

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re: : Civil Action No.: 02-44 (JJF)
: :
FANSTEEL INC., et al., : (Bankruptcy #02-10109)
: :
Debtors. : :

RESPONSE OF FREEBORN & PETERS TO OBJECTION OF UNITED STATES TRUSTEE TO APPLICATION FOR AN ORDER PURSUANT TO SECTION 1103(a) OF THE BANKRUPTCY CODE AUTHORIZING THE EMPLOYMENT AND RETENTION NUNC PRO TUNC OF FREEBORN & PETERS, AS CO-COUNSEL TO THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS

The United States Trustee (the "Trustee") does not approve of the Committee's selection of counsel. The Trustee's disapproval arises from a legitimate concern that the Committee be guided by experienced counsel, free from divided loyalties and potential conflicts. The Trustee's disapproval is premised on a misunderstanding of the facts, a misunderstanding of the difference between retention of committee counsel under Section 1103 and debtor's counsel under Section 327, and a misunderstanding of the practical realities facing creditors' committees and their counsel.

Factual Background

The Trustee's objection stems from two facts: (1) the Debtors have asserted a \$3.8 million preference demand under Section 553 against two of the seven members of the Committee, The Northern Trust Company ("The Northern") and M & I Bank; and (2) Freeborn & Peters represented The Northern prior to the bankruptcy. From these two facts, the Trustee has woven a tale of divided loyalties, actual and potential conflicts, and malpractice. The truth contains no such drama.

Nimssol Add. Subsequent Matter

Nimssol Public

The Northern, M & I Bank and Fansteel, Inc. were parties to a prepetition, unsecured \$30 million loan agreement. *See* Supplemental Affidavit of Frances Gecker (“Supplemental Affidavit”) at ¶ 8 (Exhibit A hereto); Affidavit of Jennifer Dirkin (“Dirkin Affidavit”) at ¶ 2 (Exhibit B hereto). The Northern was the agent under the loan agreement and also one of the lenders. *See* Dirkin Affidavit at ¶ 2. Prior to 2001, the Debtors were cash flow positive and Fansteel drew infrequently on amounts available under the loan agreement. *See* Affidavit of Gary L. Tessitore, Chairman of the Board, President and Chief Executive Officer of Fansteel, Inc. in Support of First Day Motions (“Tessitore Affidavit”) at ¶ 35. Beginning in late January 2001, several of the Debtors’ businesses began to suffer the effects of the recession and Fansteel began to borrow larger amounts. *See* Tessitore Affidavit at ¶ 35. Nine months later, in October 2001, Fansteel notified The Northern, as agent, and requested waivers of defaults and an amendment or restructuring of the loan agreement. *See* Tessitore Affidavit at ¶ 36. Under the loan agreement, upon the occurrence of an event of default, the lenders, The Northern and M & I Bank, had the right to offset any amounts Fansteel had on deposit at those institutions against amounts outstanding under the loan agreement. *See* Tessitore Affidavit at ¶ 35. On or about November 19, 2001, the lenders, The Northern and M & I Bank, separately notified Fansteel of default, acceleration and the exercise of their set-off rights. *See* Tessitore Affidavit at ¶ 38.

On November 5, 2001, The Northern retained Freeborn & Peters to represent The Northern, as agent, in efforts to restructure the loan agreement with Fansteel. *See* Supplemental Affidavit at ¶ 8. Jennifer Dirkin, Senior Attorney at The Northern, continued to represent The Northern in its capacity as a lender, and M & I was represented by separate counsel. *See* Supplemental Affidavit at ¶ 8. For approximately one month, from November 7, 2001 through December 4, 2001, Freeborn & Peters represented The Northern, as agent, in an attempted workout and restructuring with Fansteel. *See* Supplemental Affidavit at ¶ 9. On or about

December 4, 2001, negotiations reached an impasse and the involvement of Freeborn & Peters ceased until January 14, 2002, when The Northern was advised that Fansteel would file a Chapter 11 petition within the next day. *See* Supplemental Affidavit at ¶ 9. For nine days in January, from January 15, 2002 through January 24, 2002, Freeborn & Peters provided general bankruptcy advice to The Northern. *See* Supplemental Affidavit at ¶ 9.

