

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

In re: Chapter 11
WESTMORELAND COAL COMPANY, et al., Case No. 18-35672 (DRJ)
Debtors. (Jointly Administered)

**LIMITED OBJECTION OF MAR-BOW VALUE PARTNERS, LLC
TO THE PROPOSED SETTLEMENT BETWEEN
MCKINSEY AND THE UNITED STATES TRUSTEE
(Relates to Docket No. 1589)**

Mar-Bow Value Partners, LLC, a creditor, hereby submits this limited objection to the Joint Motion by the Acting United States Trustee for Region 7 (the “AUST”) and McKinsey Recovery & Transformation Services U.S., LLC And Certain of Its Affiliates in Furtherance of Mediation Agreement (the “Settlement Approval Motion”) and the Proposed Order attached thereto, and states:

I. Mar-Bow Does Not Object to the \$5 Million Sanction Against McKinsey in This Case.

1. In this case, the United States Trustee Program (“USTP”) and McKinsey¹ reached an historically unprecedented settlement. Even though the Court has not yet approved McKinsey’s employment in this case and even though this settlement does not resolve McKinsey’s employment status in this case, the USTP has negotiated for McKinsey to pay a sanction of \$5 million. This sanction is for McKinsey RTS’s wrongful conduct as alleged in the AUST’s Objection to the Debtors’ Application to Employ McKinsey:²

¹ As in the Proposed Order, “McKinsey” means “collectively, McKinsey & Company, Inc., McKinsey Holdings, Inc., McKinsey & Company, Inc. United States and McKinsey Recovery & Transformation Services U.S., LLC.” Dkt. 1598, Proposed Order, filed Mar. 7, 2019, p. 2, n. 1.

² Dkt. 785, filed Dec. 14, 2018

The Application withholds critical details about McKinsey RTS's connections to interested parties—including the identity of a “Confidential Client” that generates a staggering 17.5% of the firm's gross annual revenue. . . The naked fact that one of the undisclosed clients represents such a substantial source of McKinsey RTS's income renders it difficult to contemplate how McKinsey RTS can satisfy the requirements for retention in this case.³

The AUST then added:

McKinsey RTS does not even try to address its pervasive disclosure deficiencies that cover about one fifth of its annual revenues. Despite McKinsey RTS's professed engagement with the U.S. Trustee, to date it has disregarded the suggestion to seek appropriate relief with the court, for example, by filing a motion to seal under section 107. Nor did McKinsey RTS provide any specific evidence in its Application that would prohibit McKinsey RTS from disclosing the identities of any of the six “confidential” clients—including perhaps the firm's single largest client. Instead, McKinsey RTS made a calculated decision not to disclose the identities of its clients.⁴

2. Because (as discussed in greater detail below) Mar-Bow retains full rights to pursue all of its claims in its Objection⁵ to McKinsey's employment in this case and in its Amended Objection,⁶ Mar-Bow does not object to the Proposed Order (subject to the clarifications requested herein). Mar-Bow will not stand in the way of the USTP resolving its issues with McKinsey and cannot stand in the way of the USTP utilizing its resources as it sees fit. Instead, Mar-Bow will continue to press forward on its independent objections to McKinsey's employment in this case until McKinsey is held *fully* accountable for its wrongful conduct.

3. From Mar-Bow's perspective, the most critical task before this Court is setting, as expeditiously as possible, a fair and reasonable discovery schedule for Mar-Bow's Objections

³ *Id.* at p. 2.

⁴ *Id.*, pp. 6-7 (footnotes omitted).

⁵ Dkt. 629, filed Nov. 29, 2018.

⁶ Dkt. 669, filed Dec. 3, 2018.

commensurate with the complexity and gravity of the issues raised therein. Through searching discovery, Mar-Bow will allow this Court truly to get to the bottom of McKinsey's disqualification to serve as a professional in this case as well as its Rule 2014 violations. Mar-Bow is confident that full and fair adjudication of Mar-Bow's objections, which extend far beyond the USTP's objections, will fully reveal the severity of McKinsey's illegal conduct and lead to far greater penalties and denial of fees than the \$5 million sum McKinsey now agrees to pay in settlement of the USTP's narrow objection in this case.

II. Mar-Bow Respectfully Requests Two Clarifications in the Proposed Order.

4. *First*, Mar-Bow requests that the Proposed Order *clearly* state that the settlement does not affect Mar-Bow's rights. The Proposed Order acknowledges that it does not purport to adjudicate any issue of law or fact related to released claims,⁷ and that it does not purport to bind or prejudice the rights or claims of non-parties to the settlement.⁸ However, so that the record is crystal clear and to avoid future disputes, Mar-Bow requests that the order approving this settlement explicitly state that it does not have any effect whatsoever on Mar-Bow's Objections to the Debtor's application to employ McKinsey and its Amended Objection.

