

## ITS JORE BURDEN: JORE WORKING FOR FREE IF YOU DON'T FULLY DISCLOSURE UNDER BANKRUPTCY RULE 2014

The glory days when a debtor's application for retention of its chosen professionals was automatically rubber stamped by the court appear to have come to an end. A new trend seems to be emerging in the bankruptcy courts (although the retention requirements and applicable disclosures are not new) as these courts begin to look more and more closely at the connections professionals have with other parties in interest in the case. Courts seem increasingly willing to disqualify professionals who represent other parties in interest, even on unrelated matters, or who fail to adequately disclose all their connections. The United States Bankruptcy Court for the District of Montana became the latest bankruptcy court to jump on this bandwagon when it recently handed down a ruling dealing harshly with a debtor's professionals that were found to have violated the disclosure standards for professionals that is embodied in Rule 2014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

Perkins Coie LLP ("Perkins Coie") is a well-known, large law firm based in Seattle, Washington. Perkins Coie was hired by Jore Corporation ("Jore"), on recommendation by Jore's turnaround professional, to represent Jore in connection with its voluntary petition for relief under Chapter 11 of title 11, United States Code (the "Bankruptcy Code") and in the ensuing Chapter 11 case (the "Case").

Shortly after Jore's Chapter 11 petition was filed, Perkins Coie submitted its application for retention (the "Retention Application") to the United States Bankruptcy Court for the District of Montana (the "Bankruptcy Court"). In its Retention Application,

Perkins Coie represented that it had investigated any connections it may have with Jore, any creditors of Jore, or any other party in interest in the Case. In connection with this Retention Application, one of Perkins Coie's partners, Bruce MacIntyre, also submitted an affidavit stating he had investigated all connections and, except as otherwise disclosed in his affidavit, he believed (i) Perkins Coie has no significant connections to Jore, its creditors or other parties in interest and (ii) Perkins Coie was a disinterested person as defined in Section 101(14) of the Bankruptcy Code. However, one of the disclosed connections in the MacIntyre affidavit was an acknowledgment that Perkins Coie also represented Wells Fargo Bank ("Wells Fargo"), Jore's pre-petition lender (and the likely debtor in possession ("DIP") lender), in matters wholly unrelated to the Jore representation.

MacIntyre also affirmatively stated in his affidavit that Perkins Coie would "continue... to review its connections with parties in interest in the Jore bankruptcy case...and would notify the Bankruptcy Court if any actual conflicts of interest or other significant connections were discovered." *In re Jore Corporation*, 298 B.R. 703, 708 (Bankr. D. Mont. 2003).

After Perkins Coie's Retention Application was filed, another Perkins Coie partner, Alan Smith, wrote to Wells Fargo to obtain a written conflict waiver in connection with Perkins Coie's representation of Jore (the "Waiver Letter"). This Waiver Letter confirmed the oral conflict waiver Wells Fargo had previously given Perkins Coie in regards to the Jore matter and went on to state that:

[Perkins Coie] agreed that we will not represent Jore *in litigation directly adverse* to Wells, or in any matter involving the assertion against Wells of a claim of fraud,

misrepresentation, or other dishonest conduct, and are confirming that understanding with Jore in writing.

*Id.* at 709 (emphasis added). The Waiver Letter then asked Wells Fargo to consent to the representation on “an informed basis after full disclosure...and with recognition...the...representation...creates a conflict of interest.” *Id.* A representative of Wells Fargo then countersigned this Waiver Letter, acknowledging and agreeing to its contents. Perkins Coie then sent a similar letter to Jore and obtained written approval of the representation from Jore’s CEO.

Just two days after Smith sent the Waiver Letter requesting a formal conflict waiver to Wells Fargo, Perkins Coie filed a supplemental affidavit by MacIntyre to the Retention Application (the “Retention Supplement”) with the Bankruptcy Court. The Retention Supplement relayed the fact that Perkins Coie had obtained an oral conflict waiver from Wells Fargo and was in the process of obtaining a written conflict waiver. The Retention Supplement also reminded the Court that Perkins Coie was still investigating its connections with all interested parties and reaffirmed the duty Perkins Coie had undertaken in its Retention Application to continue to notify the court “if any actual conflicts of interest or other significant connections are discovered....” *Id.* at 711. Notably, no mention of the “no litigation exception” written into the Waiver Letter with Wells Fargo was disclosed in this Retention Supplement.

The Bankruptcy Court entered a final order approving Perkins Coie’s employment on June 28, 2001. Perkins Coie then submitted a second retention supplement in August 2001, pursuant to which it once again reaffirmed its duty to notify the Court of any conflicts of interest it discovered. Notwithstanding this language, Perkins Coie still made

no mention of the “no litigation exception” to the Wells Fargo Waiver Letter or the limitations in the Waiver Letter.

