

Ethical Standards:
Where Do You Find Them,
and Who Monitors Them?



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Ethical Standards: Where Do You Find Them, and Who Monitors Them?

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Goals of the Presentation:

The peculiar nature of bankruptcy representation combines with odd provisions of the Bankruptcy Code to construct an unusual array of “conduct” rules for the bankruptcy lawyer. These peculiarities exacerbate the conflicts that exist for all lawyers between our individual comfort level and our responsibility as an attorney for a client. The requirement of zealous representation, the conflicts between the interests of a corporation and its executives, odd rules such as the role of the consumer debtor’s attorney in a reaffirmation context or as a debt relief agency, and the conflicts between the CEO of a business debtor in possession and the debtor itself are a few examples of the ways in which a bankruptcy lawyer is often pulled in opposite directions as he or she winds his or her way through this maize.

The goal of this session is to make us more aware of these “pulls” and pressures, to sort them out and help us to deal more effectively with them.

Our inquiry starts and ends with a few key questions that confront all lawyers from the moment we step into law school until the final moments of our practice.

1. Where do the “ethical” or “moral” rules that bind us as bankruptcy attorneys come from?
2. Who enforces those rules?
3. How much does the likelihood of being caught effect our conduct?
4. To what extent are we proud or ashamed of the way we act as attorneys?

Let’s start with an elusive concept, the concept I will call “trickiness.” The kind of conduct we would rather not talk about or even think about; the kind we would rather not tell our friends, our ministers or rabbis and our young children if we have them. Things we do that make us a bit uncomfortable, not exactly lying but not exactly being full honest or forthcoming either.

So, during your practice make it a habit to look around at other lawyers you can see. Focus on a few whom you know pretty well. Then answer to yourself. Where do you rank them in terms of “trickiness.” Then, where do you rank yourself on that scale? See how that makes you squirm.

What is it that makes us uncomfortable with that conduct?

Our own moral compass?

Our church?

The rules of the Court or the judges before whom we practice?

The fact that our judges place significant reliance on us?

The ethical rules of the Kansas or Missouri Bar?

A worry that others will act this same way?

What moves us to act in such a manner?

Zealous advocacy?

The personal desire to win?

The need to win to attract clients and make more money?

What stops us?

Fear of being caught?

By whom? The bankruptcy judge?

The bar with whom we regularly practice?

The Missouri or Kansas Bar disciplinary authorities?

Are we worried about formal or informal sanctions, our reputation or something else?

Who enforces these standards?

Our own conscience?

The U.S. Trustee?

The individual Bankruptcy Judge?

The Missouri or Kansas Bar disciplinary folks?

What is the effect of our personality types . What are the benefits and detriments of:

Overly passive bankruptcy attorneys?

Overly aggressive bankruptcy attorneys?

To what extent do we need to extricate ourselves from our normal way of operating in order to be an effective lawyer?

What about the relationship between zealous advocacy and the attorney with a reserved nature?

Let's consider some of these issues in the context of a selection of the situations with which we are faced as bankruptcy lawyers.

The role of the consumer debtor attorney around reaffirmation;
The role of the consumer debtor attorney as debt relief agency and the statutory restrictions;

Solicitation issues:

Chasing preference defendants;
Chasing foreclosure victims;
Chasing the creditors' committee.

Representing the business or the individuals when the individual has guaranteed the debts of the business or are potentially "responsible parties" liable for tax debts of the business.

Representing the debtor in possession when the CEO is pushing activities that may be more for him or her benefit than the benefit of the business and its creditors.

Asset protection:

How much do you need to know to be competent?
How far do you have to go to be a zealous and competent advocate?
What do you do with the client that wants to go further?

Chapter 7 Trustees and post confirmation Chapter 11 agents who bring preference actions or make demands without sufficient due diligence.

Now consider the case of Mike Flaherty the "hero" of the recent movie Win, Win.



But the more interesting, thought-provoking, emotionally authentic, and topically strong film is Tom McCarthy's "[Win Win](#)" starring **Paul Giamatti** as struggling small town solo lawyer Mike Flaherty. The story by Joe Tiboni and **Thomas McCarthy** rings true and will resonate with legions of recession-weary, economically struggling and striving lawyers around the country.

Like all of us, Mike Flaherty has his share of flaws and foibles. His law practice is going down the proverbial tubes. He coaches a losing high school wrestling team and has a wife and two daughters and the kind of stress that comes from constantly worrying about paying his bills and providing for his young family.

Things are so bad for Flaherty that he not only dodges calling the tree service to take out the dead tree in his front yard but more significantly, he can't make his family's health insurance payment or fix the ominously clanging boiler in the basement of his sad-sack law office.

