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Acceptance of the Distinguished Service Award for Lifetime Achievement

Jay Alix

ACCEPTANCE OF THE DISTINGUISHED SERVICE AWARD FOR LIFETIME ACHIEVEMENT

DISCLOSURE, DISINTERESTEDNESS, AND MCKINSEY

Jay Alix[*]

Well, it's nice to be here, and I want to thank Judge Rhodes for that gracious introduction. I'm honored to be here and share this evening with all your honorees, faculty and Emory Law leaders. I also want to thank Matt Lindgren and his team for their tremendous leadership in putting this program together. I also want to recognize Keith Shapiro, who reminds me that we worked together on many matters "back in the day." He is a distinguished leader in the restructuring industry, and I applaud all of his leadership contributions to both Emory Law School and the restructuring industry.

I also want to recognize Dan Lemisch, Lisa Phillips and my other associates who are here this evening. Thank you for coming.

I am honored to be chosen for the Distinguished Service Award. I'm proud to say that I've been working in this honorable industry for over forty years. Indeed, I'm proud to say that I've worked with, or taught with, over 75% of your past twenty-one honorees. So this award, and all it represents, is very meaningful to me.

You are the future leaders of the U.S. bankruptcy system. You are the people who will have the responsibility to help keep our bankruptcy system vibrant, strong and effective, and to maintain the high integrity and full transparency that it is known for globally. We professionals are proud to work together in our bankruptcy system while living up to the high fiduciary standard that the law demands.

And so tonight, I want to share with you my story—the story about the five-year legal journey I've taken with Judge Rhodes, Dan Lemisch, Sean O'Shea, Sheldon Toll, Lisa Phillips, and many other associates, researchers, and bankruptcy professionals of integrity and distinction.

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[*] Jay Alix is the Founder of AlixPartners, a management consulting firm that focuses on complex restructurings, turnaround management, and provides other consulting services. Mr. Alix retired from AlixPartners in 2005, but he still sits on the Board of Directors for the firm and is a minority shareholder of the firm. Mr. Alix received his undergraduate education from the Wharton School of Business at the University of Pennsylvania and received his MBA in Accounting from Rutgers University.

I retired from AlixPartners about fifteen years ago, but I'm still on the board and a minority shareholder.

Since retiring, I've focused my time on some strong personal interests. Producing Broadway plays and shows is one, and I'm very active in certain philanthropies, dedicating my time, my skills, and my resources to a select group of not-for-profits, most principally the Mayo Clinic. Another strong interest that I have—well, I'll get to that in a moment.

When I started out in the bankruptcy business in the late 1970s, we were considered fringe players. People in the media said things like: they troll the bottom; worked on the margins; they said we were the undertakers. And that's when they were being nice!

But today everyone knows the truth about what we do. Just within the last year, The New York Times said:

> [T]he bankruptcy system—what seems like a grim realm of destitution—is actually a place for hope and opportunity. If the game is played fairly, lenders can be predictably compensated; failing businesses can be restructured and revived, and jobs can be saved.[1]

Our nation built our bankruptcy system for the benefit of all of us. It is a crucial part of our nation's economic system. And soon, you too will be an important part of that system.

But while it's important that people know what we do, it's even more important that people know how we do it. We professionals are charged with making our bankruptcy system work. We are trusted fiduciaries and loyal officers of the court, responsible to help the administration of justice. And we have the fundamental duty to ensure that our bankruptcy system remains strong for our country.

And so how do we fulfill that fundamental duty? We do it by adhering to the strictest principles of integrity, honesty, and transparency—principles so important that they are codified into the laws that apply to all professionals—laws that for decades have worked effectively for the country, for the parties, for the courts and for all of us.[2]

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1 Mary Williams Walsh, *One Man vs. McKinsey: A Billionaire Says the Consultancy Has Rigged the Bankruptcy System*, N.Y. TIMES (Apr. 11, 2019), https://www.nytimes.com/2019/04/11/business/jay-alix-mckinsey-bankruptcy.html.