Jore’s Case continued to proceed through Chapter 11, and Wells Fargo did in fact provide DIP financing (the “DIP Financing”) to Jore in order to enable Jore to consummate a sale of its assets. The terms of the DIP Financing that was ultimately approved by the Bankruptcy Court granted Wells Fargo senior liens and priority administrative expenses for the DIP Financing; provided, however, a carve out from these liens and administrative priority claims was to be allowed for professional fees incurred by professionals employed in connection with the Case up to a set dollar limit (the “Professional Fee Carve-Out”). In exchange, Jore agreed to waive any surcharge claims against Wells Fargo pursuant to Section 506(c) of the Bankruptcy Code and any other claims or defenses it may have against the liens and claims of Wells Fargo. The terms of the DIP Financing approved by the Bankruptcy Court also required Jore to present a plan of reorganization satisfactory to Wells Fargo.

The road to the asset sale was contentious and long, with many contested court hearings and motions by Jore (with Perkins Coie representing Jore), Wells Fargo and other interested parties along the way. Finally, Wells Fargo and Jore were able to agree to extend the terms of DIP Financing through the date of the asset sale, which was finally consummated in mid-April, 2002. All proceeds of the sale were given to the secured creditors.

Shortly after the asset sale, Smith wrote another letter to Wells Fargo to address the matter of unpaid professional fees. Perkins Coie claimed Wells Fargo had not honored the Professional Fee Carve-Out and also questioned whether Jore’s waiver of

506(c) charges remained valid. Acknowledging that Wells Fargo did not agree with Perkins Coie on these matters, Smith's letter asked Wells Fargo to acknowledge Wells Fargo's existing conflict waiver covered such matters, or in the alternative, asked Wells Fargo to provide a further waiver to allow Perkins Coie to "represent Jore in all such matters adverse to Wells Fargo." *Id.* at 717. A flurry of increasingly contentious and accusatory letters between increasingly senior members of both Perkins Coie and Wells Fargo followed, pursuant to which Wells Fargo vigorously contested Perkins Coie's right to represent Jore in such matters, and in which Perkins Coie indicated it would allow Jore's local counsel to prosecute such matters and would consider indemnifying Jore's counsel for its fees and expenses. *Id.* At no time did Perkins Coie notify the Bankruptcy Court of the increasingly contentious relations between itself and Wells Fargo, nor of the existence of the "no litigation exception" in the Waiver Letter.

Then in mid-June, Jore filed a status report and a "Second Supplemental Application to Employ Dye" to pursue the Professional Fee Carve-Out and 506(c) claims against Wells Fargo. *Id.* at 718. Only in this status report and the Second Supplemental Application to Employ Dye were the limitations of the Wells Fargo Waiver Letter first brought to the attention of the court. In the status report, MacIntyre wrote:

One aspect of that litigation is worthy of note. While Perkins Coie does not believe that the contention has merit, it must acknowledge that Wells Fargo Bank, a current client in unrelated matters, contends that Perkins Coie should not prosecute an action against Wells Fargo, whether for surcharge payments or to enforce the carveout provisions of the Final DIP Financing Order. Wells Fargo contends that the conflict waiver it granted at the outset of the case does not allow Perkins Coie to represent Jore in these matters.

*Id.* In response to this newly disclosed information, the U.S. Trustee filed a response, asking the Bankruptcy Court to postpone approval of Dye's employment until additional information regarding the Wells Fargo conflict waiver could be obtained. The matter then languished for a few months during which the Case was converted to a Chapter 7 liquidation.

In mid-February, 2003, Perkins Coie filed its Third and Final Application for Fees and Costs. In response, the U.S. Trustee filed a "Motion to Disqualify Perkins Coie, Vacate Employment Order and Disgorge and Disallow Fees" (the "Disqualification Motion"), arguing that Perkins Coie's failure to disclose the limitations of the Wells Fargo conflict waiver (i) constituted a violation of the applicable Rules of Professional Responsibility and (ii) failed the standards for representation of a Debtor set forth in Section 327(a) of the Bankruptcy Code and Rule 2014(a) of the Bankruptcy Rules. Perkins Coie vigorously contested these allegations and stated that its previous disclosures had adequately disclosed everything necessary to meet the standards set forth for employment of professionals in Section 327(a) and Rule 2014. A lengthy and substantial evidentiary hearing was ultimately held on the Perkins Coie final fee application and the Disqualification Motion.

In ruling upon the Disqualification Motion, the Court first stated that it would not consider whether Perkins Coie had violated any rules of professional responsibility, as that was an issue solely among Wells Fargo and Perkins Coie. Instead, the Court focused on Bankruptcy Rule 2014 in determining whether Perkins Coie had violated its statutory obligations and should be disqualified from employment and required to disgorge all the fees and expenses it had received in the Case.

In its opinion, the Bankruptcy Court began by outlining Section 327(a) of the Bankruptcy Code, which requires all professionals employed by a debtor “not hold or represent an interest adverse to the estate and...[be] disinterested persons.” 11 U.S.C. § 327(a). Whether a person or entity is disinterested under 327(a) is decided primarily by determining whether that person has any “interests materially adverse to...the estate...[or parties in interest]...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). To help a bankruptcy court determine whether a proposed professional has any materially adverse interests or connections, Bankruptcy Rule 2014 requires all proposed professionals to disclose to the court and the parties in interest all of their connections or any possible adverse interests to any party in interest.

