UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 11
	)	
CAESARS ENTERTAINMENT OPERATING COMPANY, INC., et al.,[1]	)	Case No. 15-01145 (ABG)
	)	
	)	
Debtors.	)	(Jointly Administered)

DEBTORS' REPLY TO THE OBJECTION TO DEBTORS' RETENTION OF KIRKLAND & ELLIS LLP AND KIRKLAND & ELLIS INTERNATIONAL LLP

The Debtors hereby file this reply (this "Reply") to the objection (the "Objection") [Docket No. 464] to their retention of K&E filed by the Official Committee of Second Priority Noteholders (the "Second Lien Committee"). In support of this Preliminary Reply, the Debtors respectfully state as follows:[2]

Preliminary Statement

1. K&E's retention should be approved. K&E is disinterested, as that term is defined by section 101(14) of the Bankruptcy Code, and K&E does not hold or represent any interest adverse to these chapter 11 estates. See 11 U.S.C. § 327(a). The Debtors selected K&E as their counsel for a reason. K&E is one of the leading restructuring firms in the world. It has guided debtors through complex restructuring proceedings. It has restructured gaming enterprises. It has led debtors through consensual out-of-court workouts, and contentious Chapter 11 proceedings, and consensual Chapter 11 proceedings. K&E is a multi-disciplinary firm that is committed to using everything in its arsenal to fully represent the Debtors in every

[1] The last four digits of Caesars Entertainment Operating Company, Inc.'s tax identification number are 1623. A complete list of the Debtors and the last four digits of their federal tax identification numbers may be obtained on the website of the Debtors' claims and noticing agent at https://cases.primeclerk.com/CEOC.

[2] Capitalized terms used but not defined herein shall have the meanings set forth in the *Debtors' Application for Entry of an Order Authorizing the Retention and Employment of Kirkland & Ellis LLP and Kirkland & Ellis International LLP as Attorneys for the Debtors and Debtors in Possession Effective Nunc Pro Tunc to the Petition Date*, filed February 18, 2015 [Docket No. 381] (the "Application").

sense of the word. K&E has studied the intricacies of the Debtors' business and their industry. It has spent thousands of hours assisting the Debtors' Governance Committee on investigating claims the Debtors may possess against affiliates and sponsors. K&E has already negotiated a settlement with the Debtors' parent company that, subject to the Debtors' fiduciary out and completion of that investigation, extracts $1.5 billion in value for the benefit of these chapter 11 estates. And to ensure that its independence could not be credibly challenged, K&E demanded, and received, full conflict waivers from the relevant funds managed by Apollo Global Management LLC ("Apollo") and TPG Capital L.P. ("TPG"). There can be no legitimate question that K&E has done everything that a debtor's counsel should do and more.

2. The Debtors acknowledge that the Second Lien Committee has challenged the Debtors' present restructuring plan—notwithstanding that plan's support from holders of more than $6.0 billion of prepetition debt. But the Second Lien Committee's plan objections are not a basis to responsibly challenge K&E's retention. The Debtors' choice of counsel remains entitled to substantial deference. See 3 Collier on Bankruptcy ¶ 327.04[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) ("Only in the rarest cases will the trustee be deprived of the ability to select qualified counsel . . . ." (internal quotation marks omitted)). The Second Lien Committee should not be allowed to bootstrap preemptive plan objections and unsupported allegations regarding prepetition conduct into a tactical disqualification of K&E as counsel. Cf. In re Rest. Dev. Grp., Inc., 402 B.R. 282, 289 (Bankr. N.D. Ill. 2009) ("While motions to disqualify can serve a legitimate purpose, they are viewed with caution because they can also be used as a litigation tactic to harass one's opponent.").

3. The Second Lien Committee objects to K&E's retention on three bases: First, that K&E's connections to TPG and Apollo are per se disqualifying adverse interests because

"K&E's substantial relationships with [Apollo and TPG] and their affiliates would prevent K&E from being a vigorous advocate for the Debtors' estates . . . ." (Obj. ¶ 17.) Second, that K&E failed to disclose its "simultaneous representation" of both the Debtors and their Governance Committee. (Id. ¶ 19.) Third, that K&E wrongly obtained $7.3 million in payments from Caesars Entertainment Operating Company, Inc. ("CEOC") during the three day "gap period" arising after three Second Lien Committee members filed an involuntary petition against CEOC on January 12, 2015—prior to CEOC's January 15, 2015 bankruptcy filing.[3] (Id. ¶ 22.)