5. The grounds that Mar-Bow has asserted to deny McKinsey's employment in this case are far broader than those asserted by the USTP. More to the point, no discovery whatsoever has been exchanged on Mar-Bow's Objections (or on the USTP's objections for that matter), and the Court has not finally ruled on the merits of those claims. Consequently, it is elemental that a settlement between the USTP and McKinsey adjudicates nothing and is not preclusive on any issues or law or fact relevant to Mar-Bow's Objections in this case under 11 U.S.C. § 327 and Rule

⁷ Dkt 1589, Proposed Order, ¶13.

⁸ *Id.*, ¶15

2014. These grounds are substantively different than those asserted by the AUST, *and McKinsey has never substantively denied the factual basis for any of these grounds:*

- a. McKinsey RTS is not qualified to serve as a professional for the Debtors because McKinsey, its partners and its employees hold multiple equity interests in the Debtors and in interested parties, and because it is not disinterested.
 - i. McKinsey, its partners and its employees hold disqualifying equity interests in the Debtors through their investments in MIO.
 - ii. McKinsey, its partners and its employees also hold disqualifying equity interests in two of the five members of the WLB Ad Hoc Group who will likely acquire the Debtors' most productive mines through the Debtors' plan. They also hold disqualifying equity interests in four of the eight members of the WLP Ad Hoc Group.
 - iii. McKinsey, its partners and its employees also hold disqualifying equity interests in other interested parties.
 - iv. McKinsey RTS's liability for preferences of \$1,565,000 is a disqualifying interest that is adverse to the estate.
 - v. McKinsey RTS's prepetition claim against the estate is a disqualifying interest that is adverse to the estate.
- b. McKinsey RTS is not qualified to serve as a professional for the Debtors because McKinsey represents multiple interests that are adverse to the Debtors' bankruptcy estates.
 - i. McKinsey RTS has multiple client connections with members of the two Ad Hoc Groups.
 - ii. McKinsey RTS has multiple client connections across a broad spectrum of creditor class with whom it interacts while serving the Debtors and who are financially affected by its work.
- c. McKinsey RTS is not qualified to serve as a professional for the Debtors because its disclosure declaration unlawfully conceals dozens of its connections and thereby violates Bankruptcy Rule 2014.
 - i. McKinsey RTS's declaration unlawfully conceals numerous equity interests in the Debtors.
 - ii. McKinsey RTS unlawfully conceals numerous equity interests in interested parties.

iii. McKinsey RTS unlawfully conceals multiple client connections to interested parties.

d. McKinsey RTS is not qualified to serve as a professional for the Debtors because it unlawfully disavows in its engagement agreement that it is a fiduciary.

e. McKinsey RTS is not qualified to serve as a professional for the Debtors because its disclosure declaration is not based on the personal knowledge of the declarant, Mark Hojnacki, and thus violates 28 U.S.C. § 1746.

6. The Court's denial of the Debtors' application for approval to employ McKinsey RTS is therefore mandated under 11 U.S.C. § 327 and Rule 2014. The Court's denial of the Debtors' application is also critically necessary to preserve both the integrity of the bankruptcy process in this case and the confidence of the parties and the public.

7. In the interests of absolute clarity, Mar-Bow requests that any order approving the settlement between the USTP and McKinsey in this case include this clarifying language:

Neither the settlement between the United States Trustee Program and McKinsey nor this Order in any way affects, limits, forecloses or resolves Mar-Bow's rights, positions or claims in this or any other case (whether closed, pending or not yet filed), including: (1) Mar-Bow's Objection and Amended Objection to McKinsey's employment in this case; (2) any objections that Mar-Bow might assert in this case in a supplemental or further amended objection; (3) Mar-Bow's right to request any additional relief relating to its objections; (4) Mar-Bow's right to discovery in this case or in any other case; and (5) Mar-Bow's right to pursue any claims against or involving McKinsey in any other case.

8. *Second*, the Proposed Order improperly dictates the distribution of McKinsey's sanction. Paragraph 2 of the Proposed Order specifies that the sanction will be paid to the *Westmoreland* bankruptcy estate. Paragraph 3 then states that these payments "will be distributed in accordance with the terms of the confirmed plan[] in [*Westmoreland*] or other applicable law." It is not, however, for the USTP and McKinsey to specify where the settlement proceeds are to be distributed. Rather, the distribution of the proceeds of a sanctions order is left strictly in the discretion of the court. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 44 (1991) ("A primary aspect of

that discretion is the ability to fashion an appropriate sanction for conduct which abuses the judicial process.”).