In response to the U.S. Trustee’s Disqualification Motion, Perkins argued that what exactly constitutes a “connection” for purposes of Rule 2014 has never been defined (true enough), and that its three initial Rule 2014 disclosures that occurred during the summer of 2001, along with its disclosure of the conflict waivers to Jore, were sufficient to meet the standards of Bankruptcy Rule 2014. However, the Bankruptcy Court disagreed and stated that the Rule 2014 disclosure requirement is to be “read broadly”. *Id.* at 725, citing *In re Fjeldheim*, 1993 WL 590145 (Bank. D. Mont. 1993); *In re Love*, 163 B.R. 164, 170-171 (Bank. D. Mont. 1993); *In re EWC, Inc.*, 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992). In fact, the court stated that all connections are to be fully disclosed and Rule 2014 “[does] not give an attorney the right to withhold information because it is not apparent to him or her that a conflict exists.” *Id.* citing *In re Park-Helena Corp.*, 63 F.3d 877 (9<sup>th</sup> Cir. 1995); *cert denied, Neben & Starrett, Inc. v.*

*Chartwell Financial Corp.*, 516 U.S. 1049 (1996); *In re Haldeman Pipe & Supply Co.*, 417 F.2d 1302, 1304 (9<sup>th</sup> Cir. 1969). The Bankruptcy Court emphatically stated all facts “pertinent to a court’s determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed.” *Id.* citing *Park Helena*, 63 F.3d at 882, quoting *In re Hathaway Ranch Partnership*, 116 B.R. 208, 219 (Bankr. C.D. Cal. 1990).

Additionally, the Bankruptcy Court did not care that the failure to disclose the limitations in the Wells Fargo Waiver Letter was not intentional or malicious in any way, or that Perkins Coie believed the “no litigation exception” did not encompass matters in the bankruptcy case. *Id.* Nor did the Bankruptcy Court find the fact that Perkins had disclosed the full scope of the conflicts waiver to the debtor persuasive, as it ruled the duty of disclosure is to the court, not the client.

Instead, the Court found the lack of disclosure to violate a strict duty to disclose imposed on Perkins by Rule 2014, especially in light of Perkins Coie’s representations in each of its filings that it *had* disclosed all connections and conflicts of interest and would continue to do so if it became of any new such conflicts of interest or connections. Based on this failure of disclosure, the Court determined it had the discretion to deny employment of Perkins Coie and order disgorgement of all its fees.<sup>1</sup>

Although Perkins Coie’s argued that the Court should use its discretion in denying or awarding fees to uphold Perkins fee awards since (i) the failure to disclose was de minimis and not intentional and (ii) Perkins Coie had provided a benefit to the estate, the Bankruptcy Court was not swayed by these arguments. Although the Court

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<sup>1</sup> The Court did allow Perkins Coie to retain fees and expenses incurred in connection with serving various papers and orders pursuant to a case management order entered in the case since this function relieved the Bankruptcy Court of performing this burdensome task. *Id.* at 732.

acknowledged it had “broad discretion in determining whether to deny or award fees when a debtor’s attorney has failed to disclose material facts” it noted in the 9<sup>th</sup> Circuit, even *de minimis* or negligent disclosure violations are sanctionable by disqualification and disgorgement.<sup>2</sup> *Id.* at 729, citing *Park Helena*, 63 F.2d at 882; *In re Maui 14K*, 133 B.R. 657, 660 (Bankr. D. Haw. 1991); *In re Coastal Equities Inc.*, 39 B.R. 304, 308 (Bankr. S.D. Cal. 1984); *In re Hathaway*, 116 B.R. at 220.

In the end, the Bankruptcy Court granted the Trustee’s Disqualification Motion and ordered Perkins Coie to disgorge all fees and costs Perkins Coie had received in the case.<sup>3</sup> In so doing, the Bankruptcy Court sent a strong message to professionals that the disclosure requirements of Bankruptcy Rule 2014 are meant to be taken seriously, and, at least in Montana, would be strictly enforced. Professionals applying for retention in any bankruptcy case in the future would be well served to remember the lesson Perkins Coie learned too late and at great expense.

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<sup>2</sup> The Court also noted that since Wells Fargo was Jore’s largest creditor and the “only source of DIP Financing” the argument that exceptions to the Wells Fargo conflict waiver were *de minimis* was completely unfounded. Therefore, the Court did not feel the need to revisit opinions set forth by other circuits stating that lack of disclosure over matters that are *de minimis* or not material to the estate are not sanctionable and concluded it was within its discretion to deny fees in these instances. *Id.* at 730. For this same reason, the Bankruptcy Court also rejected Perkins Coie’s argument that since Jore “had waived all claims against Wells Fargo, its failure to disclose had no impact on its representation of the Debtor.” *Id.*

<sup>3</sup> The case is currently on appeal, awaiting oral argument.