4. Each of these arguments should be rejected. First, speculative conflicts are no basis for disqualification. In re Marvel Entm't Grp., Inc., 140 F.3d 463, 477 (3d Cir. 1998) ("We therefore reject LaSalle's invitation to read an appearance of conflict disqualification into § 327(a)."); In re Gluth Bros. Constr., Inc., 459 B.R. 351, 369 n.9 (Bankr. N.D. Ill. 2011) (citing Marvel with approval). A disqualifying adverse interest arises only where the professional in question "serves two presently competing and adverse interests." In re Raymond Prof'l Grp., Inc., 421 B.R. 891, 902 (Bankr. N.D. Ill. 2009) (emphasis added).

5. No competing interests are present here. K&E has advised on a thorough investigation of claims held by these chapter 11 estates against Caesars Entertainment Corp. ("CEC"), the Debtors' parent, CEC affiliates, and CEC shareholders (including TPG and Apollo funds)—and that work continues. K&E advised on negotiations that have already obtained $1.5 billion for the Debtors' stakeholders through the settlement embodied in the Debtors' restructuring support agreement. K&E also remains prepared to undertake litigation against

[3] Each person that executed the involuntary petition filed against CEOC is also a representative appointed to the Second Lien Committee. Compare *Involuntary Petition*, In re Caesars Entm't Operating Co., Inc., Case No. 15-10047 (Bankr. D. Del. Jan. 12, 2015) [Del. Docket No. 1 at 2], with *Notice of Appointment of Official Committee of Second Priority Noteholders*, dated Feb. 5, 2015 [Docket No. 266 at 4–5].

CEC and its affiliates or against CEC shareholders (including TPG and Apollo), and K&E obtained conflicts waivers with respect to TPG and Apollo as part of K&E's engagement.[4] The Second Lien Committee's casual assertions that K&E attorneys would refuse to take positions adverse to Apollo or TPG, abandon their duties as estate fiduciaries, and thwart this restructuring process should not be dignified by the Court.

6. Nor is the implication that Apollo and TPG are significant K&E clients at all consistent with fact. In the twelve months ended January 31, 2015, revenues from Apollo were approximately 0.3% of firm revenues; revenues from TPG were approximately 0.1% of firm revenues.[5] In that same period, revenues from Apollo portfolio companies were approximately 0.5% of firm revenues (across three separate clients); revenues from TPG portfolio companies were less than 0.1% of firm revenues.[6] In short, there is no evidentiary basis for the Second Lien Committee to claim that K&E's connections to TPG or Apollo will prevent K&E from vigorously representing the Debtors against TPG, Apollo, CEC, or others.

7. Second, the Second Lien Committee's allegations that K&E concealed a "simultaneous representation" of the Debtors' Governance Committee is simply false. The Debtors are K&E's only clients here—full stop. K&E has advised, and will continue advise, the Debtors through its board of directors and its duly appointed committees—including the

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[4] K&E recently commenced an adversary proceeding against an Apollo fund on behalf of another K&E debtor-client less than 7 weeks ago. See *Complaint*, Twin River Worldwide Holdings, Inc. v. SOLA Ltd. (In re UTGR, Inc. d/b/a Twin River), Adv. Case No. 15-01003 (FJB) (Bankr. D.R.I. Jan. 21, 2015) [Docket No. 1].

[5] In the twelve months ended January 31, 2015, K&E's total revenues exceeded $2.0 billion. The revenue disclosures set forth herein are supported by the supplemental declaration of David R. Seligman, attached hereto as **Exhibit A**. It is also a matter of public record that a K&E partner that handled Apollo-related matters has recently left the firm. See Julie Treadman & Brian Baxter, Top Rainmaker Leaves Kirkland for Paul Weiss, *American Lawyer* (Jan. 26, 2015) *available at* http://www.americanlawyer.com/id=1202716144338/Top-Rainmaker-Leaves-Kirkland-for-Paul-Weiss?slreturn=20150201115956.

[6] And, as a more fundamental matter, a law firm's client in any portfolio company representation is the company itself—not the company's equity sponsor. See ILCS S. Ct. Rules of Prof'l Conduct R. 1.13(a).

