

Until recently Sabi, Inc. was an integrated sand provider to various industries in need of sand products, with mining, glass manufacturing, transportation, refining, and delivery divisions. The mining division operated about 100 sand mining operations located in multiple states. The glass division operated three plants in different states to manufacture products for the auto industry and commercial construction industry. Two years ago, Sabi sold all of its sand products operations to Wabi, Inc.

A Proposed Texas-Two Step Bankruptcy Filing

Both Wabi and Sabi have recently become targets of the plaintiffs' bar and are increasingly being named as defendants in personal injury suits alleging exposure to silica dust. Sabi's long-time counsel is Dewey Cheatham & Howe LLP ("DCH"). DCH partner Curly Howard has urged the Sabi board of directors to consider a so-called Texas Two-Step bankruptcy filing as a means to manage its silica litigation exposure. That would involve using a state divisional merger statute to split Sabi into two new corporations: Sabi-B, Inc. and Sabi-L, Inc. In the divisional merger, Sabi-B would be allocated all of the former Sabi's assets and debts, except the Sabi silica litigation liability, which would be allocated to Sabi-L. In conjunction with the divisional merger, Sabi-B would execute a funding agreement undertaking to fully pay all of Sabi-L's expenses and liabilities, including those incurred and established in a contemplated Chapter 11 bankruptcy filing by Sabi-L. After the divisional merger, Sabi-L would immediately file Chapter 11 with the intention of confirming a plan that will pay Sabi's estimated silica liability in full. Sabi-B would continue Sabi's business operations uninterrupted without filing Chapter 11.

Should Curly advise Sabi's board to appoint one or more independent directors who would be vested with sole authority to represent Sabi-L's interests in connection with the proposed divisional merger?

Should Curly recommend that the board be divided into two groups in connection with the proposed divisional merger—one representing Sabi-L's interests and the other representing Sabi-B's interests?

If DCH is the only professional advising Sabi in connection with the proposed divisional merger and wants to be retained as DIP counsel in Sabi-L's contemplated bankruptcy filing, will DCH have to disclose its involvement in the transaction in the retention application?

- Will DCH have an interest adverse to the estate?
- Will DCH be disinterested?

Should Curly advise retention of multiple sets of counsel and other professional advisers—one set representing Sabi-L's interests and the other representing Sabi-B's?

- Would either set of professionals meet the § 327(a) retention standards in Sabi-L's contemplated bankruptcy filing?

If DCH is the only professional advising Sabi in connection with the proposed divisional merger and the entire Sabi board (without appointing any new directors or dividing the board) approves the divisional merger, should Curly advise the new Sabi-L board, before it files bankruptcy, to appoint new independent directors who will comprise a special committee that will retain its own separate counsel and other professionals and that will have the sole responsibility for investigating the divisional merger and recommending the appropriate course of action?

If the special committee, after its investigation, recommends that Sabi-L file Chapter 11, will DCH meet the § 327(a) standards for retention as DIP counsel?

- What if Curly is the one who recommended the new independent directors and counsel for Sabi-L?

A Bad-Faith Dismissal of the Texas Two-Step Bankruptcy Filing

On Curly Howard's advice and with Curly "running the deal," Sabi consummates the divisional merger and Sabi-L files a Chapter 11 petition. An official silica personal injury claimants' committee ("OSPICC") is appointed and moves to dismiss the Sabi-L bankruptcy case as filed in bad faith. The bankruptcy court dismisses the case, finding that (1) Sabi-L was not experiencing any apparent and immediate financial distress and (2) the Sabi-L bankruptcy filing was a bad-faith "litigation tactic."

Does Curly have any personal exposure for civil or criminal liability, or for discipline for a professional ethics violation?

An Attorney Exculpation Provision in a Proposed Plan of Reorganization

Instead of dismissing the Sabi-L bankruptcy case, the bankruptcy court denies the OSPICC motion to dismiss the Sabi-L bankruptcy case. Sabi-L proposes a plan of reorganization, drafted by Curly Howard, that includes the following provision:

Section 10.8 Exculpation of Attorneys

Confirmation of the Plan shall constitute a release by the Reorganized Debtor, by Debtor Sabi-L, Inc., by Sabi-B, Inc., and by their predecessor-in-interest Sabi, Inc. of any claim or cause of action against their attorneys attributable in any way to services rendered by said attorneys on or before the Effective Date of the Plan, excepting only claims for willful or reckless misconduct (the “Exculpated Claims”). The Confirmation Order shall permanently enjoin any assertion of an Exculpated Claim.

Should the bankruptcy court confirm the proposed plan with Section 10.8 intact?

- If the plan is confirmed with Section 10.8 intact, does Curly have any personal exposure for a professional ethics violation?
- Does Curly have any personal exposure for a professional ethics violation if the bankruptcy court refuses to confirm any plan containing the proposed Section 10.8?

*AMERICAN BAR ASSOCIATION
MODEL RULES OF PROFESSIONAL CONDUCT*

Rule 1.8 Current Clients: Specific Rules

Client-Lawyer Relationship

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(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement;

or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.