As the largest unsecured creditor, The Northern decided to seek appointment to the Committee. *See* Dirkin Affidavit at ¶ 6. Prior to the Meeting of the Twenty Largest Creditors on January 28, 2002, The Northern and Freeborn & Peters discussed the representation by Freeborn & Peters of both The Northern and the Committee in the Fansteel bankruptcy case. *See* Supplemental Affidavit at ¶ 10; Dirkin Affidavit at ¶ 6. Freeborn & Peters advised The Northern that the firm could not continue to represent The Northern in the Fansteel bankruptcy case and also represent the Committee. *See* Supplemental Affidavit at ¶ 10. On January 24, 2002, at the request of The Northern, Freeborn & Peters withdrew from its representation of The Northern in the Fansteel case, and The Northern waived any conflicts regarding Freeborn & Peters' prior representation of The Northern as agent under the loan agreement. *See* Dirkin Affidavit at ¶ 6; Supplemental Affidavit at ¶ 10.

On January 28, 2002, the Trustee appointed the Committee. The Committee is composed of seven creditors: the two unsecured lenders – M & I Bank and The Northern, and five trade creditors – Liberty Pattern Company, Metalworking Products, OMG Americas, Inc., Reade Manufacturing and H.C. Starck. Upon its appointment, the Committee immediately convened to select counsel. When Freeborn & Peters interviewed with the Committee, the firm fully informed the Committee of Freeborn & Peter's representation of The Northern. *See* Supplemental Affidavit at ¶ 12. In addition, the allegations that The Northern and M & I Bank may have received preferences were well known to each of the Committee Members as those allegations

were repeated in each of the fifteen first day motions filed by Fansteel and were the subject of a question posed to Fansteel's representatives during the question and answer portion of the Meeting of the Twenty Largest Creditors. *See* Supplemental Affidavit at ¶ 12.

On February 5, 2002, the Committee filed its application to retain Freeborn & Peters pursuant to Section 1103(b) of the Bankruptcy Code. On February 15, 2002, a single objection was filed to the Application – the objection of the Trustee (“Trustee’s Objection”). Freeborn & Peters provided each Committee Member with a copy of the objection and a brief overview of the law. The Committee then met outside the presence of Freeborn & Peters to discuss the Trustee’s objection and the Committee’s response. The Committee unanimously agreed to continue all efforts to obtain authorization to retain Freeborn & Peters.

The Trustee’s Objection

The Trustee claims that an actual conflict of interest exists and therefore Freeborn & Peters is not qualified to serve as counsel to the Committee. Trustee’s Objection at ¶ 20. According to the Trustee, an actual conflict exists because Freeborn & Peters has divided loyalties. The Trustee spins a scenario in which the Debtors will sue The Northern and M & I under Section 553 to recover the amount by which the lenders improved their position as a result of their setoffs, and Freeborn & Peters, because of its prior representation of The Northern, will then breach its fiduciary duty to the Committee and render tainted advice on the merits of the Debtor’s Section 553 preference action. According to the Trustee, Freeborn & Peters’ loyalty to The Northern is likely to taint advice to the Committee on everything, even formulation of a plan. The Trustee then makes a remarkable leap and implies that The Northern and M & I Bank may exert undue influence over Freeborn & Peters, which would induce the firm to breach its duties because “no party in interest can know to what extent, if any, the Prepetition Lenders may have or intend to assert any claim against Freeborn.” Trustee’s Objection at ¶ 19.

Freeborn and Peters Meets The Standard For Retention Under Section 1103(b)

Section 1103 of the Bankruptcy Code, not Section 327, authorizes a committee of unsecured creditors in a Chapter 11 case to employ an attorney. 11 U.S.C. § 1103(a). Unlike retention under Section 327, Committee counsel retained under Section 1103 need not be a disinterested person, as defined in 11 U.S.C. § 101(14). See *In re Carlton House of Brockton, Inc.*, 1996 Bankr. LEXIS 170 at *11 (Bankr. D. Mass. 1996). Committee counsel, though, “may not while employed by such committee represent any other entity having an adverse interest in connection with the case.” 11 U.S.C. § 1103(b).

