YOU BE THE JUDGE!

ATTORNEY CONCURRENT REPRESENTATION AND DISCLOSURES IN CHAPTER 11 CASES

CODE SECTIONS REGARDING EMPLOYMENT OF PROFESSIONALS

- **§ 327(a)** professionals must 1) not hold or represent an interest adverse to the estate; and 2) be disinterested
- **§ 327(c)** no disqualification solely based on employment by or representation of a creditor, unless there is an objection and an actual conflict of interest
- **§ 327(e)** employment of special counsel: attorney must not represent or hold any interest adverse to the debtor or the estate with respect to the matter for which the attorney will be employed

DEFINITION OF "DISINTERESTED"

- **101(14)** "disinterested person" means—

  (A) not a creditor, equity security holder or insider;

  (B) not a director, officer or employee of debtor (currently or w/in 2 years of the petition date); AND

  (C) holds no materially adverse interest

PROFESSIONALS REPRESENTING A COMMITTEE

- **1103(b)** **while employed by a creditors' committee, an attorney or accountant may not represent any other entity with an adverse interest; representation of one or more creditors represented by the committee is not a "per se" adverse interest**

DENIAL OF COMPENSATION AS A SANCTION

- **328(c)** **With limited exceptions, if at any time a professional employed with court approval is not disinterested or represents or holds an interest adverse to the estate with respect to the matter on which the professional is employed, the court may disallow compensation to the professional**

TYPES OF CONFLICTS

- **Actual Conflict of Interest** – *per se disqualification*
- **Potential Conflict of Interest** – *disqualification is within court's sound discretion*
- **Appearance of Conflict** – *generally not disqualifying*

(1) **Professional has no economic interest that would tend to lessen the value of the bankruptcy estate**

(2) **No actual or potential dispute in which the estate is a rival claimant to the professional**

(3) **Professional has a predisposition of bias against the estate**

(4) **Representation must be unclouded by divided loyalty**

(5) **Professional has no personal interest that might affect its judgment**

ACTUAL CONFLICT: DOES NOT HOLD OR REPRESENT AN ADVERSE INTEREST AND IS DISINTERESTED

GENERAL PRINCIPLES REGARDING EMPLOYMENT

- Preserve the integrity of legal proceedings
- Prevent unfair prejudice
- Ability of litigants to retain loyal counsel of their choice
- Ability of attorneys to practice without undue restriction
- Prevent the use of disqualification as a litigation strategy
- Risks of concurrent representation include:
  a) Cannot give undivided loyalty to each client
  b) Divided loyalty impairs the exercise of untainted independent judgment on behalf of each client

- **Ethical Screen** – to avoid exchanges of information between attorneys working for each client

- **Conflicts Counsel** – on discreet issues

HOW TO AVOID DISQUALIFICATION IN CERTAIN CIRCUMSTANCES

“Use of conflicts counsel is not appropriate where the adverse interests of the debtors represented by the same general bankruptcy counsel are central to the reorganization efforts of either debtor or to other resolutions of the chapter 11 case or where the adverse interests are so extensive that each debtor should have its own independent general bankruptcy counsel.”

In re Enviva, Inc., 2024 WL 2795274, at *8 (Bankr. E.D. Va May 30, 2024) (quoting *In re WM Distribution, Inc.*, 571 B.R. 866, 873 (Bankr. D.N.M. 2017)

RULE 2014 DISCLOSURE REQUIREMENTS

Required disclosures include:

(1) **Any proposed arrangement for compensation AND**

(2) **To the best of applicant's knowledge, 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 in the office of the United States trustee**

"Neither Rule 2014 nor the Bankruptcy Code mandates a sanction for the violation of Rule 2014. In such situations, whether to impose a penalty and the nature and extent of the penalty is generally a matter left to the bankruptcy court's discretion."

In re Citation Corp., 498 F.3d 1313, 1321 (11th Cir. 2007)

DISQUALIFYING CONFLICT? YES/NO

- **Law Firm represents (a) Debtor (the world's largest producer of wood pellets) as its general bankruptcy counsel; (b) an Entity that owns 43% of the stock of Debtor in matters wholly unrelated to the bankruptcy case for which Entity pays Law Firm approximately $14 million a year in legal fees (about 3% of Law Firm's annual revenue), and (c) certain of Debtor's officers and directors in a shareholder derivative action who may have indemnity claims against Debtor. Under a plan being negotiated, existing shareholders will retain 5% of the equity in Debtor.**
- **The Entity has separate bankruptcy counsel. Law Firm proposes to erect an ethical wall between the lawyers representing Debtor and the Entity. A Plan Evaluation Committee appointed by Debtor's board evaluates the fairness of the Plan to Debtor and reports to the board. Law Firm's co-counsel will represent Debtor with represent to Plan issues affecting the Entity.**
- **The Committee would be granted derivative standing re possible prepetition preference claims against Law Firm, who would waive possible § 502(h) claims.**
- *In re Enviva, Inc.*, 2024 WL 2795274 and 2024 WL 3285781 (Bankr. E.D. Va)

1) **Debtor filed a chapter 11 case due to many sexual abuse claims. The claims are partly covered by insurance. Insurance Company purchased reinsurance to mitigate its risk.**

2) **Law Firm gave Debtor prepetition restructuring advice and prepared the bankruptcy case for filing; at the same time Law Firm represented Insurance Company on its reinsurance claims against reinsurer relating to Debtor's claims against Insurance Company.**

3) **Both pre- and post-petition Debtor and Insurance Company each had counsel other than Law Firm regarding Debtor's claims against Insurance Company.**

