

Best Practices/Ethical Practice in the Region



Hon. Paul G. Hyman, Moderator

Chief Judge, U.S. Bankruptcy Court; Southern District of Fla.

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CONCURRENT/FORMER CLIENTS



HYPOTHETICAL NUMBER ONE

FACTS

- Counsel files both the shareholders' Chapter 11 case and the corporation's Chapter 11 case
- Regardless of a \$30,000 claim of one debtor against the other, Court determines there is no actual conflict of interest between the parties due to the immaterial amount of the claim within the context of the case and the lack of dispute
- Court also determines that should a conflict regarding the claim arise, it would appoint another counsel



FACTS

- Creditors' Committee is appointed in the corporate case
- Creditors' Committee files a POC on behalf of the corporation in the shareholders' case
- Creditors' Committee files derivative action on behalf of corporation against shareholders
- Counsel converts corporate case to Chapter 7



FACTS

- Chapter 7 Trustee is appointed and amends to increase POC filed by Creditors' Committee in shareholders' case
- Chapter 7 Trustee files a motion for leave to file a non-dischargeability action of said claim
- Representing the shareholders, Counsel files an objection to the corporation's POC filed by the Chapter 7 trustee in the shareholders' case
- Representing the shareholders, Counsel files an objection to the filing of a non-dischargeability action by the Chapter 7 trustee in the shareholders' case – as time-barred



POTENTIAL ETHICS VIOLATIONS

- Rule 1.7, **Conflict of Interest, Current Client** which provides in pertinent part (b)(3), that it allows the representation as long as it does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or tribunal.



POTENTIAL ETHICS VIOLATIONS

- Rule 1.8, **Conflict of Interest, Current Client: Specific Rules** which provides in pertinent part (b), that a lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent.



POTENTIAL ETHICS VIOLATIONS

- Rule 1.9, **Duties to Former Clients** which provides in pertinent part that an attorney that has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to those of the former client unless the former client gives consent.



POTENTIAL ETHICS VIOLATIONS

- State law is the starting point for analyzing conflicts of interest for bankruptcy professionals.
- Attorneys are bound by the ethical codes or rules in force in the jurisdiction in which they practice law, regardless of the particular type of law they practice. Attorneys have an independent duty to conform their activities to these codes or rules. The substance of the basic concepts of bankruptcy ethics – such as loyalty, independent judgment and even who is considered a client - are drawn from non-bankruptcy law. Bankruptcy law often sets higher standards for the application of these concepts, selecting the unique nature of a bankruptcy proceeding. For example, a debtor in bankruptcy is generally not permitted unilaterally to waive its attorney's potential conflict of interest, as it might do outside of bankruptcy.
- *Retention of Professionals in Bankruptcy Cases: Ethical Issues and Special Considerations*, SG108 ALI-ABA 245 (2002).



CONSIDERATIONS

1. Section 327(a) of the Code requires that attorneys for the debtor in possession “not hold or represent an interest adverse to the estate and that [they] are disinterested persons...” **11 U.S.C. §327(a)**.
2. Professionals are expected to tender “undivided loyalty” and provide “untainted advice”.
3. Do the clients have claims against each other? Are these claims material? Material claims lead to actual conflict of interest.



CONSIDERATIONS

4. Counsel's duty to preserve confidentiality – will confidences from one client be used against other client? It is presumed they will be.
5. As counsel, who do you owe a fiduciary duty to? The corporation.
6. If concurrent clients consent, does that make it ok? Allowed by MRPC, may be prohibited by state law.
7. Would consent be valid if the principals appear on their behalf and that of the corporation? Tainted, self-serving.



CONSIDERATIONS

8. The chapter 7 case is the same entity as the previous chapter 11 for conflict of interest purposes. *In re Peck Foods*, 196 B.R. 434 (1996). Collier on Bankruptcy, 8.03(a)(3).

9. Chapter 7 Trustee is now asserting actions which should have been brought by Counsel against the shareholders for the benefit of the corporation. Since he was counsel for both the corporation and the shareholders in their Chapter 11 cases, Counsel did not assert any such action.