9. In the Court’s discretion, a more appropriate distribution would be to the parties who were injured by McKinsey’s wrongful conduct in this case and on a *pro-rata* basis. Any other distribution risks a windfall or other unfairness. Specifically, a distribution to the bankruptcy estate risks indirectly benefiting McKinsey because of its equity interests in the estate and in interested parties. Regardless, it is for the Court to determine that question in this case after an appropriate process that allows all interested parties to be heard. It is not for the USTP and McKinsey to stipulate to it and thereby both to deny the injured parties their rights to be heard and to preempt the Court’s discretion.

10. Mar-Bow recognizes that paragraph 3 of the Proposed Order states, “If any of the \$15 million is distributed to McKinsey, it will be refunded by McKinsey to the distributing party.” Nevertheless, as noted, it is improper for the USTP and McKinsey to dictate the distribution of the proceeds of the sanctions. And in any event, McKinsey should be barred from the benefit of that distribution, whether the benefit is *direct* (as paragraph 3 appears to address) or *indirect* (as a result, for example, of a MIO investment in the Debtors or an Interested Party).

11. Accordingly, Mar-Bow requests this text in lieu of the present text in paragraph 3:

3. The payment identified in Paragraph 2 will be distributed in accordance with a distribution plan to be determined in the discretion of the Court after a hearing and an opportunity for interested parties to be heard. Until the Court enters an order approving a distribution plan, the reorganized debtor shall maintain the proceeds of McKinsey’s payment in a separate escrow account.

III. The Proposed Settlement Has Significant Shortcomings, But No Objection Is Necessary Because the Settlement Order Will Have No Impact on Mar-Bow's Right to Pursue Its Own Objections to McKinsey's Employment in This Case.

12. Although Mar-Bow does not object to the settlement, it is not without flaws – chief among them is that it does not require McKinsey's disqualification even though McKinsey is patently not qualified to serve as a professional in this matter and it has patently violated Rule 2014. Mar-Bow points out these flaws not by way of objection, but rather for the purpose of making clear that its position on the settlement should not be construed as Mar-Bow's approval of it. As long as Mar-Bow retains the right to pursue its own claims (and under the terms of the clarified order requested herein it plainly does), these disagreements need not be, and are not, asserted as objections to this settlement.

13. The Settlement Approval Motion discloses no facts from which the Court can determine whether to approve the settlement. Nothing in the Settlement Approval Motion even attempts to identify either the factual grounds upon which they seek that approval or the legal standard by which the court should determine whether to grant approval. Effectively, the Settlement Approval Motion does nothing more than say, "We've settled. Please approve our settlement."

14. As this Court has repeated emphasized, *transparency* is crucial in the Court's processing of all aspects of this matter, including its processing of this Settlement Approval Motion. At a hearing in this case on January 3, 2019, the Court pointedly insisted on the very transparency that this settlement process lacks: "The process demands transparency. And if you are working through objections -- which you certainly have every right to do, and I encourage you to work through that. *But at the end of the day, what is the record of how those issues get*

*resolved?*⁹ There is, however, quite literally nothing transparent about this settlement, except its terms.¹⁰

15. The Settlement Approval Motion violates Bankruptcy Rule 9013. That Rule states: “A request for an order, except when an application is authorized by these rules, shall be by written motion, unless made during a hearing. The motion shall state with particularity the grounds therefor, and shall set forth the relief or order sought.” The Settlement Approval Motion does not state “with particularity the grounds” for the Court’s approval of the settlement.

16. The settlement violates Rule 2014 by illegally excusing McKinsey from disclosing its “confidential clients” in exchange for a monetary sanction. The disclosure obligations of Rule 2014 are mandatory. A waiver of or release from the disclosure obligations of Rule 2014 cannot be approved upon the agreement to pay a sanction. The USTP’s decision to compromise its position in this respect is not binding on this Court, Mar-Bow, or anyone else. Through its pending Objections, Mar-Bow will continue to press for transparency and full public disclosure of McKinsey’s “confidential clients,” as required by Rule 2014.

⁹ Hearing Transcript, Jan. 3, 2019, at 22:4-8.

This Court also emphasized the need for transparency in resolving the claims against McKinsey at a hearing on December 18, 2018: “And transparency and honesty is something I just fundamentally believe in.” Hearing Transcript, Dec. 18, 2018, at 143:6-8. And later in the same hearing, “And the thing that I want more than anything is that the process is transparent. That’s what I want.” *Id.*, at 144:7-9. And yet later in the hearing this Court added, “Because I want, you know, [every]one of the 67 people on the telephone who isn’t here and who may not be a lawyer to be able to understand what it is that we’re trying to address.” *Id.*, at 150:13-15.