And so with twigs and no buds on his existing client files and his economic back to the wall, he momentarily shelves his ethics and takes what he thinks is an easy way out. He's so financially hard-up that he lies to the court and to his elderly and wealthy client, Leo Poplar, by volunteering for a guardianship appointment under a false pretext.

He tells the judge that he will keep Leo, who has mild dementia, in his home like he wants. But it quickly becomes apparent that Flaherty took the appointment not to help Leo but to help himself. He desperately needs the \$1500 monthly guardianship fee to keep the economic wheels from coming off. No sooner does he become Leo's guardian that after lying to him, he promptly dumps him off at an assisted living home.

When Leo's teenage grandson, talented high school wrestler Kyle Timmons, shows up, things get even more interesting. The result is pathos, humor, conflict, and what happens when the choices we make threaten to overwhelm us.

THE ETHICS OF REPRESENTING DEBTORS AND CREDITORS IN BANKRUPTCY

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TABLE OF CONTENTS

	Page
I. Sources of Applicable Law	1
II. Fiduciary Duties of the DIP and DIP Counsel	6
A. Fiduciary Duties, In General	6
B. Management of the Estate	11
C. DIP Duties With Respect to Asset Sales	19
D. Drafting a Reorganization Plan	22
E. Duties of DIP Counsel	23
III. Representation of Creditors and Committees	42
A. Conflicts of Interest With Bankruptcy Estates	42
B. Representation of Multiple Creditors	43
C. Fiduciary Duties of Creditors' Committee Members	46
D. Committee Counsel's Fiduciary Duties	51
IV. Client Misconduct and Improper Requests	58
A. Prepetition Counseling	58
B. Illegal Client Conduct During a Bankruptcy Case	66
V. Litigation Tactics and Defenses	72
A. Attorney-Client Privilege and Ethics	72
B. Trustee Power to Waive the Debtor's Privilege	73
C. Creditors' Committee Exercise of Privilege	77
D. The Joint Defense or Common Interest Doctrine in Bankruptcy	79
VI. Abusive Litigation Tactics	81
A. Standards Under Rule 9011 and Related Rules	81
B. Obtaining Sanctions	85
C. Reporting Bankruptcy Misconduct	90
D. Judicial Disqualification	92

**THE ETHICS OF REPRESENTING DEBTORS
AND CREDITORS IN BANKRUPTCY**

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I. Sources of Applicable Law.

1. Attorneys confront ethical issues and problems daily in all aspects of their practice. Ethical guidance for all attorneys may be found in the 1969 ABA Model Code of Professional Responsibility and the 1983 ABA Model Rules of Professional Conduct. A variation of one of those standards is applicable in every state. In addition to court opinions, ABA Ethics Opinions are published, as are state bar rulings, and sometimes county and city bar rulings. Bankruptcy counsel, like other attorneys, are bound by these ethical standards and interpretations. Bankruptcy courts in particular have found that state codes or rules of professional ethics apply in bankruptcy cases, and are relevant to attorney disqualification.¹ The ethical rules for

¹ See e.g. In re Pro Education Int'l, Inc., 587 F.3d 296 (5th Cir. 2009) (disqualification of creditor's attorney under state professional rules reversed); Baron & Budd, P.C.v. Unsecured Asbestos Claimants, 321 B.R. 147 (D. N.J. 2005) (regulation of professional responsibility extends to lawyers for creditors as well as court-approved lawyers); In re Muscle Improvement, Inc., 437 B.R. 389 (Bankr. C.D. Cal. 2010) (same; attorney who consulted with debtor but not hired for bankruptcy case could not represent creditor in case); In re Creative Desperation, Inc., 415 B.R. 882 (Bankr. S.D. Fla. 2009); In re Cash Media Systems, Inc., 326 B.R. 655 (Bankr. S.D. Tex. 2005); In re Disciplinary Proceedings, 282 B.R. 79 (1st Cir. BAP 2002); In re Creative Restaurant Management, Inc., 139 B.R. 902 (Bankr. W.D. Mo. 1992); In re Lee, 94 B.R. 172, 177-178 (Bankr. C.D. Cal. 1988); In re Glenn Electric Sales Corp., 99 B.R. 596, 598 (D. N.J. 1988); In re Star Broadcasting, 81 B.R. 835, 839 (Bankr. D. N.J. 1988); In re Kendavis Industries International, Inc., 91 B.R. 742, 754 (Bankr. N.D. Tex. 1988); In re Stamford Color Photo, Inc., 98 B.R. 135, 136 (Bankr. D. Conn. 1989); In re Taylor Transport, Inc., 28 B.R. 832 (Bankr. N.D. Ohio 1983); In re Roberts, 46 B.R. 815 (Bankr. D. Utah 1985), modified 75 B.R. 402 (D. Utah 1987). But c.f. In re Kelton Motors, Inc., 109 B.R. 641, 650 (Bankr. D. Vt. 1989) (violation of professional ethics does not result in automatic disqualification of counsel); see also Matter of Breen, 171 Ariz. 250, 252, 830 P.2d 462 (Ariz. 1992) (Bankruptcy Code restrictions on counsel representation of an estate do not release attorneys from duties under state ethics rules).