CONCLUSIONS

- In a situation where the possibility of disqualification arises due to conflict of interest, any doubt must be resolved in favor of disqualification. *Rome v. Braunstein*, 19 F.3d 54 (1995).
- Doubts regarding professional ethics issues must be solved by the attorney's own strict self-analysis.
- In sum, no man can serve two masters. *Cinema 5 Ltd v. Cinerama Inc.*, 528 F 2nd 1384 (2nd Cir 1976) (quoting Mathew 6:24), as cited in Simultaneous Representation of Adverse Interests: Suing one Client on Behalf of Another, 15 Miss C L Review 189.



CH. 11 DISCLOSURE/SELF DEALING



HYPOTHETICAL NUMBER TWO

FACTS

- Company files chapter 11
- Debtor files plan of reorganization and disclosure statement, which state that debtor intends to pay creditors from profits derived in ordinary course of business
- Debtor's counsel requests continuance and rescheduling of confirmation hearing
- Ten months later, still before confirmation and without court approval and with no disclosure, debtor enters multi-million dollar contract to sell substantially all assets



FACTS

- One month later, prospective buyer wires earnest money to debtor, which debtor allegedly uses to improve property
- Debtor does not disclose receipt of money in monthly operating report
- Three weeks later, debtor's attorney files motion to schedule confirmation hearing with no disclosure of sales contract
- Almost two months later, court holds confirmation hearing and orally confirms amended plan, which still does not disclose sales contract



FACTS

- Little over one month later, title commitment is issued
- Closing scheduled for one month later does not occur
- Two weeks later (but three months after hearing), court enters confirmation order (presumably tendered late by debtor's counsel)
- Next day, prospective buyer and second mortgagee file motions to revoke confirmation order
- Two weeks later and after hearing, court revokes confirmation



SOME ADDITIONAL RELEVANT FACTS

- There were allegations that debtor's attorney attempted joint venture with debtor's principal to develop subject property
- Counsel for first mortgagee was listed as escrow agent in sales contract



POTENTIAL ETHICS VIOLATIONS

- RPC 4-1.8(a) (conflict of interest; prohibited and other transactions):
 - Lawyer shall not enter into business transaction with client or knowingly acquire ownership . . . or other pecuniary interest adverse to client (except lien to secure fee) unless:
 - Transaction and terms are fair and reasonable and fully disclosed and transmitted in writing to client in manner reasonably understood;
 - Client is advised in writing of desirability of seeking, and is given reasonable opportunity to seek, advice of independent legal counsel; and
 - Client gives informed consent in writing to terms and lawyer's role



POTENTIAL ETHICS VIOLATIONS

- RPC 4-1.8(b) (conflict of interest; prohibited and other transactions):
 - Lawyer shall not use information relating to representation of client to disadvantage of client unless client gives informed consent
- RPC 4-1.1(competence):
 - Lawyer shall provide competent representation to client



POTENTIAL ETHICS VIOLATIONS

- RPC 4-3.2 (expediting litigation):
 - Requires lawyer to make reasonable efforts to expedite litigation consistent with interests of client
- RPC 4-3.3(a)(2) (candor toward tribunal):
 - Lawyer shall not knowingly make false statement of material fact or law to tribunal
- RPC 4-3.4 (fairness to opposing party and counsel):
 - Lawyer shall not unlawfully obstruct another party's access to evidence or otherwise unlawfully conceal material that lawyer knows or reasonably should know is relevant to pending proceeding



WHAT DID OUST DO?

- Filed motion to examine transactions with attorney
- Debtor's attorney settled with disgorgement of \$5,000 retainer plus \$20,000 more, to be applied first to UST quarterly fees due and owing and then to not-for-profit legal services entity
- Other confidential terms



CONCURRENT CLIENTS AND REPORTING VIOLATIONS



HYPOTHETICAL NUMBER THREE

FACTS

- ABC law firm served as counsel for Developer Group, LLC in an uncontested foreclosure action against Defunct Developer, Inc.
- A year after the Foreclosure Action was filed (and while the action remained pending) , Defunct asked ABC to represent it in an unrelated appeal.
- Both Defunct and Developer agreed that ABC's representation of Defunct was not an actual conflict and each signed a waiver.
- Several months after briefing of the appeal was complete, Condo Association (COA) filed an involuntary Chapter 7 proceeding against Defunct for unpaid dues and assessments allegedly owed to COA. ABC appears on behalf of Developer; another firm appears for Defunct. COA moves to disqualify ABC based on a conflict of interest.