Governance Committee. See 8 Del. C. § 141(c);[7] ILCS S. Ct. Rules of Prof'l Conduct R. 1.13(a). K&E's role in the Governance Committee's investigation has also been a matter of public record from the outset of these chapter 11 cases. There is no "separate representation," and any assertion to the contrary is simply wrong.[8]

8. Third, and finally, K&E did not receive any "payment" (avoidable or otherwise) during the gap period arising after members of the Second Lien Committee filed their involuntary petition. As disclosed in the Application and as set forth in K&E's Engagement Letter attached thereto, K&E received a classic retainer from the Debtors when it was first engaged, and K&E has owned a classic retainer at all relevant times. (See Engagement Letter 2;[9] Seligman Decl. ¶ 16.) These chapter 11 estates have no interest in K&E's classic retainer, and court approval was not required before K&E took any action with respect to its classic retainer. See In re McDonald Bros. Constr., Inc., 114 B.R. 989, 997–99 (Bankr. N.D. Ill. 1990).

9. The Debtors readily acknowledge that "[t]he conduct of bankruptcy proceedings not only should be right but must seem right," In re Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) (Friendly, J.)—particularly in matters of professional responsibility. K&E is both disinterested and does not hold or represent any interest adverse to these chapter 11 estates. Certain parties may dispute the Debtors' current restructuring plan, and those disputes will be addressed in due course. But such disputes are no basis to deprive the Debtors of their attorneys or to impose the significant and perhaps irreparable harm that could arise if the Debtors were now stripped of K&E's counsel. Motions to disqualify are disfavored precisely to avoid this type

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7 CEOC is a corporation organized under Delaware law.

8 See ILCS S. Ct. Rules of Prof'l Conduct R. 1.13 [Comment 2] ("[I]f an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. **This does not mean, however, that constituents of an organizational client are the clients of the lawyer**." (emphasis added)).

9 K&E's Engagement Letter is annexed as **Exhibit 1** to the proposed form of order attached to the Application as **Exhibit A**.

of gamesmanship. See Freeman v. Chi. Musical Instrument Co., 689 F.2d 715, 722 (7th Cir. 1982) ("[S]uch motions should be viewed with extreme caution for they can be misused as techniques of harassment."). The Objection should be overruled, and the Application should be approved.

Reply

10. Professional retentions under section 327(a) are analyzed on an individual basis by reference to the particular facts of the case. See In re Envirodyne Indus., Inc., 150 B.R. 1008, 1017 (Bankr. N.D. Ill. 1993). The Bankruptcy Code does not permit a professional to be disqualified simply because the professional represents parties in interest in unrelated matters. See 11 U.S.C. § 327(c). Courts have in fact consistently rejected any "per se" rule under which a professional may be disqualified for the mere allegation or appearance of conflict. "[C]onflicts based purely on conjecture or mere speculation do not necessarily warrant an attorney's disqualification as section 328(c) of the Code can be used as a safeguard to protect estates if potential conflicts ripen into actual adverse interests." In re J.S. II, LLC., 371 B.R. 311, 321 (Bankr. N.D. Ill. 2007).[10]

11. Thus, a professional is disinterested for purposes of section 327(a) except where a connection imposes an actual prospect of material adversity to the chapter 11 estate. See 11 U.S.C. § 101(14)(C). Similarly, a professional holds a prohibited "adverse interest" per section 327 where that professional holds or represents interests in competition with the debtor that would actually (as opposed to speculatively) impair its service as an estate fiduciary. See Raymond, 421 B.R. at 902; In re Leslie Fay Cos., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994)

[10] See Gluth, 459 B.R. at 368–69; Raymond, 421 B.R. at 902 (observing "the better view disfavor[s] bright-line per se rules of disqualification"); In re Diamond Mortg. Corp. of Ill., 135 B.R. 78, 92 (Bankr. N.D. Ill. 1990); In re Jartran, Inc., 78 B.R. 524, 525 (Bankr. N.D. Ill. 1987).

("[I]nterests are not considered 'adverse' merely because it is possible to conceive a set of circumstances under which they might clash.").

I. The Potential Conflict Asserted by the Second Lien Committee Is Both Non-Existent and Forms No Basis to Deny the Application.