the district in which the bankruptcy case is pending generally govern lawyers admitted *pro hac vice* in that case, or otherwise appearing.²

2. Many lawyers find the relevant ethical guidelines difficult to understand and apply, even when counseling and litigating on behalf of only one client. Problems increase for counsel for a debtor-in-possession (“DIP”) or trustee, since those clients bear responsibilities to other entities and people as well. They are fiduciaries to the bankruptcy estate, perform duties for the benefit of creditors, and operate only with restraint.³

3. While the ethical duties of counsel for a debtor in possession (“DIP”) or committee, or any other client, run primarily to the client, and emphasize loyalty and sound representation to the client,⁴ loyal and responsible service must be performed in the context of the client’s rights and duties. And, such service cannot transgress ethical rules of fair and honest dealing with third parties, including the court and opposing counsel.⁵ Given the fiduciary duties of the DIP and committee members to creditors, and the conflicts that result when the interests of creditors in general differ from self-interest, counsel in many cases has a difficult time counselling as well as advocating. Courts holding that counsel has her own fiduciary

² In re Proeducation Intern., Inc., 587 F.3d 296 (5th Cir. 2009); In re Chase, 372 B.R. 142 (Bankr. S.D.N.Y. 2007); Cash Media Systems, *supra*; In re Zuniga, 332 B.R. 760 (Bankr. S.D.Tex. 2005); In re Mortgage & Realty Trust, 195 B.R. 740 (Bankr. C.D. Cal. 1996). Counsel engages in the unauthorized practice of law if she appears in a bankruptcy court in which she is not admitted. In re Brown, 270 B.R. 43 (Bankr. D. S.C. 2001).

³ See, e.g. 11 U.S.C. §§ 323, 704, 721, 1106, 1107. The debtor and his counsel may have a significant role to play in a Chapter 7 case, too, warranting court control over the attorney’s conflicts of interest. In re Nu-South Industries, Inc., 115 B.R. 90 (Bankr. S.D. Miss. 1990). For a comprehensive article on the issues set forth in this outline, see Kelbon, Herman and Bell, Conflicts, The Appointment of “Professionals,” and Fiduciary Duties of Major Parties in Chapter 11, 8 Bankr. Dev. J. 349 (1991).

⁴ E.g. Model Rules of Professional Conduct (“Model Rules”) 1.1- 1.9.

⁵ E.g. Model Rules 3.1- 3.4, 4.1- 4.4; In re Dinova, 212 B.R. 437 (2d Cir. BAP 1997)

duties to the general creditors, apart from and sometimes conflicting with duties to her client, exacerbate the difficulty, and intensify the need to understand bankruptcy fiduciary duties, as described more fully below.⁶

4. Counsel for the DIP and for the debtor in chapter 7 and chapter 13 cases must also abide by a number of Bankruptcy Code provisions with ethical connotations, including those requiring disclosures of compensation arrangements, with DIP and trustee counsel also obliged to comply with disinterestedness requirements.⁷ Bankruptcy Rule 9011 now provides that counsel's "filing" or "later advocating" any paper in a case is a certification that to the best of the attorney's knowledge, information, and belief formed after a reasonable inquiry, it is not presented for delay or any other improper purpose, is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and either has evidentiary nonfrivolous support or is likely to be so supported after reasonable discovery. Local Bankruptcy Rules may well have similar ethical components.⁸

(attorney duties of candor and full disclosure to bankruptcy court).

⁶ See In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re Bonneville Pacific Corp., 196 B.R. 868 (Bankr. D. Utah 1996) rev'd in part in case with thorough analysis of DIP counsel's fiduciary duties, Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998); In re Rivers, 167 B.R. 288 (Bankr. N.D. Ga. 1994); In re United Utensils Corp., 141 B.R. 306 (Bankr. W.D. Pa. 1992); In re Doors and More, Inc., 126 B.R. 43 (Bankr. E.D. Mich. 1991); Matter of Arlan's Department Stores, Inc., 615 F.2d 925 (2d Cir. 1979); In re Kelton Motors, Inc., 109 B.R. 641 (Bankr. D. Vt. 1989); In re Coastal Equities, Inc., 39 B.R. 304 (Bankr. S.D. Cal. 1984). See also In re Hudsar, 199 B.R. 266 (Bankr. D.N.J. 1996)(DIP counsel may be liable in malpractice to non-client creditor if assumes fiduciary duty to creditor).

⁷ 11 U.S.C. §§326-329. Bankruptcy Rules 2014, 2016 and 2017 provide for implementation of these provisions.