The Trustee’s objection that Freeborn & Peters has an impermissible conflict because of its prior representation of The Northern during the pre-bankruptcy workout, and ongoing representation of The Northern in wholly unrelated matters, is unsupported by the law and the facts. First, Section 1103 has never barred professionals from representing entities in matters unrelated to the case. See *In re Walnut Equipment Leasing Co., Inc.*, 213 B.R. 285, 289 (Bankr. E.D.Pa. 1997) citing H.R.Rep.No. 595, 95th Cong., 1st Sess. 104-5 (1977); *S Code Cong. & Admin. News* 5963, 1997 WL 9628 at 226; see also *Daido Steel co. v. Official Comm. Of Unsecured Creditors*, 178 B.R. 129, 131-32 (N.D.Ohio 1995); *In re Caldo, Inc.*, 193 B.R. 165, 174-75 (Bankr. S.D.N.Y. 1996). Freeborn & Peters’ representation of The Northern in wholly unrelated matters cannot be the basis for any serious objection, particularly where The Northern is not a major client of the firm and the firm is not the primary provider of legal services to The Northern. Legal fees from Freeborn & Peters’ representation of the Northern on all matters are less than \$100,000 per year. This is simply not a case where a client is so important to a law firm that the firm could never take an adverse position to the client. See Supplemental Affidavit at ¶ 6.

Second, while Section 1103(b) does not address pre-bankruptcy representation of a creditor and then the committee, Section 1103 condones the simultaneous representation of the committee and a creditor of the same class as represented by the committee. 11 U.S.C. § 1103(b). Prior to 1984, Section 1103(b) imposed a *per se* bar on any professional employed by the committee from representing any other entity in connection with the case. In 1984, Section 1103(b) was amended to provide that an attorney employed to represent a committee may represent another entity unless that entity has an adverse interest in connection with the case. 11 U.S.C. § 1103(b). A conflict only arises under Section 1103(b) in the event that counsel seeks to represent both individual creditors and a committee, which have adverse interests. *In re Rusty Jones, Inc.*, 107 B.R. 161, 164 (Bankr. N.D. Ill. 1989). The individual creditor's interest must be adverse to the committee's interests, not to the debtor's interests. In this case, Freeborn & Peters purposely decided to avoid even the appearance of impropriety and declined to represent both The Northern and the Committee in the Fansteel bankruptcy, despite the fact that the Bankruptcy Code condones such dual representation.

Moreover, a creditor's interest cannot be adverse to the committee's interest simply because the creditor received a preference or the creditor's claim is subject to objection. A creditors' committee ordinarily consists of the seven largest unsecured creditors willing to serve. 11 U.S.C. § 1102(b)(1). As the largest unsecured creditors, the committee members frequently are the recipients of payments made within the ninety days prior to bankruptcy and subject to avoidance. Having been the recipient of a preference does not disqualify a creditor from serving on the committee, because the trustee or debtor-in-possession, not the committee, is the party authorized to bring avoidance actions. *See, e.g.*, 11 U.S.C. § 547(b). In innumerable cases, the debtor sues committee members to recover preferences and the debtor objects to the claims of committee members. As explained by the Court in *Rusty Jones*, "Individual members of this

Creditors' Committee assert claims in differing amounts and subject to differing potential setoffs. However, that does not create an adverse interest which would prohibit one counsel from representing individual members of the committee and also the committee as a whole when all members of the committee share claims of a similar nature." *Id.* at 165. "An inherent tension exists between any committee and its members. In amending § 1103(b) to expressly state that 'representation of one or more creditors of the same class as represented by the committee shall not *per se* constitute the representation of an adverse interest,' Congress apparently decided that such an inherent tension is insufficient to constitute an 'adverse interest' under the statute." *Walnut Equipment*, 213 B.R. 285, 290.

In place of the requisites of Section 1103, the Trustee posits his own rule: an attorney can never represent a committee if the attorney previously represented a creditor who the attorney knows will be subject to a preference demand by the debtor. The legal basis for the Trustee's rule is perplexing, particularly where dual representation of the committee and a committee member who is a potential preference defendant is not a *per se* disqualifying conflict. Underlying the Trustee's new rule is the concern that the prior representation impairs the attorney's duties to the committee because the attorney will never counsel the committee to take an adverse position against the preferred creditor. The Trustee's concerns ignore the realities of preferences and creditors' committees, where every member may be subject to a preference demand that would be pursued by the debtor or special counsel, not committee counsel.

