IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
Medley LLC,	)	Case No. 21-10526-KBO
	)	
Debtor.	)	**Hearing Date: May 18, 2021 at 1:00 p.m.**
	)	**Objection Deadline: May 11, 2021 at 4:00 p.m.**
	)	**(Extended by consent of the Debtor)**
	)	
	)	**Re: Docket Nos. 80, 112, 134**

OBJECTION OF THE U.S. SECURITIES AND EXCHANGE COMMISSION TO DEBTOR'S APPLICATION FOR ENTRY OF AN ORDER AUTHORIZING THE EMPLOYMENT AND RETENTION OF LOWENSTEIN SANDLER LLP AS COUNSEL TO THE DEBTOR EFFECTIVE AS OF THE PETITION DATE

The U.S. Securities and Exchange Commission (the "**SEC**") hereby objects to *Debtor's Application For Entry Of An Order Authorizing The Employment And Retention Of Lowenstein Sandler LLP As Counsel To The Debtor Effective As Of The Petition Date* [Docket No. 80] ("**Lowenstein Retention**") because Lowenstein is irreconcilably conflicted and should not be employed pursuant to Section 327(a) of the Bankruptcy Code due to its concurrent representation of the Debtor and the Debtor's parent (Medley Management, Inc. ("**MDLY**")). The SEC is the federal agency responsible for regulating the U.S. securities markets, protecting investors, and enforcing the federal securities laws. In that capacity, the SEC is formally investigating whether Debtor, Medley LLC ("**Medley**" or, the "**Debtor**"), and others, violated the anti-fraud and other provisions of the federal securities laws. The SEC has filed a proof of claim [Claim No. 11] in this case in connection with its contingent unliquidated claim against Medley for penalties and disgorgement.

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INTRODUCTION

1. On March 7, 2021, the same day Medley filed its voluntary petition under Chapter 11, it also filed a plan of reorganization (the "**Plan**") which would exchange unsecured "baby bonds" for equity of MDLY, the publicly traded parent of Medley, whose only asset is its ownership of Medley. Baby bonds are typically purchased by retail investors—*i.e.*, non-professional, mom and pop investors.

2. The SEC objects because Lowenstein's various representations place its attorneys in the untenable position of concurrently representing parties whose interests are adverse. On the one hand, Lowenstein has long represented the Debtor's parent, MDLY, and its control persons. Upon information and belief, it also represents the subcommittee of the MDLY board of directors tasked with managing the Debtor's bankruptcy case. As directors of MDLY, the members of the subcommittee are obliged to protect the interests of MDLY and its shareholders. The Debtor has no independent fiduciary whose only duties are to the Debtor and its stakeholders. Nevertheless, as an estate fiduciary, Lowenstein owes duties to the Debtor's estate and its creditors, whose interests are directly at odds with Lowenstein's other clients, MDLY and its control persons.

3. In short, it does not appear that Lowenstein, as an estate fiduciary, can represent both MDLY and the Debtor concurrently. The tensions are too acute. This is made plain by the Plan which contemplates MDLY retaining all of its equity in the Debtor in violation of the absolute priority rule to the detriment of higher priority bondholders, who have claims of over $120 million, and general unsecured creditors, including the SEC. [1] As set forth in more detail

[1] The SEC staff has informed the Debtor that the Plan is fatally flawed in a number of respects. In response, the Debtor has represented that the objectionable provisions of the Plan, including provisions violating the absolute priority rule, will be addressed in a forthcoming amendment, that the current hearing date will be adjourned, and that

below, these concurrent representations present a significant impediment to Lowenstein's proposed retention pursuant to Section 327(a) of the Bankruptcy Code.