⁸ The bankruptcy court also has broad powers to prevent an abuse of process and enforce court rules and orders under 11 U.S.C. §105, but contempt may need to be determined by the district court. In re Ragar, 3 F.3d 1174 (8th Cir. 1993)(appropriate method for imposing contempt described; circuit cases discussed); Bankruptcy Rule 9020; but see In re Sorrell, 346 B.R. 417 (Bankr. N.D. W.Va. 2006) (civil contempt for failure to comply with fee

5. The 2005 Bankruptcy Code amendments include specific remedies that may be imposed if the debtor’s lawyer violates Bankruptcy Rule 9011 and the case is dismissed or converted under Bankruptcy Code § 707(b).⁹ The amendments authorize civil penalties for any Rule 9011 violation.¹⁰ The amendments further incorporate into the Bankruptcy Code a variation on Bankruptcy Rule 9011 that is harsher than the current rule, and applies to every attorney’s signature on a petition, pleading or written motion.¹¹ Among other things, the new Code language requires that all factual contentions be “well grounded” instead of having “evidentiary support,” and that all legal arguments be made in “good faith,” instead of being “nonfrivolous.”¹² Bankruptcy Rule 9011 may also be amended to expressly extend its reach to all documents, including schedules, submitted to the court or a trustee, even if the documents, including schedules, submitted to the court or a trustee, even if the lawyer does not sign them, to comply with the “sense of Congress” in the 2005 Bankruptcy Code amendments.¹³ The 2005 Code amendments may also define lawyers providing consumer bankruptcy assistance in return for compensation in certain circumstances as “debt relief agencies.”¹⁴ The amendments impose restrictions on debt relief agencies, and authorize courts to enjoin such behavior and

disgorgement order after bankruptcy court show cause hearing).

⁹ 11 U.S.C. § 707(b)(4)(A), (5)(A).

¹⁰ 11 U.S.C. § 707(b)(4)(B).

¹¹ 11 U.S.C. § 707(b)(4)(C), (D).

¹² 11 U.S.C. § 707(b)(4)(C).

¹³ 109 P.L. 8 § 319.

¹⁴ 11 U.S.C. § 101(3), (4A), (12A). *Milzvetz, Gallop & Milavetz, P.A. v. U.S.*, ____ U.S. ____, 130 S. Ct. 1324 (2010).

impose civil penalties.¹⁵ This does not, however, curtail the authority of State bar disciplinary bodies.¹⁶

6. Several statutes and case law interpreting them provide additional sources of authority on ethics in bankruptcy. 28 U.S.C. §1927 authorizes courts to require counsel to satisfy personally excess costs, expenses and attorneys' fees incurred as a result of unreasonable and vexatious multiplication of proceedings.¹⁷ Concealment of assets, false oaths and claims, including knowing and fraudulent efforts to obtain advantage for acting or forbearing to act in a bankruptcy case, are bankruptcy crimes.¹⁸ Knowing and fraudulent appropriation of property of a bankruptcy estate, or destruction of any document belonging to a bankruptcy estate which came into his charge as trustee, custodian, or other officer of the court, is criminal as well.¹⁹ Knowing and fraudulent agreements to fix fees or compensation in a bankruptcy case is also illegal.²⁰ Further, the bankruptcy court may have the inherent power to sanction attorneys appearing before it for unethical or bad faith conduct.²¹ Sanctions can include suspending or disbaring an attorney from practicing in the bankruptcy court for that district.²²

¹⁵ 11 U.S.C. § 526(c). See In re Irons, 379 B.R. 680 (Bankr. S.D. Tex. 2007)(OSC given Chapter 13 counsel's noncompliance with §526 and incompetence); In re Gutierrez, 356 B.R. 496(Bankr. N.D. Cal. 2006)(fee disgorgement).

¹⁶ 11 U.S.C. § 526(d). See In re Phillips, 597 Ariz. Adv. Rep. 19 (2010) (manager of high volume consumer debtor firm sanctioned for firm practices and procedures).

¹⁷ But see cases regarding whether the bankruptcy court has jurisdiction to impose sanctions under §1927 as a "court of the United States" in **fn 639**.

¹⁸ 18 U.S.C. § 152.

¹⁹ 18 U.S.C. § 153.

²⁰ 18 U.S.C. § 155.

²¹ Chambers v. NASCO, Inc., 111 S.Ct. 2123 (1991); In re Lehtinen, 564 F.3d 1052 (9th Cir. 2009); In re Mroz, 65 F.3d 1567 (11th Cir. 1995); In re Disciplinary Proceedings, 282 B.R. 79 (1st Cir. BAP 2002); In re Steffen, 406 B.R. 148 (Bankr. S.D. Fla. 2009); In re Kozich, 406 B.R. 949 (Bankr. S.D. Fla. 2009); In re Henderson, 360 B.R. 477 (Bankr. D. S.C. 2006); In re Sorrell, 346 B.R. 417 (Bankr. N.D. W.Va. 2006); In re Vettori, 217 B.R. 242 (Bankr. N.D. Ill.