12. The Second Lien Committee argues that K&E's representation of Apollo, TPG, and their affiliates in matters unrelated to the Debtors creates "a potential for divided loyalties" such that K&E's retention must be denied. (Obj. ¶ 13 (emphasis added).) The Second Lien Committee cites no instance where K&E's representation of Apollo, TPG, or their affiliates in unrelated matters actually conflicts with K&E's representation here. Instead, the Second Lien Committee only muses that K&E will abandon both the Debtors and its professional responsibilities because of the purported significance of its separate relationships with TPG and Apollo. (Obj. ¶ 1.)

13. Setting aside the propriety of that attack on K&E's professional integrity, disqualification by speculation is contrary to law: "[H]orrible imaginings alone cannot be allowed to carry the day. Not every conceivable conflict must result in sending counsel away to lick his wounds." In re Martin, 817 F.2d 175, 183 (5th Cir. 1987).[11] This rule is regularly enforced in practice, where professionals disclose their connections to parties in interest and yet are not disqualified because of speculation that a "potential conflict" exists. (See, e.g. **Ex. B**.)[12] This practice recognizes that an alternative rule would wrongly permit adversaries to disqualify counsel at will by raising the specter of potential conflict at every turn. See Jartran, 78 B.R. at 525 ("[T]o rule blindly in [objector's] favor without considering the factual and economic

[11] See also Diamond Mortg., 135 B.R. at 92 (citing Martin with approval); J.S. II, 371 B.R. at 321.

[12] **Exhibit B** attached hereto summarizes comparable connections (including connections to direct and indirect equityholders) disclosed in connection with professional retentions approved in comparable bankruptcy cases.

realities of this case would result in a disqualification based on speculation, a precept previously frowned upon.").

14. K&E's connections to TPG, Apollo, or affiliated entities in unrelated matters are not material to K&E's business. Again, revenues generated from Apollo were approximately 0.3% of firm revenues in the twelve months ended January 31, 2015; revenues from TPG were less than 0.1% of that total over that time.[13] Even including billings from TPG and Apollo portfolio companies (which, as noted above, are wholly separate firm clients), those revenues total approximately than 0.8% (for Apollo) and less than 0.2% (for TPG) over that period.[14] Regardless, K&E also obtained conflict waivers ensuring that K&E can be directly adverse to TPG and Apollo in connection with K&E's representation here—including with respect to litigation—and K&E is regularly adverse to those parties in its debtor representations. (See, e.g., **Ex. C**.)[15] K&E has already advised the Debtors in hard-fought negotiations with CEC prior to the Petition Date, through which the Debtors obtained contributions from CEC in excess of $1.5 billion. And, as previously noted, K&E recently commenced an adversary proceeding against Apollo on behalf of a different K&E debtor-client. See *Complaint*, Twin River Worldwide Holdings, Inc. v. SOLA Ltd. (In re UTGR, Inc. d/b/a Twin River), Adv. Case No. 15-01003 (FJB) (Bankr. D.R.I. Jan. 21, 2015) [Docket No. 1].

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[13] As disclosed in the Seligman Declaration, K&E currently represents Energy Future Holdings, Inc. and certain of its affiliates ("EFH") in its pending chapter 11 cases in the United States Bankruptcy Court for the District of Delaware. As set forth therein, TPG is an equityholder in EFH's parent company and TPG principals are members of EFH's board of directors. (See Seligman Decl. ¶ 35.) Compensation requested by K&E in EFH's bankruptcy proceedings totals approximately $62 million since EFH's April 2014 chapter 11 filings. Because K&E's representation of EFH is adverse to EFH's equityholders, including TPG, such fees are not included in the revenue figures set forth herein. Revenues totals set forth herein similarly exclude K&E clients affiliated with but not controlled by Apollo or TPG.

[14] While the Second Lien Committee concedes that no discovery is required for the Court to address the Application, (see Obj. ¶ 4), it has still propounded discovery on, among other things, "any meal, lodging, travel, or entertainment expense" incurred by the Debtors in connection with TPG and Apollo.

[15] As set forth on **Exhibit C** hereto, K&E is regularly adverse to TPG and Apollo in its debtor representations.