ISSUES

- Does ABC have a conflict of interest?
 - If yes, is the written waiver sufficient to allow ABC to represent Defunct and Developer?
 - Does the scope of representation matter?
 - Is access to client confidences a factor?
- Does COA, as neither a client or former client, have standing to bring a motion to disqualify ABC?
- Was the COA required to move for disqualification under ABA Model Rule



ABA MODEL RULE 1.7

- Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
 - (1) the representation of one client will be directly adverse to another client; or
 - (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.



THE SUBSTANTIAL RELATIONSHIP TEST

- Courts and legal scholars have interpreted Rule 1.7 as requiring an inquiry into whether a firm's alleged concurrent representation of a client in one litigation and another client in an unrelated suit will materially interfere with its independent professional judgment.



- **First**, the court must factually reconstruct the scope of the prior legal representations.
- **Second**, the court must determine what confidential information may reasonably be inferred to have been provided to a lawyer representing a client in such matters.
- **Third**, the court must decide whether that information is relevant to the current litigation.

See, e.g., Gen-Cor LLC v. Buckeye Corrugated, Inc., 111 F. Supp. 2d 1049, 1055 (S.D. Ind. 2000); Elonex I.P. Holdings, Ltd. v. Apple Computer, Inc., 142 F. Supp. 2d 579 (D. Del. 2001)



CLIENT CONSENT

- Favoring: “[t]he preferred position . . . is that in most circumstances concern for client autonomy warrants respecting a client’s informed consent.” Restatement (Third) of the Law Governing Lawyers, § 122 cmt. g(iv); *See also*, G. Hazard & W. Hodes, *The Law of Lawyering* §11.21 (2005-1 Supp.) (“The modern consensus view is in favor of consentability . . .”).
- Disapproving: In the case where the lawyer is suing A on behalf of B, while simultaneously representing A in another, *completely unrelated* matter, it is unclear whether client consent is ever effective.” Rotunda, et. al., Legal Ethics: The Lawyer’s Deskbook on Professional Responsibility (2006-2007 ed.)



LIMITATION ON THE SCOPE OF THE REPRESENTATION

- The limitation must be adequate to eliminate the adversity.
- The “terms of the limited engagement” should be memorialized in writing as soon as possible, and in detail.



How does Rule 1.7, the substantial relationship test, and limited representation apply in our case?

- Was the scope of ABC's representation of Defunct sufficiently limited?
- Are the cases closely related?
- Did ABC obtain confidential information from Defunct that may be used against it in the foreclosure case or bankruptcy?
- Did client consent "cure" the possible conflict?



- Does the analysis of whether there is an actual conflict change if: (1) the bankruptcy involves a large corporation; (2) includes hundreds of creditors, and, (3) a large law firm who may have represented several large corporate creditors and the debtor in separate, unrelated matters?



- Does COA, as neither a client or former client, have the obligation and legal standing to bring a motion to disqualify ABC?



RULE 8.3(a) – DUTY TO REPORT ETHICAL VIOLATIONS

- A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority.



STANDING TO MOVE FOR DISQUALIFICATION OF CONFLICTED COUNSEL

- There is a split in opinion:
 - Most courts have held that only a client may move to disqualify based on a conflict of interest. *See, e.g., Shire Labs., Inc. v. Nostrum Pharms., Inc.*, 2006 U.S. Dist. LEXIS 51043 at *12 (D.N.J. 2006)
 - Others have held that “[a]ny attorney, not just a former client’s attorney, has standing, and, indeed, the obligation, to call a conflict of interest to the attention of the court because attorneys must report any actual or potential ethical violations.” *In re Pittsburgh Corning Corp.*, 308 B.R. 716, 721 (W.D. Pa. 2004).