7. When a sanctioned lawyer's conduct is illegal or violates the ethical rules governing his practice of law in a manner that raises a substantial question as to the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, that lawyer and other lawyers knowing of it are obligated to report that conduct to the applicable state bar disciplinary authorities.²³ Judges are likewise required to report conduct meeting this standard.²⁴

II. Fiduciary Duties of the DIP and DIP Counsel.

A. **Fiduciary Duties, In General.**

1. A DIP has not only the powers, but also most of the *duties* of a trustee, and is a fiduciary to its creditors as well as its equity owners.²⁵ It is difficult

1998); Matter of Malmen, 140 B.R. 819 (Bankr. M.D. Fla. 1992); see discussion in In re Gioioso, 979 F.2d 956 (3d Cir. 1992).

²² In re Brooks-Hamilton, 329 B.R. 270 (9th Cir. BAP 2005), aff'd in part, rev'd in part, 271 Fed. Appx. 654 (9th Cir. 2008); In re Evergreen Sec., Ltd., 391 B.R. 184 (M.D. Fla. 2008); In re Stone, 421 B.R. 401 (Bankr. W.D. Ky. 2009) (permanent disbarment); In re Creative Desperation, Inc., 415 B.R. 882 (Bankr. S.D. Fla. 2009); In re Brown, 408 B.R. 509 (Bankr. D. Idaho 2009); In re Reeves, 372 B.R. 525 (Bankr. N.D. Ga. 2007); In re Ebel, 371 B.R. 866 (Bankr. S.D. Ill. 2007); In re Bellows-Fairchild, 322 B.R. 675 (Bankr. D. Or. 2005); In re Crayton, 192 B.R. 970 (9th Cir. BAP 1996), but see In re Gage, 394 B.R. 184 (Bankr. N.D. Del. 2008) (only district court can suspend attorney from practice or otherwise enter disciplinary relief. See notes 623-28 regarding procedures for imposing such severe sanctions.

²³ Model Rule 8.3 RESTATEMENT OF THE LAW GOVERNING LAWYERS § 5 (1998); see § 27:28.

²⁴ Model Code of Judicial Conduct 3D(2).

²⁵ 11 U.S.C. § 1107(a); CFTC v. Weintraub, 471 U.S. 343, 355, 105 S. Ct. 1986, 1994 (1985); Wolf v. Weinstein, 372 U.S. 633, 83 S. Ct. 969, 979-80 (1963). In re Americana Expressways, Inc., 133 F.3d 752 (10th Cir. 1997); Home Ins. Co. of Illinois v. Adco Oil Co., 154 F.3d 739 (7th Cir. 1998); In re McConville, 110 F.3d 47 (9th Cir. 1997). A corporation's directors owe fiduciary duties to creditors when the company becomes insolvent, even absent bankruptcy. FDIC v. Sea Pines Co., 692 F.2d 973 (4th Cir. 1982), cert. denied 461 U.S. 928 (1983); Pereira v. Logan, 294 B.R. 449, 519-20 (Bankr. S.D.N.Y. 2003) (fiduciary duty owed to corporate creditors under Delaware law when the corporation is "in the vicinity of insolvency"); In re Harloff, 289 B.R. 770 (Bankr. M.D. Fla. 2002) (duty to collect estate property without personal compensation); Whitley v. Carolina Clinic, Inc., 455 S.E.2d 896 (N.C. App. 1995); see In re Metropolitan Cosmetic & Reconstructive Surgical Clinic, 115 B.R. 185 (Bankr. D. Minn. 1990); but see also In re SIDCO, Inc., 162 B.R. 299 (Bankr. E.D. Cal. 1993), aff'd. 173 B.R. 194 (E.D. Cal. 1994)(questioning existence of fiduciary duties to

to determine, however, the precise scope of a DIP's fiduciary responsibilities, and how to avoid participating in or assisting a DIP in the breach of its fiduciary duties, and to counsel a DIP to meet its fiduciary obligations.²⁶ The DIP's attorney must be pro-active and render unsolicited advice, as well as respond to client requests for advice, to inform the client of the need for preventative or corrective action in carrying out fiduciary duties.²⁷

2. Courts have sometimes described the DIP's fiduciary duties broadly but vaguely, as an obligation to act not in his or her own best interest, but rather in the best interest of the entire estate, including the creditors and owners of the estate.²⁸ Yet Congress did not require the DIP or its constituents to be disinterested, and competing creditors' interests are generally protected by their own counsel, the creditors' committee and the U.S. Trustee. The interests of DIP management (especially when they are liable for some DIP debts as guarantors or general partners)

creditors). Outside of bankruptcy, a debtor does not owe fiduciary duties to creditors. In re Lifschultz Fast Freight, 132 F.3d 339, 346 (7th Cir. 1997). Nor does a chapter 7 debtor owe such duties. In re Kreisler, 546 F.3d 863, 867 (7th Cir. 2008).