BACKGROUND

A. The Taube Brothers and Other Pre-IPO Owners Control the Debtor

4. The Debtor is a Delaware limited liability corporation that was formed in 2010. *See* Declaration of Richard T. Allorto, Jr. in Support of Chapter 11 Petition and First Day Pleadings ("**Allorto Decl.**") [Docket No. 5], at 3. With its subsidiaries, the Debtor "provides investment management services to a permanent capital vehicle, long-dated private funds, and separately managed accounts, and serves as the general partner to the private funds." *Id.*

5. In June 2014, MDLY was incorporated and commenced operations upon the completion of its initial public offering ("**IPO**"). MDLY "is a holding company and has ***no material assets other than its ownership of LLC Units" in the Debtor***. MDLY Annual Report on Form 10-K for the period ended December 31, 2020 ("**2020 10-K**"), at 27 (emphasis added).

6. The IPO resulted in public shareholders owning a ***minority*** of MDLY's economic interests. The pre-IPO owners have also continued to maintain a firm grip on the management of MDLY. For example, until recently, Brook and Seth Taube (the "**Taube Brothers**") were Co-Chief Executive Officers and Co-Chairman of MDLY. On April 14, 2021, the Taube Brothers submitted their resignations from their chief executive roles, but they remain co-chairmen and still own controlling positions in MDLY. The Taube Brothers also are among the handful of pre-

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the SEC will have an opportunity to review and object to any amended disclosure statement. Although the Debtor has informed the SEC staff that the structure of the Debtor's Plan may change, as of the date hereof, an amended plan and disclosure statement have not been filed, and the Debtor has not agreed to further extend the date on which the SEC must object to the retention applications. As such, the SEC has no choice but to file its objection based on the currently-filed Plan. The SEC reserves the right to amend this objection if and when such an amended plan and disclosure statement are filed.

IPO owners. The pre-IPO owners also include the Debtor's Chief Financial Officer ("**CFO**") and first-day declarant, Richard Allorto ("**Allorto**"), who is also MDLY's CFO.

7. On January 19, 2021, pursuant to a previously executed exchange agreement, the pre-IPO owners exchanged their interest in the Debtor for Class A Common Stock of MDLY on a one-for-one basis. Due to this exchange, as of March 26, 2021, MDLY owned 98% of the Debtor. On the same date, as a result of the exchange, the pre-IPO owners directly controlled 66.9% of the voting power of MDLY, and indirectly controlled 14% of the voting power through their ownership of the Medley Group LLC. In short, after the share exchange, the pre-IPO owners remained in control of the Debtor, since the pre-IPO owners, particularly the Taube Brothers, continued to control the Debtor through their supermajority ownership of MDLY—the Debtor's sole managing member. As further discussed below, the Plan accords MDLY and its shareholders, including the Taube Brothers, special treatment.

B. The Debtor's Bankruptcy Case and Restructuring Plan

8. On March 7, 2021, Medley filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the District of Delaware (the "**Court**"). That same day, Medley filed the Plan which would exchange the debt owed to holders of the Notes for equity in MDLY.[2] The noteholders are among the Debtor's most senior class of debt, as the Debtor has scheduled no secured or priority claims. Under the Plan, holders of the Notes are estimated to receive a recovery between 5% and 22.4%, depending on whether the noteholders

[2] On August 9, 2016 and October 18, 2016, the Debtor issued debt consisting of $53,600,000 in aggregate principal amount of senior unsecured notes due in 2026 at a stated coupon rate of 6.875% (the "**2026 Notes**"). The 2026 Notes are listed on the New York Stock Exchange under the symbol "MDLX." On January 18, 2017 and February 22, 2017, the Debtor issued $69,000,000 million in aggregate principal amount of senior unsecured notes due in 2024 at a stated coupon rate of 7.25% (the "**2024 Notes**," collectively with the 2026 Notes, the "**Notes**"). The 2024 Notes are also listed on the New York Stock Exchange under the symbol "MDLQ." The aggregate principal amount outstanding on the Notes is approximately $122.6 million. *See* Allorto Decl. [Docket No. 5], at 7.

vote in favor of the Plan. But because the recovery hinges on the market value of MDLY stock, noteholders could receive much less under the Plan. The Debtor has scheduled only $7.7 million in general unsecured claims, all but approximately $86,039 of which relate to one creditor. These claims are also impaired.