15. Certainly, K&E has represented the Debtors since K&E's engagement in July 2014, and stakeholders will seek to review prepetition transactions undertaken by the Debtors since that time. This fact applies in every case where a debtor engages restructuring counsel in advance of its bankruptcy filing (and not on the eve of bankruptcy)—which is customary and advisable in chapter 11 practice. (See, e.g., **Ex. B**.) But any assertion that K&E's prepetition engagement would somehow preclude an independent review of the transactions at issue, (see Obj. ¶ 16), is belied by the fact that the Debtors have themselves moved to appoint an examiner. Nor did K&E represent TPG, Apollo, or CEC in connection with the prepetition transactions that may be at issue, or, for that matter, those CEC affiliates that may be the subject of claims or causes of action analyzed (whether through Governance Committee's investigation or otherwise), such as Caesars Acquisition Company ("CAC"), CGP Partners, LLC ("CGP"), or Caesars Entertainment Resort Properties, Inc. ("CERP").

16. Envirodyne—a case relied on by the Second Lien Committee—is instructive in this regard. In Envirodyne, proposed debtor's counsel had advised Salomon Brothers and other parties on their acquisition of the debtor through a prepetition leveraged buyout, or LBO. 150 B.R. at 1012–13. Salomon Brothers subsequently remained a significant creditor and the debtor's majority equity holder, and the bankruptcy court ultimately determined that bankruptcy was, in essence, "an unwinding of the LBO." Id. at 1019. This posed a fundamental conflict for debtor's counsel where it had not initially disclosed its prior representation of Salomon Brothers and, even after disclosure, stated it "[would] not represent the Debtor Envirodyne in the investigation and prosecution of a claim against Salomon." Id. Such a record differs materially from K&E's retention here. K&E disclosed its connections to TPG and Apollo from the outset. K&E did not represent TPG or Apollo in connection with their investments in the Debtors or

their affiliates, nor has K&E ever represented CEC. Cf. id. at 1012–13. Moreover, K&E demanded, and received, conflicts waivers from both Apollo and TPG. Cf. id. at 1020.

17. The Second Lien Committee's reliance on In re American Printers & Lithographers, Inc., 148 B.R. 862 (Bankr. N.D. Ill. 1992), is similarly misplaced. (See Obj. ¶ 14 n.7.) The American Printers court found that a disqualifying conflict actually (not speculatively) existed where: (a) the debtor's proposed counsel generated 10% of its annual revenues from the largest single creditor in that case, see id. at 863–64; (b) that creditor held approximately 50% of the debtor's total secured debt, see id. at 864; and (c) the debtor's proposed counsel represented that it "***could not file any litigation that might be warranted***" against that creditor, id. at 865 (emphasis added). Here, K&E's revenues from TPG and Apollo are each significantly less than the 10% of annual revenues at issue in American Printers. K&E has already undertaken substantial efforts with respect to claims and causes of action available to the Debtors' estates and derived value for these estates through the $1.5 billion settlement embodied in the Debtors' restructuring support agreement. K&E is also prepared to litigate against CEC, Apollo, or TPG should the facts or circumstances warrant. This record is a far cry from the actual conflict found in American Printers, where the debtor's proposed counsel flatly stated that it "would not bite the hand that feeds it." Id. at 865 (internal quotation marks omitted).

II. There Is Only One Client: K&E Appropriately Disclosed Its Connection to the Governance Committee.

18. The Second Lien Committee further seeks to disqualify K&E by creating the impression that K&E was separately retained by the Governance Committee—in addition to K&E's retention by the Debtors. The Second Lien Committee states, "the Special Governance Committee retained K&E to advise on legal issues," citing the Debtors' *Memorandum in Support of Chapter 11 Petitions* filed on January 15, 2015 [Docket No. 4] (the "Memorandum in

Support"). (Obj. ¶ 18.) Of course, the Memorandum in Support is not an engagement letter or a retention application.[16] But the Second Lien Committee nonetheless demands disqualification because this "retention" was not specifically disclosed in the Application.

19. This argument ignores the facts and the law. The Application does not identify a separate 'representation of the Special Governance Committee' by K&E because no separate representation existed. K&E has been counsel to the Debtors, including CEOC, since July 2014. Like every Delaware corporation, CEOC's business and affairs are managed by its board of directors. See 8 Del. C. § 141(a). In turn, the CEOC board is authorized both by statute and its bylaws to delegate its affairs to one or more separate committees. See 8 Del. C. 141(c); *Bylaws* § 5.[17] The formation of a corporate governance committee and delegation of authority by the underlying board is an accepted, if not recommended, practice among large corporations. See 2A William Meade Fletcher, Fletcher Cyclopedia of the Law of Corporations Ch. 11 §§ 549–549.10. Similarly, a law firm represents an organizational client through its authorized constituents—such as a board or its committees. See ILCS S. Ct. Rules of Prof'l Conduct R. 1.13(a).[18]