²⁶ See Davis, McCullough, McNulty and Schuler, Corporate Reorganizations in the 1990s: Guiding Directors of Troubled Corporations Through Uncertain Territory, 47 Business Lawyer 1 (Nov. 1991); Varallo and Finkelstein, Fiduciary Obligations of Directors of the Financially Troubled Company, 48 Business Lawyer 239 (Nov. 1992). A DIP's fiduciary duties to creditors do not extinguish fiduciary duties to its partners. Washington Medical Center v. Holle, 573 A.2d 1269 (D.C. App. 1990).

²⁷ In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re Count Liberty, LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007); In re Texasoil Enterprises, Inc., 296 B.R. 431 (Bankr. N.D. Texas 2003); In re Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992); In re Whitney Place Partners, 123 B.R. 117 (Bankr. N.D. Ga. 1992); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); In re V. Savino Oil & Heating Co., 99 B.R. 518 (Bankr. E.D.N.Y. 1989)(DIP holds powers in trust for creditors); In re Sowers, 97 B.R. 480 (Bankr. N.D. Ind. 1989); In re Consupak, Inc., 87 B.R. 529 (Bankr. N.D. Ill. 1988); Model Rule 2.1; ABA Code DR 7-101, EC 7-8.; see also In re Cochener, 382 B.R. 311 (S.D. Tex. 2007)(same duty in context of Chapter 7 debtor-client); In re Williams, 378 B.R. 811 (Bankr. E.D. Mich. 2007)(Chapter 13).

²⁸ E.g. In re Rancourt, 207 B.R. 338 (Bankr. D. N.H. 1997); In re Doors and More, Inc., 126 B.R. 43 (Bankr. E.D. Mich. 1991); In re Modern Office Supply, Inc., 28 B.R. 943 (Bankr. W.D.

may differ from the interests of the DIP entity or some or all of its creditors. The DIP is to forego from self-dealing at the expense of creditors,²⁹ and obey Code restrictions and court orders.³⁰ But beyond that proscription, how is the DIP to act in the best interests of all?³¹

3. There are two oft-discussed prongs to fiduciary duties: a duty of care, and a duty of loyalty.³² A fiduciary must make informed decisions and exercise

Okla. 1983); In re APP Plus, Inc., 223 B.R. 870 (Bankr. E.D.N.Y. 1998).

²⁹ Home Ins. Co. of Illinois v. Adco Oil Co., 154 F.3d 739 (7th Cir. 1998)(lawyer-debtor reduced assets by failing to pursue malpractice coverage); In re Simon Transportation Services, Inc., 292 B.R. 207 (Bankr. D. Utah 2003) (DIP omissions gave insiders competitive advantage in §363 sale); In re Harloff, 289 B.R. 770 (Bankr. M.D. Fla. 2002) (collect estate property for no additional compensation); In re Hampton Hotel Investors, L.P., 270 B.R. 346 (Bankr. S.D.N.Y. 2001)(failure to collect receivables from partners' affiliate, and collusive agreement on asset sales); In re Honey Creek Entertainment, Inc., 246 B.R. 671 (Bankr. E.D. Okla. 2000)(unauthorized transfers to non-debtor companies controlled by DIP management); In re Performance Nutrition, Inc., 239 B.R. 93 (Bankr. N.D. Tex. 1999)(officer's self-interest took priority over debtor corporation's interests in sale of assets); Tenn-Fla Partners v. First Union Nat. Bank of Fla., 229 B.R. 720 (W.D. Tenn. 1999); In re 239 Worth Ave. Corp., 236 B.R. 492 (Bankr. S.D. Fla. 1999)(use of estate assets for personal expenses); In re General Homes Corp., 199 B.R. 148 (S.D. Tex. 1996)(directors substantially increased their own compensation just before order for relief); In re Microwave Products of America, Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989); In re Colby Construction Corp., 51 B.R. 113 (Bankr. S.D.N.Y. 1985)(breach of fiduciary duties through undocumented loans to insiders); see cases cited in In re Schipper, 109 B.R. 832, 835 (Bankr. N.D. Ill. 1989), aff'd., 112 B.R. 917 (N.D. Ill. 1990); aff'd., 933 F.2d 513 (7th Cir. 1991); see also 18 U.S.C. § 154 prohibiting trustee or other officer of the court from purchasing estate assets, and In re Q.P.S., Inc., 99 B.R. 843 (Bankr. W.D. Tenn. 1989)(DIP's accountant prohibited from buying estate car); In re Exennium, 23 B.R. 782 (9th Cir. BAP 1982), rev'd. on other grounds 715 F.2d 1401 (9th Cir. 1993)(former DIP counsel barred from purchasing lease from trustee after conversion).