9. The Plan gives equity special treatment. Specifically, the Plan treats the Debtor's equity interests as unimpaired and contemplates that unitholders—*i.e.*, MDLY—will continue to own the reorganized Debtor. According to the Debtor's CFO, equity interests remain unimpaired under the Plan in order to avert "material adverse consequences." *See* Allorto Decl. [Docket No. 5], at 12. Specifically, "[t]he Plan is designed to avoid a change of control event through the Chapter 11 Case and limit the potential for client defections." *Id.*

10. It is clear from the first-day declaration and testimony at the Section 341 Meeting of Creditors that at no time prior to the petition date did the Debtor consider any strategic alternative that would have impaired the pre-IPO owners' interests in the Debtor.[3]

A. The Lowenstein Retention

11. On April 1, 2021, the Debtor filed the Lowenstein Retention, to retain and employ Lowenstein as its bankruptcy counsel pursuant to Sections 327(a), 329, and 330 of the Bankruptcy Code.

12. On April 23, 2021, the Supplemental Declaration of Robert Hirsh was filed in support of the Lowenstein Retention ("**Supplemental Declaration**") [Docket No. 112].

[3] During the Meeting of Creditors in this case, Mr. Allorto was asked by an investor: "The purpose of the bankruptcy filing is to facilitate the [debt-to-equity] transaction, correct?" To which Mr. Allorto answered simply, "Correct."

13. On May 10, 2021, the Second Supplemental Declaration of Robert Hirsh was filed in support of the Lowenstein Retention ("**Second Supplemental Declaration**") [Docket No. 134].

14. The Lowenstein Retention discloses that, due to the structure of the Debtor, MDLY, and other non-Debtor subsidiaries and affiliates, Lowenstein seeks to continue to provide the same services it provided pre-petition to the Debtor, MDLY, and certain other subsidiaries and affiliates. Currently, Lowenstein "performs work on behalf of MDLY and the Debtor for corporate governance and SEC reporting relating to the specific operations of the Debtor." Lowenstein Retention [Docket No. 80], at 7.

15. The Supplemental Declaration discloses that, "beginning in 2010, Lowenstein Sandler performed legal services on behalf of Medley Capital LLC covering regulatory compliance associated with the conduct of the advisory business to Medley Capital LLC's private funds and business development companies . . . At the end of 2016, Lowenstein Sandler was engaged to advise Medley Management, Inc. ('MDLY') in connection with its 1934 Act filings and associated corporate governance matters—including attending and documenting board meetings—and matters pertaining to the administration of its equity plan . . . In December 2020, pursuant to a separate engagement letter, Lowenstein Sandler was engaged to advise MDLY in connection with a proposed reverse merger transaction." Supplemental Decl. [Docket No. 112], at 3.

16. Accordingly, it appears that Lowenstein participated in meetings of the MDLY Board of Directors (the "**MDLY Board**") at which MDLY's dividend rate of 20 cents per share was approved by its Board. The amount of the distributions made to management by the Debtor

was tied to these decisions of the MDLY Board. *See generally* Medley Management Inc. (Annual Report) 10-K, for fiscal year ending 12/31/2016.

17. Upon information and belief, Lowenstein also advises the restructuring subcommittee (the "**Restructuring Subcommittee**") of the MDLY Board that has been delegated authority to file the Debtor's bankruptcy case and make all decisions in connection therewith. The Restructuring Subcommittee is comprised of MDLY Board members John H. Dyett, Guy Rounsaville, Jr., and Peter Kravitz.[4] .

LEGAL DISCUSSION

A. Lowenstein Is not Disinterested and Holds an Interest Adverse to the Estate

18. Section 327(a) of the Bankruptcy Code provides in pertinent part:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

See 11 U.S.C. § 327(a).