¹⁰ In addition, this settlement can provide a critical opportunity to provide guidance to other bankruptcy professionals about their responsibilities under Rule 2014. Indeed, professionals across the country are closely following the litigation over McKinsey’s disclosure practices under Rule 2014 because they want to comply with Rule 2014. This litigation has been and will continue to be the subject of numerous presentations and discussions at professional conferences and seminars. Yet because the premise of this settlement is not disclosed, the settlement does nothing to provide that guidance.

17. The settlement also seriously impairs the rights of the parties in McKinsey's first eleven bankruptcy cases. McKinsey's conduct in violating Rule 2014 in *all* of its cases harmed *all* of the parties in those cases. By granting McKinsey a release from the consequences of all of that misconduct, this settlement impairs the rights of all of those the parties. Yet nothing in this process for court approval of this settlement provides for notice and an opportunity for the interested parties in the other eleven of McKinsey's cases to be heard on the settlement. Also, the settlement imposes sanctions on McKinsey in only three of the fourteen cases in which it violated Rule 2014. This result is grossly unfair to the interested parties in the other eleven cases. Yet once again, the Settlement Approval Motion does not disclose the basis for this.

18. At the same time, the settlement illegally deprives the bankruptcy judges in McKinsey's other bankruptcy cases of their authority and responsibility to review the settlement. The Settlement Approval Motion purports to settle the USTP's claims against McKinsey in its eleven cases other than *Westmoreland*, *ANR* and *SunEdison*. Nevertheless, the settlement has not been and apparently will not be presented to the judges in those cases for their review. Accordingly, this settlement process divests from those judges their *exclusive* jurisdiction, authority and responsibility to make the decisions that will directly impact their cases and the parties in them. However, because Mar-Bow cannot force the USTP to investigate or act in McKinsey's first eleven cases, and because Mar-Bow and others retain the right to seek appropriate relief in those cases, Mar-Bow will not object to the settlement on these grounds.

19. Next, the settlement does not address the issues arising from McKinsey's misconduct in *GenOn*, which is also pending before this Court:

- a. McKinsey RTS investigated GenOn's multimillion-dollar fraudulent transfer claims against its own undisclosed client, NRG, the Debtors' parent company.

- b. McKinsey RTS assisted GenOn in obtaining confirmation of a plan of reorganization that impacted dozens of its own undisclosed clients who were GenOn's creditors.
- c. McKinsey RTS assisted GenOn in making business decisions that impacted the commercial interests of its other undisclosed clients who are GenOn's creditors.
- d. McKinsey RTS held a disqualifying interest adverse to the GenOn bankruptcy estate because it was liable to the estate on a \$4.5 million preference claim while fraudulently representing to the U.S. Trustee and the Court that it held no interest adverse to the estate.
- e. McKinsey RTS is presently reviewing claims, including the claims of its own clients.

Mar-Bow's Amended Objection incorporates the foregoing allegations and this Court has made it clear that it is committed to determining whether McKinsey's conduct in *GenOn* was unlawful and, if so, to rectifying that misconduct.¹¹ Thus, the USTP's continued involvement is unnecessary and therefore Mar-Bow does not object to the settlement on these grounds.

20. The Settlement Approval Motion discloses no basis for the release of McKinsey's claims against the USTP that paragraph 4 of the Proposed Order grants. It does not disclose what claims McKinsey might hold against the USTP, the reason for the release, what that value, if any, was provided to McKinsey for the release, or who provided that value to McKinsey.

IV. Conclusion

21. On March 26, 2019 at 10:09 am ET, counsel for Mar-Bow sent an email to counsel for the USTP for the *SunEdison*, *Westmoreland* and *ANR* cases, and to counsel for McKinsey proposing the changes requested in this Limited Objection in paragraphs 7 and 11, above. On March 27, 2019, counsel for the USTP responded to Mar-Bow's counsel by email and declined to

¹¹ At the hearing on December 18, 2018, the Court stated, "I'll just tell everybody, I'm worried to death that I made a mistake in Genon. I hope I didn't. I never want to intentionally make a mistake. But I'm worried that I did something wrong in Genon. And if I did something wrong, I'm going to fix it. You know, I hope I didn't. But if I did, I will be the first to acknowledge that I made a mistake." Hearing Transcript, Dec. 18, 2018, at 174:19-25.

agree to the changes requested. On March 27, 2019, counsel to McKinsey replied to the response from the USTP saying that they agreed that “Mar-Bow’s position is adequately preserved in the language in the proposed order.”

22. Mar-Bow does not object to the settlement between the USTP and McKinsey. However, Mar-Bow requests that the order approving the settlement between the USTP and McKinsey include the clarifying modifications identified in Part II, above.

Respectfully submitted, March 28, 2019.

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Certificate of Service

I certify that on March 28, 2019, I caused a copy of this pleading to be filed through the Court's electronic filing system and thereby served all parties registered to receive such service.

/s/ Christopher Murray
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