³⁰ In re McConville, 110 F.3d 47 (9th Cir. 1997)(breach of fiduciary duty to obtain postpetition secured financing without §364 court authorization); In re Four Seasons Marine & Cycle, Inc., 263 B.R. 764 (Bankr. E.D. Tex. 2001)(cash collateral restrictions); In re Honey Creek Entertainment, Inc., 246 B.R. 671 (Bankr. E.D. Okla. 2000)(postpetition non-ordinary course transfers without court authorization); In re 239 Worth Ave. Corp., 236 B.R. 492 (Bankr. S.D. Fla. 1999)(payment of prepetition debt and obtaining postpetition financing without court orders); In re Urbanco, Inc., 122 B.R. 513 (Bankr. W.D. Mich. 1991); In re Wells, 71 B.R. 554 (Bankr. N.D. Ohio 1987).

³¹ See extensive analysis in Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway? 17 Amer. Bankr. L. Inst. C. Rev., 291 (Winter 2009).

³² In re Western World Funding, Inc., 52 B.R. 743 (Bankr. D. Nev. 1985) aff'd. in relevant part 985 F.2d 1021 (9th Cir. 1993).

the judgment that a person of ordinary intelligence and prudence would exercise, in fulfilling those duties.³³

4. One aspect of the duty of loyalty for fiduciaries with multiple beneficiaries is the duty to resolve conflicts among beneficiaries.³⁴ By way of example, in a corporate context outside of bankruptcy, such a duty arises for directors when some stockholders strongly desire current profits and high dividends, while others with equal fervor desire low dividends, high reinvestment of earnings, and maximum long-term growth.³⁵

5. In a Chapter 11 context, DIP duties to treat all constituents “fairly”³⁶ and resolve conflicts among them may be analyzed under three theories: (a) Pro-equity—the DIP’s duties are limited to the duty of care and to avoid improper personal conflicts and self-dealing, so the DIP can battle from the equity’s perspective, because the creditors’ interests are protected by the creditors’ committee, individual creditors’ counsel, and the U.S. Trustee; (b) Pro-debt—given the absolute priority rule, the DIP must disregard shareholder interests until creditors are paid in full; (c) Stakeholder-mediator—the DIP should be sure each constituency is informed about its role and represented in the case, let those constituencies battle among

³³ In re Four Score Broadcasting, Inc., 77 B.R. 404 (Bankr. W.D.N.Y. 1987); In re Roblin Industries, Inc., 52 B.R. 241 (Bankr. W.D.N.Y. 1985); See In re Cochise College Park, Inc., 703 F.2d 1339 (9th Cir. 1983)(applying standard to bankruptcy trustee).

³⁴ See RESTATEMENT (SECOND) OF TRUSTS § 183 (1959).

³⁵ Case, Fiduciary Duty of Corporate Directors and Officers, Resolution of Conflicts Between Creditors and Shareholders, and Removal of Directors by Dissident Shareholders in Chapter 11 Cases, Materials of the Williamsburg Bankruptcy Conference on Bankruptcy 373 (ALI-ABA 1988)(hereafter “Case”).

³⁶ CFTC v. Weintraub, 471 U.S. at 356; Pepper v. Litton, 308 U.S. 295, 306 (1939); In re Bellevue Place Associates, 171 B.R. 615 (Bankr. N.D. Ill. 1994) (DIP cannot surrender control over decisions to single creditor, but must be fair to all).

themselves, and propose a plan the DIP regards as a fair balancing of the competing interests involved or let the others pursue their own plan proposals.³⁷

6. The DIP (and its counsel) is at risk if it acts based on the pro-equity theory, without express court sanction, because numerous courts have held that the DIP cannot advocate the perspective of equity alone, with a creditors-be-damned attitude.³⁸ Likewise, courts have cautioned that the interests of equity must not be overlooked in focusing on the interests of creditors.³⁹ When there are different factions of equity holders, counsel must refrain from taking part in disputes and advise the corporation.⁴⁰

7. The duty of loyalty is also owed by the debtor's senior officers. They must avoid any conflict of interest with the estate, including by personal commitments to creditors,⁴¹ asset transfers,⁴² actions with respect to liability for avoidance actions,⁴³ and sales of estate assets in which insider-controlled activities

³⁷ Case at 383.

³⁸ See In re Kendavis Industries International, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988); In re Marathon Home Loans, 101 B.R. 216 (Bankr. E.D. Cal. 1989); In re Downtown Investment Club III, 89 B.R. 59 (9th Cir. BAP 1988).