The Trustee's new rule also rests on an irrebutable presumption that the prior representation of a preferred creditor and the representation of the committee creates an actual conflict. Actual conflicts, though, are not presumed. There must be evidence "suggesting the likelihood of some actual dispute, strife, discord or difference" between the Committee and The Northern. *Walnut Equipment*, 213 B.R. 285, 290, citing *In re National Liquidators, Inc.*, 182

B.R. 186 (S.D.Ohio 1995). Mere speculation or the potential that The Northern may, in the future, have an interest adverse to the Committee will not suffice to bar employment of Freeborn & Peters. “[I]nterests are not considered ‘adverse’ merely because it is possible to conceive a set of circumstances under which they might clash.” *See In re Leslie Fay Companies, Inc.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994).

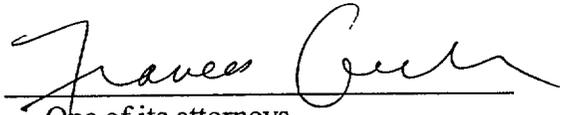
Here, the Trustee has substituted unsupported speculation for any evidence of an actual dispute between The Northern and the Committee. The Northern has a dispute with the Debtor. M & I Bank has a dispute with the Debtor. Indeed, every member of the Committee undoubtedly has a dispute of some sort with the Debtor. After all, the Debtor owes each Committee Member large sums of money. The Northern, though, has no actual dispute, strife, discord or difference with the Committee. The fact that unsecured creditors are likely to benefit from potential preference recoveries does not create an actual dispute between The Northern and the Committee. The Debtor will pursue its Section 553 setoff action against The Northern and M & I Bank, and if the lenders improved their position during the ninety days before bankruptcy, the Debtor may be entitled to recover the amount of the improvement in position. If the Debtor and the lenders settle the Section 553 claim, the Debtor will have to establish that the settlement is in the best interests of the estate. It is difficult to understand how Freeborn & Peters’ prior representation of The Northern, as agent under the loan agreement, may impair Freeborn & Peters’ ability to advise the Committee on whether a settlement proposed by the Debtor is in the best interests of the estate. It is even more difficult to understand how Freeborn & Peters’ prior representation of The Northern, as agent under the loan agreement, may impair Freeborn & Peters’ ability to advise the Committee on the formulation of a plan. The Northern is an unsecured creditor, like every other Committee Member, and will receive the same treatment as other unsecured creditors under any plan.

Conclusion

Motions for disqualification are not generally viewed with favor by the court because “disqualification has an immediate adverse effect on the client by separating him from counsel of his choice and because such motions are often interposed for tactical reasons.” *See In re Levy*, 54 B.R. 805, 806 (S.D.N.Y. 1985). The Committee has selected Freeborn & Peters as its counsel and desires to continue with that representation. The Trustee legitimately desires to protect the integrity of the bankruptcy process. However, the Trustee has failed to show that the Committee’s choice of counsel will jeopardize the bankruptcy process. Where, as here, there is neither an actual nor potential conflict of interest, disqualification serves no purpose other than to force upon the Committee Members’ counsel not of their first choosing.

Respectfully submitted,

FREEBORN & PETERS

By: 

One of its attorneys

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EXHIBIT A

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

In re: : Civil Action No.: 02-44 (JJF)
: :
FANSTEEL INC., et al., : (Bankruptcy #02-10109)
: :
Debtors. : :

**SUPPLEMENTAL AFFIDAVIT OF FRANCES GECKER IN SUPPORT OF
APPLICATION FOR AN ORDER PURSUANT TO SECTION 1103(a) OF THE
BANKRUPTCY CODE AUTHORIZING THE EMPLOYMENT AND RETENTION
NUNC PRO TUNC OF FREEBORN & PETERS, AS CO-COUNSEL TO
THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS**

STATE OF ILLINOIS)
) SS.
COUNTY OF COOK)

Frances Gecker, being duly sworn, does depose and say as follows:

1. I am a partner of the firm of Freeborn & Peters ("Freeborn"), and I am duly authorized to make this Affidavit on behalf of Freeborn. I am familiar with the facts set forth herein and submit this Affidavit in accordance with Section 1103(a) of Title 11 of the United States Code (the "Bankruptcy Code") and Rule 2014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") in support of the Application For An Order Pursuant To Section 1103(a) Of The Bankruptcy Code Authorizing The Employment And Retention Nunc Pro Tunc Of Freeborn & Peters, As Co-Counsel To the Official Committee of Unsecured Creditors (the "Application").