2 *See* 11 U.S.C. § 327 (2019); *id.* § 101(14) (defining a "disinterested person"); *see also* John D. Ayer, et al., *Basics of Professional Retention and Compensation*, AM. BANKR. INST. J. 1, 1–5 (1995). Section 327(a) is

And there are two very specific parts of bankruptcy law that impose this fundamental duty that we're talking about: disclosure and disinterestedness. Disclosure is what it sounds like. It's simple, just three words: Disclose All Connections. It's in Bankruptcy Rule 2014.[3]

And disinterestedness: That's a hard word to say, but it too is a simple concept that is precisely defined in the Bankruptcy Code.[4] Simply put, bankruptcy professionals are fiduciaries and can have no conflict of interest in the case they're working on. And, without question, this includes no hidden investments, no hidden financial interests, no self-dealing, and no secret engagements with secret undisclosed clients.[5]

Everybody in the industry knows that. Everyone here knows that. We cannot fulfill our fiduciary duties to our debtor clients and to the courts (1) if we don't fully disclose our connections, or (2) if we're not disinterested.

Often, to understand the full scope of something, I find it helpful to imagine the alternative situation or opposite condition. So, let's think about it this way: What would happen if this system stops working in the way it's supposed to work? What would happen to our bankruptcy system if all professionals worked without integrity and transparency—a system where the law does not apply to all participants equally and where legal compliance is self-selected by each participant?

What if the system malfunctions, not because of some systemic failure by professionals generally, but for a much simpler reason: Because one very large player decides for itself that it doesn't have to abide by the same laws and rules as everybody else and that it doesn't have to comply with the law?

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pertinent to professionals other than counsel:

> [T]he 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.

11 U.S.C. § 327(a) (emphasis added). Bankruptcy attorneys are subject to rules of professional conduct, both those promulgated by their state bar and standards promulgated by the Federal Judicial Center. *See* MARIE LEARY, STANDARDS GOVERNING ATTORNEY CONDUCT IN THE BANKRUPTCY COURTS, FED. JUDICIAL CTR. 1–10 (1999).

[3] The rule requires professionals to disclose "all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed by the office of the United States Trustee" to "the best of the applicant's knowledge." FED. R. BANKR. P. 2014.

[4] *See* 11 U.S.C. § 101(14).

[5] *See* FED. R. BANKR. P. 2014.

When that happens, the integrity of the entire system comes into question, because stakeholders now know they can't reasonably rely on the system. The system is no longer consistent, predictable, and reliable. This kind of self-selected non-compliance not only exposes the system to dishonesty and deceit, but it actually leads to full-on corruption in our federal court system.

OK, so what's the problem? As we sit here tonight, we are indeed on a journey down that path. But it's not because the entire industry is doing this. No, we're not. Instead, what I discovered about six years ago is that one player is deceptively leading us down this dangerous path. This one player decided for itself that the law simply did not apply to it because it sees itself as unusual and special, and this one player placed its own commercial interests above the law.

This one player is McKinsey Recovery and Transformation Services, also known as McKinsey RTS. It is the wholly owned and controlled bankruptcy affiliate of the global consulting firm McKinsey & Company.

McKinsey, which advises businesses and governments around the world, cynically responds that it is confused - confused about its disclosure duties as a professional. The New York Times said:

> for years McKinsey has had a 57-page primer—titled "Bankruptcy 101"—that lays out how to identify possible conflicts and make proper disclosures. The only problem: McKinsey hasn't been following its own instruction manual.[6]

I was shocked because Bankruptcy Rule 2014 is not confusing. It has functioned exactly as it was designed to function: to ensure a professional's full disclosure of its connections to interested parties, and to allow the court to determine that professional's disinterestedness under sections 327 and 101(14).

Those provisions of the Bankruptcy Code make it illegal for a professional to have either direct or indirect financial interests or adverse interests in the bankruptcies they work on. Those rules have guided the disclosure of connections by bankruptcy professionals for decades, and the case law is clear and unambiguous, without exception.[7] Those laws and rules work.

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[6] Mary Williams Walsh, *McKinsey Said Disclosure Rules Were Confusing. It Ignored Its Own Primer.*, N.Y. TIMES (May 27, 2019), https://www.nytimes.com/2019/05/27/business/mckinsey-bankruptcy-rules-jay-alix.html.

[7] *See* Ayer, et al., *supra* note 2.