20. The Governance Committee is permitted to retain its own professionals, in addition to those representing the corporation, but neither Delaware law nor CEOC's organizational documents require this result. Rather, a committee may seek advice from, and rely on, counsel to the corporation in the discharge of its duties inasmuch as the board is entitled

[16] In fact, the Second Lien Committee's cited language from the Memorandum in Support actually states: "The Special Governance Committee asked Kirkland & Ellis LLP ("K&E") and Mesirow Financial Consulting, LLC ("Mesirow," and together with K&E, the "Advisors") to advise on legal and financial issues, respectively, in connection with its independent investigation." (Memorandum in Support p.39; see Obj. ¶ 18.)

[17] CEOC's bylaws are attached as **Exhibit D**. The Governance Committee's charter is attached hereto as **Exhibit E**.

[18] See ILCS S. Ct. Rules of Prof'l Conduct R. 1.13 [Comment 1] ("An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client.").

to seek advice from, and rely on, such counsel. See 8 Del. C. § 141(c) ("Any such committee, to the extent provided in the resolution of the board of directors, or in the bylaws of the corporation, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation . . . ."); *Bylaws* § 5 ("Any committee, to the extent allowed by law and provided in the resolution establishing such committee, shall have and may exercise all the powers and authority of the Board of directors in the management of the business and affairs of the Corporation."). Thus, a committee's reliance on corporate counsel does not create a "separate retention" or engagement. See ILCS S. Ct. Rules of Prof'l Conduct R. 1.13 [Comment 2].

21. Such is the case here. Since July 2014, K&E advised the Debtors through the Governance Committee, consistent with the Governance Committee's delegated authority under both Delaware law and CEOC's bylaws. While the Governance Committee was, and is, authorized to retain separate counsel, it has not done so. Moreover, K&E's role in the investigation undertaken by the Governance Committee has been a matter of public record since at least January 15, 2015. The Second Lien Committee's claim that work performed by K&E at the Governance Committee's direction constituted both a separate, undisclosed representation is nothing short of fiction. This objection should be overruled.

III. K&E Owned a Classic Retainer: K&E Did Not Receive an Avoidable Payment During the Gap Period.

22. Finally, the Second Lien Committee would disqualify K&E as a result of the involuntary bankruptcy petition filed by its members on January 12, 2015.[19] The Second Lien Committee asserts that K&E received "payments . . . not made in the ordinary course" totaling

[19] For the avoidance of doubt, the Debtors reserve all rights with respect to the involuntary petition filed by the Second Lien Committee members, including with respect to actual and punitive damages. See 11 U.S.C. § 303(i).

$7.3 million on January 13, and January 14, 2015—i.e., during the "gap period" prior to the Debtors' January 15, 2015 voluntary filings. (See Obj. ¶ 22.) The Second Lien Committee argues such payments are therefore recoverable because K&E wrongly "exercised control" over estate assets by collecting payment from what the Second Lien Committee alleges was a security deposit held by K&E—as opposed to obtaining stay relief with respect to such payment. (Id. ¶ 24.) Alternatively, the Second Lien Committee argues that the $7.3 million in "payments" allegedly transferred by CEOC to K&E are recoverable under section 549(a) of the Bankruptcy Code because those payments were made outside the ordinary course. (Id. ¶ 25.)

23. This argument mischaracterizes both the "payments" received by K&E during the gap period and the nature of K&E's retainer. Section 303(f) of the Bankruptcy Code in no way limits an alleged debtor's to undertaking only 'ordinary course' transactions, and section 549(a) provides no basis to avoid payments on that basis. More importantly, no such payments occurred. CEOC never transferred any cash or made any payment to K&E during the gap period. (Seligman Decl. ¶ 16) Rather, K&E delivered two statements for services rendered on January 13 and January 14, and those statements totaled $7.3 million. (Id.) But K&E has owned a classic retainer since well before the Second Lien Committee members filed their involuntary petition on January 12, 2015. (See Seligman Decl. ¶ 16; Engagement Letter p.2.) That $7.3 million figure was also less than the classic retainer balance held by K&E at that time. (See Seligman Decl. ¶ 16.)