Background

2. On January 15, 2002 (the "Petition Date"), Fansteel, Inc. and certain of its direct and indirect subsidiaries (collectively, the "Debtors"), commenced their respective reorganization cases by filing voluntary petitions for relief under Chapter 11 of the Bankruptcy Code, in the United States

Bankruptcy Court for the District of Delaware. Subsequently, the Debtors' withdrew the reference of their reorganization cases to United States District Court for the District of Delaware (the "Court").

3. The Debtors are continuing in possession of their respective properties and are operating and managing their businesses as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

4. The Committee was appointed by the United States Trustee (the "UST") on January 28, 2002.

Freeborn's Representation of The Northern Trust Company

5. The Northern Trust Company ("The Northern") is an Illinois banking association.

6. Freeborn is not the primary provider of legal services to The Northern and The Northern is not a major client of Freeborn in terms of fees generated. During the past two years, Freeborn has provided legal services to The Northern on approximately ten (10) transactions per year. The legal fees from Freeborn's representation of The Northern are less than \$100,000 per year.

7. Freeborn has never represented M & I Bank.

8. On November 5, 2001, Jennifer Dirkin, Senior Attorney at The Northern, contacted me regarding representation of The Northern, as agent, under an unsecured loan agreement among The Northern, M & I Bank and Fansteel, Inc. (the "Unsecured Loan Agreement"). Ms. Dirkin represented The Northern in its capacity as a lender under the Unsecured Loan Agreement. M & I Bank, the other lender under the Unsecured Loan Agreement, was represented by separate counsel. Prior to November 5, 2001, neither I nor Freeborn had any knowledge of, nor involvement in, the Unsecured Loan Agreement.

9. For approximately one month, from November 7, 2001 through December 4, 2001, I advised The Northern, as agent under the Unsecured Loan Agreement, in its efforts to restructure the Unsecured Loan Agreement and continue funding Fansteel. I did not advise The Northern, nor was I retained by The Northern, to provide legal advice as to The Northern's rights as a lender under the Unsecured Loan Agreement. Ms. Dirkin continued to provide legal advice to The Northern on all issues related to The Northern's rights as a lender. On or about December 4, 2001, negotiations on a restructuring of the Unsecured Loan Agreement came to an impasse and my involvement ceased until on or about January 14, 2002, when The Northern learned from Fansteel that the company would file a Chapter 11 petition within the next day. From January 15, 2002 through January 24, 2002, I provided general bankruptcy advice to The Northern.

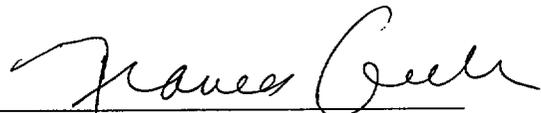
10. On January 24, 2002, The Northern decided that it would attend the Meeting of the Twenty Largest Creditors on January 28, 2002 and seek appointment to the Committee. On January 24, 2002, The Northern and I discussed Freeborn's continued involvement in the Fansteel bankruptcy. I advised The Northern that Freeborn could not continue to represent The Northern in the Fansteel bankruptcy case and also represent the Committee. The Northern stated that if it were selected to serve on the Committee, The Northern would endorse Freeborn's representation of the Committee, over Freeborn's representation of The Northern, because of the efficiencies resulting from the familiarity with Fansteel, its principals and its financial situation that Freeborn gained during the attempted restructuring in November 2001. On January 24, 2002, I informed The Northern that Freeborn was withdrawing from its representation of The Northern in the Fansteel bankruptcy case and The Northern accepted Freeborn's withdrawal.