And they work because we professionals, collectively, have made them work. We all participate in a self-reporting system; this system relies on a policy and practice of self-reporting. All professionals are trusted to self-report.

Over the course of many months of careful study, I came to see that McKinsey RTS was engaged in a stunning and coordinated attempt to conceal its bankruptcy connections on a massive scale, not revealing its client and investment connections, while playing a game of cat and mouse with its bankruptcy disclosures. My first impulse and reaction was to contact McKinsey's CEO and advise him as I was convinced he couldn't possibly know this, and that he'd want to correct it. I wanted to help him. We met and spoke on eleven occasions over fourteen months.[8] He never stopped it or corrected it, even though he promised to do so. Watching it continue into three more bankruptcy case over those 14 months told me I had no choice but to report it all to the U.S. Trustee. I've learned a lot more since then.

Through my expanded investigations, I learned that McKinsey RTS has concealed over 5,000 client connections to interested parties in forty-four false Rule 2014 declarations, filed in fourteen bankruptcies. We also now know that McKinsey has over 300 undisclosed direct and indirect investments related to these fourteen bankruptcy cases, again, all undisclosed. In contrast, most professionals hope and pray they don't miss even one connection in their Rule 2014 disclosures.

We know about those concealed connections because we have researched McKinsey's public SEC ADV forms and Department of Labor 5500 forms, both documents filed annually, as well as multiple bankruptcy claims registers, court dockets, debtor filings, and McKinsey's own Rule 2014 declarations.

But further investigation shows McKinsey's misconduct is much worse than just concealing 5,000 client and investment connections. In its capacity as a fiduciary advisor to large corporate chapter 11 debtors in fourteen major bankruptcy cases, McKinsey has committed at least five categories of unlawful conduct:

- First, McKinsey advised its debtor clients in their negotiations with their major creditors, creditors who were also McKinsey's concealed clients. In the Alpha Natural Resources ("ANR") case, with McKinsey's help,

[8] *See generally* Michelle Celarier, *The Man Who Would Take Down McKinsey*, INSTITUTIONAL INVESTOR (Mar. 18, 2019), https://www.institutionalinvestor.com/article/b1dldlnb6wvx7f/The-Man-Who-Would-Take-Down-McKinsey (documenting the meeting that occurred and is discussed by Mr. Alix in his speech).

ANR's best assets were transferred to approximately forty senior creditors, over thirty of whom were undisclosed active McKinsey clients.[9]

- Second, McKinsey RTS consultants were advising ANR on maximizing its coal sales while, at the same time, the same team simultaneously advised U.S. Steel on reducing its coal costs from ANR. It was all concealed.[10]
- Third, in multiple chapter 11 cases, McKinsey RTS has worked on the sale of billions of dollars of debtor assets to other undisclosed McKinsey clients. In the NII Holdings (formerly Nextel) bankruptcy case in New York, McKinsey advised NII Holdings on the sale of Nextel Mexico to AT&T for $1.8 billion. The problem was that the buyer, AT&T, was an undisclosed McKinsey client at the same time McKinsey was advising NII Holdings on the sale. McKinsey was on both sides of the transaction, and no one knew it. And the same thing also happened in the Edison Mission bankruptcy case in Chicago, and then it happened again in the SunEdison case in New York. There were over $5.0 billion in asset transfer transactions with multiple undisclosed McKinsey clients.[11]
- Fourth, McKinsey helped arrange for the sale or transfer of debtors' assets to entities in which McKinsey's partners had either a direct or indirect financial interest. In the ANR case, a hedge fund named Whitebox purchased ANR debt during the bankruptcy case and ended up owning a large part of the Newco/Contura equity stake that emerged in the ANR case. McKinsey's own partners, including those overseeing RTS's work, had known about the investment of McKinsey's partners in Whitebox for over 10 years. Yet, McKinsey's connection to Whitebox was never disclosed, and Whitebox, with millions in McKinsey partners' money, ended up as a major shareholder of the Newco/Contura under the plan.[12] The same type of transaction happened in the NII Holdings case, along with similar undisclosed investments in still five other bankruptcies.[13] It's a pattern.
- Fifth, and this one really stands out for its chutzpah, in the SunEdison

[9] The Alpha Natural Resources bankruptcy was widely covered in the media. *See, e.g.*, Jacqueline Palank, *Judge Approves Alpha Natural Resources' Restructuring Plan*, WALL ST. J. (July 7, 2016), https://www.wsj.com/articles/judge-approves-alpha-natural-resources-restructuring-plan-1467920639.