24. K&E's classic retainer is not (and never was) "property of the estate," and K&E was not obliged to seek relief from the stay to apply payment. See McDonald Bros, 114 B.R. at 997–99. Classic retainers are customary compensation arrangements for restructuring professionals precisely to mitigate concerns that a retainer might be construed as estate property

and therefore impair a debtor's ability to retain the counsel of its choice.[20] Yet the Second Lien Committee asserts that "a review of the specific terms of the Engagement Letter, as well as the actual dealings between K&E and CEOC, makes clear that the retainer is in fact not a 'classic' retainer but a security retainer, which remains property of the bankruptcy estate . . . ." (Obj. ¶ 23.) But the Second Lien Committee does not cite any "specific terms" or identify "actual dealings" between K&E and CEOC to support that assertion. (See id.)

25. Nor could it. K&E's Engagement Letter provides:

> The Company will provide to the Firm a 'classic retainer' in the amount of $3,000,000 as defined in In re Production Associates, Ltd., 264 B.R. 180, 184–85 (Bankr. N.D. Ill. 2001), and In re McDonald Bros. Construction, Inc., 114 B.R. 989, 997–999 (Bankr. N.D. Ill. 1990). As such, the classic retainer was earned by the Firm upon receipt. . . . . The classic retainer will be placed into K&E LLP's general cash account, will not be held in a separate account on your behalf, and you will not receive any interest on these monies. You have no interest in the classic retainer. This amount does not constitute a security deposit.

(Engagement Letter at 2) The Debtors' estates therefore had no interest in the retainer balance held by K&E as of January 12, 2015.[21] Certainly, K&E identified the retainer payments it received in the 90 days prior to the Debtors' bankruptcy filings. (See Seligman Decl. ¶ 16.) These disclosures were made in recognition of the fact that even classic retainer payments may

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[20] See, e.g. In re Old HB, Inc. f/k/a Hostess Brands, Inc., Case No. 12-22052 (RDD) (Bankr. S.D.N.Y. Jan. 11, 2012) [Docket No. 15], at **Ex. C.** at 3 ("To retain the services of [Jones Day], Hostess agrees to pay us a $250,000 retainer upon the execution of this letter (the 'Retainer'). It has been agreed that the Retainer constitutes a 'classic retainer' as defined in In re Prod. Assoc., Ltd., 264 B.R. 180 (Bankr. N.D. Ill. 2001).").

[21] This result does not change if K&E's retainer is characterized as an advance payment retainer, where "the debtor pays, in advance, for some or all of the services that the attorney is expected to perform on the debtor's behalf," are not estate property and "[n]either approval of a fee application nor leave of court is required for [counsel's] use of the retainer." McDonald Bros., 114 B.R. at 1002; see also Dowling v. Chi. Options Assocs., Inc., 875 N.E. 2d 1012, 1022 (Ill. 2007) ("An appropriate use of advance payment retainers is illustrated by the circumstances of the instant case, where the client wishes to hire counsel to represent him or her against judgment creditors"). See, e.g., In re Old Carco LLC, f/k/a Chrysler, LLC, Case No. 09-50002 (AJG) (Bankr. S.D.N.Y. Apr. 30, 2009) [Docket No. 68], at **Ex. C** at 3 **(**"To retain the services of [Jones Day], and as advance payment for services to be rendered and expenses to be incurred, Chrysler has agreed to pay a $1,000,000 retainer upon the execution of this letter, and to provide additional advance payment retainers in such amounts as necessary . . . . [T]he Retainers will be deemed property of the Firm and will not be held in a trust account.").

be subject to avoidance as preferential transfers in certain circumstances. See In re Prod. Assocs., Ltd., 264 B.R. 180, 190 (Bankr. N.D. Ill. 2001). But no preferential transfers were made to K&E as its classic retainer at all times exceeded K&E's statements of services, and at no time in the relevant period did K&E receive payment on account of an antecedent debt. (See Seligman Decl. ¶ 16.) The Second Lien Committee's objection in this regard is simply without merit.

Conclusion

26. The Second Lien Committee cannot deprive the Debtors of their right to counsel by pointing to non-existent conflicts, by misleading parties as to K&E's "representation" of the Governance Committee, or by mischaracterizing K&E's retainer. The Objection should be overruled and the application should be approved.

March 2, 2015
Chicago, Illinois

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