Freeborn's Disclosure To The Creditors' Committee

11. On January 28, 2002, the United States Trustee appointed the Committee. The Committee is composed of seven creditors: the two unsecured lenders -- M & I Bank and The Northern, and five trade creditors -- Liberty Pattern Company, Metalworking Products, OMG Americas, Inc., Reade Manufacturing and H.C. Starck.

12. Upon its appointment, the Committee immediately convened to select counsel. When I interviewed with the Committee, I fully informed the Committee of my prior representation of The Northern. In addition, the allegations that The Northern and M & I Bank received preferences were well known to the Committee as those allegations were repeated in each of the fifteen first day motions filed by Fansteel and were the subject of a question posed to Fansteel's representatives during the question and answer portion of the Meeting of the Twenty Largest Creditors.

FREEBORN & PETERS



Frances Gecker

Subscribed and Sworn to before me this

6th day of March, 2002.



Notary Public

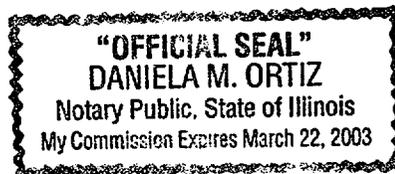


EXHIBIT B

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

In re: : Civil Action No.: 02-44 (JJF)
: :
FANSTEEL INC., et al., : (Bankruptcy #02-10109)
: :
Debtors. : :

**AFFIDAVIT OF JENNIFER DIRKIN IN SUPPORT OF APPLICATION FOR AN
ORDER PURSUANT TO SECTION 1103(a) OF THE BANKRUPTCY CODE
AUTHORIZING THE EMPLOYMENT AND RETENTION NUNC PRO TUNC OF
FREEBORN & PETERS, AS CO-COUNSEL TO THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS**

STATE OF ILLINOIS)
) SS.
COUNTY OF COOK)

Jennifer M. Dirkin, being duly sworn, does depose and say as follows:

1. I am a Senior Attorney in the legal department of The Northern Trust Company (“The Northern”), and I am duly authorized to make this Affidavit on behalf of The Northern. I am familiar with the facts set forth herein and submit this Affidavit in accordance with Section 1103(a) of the Bankruptcy Code in support of the Application For An Order Pursuant To Section 1103(a) Of The Bankruptcy Code Authorizing The Employment And Retention Nunc Pro Tunc Of Freeborn & Peters, As Co-Counsel To The Official Committee of Unsecured Creditors.

2. The Northern, M & I Bank and Fansteel, Inc. (“Fansteel”) are parties to a certain prepetition unsecured loan agreement (the “Loan Agreement”). Under the Loan Agreement, The Northern was both the agent and a lender.

3. In October 2001, Fansteel informed The Northern that Fansteel was in default under the Loan Agreement. During October 2001, I met with representatives of The Northern, Fansteel and M & I Bank regarding the defaults and Fansteel’s deteriorating financial condition. During the course of those meetings, Fansteel requested a restructure of the Loan Agreement.

4. On November 5, 2001, I called Frances Gecker at Freeborn & Peters regarding representing The Northern, as agent, under the Loan Agreement. I continued to represent The Northern in its capacity as a lender while Freeborn & Peters represented The Northern, as agent. Under the Loan Agreement, The Northern, as agent, was responsible for negotiating, subject to the consent of the lenders, any restructure of the Loan Agreement.

5. In early December 2001, negotiations with Fansteel ceased. After Fansteel filed its Chapter 11 petition on January 15, 2002, Freeborn & Peters provided additional bankruptcy advice to The Northern, as agent.

6. The Northern decided to seek appointment to the unsecured creditor's Committee. Prior to the Meeting of The Twenty Largest Creditors on January 28, 2002, I discussed with Frances Gecker the ability of Freeborn & Peters to serve as counsel to the Committee. On or about January 24, 2002, Freeborn & Peters withdrew from its representation of The Northern as agent, in the Fansteel case, and The Northern waived any conflicts regarding Freeborn & Peters' prior representation of The Northern as agent under the Loan Agreement.

THE NORTHERN TRUST COMPANY

Jennifer M. Dirkin
Jennifer M. Dirkin

Subscribed and Sworn to before me this
6th day of March, 2002.

Antoinette Zolig
Notary Public