[10] *See* Linly Lin, *McKinsey Faces Probe Over Conduct in Bankruptcy Cases, NYT Says*, BLOOMBERG NEWS (Nov. 8, 2019), https://www.bloomberg.com/news/articles/2019-11-09/mckinsey-faces-probe-over-conduct-in-bankruptcy-cases-nyt-says.

[11] *See id.*

[12] *Id.*

[13] *Id.*

> case, McKinsey engaged in a fraudulent self-help financial manipulation in the run-up to the bankruptcy filing. SunEdison was a McKinsey client. Before it filed, SunEdison owed McKinsey millions of dollars. Seeing that bankruptcy was imminent, McKinsey issued invoices and then called them back and re-issued fraudulent invoices to SunEdison's non-debtor affiliates, and then used cash wire transfers and multiple "round-trip" financial transactions to first cleanse and then mischaracterize preference payments of $22 million, all to get themselves paid.[14]

So, what does it mean? McKinsey first defrauded SunEdison's creditors; and then they defrauded the non-debtor affiliates; and then McKinsey defrauded the court as well as the U.S. Trustee when it submitted multiple false Rule 2014 declarations stating that it was disinterested.

Here is the bottom line on McKinsey's pattern of illegal conduct: Over the course of the last five years, my multi-phase forensic fraud investigation and my significant legal efforts to hold McKinsey accountable have demonstrated to me and my team of bankruptcy experts that McKinsey RTS has engaged in a calculated campaign of non-disclosure deception. McKinsey concealed client and investment connections that were unquestionably disqualifying. Even worse, McKinsey used the shroud of its nondisclosure to engage in a series of profiteering and trafficking transactions in chapter 11 reorganizations that is breathtaking in its brazenness.

McKinsey's scheme involves the McKinsey Investment Office (the "MIO") which is a $26 billion hedge fund that is 100% owned and controlled by McKinsey, overseen by McKinsey, governed by McKinsey, and has only McKinsey partners' and employees' money in it. The evidence establishes that McKinsey is actually a $26 billion hedge fund with a $10 billion consulting firm connected to it.[15]

Our work in exposing McKinsey's frauds on the various courts has had a big impact and is bearing fruit. Just over a year ago, McKinsey entered into a settlement with the creditors' trust in the SunEdison case for $17.5 million, all

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[14] *See* Mary Williams Walsh & Emily Flitter, *McKinsey Faces Criminal Inquiry Over Bankruptcy Case Conduct*, N.Y. TIMES (Nov. 8, 2019), https://www.nytimes.com/2019/11/08/business/mckinsey-criminal-investigation-bankruptcy.html.

[15] *See* Michelle Celarier, *The Story McKinsey Didn't Want Written*, INSTITUTIONAL INVESTOR (July 8, 2019), https://www.institutionalinvestor.com/article/b1g5zjdcr97k2y/The-Story-McKinsey-Didn-t-Want-Written.

based on the very allegations we've raised. And it was our that work brought the secret settlement to light.

Additionally, our work has brought about further accountability and penalty. McKinsey recently made a record-setting $15 million settlement with the U.S. Trustee,[16] effectively admitting that it has a major disclosure problem in ANR, SunEdison and Westmoreland Coal. The Department of Justice's press release regarding that settlement stated:

> This settlement ensures that McKinsey is held accountable for its conduct. . . Transparency is the linchpin of the bankruptcy system and professionals employed in bankruptcy cases must be free of conflicts of interest. McKinsey failed to satisfy its obligations under bankruptcy law and demonstrated a lack of candor with the courts and USTP. This settlement ensures that McKinsey is held to the same standards applicable to all professionals who participate in bankruptcy cases. If this conduct is repeated in future cases, we will seek even more far-reaching remedies.[17]