REPORTING ANOTHER ATTORNEY'S CONFLICTS

- Is it proper to report another attorney's disregard of an apparent conflict of interest?
 - Only if the conflict raises a “**substantial question**” regarding the other attorney's honesty, trustworthiness, or fitness as a lawyer.
 - A Substantial Question is a “material matter of clear and weighty importance.”
 - Given the intricacies of determining whether an actual conflict exists, it would be difficult to truly “**know**” that another attorney has committed an ethical violation.



INDIVIDUAL 11 ISSUES



HYPOTHETICAL NUMBER FOUR

FACTS

- John moves to Florida and buys large home and property in Florida with wife as tenants by entirety
- Two years later, he files an individual 11 case
- His monthly net salary of \$16,000 will continue during his bankruptcy case
- His monthly expenses are about \$15,500, including a \$5,500 mortgage and related expenses, golf club dues, expenses for college children, a Mercedes and other “questionable” expenses



FACTS

- Upon advice of counsel, he claims his homestead, with equity of \$1,000,000, as exempt
- Upon advice of counsel, his plan proposes to pay \$30,000 to creditors over five years (\$500 times 60)
- In pre-petition divorce, wife received 90% of marital assets even though her income exceeds his
- He has a lawsuit settlement offer on the table that would pay all creditors in full but he wants to reject it and litigate for more
- Committee objects to exemption and plan



ETHICAL DUTIES OF COUNSEL UNDER MODEL RULES

- Fiduciary duties of loyalty and care to client
- Duty to maintain client confidentiality
- Duty to prevent conflicts of interest
- Duty to abide by client's decisions regarding legal objectives of the representation
- Duty to act competently and with reasonable diligence
- Duty to zealously represent the client
- Duty to keep the client reasonably informed
- Duty to exercise independent judgment and render candid advice



DUTIES OF COUNSEL IN BANKRUPTCY CONTEXT

- 327(a) retention is to assist the trustee (DIP) in carrying out trustee's (DIP's) duties under the Bankruptcy Code
- Trustee/DIP duties include duties to preserve the estate and to act in best interest of the estate



WHO IS THE CLIENT?

- Debtor, DIP, estate, some combination?
- Tension between fundamental ethical obligations to person who hires you and the overlay of trust-derived fiduciary obligations to the estate
- “Counsel for estate must keep firmly in mind that his client is the estate and not the debtor individually.”
In re Perez, 30 F.3d. 1209 (9th Cir. 1994)
- Even in cases holding that DIP, not estate is client, there is derivative duty to estate by virtue of assisting the DIP in duty to act in best interests of estate



POTENTIAL ETHICS VIOLATIONS

- Is it an ethical violation to counsel the debtor to take the position that section 522(p)(1) does not apply to limit his homestead exemption?
 - “Under no circumstances, however, may the lawyer for a bankruptcy estate pursue a course of action, unless he has determined in good faith and as an exercise of his professional judgment that the course complies with the Bankruptcy Code and serves the best interests of the estate.” *Perez*, 30 F.3d at 1219.
 - Candor toward the tribunal
 - Rule 9011



POTENTIAL ETHICS VIOLATIONS

- Is it an ethical violation to counsel the debtor that he may maintain his current style of living and propose a plan based upon his pre-bankruptcy expenses?
 - No standing trustee so debtor can generally manage his expenditures but limited by fiduciary duty to creditors
 - Application of code sections to limit expenses: 503(b), 363, 1112 and/or 1123(a)(8)



POTENTIAL ETHICS VIOLATIONS

- Do ethical considerations require counsel to advise debtor to accept the settlement that would pay all creditors in full?
 - ABA Rule 1.2 requires a lawyer to abide by a client's decision whether to settle, but again, who is the client?
 - “While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate's interests, he must seek to persuade his client to take a different course or, failing that, resign.” *Perez*, 30 F.3d at 1219.



POTENTIAL ETHICS VIOLATIONS

- What are the ethical considerations in seeking to avoid the divorce settlement as a fraudulent transfer?
 - At what point do the interests of the estate and the interests of the debtor diverge so as to require separate counsel?