19. Thus, to be employed pursuant to Section 327(a), a professional must not hold an "interest adverse to the estate" and must be "disinterested." *In re Martin*, 817 F.2d 175, 180 (1st

[4] The Restructuring Subcommittee may not be independent. For example, outside directors Dyett and Rounsaville receive their compensation from MDLY and each has substantial equity holdings of MDLY. *See* MDLY Definitive Proxy Statement, filed Sept. 22, 2020, at 18 and 41. Accordingly, they will suffer personal financial losses if MDLY's interests are impaired in this case. Similarly, Kravitz is employed by MDLY under agreements paying him $30,000 monthly. *See* MDLY Form 8-K, filed Feb. 9, 2021. Further, as directors of MDLY—the 98% holder of the Debtor's equity—Delaware law dictates that the Restructuring Subcommittee's fiduciary duties run to MDLY's equity holders, *see Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1997) (duties to corporation and shareholders), whose interests appear to conflict with the interests of the Debtor's creditors in this case. As such, even if the Plan is restructured, Lowenstein's longtime representation of MDLY (the Debtor's equity holder), and of its newly-formed but potentially conflicted Restructuring Subcommittee, may hobble Lowenstein's ability to fulfill its fiduciary duties to the estate and all creditors, particularly the SEC and noteholders.

Cir. 1987) (In determining whether an adverse interest exists, courts have looked to whether the professional has "a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors."); *In re Project Orange Assocs. LLC*, 431 B.R. 363, 370 (Bankr. S.D.N.Y. 2010) (The analysis of whether the proposed professional is "disinterested" under Section 101(14)(c) overlaps substantially with the "adverse interest" standard, although the language is not identical).[5]

20. Lowenstein's retention is not appropriate in this case. As set forth in the Hirsh Declaration, Lowenstein has served, and intends to continue to serve, as counsel to the Debtor, MDLY, and other non-debtor affiliates. While it is not uncommon for one law firm to represent affiliated debtors, the contemporaneous representation of a debtor and its non-debtor shareholders poses inherent conflict, particularly where the recovery to shareholders is an issue in the bankruptcy case. *See In re N. John Cunzolo Associates, Inc.*, 423 B.R. 735 (Bankr. W.D. Pa. 2010) (firm was not disinterested and held an interest adverse to the bankruptcy estate where it had extensively represented debtor, its principal and sole shareholder, and other business interests of the shareholder in various legal matters for many years prepetition); *In re Kendavis Industries Int'l, Inc.*, 91 B.R. 742, 752 (Bankr. N.D. Tex. 1988) ("Representing the principals of the debtor, and not the debtor itself lacks the disinterestedness required by section 327, because once counsel is employed, 'a lawyer owes his allegiance to the entity and not to the stockholder,

[5] Section 101(14) defines a "disinterested person" as one that:

> (A) is not a creditor, an equity security holder, or an insider;
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14).

director, officer, employee, representative or other person connected with the entity.'") (internal quotations omitted); *In re Envirodyne Indus., Inc.,* 150 B.R. 1008 (Bankr.N.D.Ill.1993) (representation of substantial shareholder/creditor in connection with leveraged buyout of debtor precluded firm's retention as counsel to debtor); *see also In re Straughn*, 428 B.R. 618, 627-28 (Bankr. W.D. Pa. 2010) (Noting that where corporate debtor and majority shareholder and president sought to employ the same counsel in their bankruptcy cases, "[t]hese types of relationships require debtor's counsel to analyze and ponder the effect of … actual or potential conflict situations in the bankruptcy context before the case is even filed. Where circumstances are presented that interfere with counsel's exercise of independent judgment on behalf of client and creditors, the wise choice is not to assume a dual representation relationship."). *But see In re Jade Mgmt. Servs.*, 2010 WL 2712139, 386 Fed.Appx. 145 (3d Cir. July 9, 2010) (under facts of case, dual representation unlikely to ripen into actual conflict).

