the court ordered disgorgement of all fees and expenses previously awarded to Thomas and his firm as a sanction for failure to make the required disclosures. *Id.* The court held that it had the authority under Sections 327(a) and 328(c) to order disgorgement of fees, even if already paid. The court also held that even absent a specific finding of ill will or wrongful intent, failure to disclose a relationship is in and of itself a sufficient basis for total disgorgement of fees and expenses.

41. Unlike *R&R Associates*, this case does not involve a novice bankruptcy professional who borrowed a form of Rule 2014 affidavit from someone else in his firm. It instead involves experienced bankruptcy professionals who have filed applications to be retained as a financial advisor and investment banker under Section 327(a) or Section 1103 in dozens of large and sophisticated Chapter 11 cases, both in Delaware and elsewhere. HLHZ is well-versed in the comprehensive and ongoing relationships analysis required of a professional employed at estate expense.

The Court Should Grant a Substantial Remedy Against HLHZ

42. The Debtors' plan of reorganization has already been confirmed and has become effective; one of the few remaining issues is HLHZ's compensation. Disqualification of HLHZ does not appear to be a practical remedy. *eToys, supra*, 331 B.R. at 193. Thus, fee disgorgement is the only appropriate remedy for what appears to be a willful lack of disclosure under FED.R.BANKR.P. 2014(a).

43. A court's power to order disgorgement of a professional's fees and expenses should be "exercised with restraint and discretion;" in exercising that discretion, the court "should apply principles of equity, as other courts have done." *Olsen Indus., supra*, 222 B.R. at 62. consider By the same token, the nature of the sanction "should be determined with a view to its deterrent value, not necessarily limited to the harm caused litigants." *Pearson, supra*, 200 F.3d at 42 n.7. The Court must also consider that HLHZ's Rule 2014 violation harmed the integrity of the Court, of the professional retention process, and of the bankruptcy system. In this case, it also undermined public confidence in the integrity of the bankruptcy system.

44. HLHZ has requested total fees in the amount of $4,903,790.33, together with reimbursement of expenses in the amount of $147,921.43, for its services in these cases. The UST respectfully submits that disgorgement of HLHZ's fees is necessary and appropriate both to create an incentive to comply with disclosure obligations under Rule 2014(a) and to deter indolence in making such disclosures. As discussed above, many other courts have required disgorgement of *all* fees. Here, the UST submits that under the circumstances of this case, disgorgement of 50% of HLHZ's requested fees is not excessive and is needed to provide the appropriate deterrent. Any lesser reduction may simply be viewed as a "cost of doing business" and encourage professionals to encounter the risk of silence in the face of their duty to disclose. In *eToys, supra*, the Court found that disgorgement of approximately 50% of counsel's fees was "a reasonable penalty for the transgression" of failure to disclose connections pursuant to FED.R.BANKR.P. 2014(a). 331 B.R. at 198. Here, too, the requested penalty for HLHZ's transgression is reasonable.

WHEREFORE, the United States Trustee respectfully requests that this Court order a reduction of HLHZ's fees in the amount of 50% of the total compensation requested, and grant such other relief at the Court deems just.

Respectfully submitted,

ROBERTA A. DeANGELIS
ACTING UNITED STATES TRUSTEE

Dated: May 26, 2010

BY: /s/ Mark S. Kenney

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CERTIFICATE OF SERVICE

I certify that, on May 26, 2010, I caused to be served a copy/copies of the United States Trustee's Objection to the Final Application of Houlihan Lokey Howard & Zukin Capital, Inc. for Compensation and Reimbursement of Expenses as the Debtors' Financial Advisor and Investment Banker via facsimile to the following person(s):

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