McKinsey is unrepentant and continues to spin its excuses and publicly states that it's working under a new disclosure protocol, which McKinsey hopes will wash away its past misdeeds. But this new protocol only perpetuates McKinsey's concealments of its connections, by allowing even more violations of well-established case law under Rule 2014. The absurdity of that situation was summed up quite nicely in a Wall Street Journal headline which said: "McKinsey Broke the Rules; Now It Wants to Rewrite Them."[18]

Like you, I've often asked myself: How has McKinsey been able to get away with this? First, everyone has simply assumed McKinsey was both compliant and honest. And second, for those who saw what McKinsey was doing, McKinsey is like the 800-pound gorilla in the room, and nobody wants to tangle with it. As the New York Times wrote "McKinsey Makes Its Own Rules."[19]

McKinsey is so big and so well-connected that it scares people. No one relished the idea of taking on the gorilla. But that has changed. Now McKinsey

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[16] *See U.S. Trustee Program Reaches $15 Million Settlement with McKinsey & Company to Remedy Inadequate Disclosures in Bankruptcy Cases*, U.S. DEP'T OF JUST. (Feb. 19, 2019), https://www.justice.gov/opa/pr/us-trustee-program-reaches-15-million-settlement-mckinsey-company-remedy-inadequate.

[17] *Id.* (quoting USTP Director Cliff White).

[18] Gretchen Morgenson & Tom Corrigan, *McKinsey Broke the Rules, Now It Wants to Rewrite Them*, WALL ST. J. (Apr. 11, 2019), https://www.wsj.com/articles/mckinsey-broke-the-rules-now-it-wants-to-rewrite-them-11555017761.

[19] Ian MacDougall, *How McKinsey Makes Its Own Rules*, N.Y. TIMES (Dec. 14, 2019), https://www.nytimes.com/2019/12/14/sunday-review/mckinsey-ice-buttigieg.html.

is under a comprehensive investigation by the U.S. Trustee Program, as well as another separate investigation by the U.S. Attorney, according to both the New York Times and the Wall Street Journal.[20] And, McKinsey's disclosures are being challenged in the U.S. Bankruptcy Court in Houston.

And for the first time in all of McKinsey's cases, it's the Houston Court in the Westmoreland case that is in a position to get to the truth and rule on the merits. In the other cases, we were held up when McKinsey argued technical issues of legal standing and other procedural technical defenses, but never has any case been brought to trial or heard on the full merits, until now.

This story is bigger than me, and it's bigger than McKinsey. It's about choices—the choices that McKinsey has made, and the choice that I made in response. It's about the same choice that every bankruptcy court and every professional in the country makes. And it's the same choice that each of you will have to make on your journey.

What kind of bankruptcy process do we want to have for the people and businesses of our country? Do we want one that follows the rule of law, one that is a uniform bankruptcy system? Or do we want McKinsey's concealed-conflicts system, where core and fundamental principles like fiduciary duty, disclosure, and disinterestedness are no more meaningful than a throwaway line in a McKinsey PowerPoint slide?

I don't think we want McKinsey's system. It's bad for our country's financial recovery system. It's bad for our vibrant financial markets that underpin our economy. It's bad for the courts. And it's bad for our industry. And as you've seen, I've made my choice. And I've put my reputation on the line to do what's right—to report to the courts what I've learned—and not just for me and my interests. But to do what's right for the health and protection of our system.

I choose to continue this important work by fighting for our values of integrity, transparency, and honesty in the United States Bankruptcy Courts. I choose to live up to what your important award to me tonight stands for, and what Emory Law stands for. For me to be true to my values, there can be no other choice.

Like all of us industry veterans, you too will work long and hard over the course of your careers. You too will contribute to the development and integrity

[20] *See* Walsh & Flitter, *supra* note 14; Morgenson & Corrigan, *supra* note 18.

of the bankruptcy court system as well as our nation's economic recovery system. You're next up. And you too will need to make your choice.

I ask you to join me and choose:

To use your strong and powerful voices to speak up;

To speak truth to McKinsey's power;

To be a strong advocate to protect our bankruptcy system from dishonesty and from self-serving and deceptive behavior;

To help protect our courts and the bankruptcy process from the repeated and intentional illegal behavior by any offender of our bankruptcy laws;

And not to let anything corrupt these values or steal these principles from you.

I hope that each of you will join me in that choice. Thank you very much.