4) **Law Firm obtained confidential information from Insurance Company relating to its reinsurance claims that also relate to Debtor's claims against Insurance Company. Law Firm erected an ethical screen.**

5) **Law Firm withdrew from representing Insurance Company shortly after the chapter 11 case was filed. Insurance Company did not consent to the joint representation and asserted that Law Firm violated Rules of Professional Responsibility.**

In re Boy Scouts of America, 530 B.R. 122 (D. Del. 2021), *aff'd,* 35 F.4th 149 (3rd Cir. 2022)

- **Does it make a difference whether Law Firm violated Rules of Professional Responsibility in its representation of Insurance Company without a conflicts waiver while also representing Debtor?**
- **Does it make a difference that Law Firm's retention letter with Debtor carved out insurance issues from its representation?**
- **Does it make a difference that Debtor hired special insurance counsel as conflicts counsel?**
- **Does it make a difference that Law Firm erected an ethical screen?**

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GRANT THE RETENTION APPLICATION? YES/NO

Counsel for 8 affiliated Chapter 11 debtors failed to disclose prior limited representation in non-bankruptcy litigation of individuals associated with the debtors but amended its disclosure after objections were filed to its employment application

Counsel filed the Rule 2016 disclosure 16 days after the deadline. Its excuse was the enormity of representing 8 related debtors and time-consuming cash collateral issues

In re Chardon, LLC, 536 B.R. 791 (Bankr. N.D. Ill. 2015)

DID SUCH FAILURE AND DELAY BAR EMPLOYMENT? YES/NO

Debtors' counsel allegedly received a $250,000 pre-petition retainer from a non-debtor affiliate of the Debtors that allegedly was paid from the proceeds of money Debtor fraudulently transferred to the affiliate within one year prior to the bankruptcy filing

In re Chardon, LLC, 536 B.R. 791 (Bankr. N.D. Ill. 2015)

DISQUALIFYING CONFLICT? YES/NO

Law Firm did not disclose its receipt of retainer in its Rule 2016 statement and never amended its 2016 statement but retainer was disclosed in the SOFA

Law Firm asserted its omission was inadvertent, was due to the emergency nature of the Chapter 11 filing, and was not made in bad faith or to conceal the retainer

The bankruptcy court disallowed all Law Firm's fees and required disgorgement of fees already paid

In re Smitty's Truck Stop, Inc., 210 B.R. 844, 847 (10th Cir. BAP 1997)

AFFIRMED OR REVERSED ON APPEAL?

Law Firm representing the debtor in a chapter 7 case failed to file a Rule 2016(b) disclosure until the bankruptcy court ordered it to do so more than 2 years after the disclosure should have been filed. Law Firm was paid about $350,000 by Debtor's affiliates for representing Debtor in the bankruptcy case and Debtor and the affiliates in adversary proceedings.

The bankruptcy court ordered partial disgorgement of $25,000 guided by the principle that "the appropriate sanction should be the least severe sanction adequate to deter and punish the offender and deter future violations of the rules."

In re Stewart, 970 F.3d 1255 (10th Cir. 2020)

AFFIRMED OR REVERSED ON APPEAL?

Law Firm failed to disclose in its 2014 disclosure that the chapter 11 Debtor owed it fees for pre-petition services. The bankruptcy schedules disclosed the debt. Law Firm blamed the omission on its lack of a full understanding of his disclosure obligations under the Code and Rules and asserted that the omission did not cause prejudice.

The bankruptcy court disallowed all fees in excess of Law Firm's retainer (a reduction of about 45% or $18,500).

In re Midway Indus. Contractors, Inc., 272 B.R. 651, 663 (Bankr. N.D. Ill. 2001)

IS THIS AN APPROPRIATE SANCTION? YES/NO

Firm representing eleven related chapter 11 debtors failed to disclose "numerous connections" between its many clients in its Rule 2014 statement

In addition, one debtor had a claim against another debtor that allegedly wrongfully depleted assets pledged to it

In re Jennings, 199 F. App'x 845 (11th Cir. 2006)

IS IT NEVERTHELESS SUFFICIENT IF THE DISCLOSURES CAN BE FOUND ELSEWHERE IN THE RECORD? ACTUAL CONFLICT?

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IS JOINT REPRESENTATION ACCEPTABLE?

- **Law Firm represents an auto Dealership and a Landlord in jointly administered liquidating chapter 11 cases, each of which is wholly owned by two Individuals. Dealership owes Landlord a significant amount of past due rent. The Dealership is closed. The Dealership and the Individuals are the subject of numerous consumer claims alleging wrongful failure to pay off loans secured by traded in vehicles. In one state court lawsuit, Law Firm represented the Dealership and also represented the Individuals to prevent entry of a default judgment against them but will withdraw as their counsel.**

- **Dealership's only assets are potential claims against the Individuals and a lender liability claim. The value of the land and buildings owned by Landlord may (or may not) be sufficient to pay in full all claims against both the Landlord and Dealership. The Individuals agreed to contribute any surplus sale proceeds to the Dealership if a chapter 11 joint liquidating plan is confirmed.**

- **Law Firm did not disclose, until after the UST objected (a) that the Individuals paid the Law Firm's retainer and agreed to pay its legal fees incurred in representing the Debtors, (b) the Law Firm's representation of the Individuals in state court, or (c) any potential claims by the Dealership against the Individuals if it is found liable for the consumer claims.**

THANK YOU!

Hon. Robert H. Jacobvitz

Chief United States Bankruptcy Judge

District of New Mexico