21. Under the circumstances of this case, the Debtor could not effectively "consent" to the concurrent representation because it is dominated by its non-debtor parent, MDLY. Yet, even if that was not the case, the "disinterested person" requirement is not a matter that can be waived under the Bankruptcy Code. *See, e.g., In re Granite Partners, L.P.*, 219 B.R. 22, 34 (Bankr. S.D.N.Y. 1998) ("the mandatory provisions of section 327(a) do not allow for waiver."); *In re Envirodyne Indus., Inc.*, 150 B.R. at 1016 ("Section 327 does not allow these limitations to be excused by waiver."); *see generally* 3 Lawrence P. King, *et al. Collier on Bankruptcy* ¶ 328.05[2].[6]

[6] The Debtor belatedly filed an Application for Entry of an Order Authorizing the Employment and Retention of Gellert Scali Busenkell & Brown, LLC as Counsel to Peter Kravitz, Chair of the Independent Subcommittee of the Board of Medley LLC Nunc Pro Tunc April 14, 2021 [Docket No. 129] (the "Gellert Retention"). The SEC staff understands that this firm's role is limited to certain investigative activities and that is not acting as conflicts counsel or otherwise assisting the Debtor in general bankruptcy or governance matters. The anticipated investigative work

22. Lowenstein currently represents MDLY and its affiliates, and has done so since 2010. Here, the structure of the Plan provides that MDLY's equity will ride through while the claims of bondholders and unsecured creditors, including the SEC, are impaired under the Plan. The proposed treatment of equity violates the absolute priority rule and presents an actual conflict with the Debtor's duties to the bankruptcy estate. *In re Angelika Films 57th Inc.*, 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998), *aff'd*, 243 B.R. 176 (S.D.N.Y. 2000) ("Counsel for a chapter 11 debtor owes a fiduciary duty of loyalty and care to his client, which is the debtor-in-possession, not the debtor's principals.")

23. Additionally, Lowenstein likely has actual conflicts of interest because it has advised MDLY in connection with matters that are at issue in the case. First, it advised MDLY in connection with the composition of the current governance of the Debtor, including the composition of the MDLY Restructuring Subcommittee. Second, it advised MDLY in connection with the Plan, the approval of which may have constituted a breach of MDLY's fiduciary duties to creditors in this case. In addition, Lowenstein participated in board meetings for MDLY at which determinations may have been made regarding transactions that may be avoidable in the bankruptcy case, including distributions made to management within the avoidance period.

24. Because Lowenstein holds an actual conflict of interest, it is not "disinterested" and cannot serve as counsel to the Debtor under Section 327(a). *In re Marvel Entm't Grp., Inc.*, 140 F.3d 463, 476 (3d Cir. 1998) (section 327(a) imposes a per se disqualification of any

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of Gellert Scali may be duplicative of the other professionals in this case, including counsel for the Official Committee of Unsecured Creditors. The same is true of the Restructuring Subcommittee's financial advisor. *See* Motion of Debtor for Entry of Order Authorizing and Approving Debtor's Retention and Employment of Rock Creek Advisors LLC as Financial Advisor to Peter Kravitz, Chair of the Independent Subcommittee of the Board of Medley LLC Nunc Pro Tunc April 14, 2021 [Docket No. 130]. As such, the SEC reserves the right to object to the retention and fess of these professionals.

attorney who has an actual conflict of interest); *see also In re BH & P Inc.,* 949 F.2d 1300, 1316 (3d Cir.1991).

25. For the reasons set forth herein, the Lowenstein Retention should not be approved.

RESERVATION OF RIGHTS

26. The SEC reserves all rights to supplement this Objection, including on grounds not raised in this objection.

Dated: May 11, 2021

Respectfully Submitted,

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 11th day of May, 2021, a true and correct copy of the foregoing Objection was furnished to all ECF Participants via the CM/ECF system, and further, served by email upon the following:

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