³⁹ In re Central Ice Cream Co., 836 F.2d 1068 (7th Cir. 1987); In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983); In re Bush Industries, Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004); In re Water's Edge Ltd. Partnership, 251 B.R. 1 (Bankr. D. Mass. 2000); In re Philadelphia Athletic Club, Inc., 15 B.R. 60 (Bankr. E.D. Pa. 1981).

⁴⁰ In re Entertainment, Inc., 225 B.R. 412 (Bankr. N.D. Ill. 1998)(cannot pursue plan for one faction against competing faction's plan).

⁴¹ In re R&R Associates of Hampton, 402 F.3d 257 (1st Cir. 2005); In re Coram Healthcare Corp., 271 B.R. 228 (Bankr. D. Del. 2001), but see In re Airway Industries, Inc., 354 B.R. 82 (Bankr. W.D. Pa. 2006)(secured creditor agreement to pay management bonuses permitted under all the circumstances).

⁴² In re WBE Company, Inc., 2007 Bankr. LEXIS 4250 (Bankr. D. Neb. 2007)(diversion of business to other entities); In re Count Liberty, LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007); In re Chief Executive Officers Clubs, Inc., 359 B.R. 527 (Bankr. S.D.N.Y. 2007).

⁴³ In re Tel-Net Hawaii, Inc., 105 B.R. 594 (Bankr. D. Ha. 1989); In re Sal Caruso Cheese, Inc., 107 B.R. 808 (Bankr. N.D.N.Y. 1989). See note 53.

are bidders.⁴⁴ When DIP management has substantial, inherent conflicts of interest that interfere with carrying out the fiduciary obligations of a DIP, the court may appoint a Chapter 11 Trustee without finding fraud, dishonesty, incompetence or gross mismanagement.⁴⁵

B. Management of the Estate.

1. Indisputably, the DIP's fiduciary duty of care includes a duty to protect and maximize the return on estate assets.⁴⁶ Appropriate insurance must be maintained.⁴⁷ Maximizing estate assets entails investing all funds not needed to meet current expenses, whenever a period of time is expected to elapse before distribution, even after a final report is filed.⁴⁸ Attorney retainers should likewise be invested in interest-bearing accounts.⁴⁹ Protection of estate assets includes payment of actual and necessary costs to preserve and maintain estate property.⁵⁰

2. A DIP may delegate duties to court-appointed counsel.⁵¹

However, DIP officers may not surrender all their obligations to oversee the estate to

⁴⁴ In re Simon Transportation Services, Inc., 292 B.R. 207 (Bankr. N.D. Utah 2003).

⁴⁵ See In re Cajun Electric Power Corp., 74 F.3d 599 (8th Cir. 1996); In re Marvel Entertainment Group, Inc., 140 F.3d 463 (3rd Cir. 1998); In re RJ Manufacturing, Inc., 2004 WL 764669 (Bankr. N.D. Iowa 2004); In re Suncruz Casinos, LLC., 298 B.R. 821 (Bankr. S.D. Fla. 2003).

⁴⁶ United States v. Aldrich (In re Rigden), 795 F.2d 727 (9th Cir. 1986); In re James River Associates, 156 B.R. 494 (E.D. Va. 1993). But see In re Texas Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010) (if creditors part in full and all equity owners consent to treatment, debtor need not maximize value).

⁴⁷ In re Campbell-Erskine Apothecary, Inc., 302 B.R. 169 (Bankr. W.D. Pa. 2003).

⁴⁸ In re Consupak, Inc., 87 B.R. 529 (Bankr. N.D. Ill. 1988); see In re Charlestown Home Furnishing, 150 B.R. 226 (Bankr. E.D. Mo. 1993) (trustee negligent in failing to invest estate funds).

⁴⁹ In re J & J Record Distributing Corp., 80 B.R. 53 (Bankr. E.D. Pa. 1987); but see In re Mondie Forge Co., 154 B.R. 232 (Bankr. N.D. Ohio 1993) (state law requirement that interest earned on trust account money may not inure to client); In re Hunt, 196 B.R. 356 (N.D. Tex. 1996) (Code §345 vests investment discretion in trustee and DIP).

⁵⁰ In re Taub, 427 B.R. 208 (Bankr. E.D.N.Y. 2010).

⁵¹ In re Mushroom Transportation Co., Inc., 247 B.R. 395 (E.D. Pa. 2000).

that counsel, and may themselves be held liable for breach of fiduciary duty if the lawyer steals estate funds in those circumstances.⁵²

3. The duty to maximize estate assets has been held to include prosecution of causes of action against the DIP's principals for negligence, mismanagement, breach of fiduciary duty, and avoidance of fraudulent transfers when such a suit would be beneficial for the estate (albeit not the DIP management).⁵³ Waiver of all claims against a proposed DIP lender, without sufficient investigation, was also deemed not in accord with the DIP's fiduciary duties in one case,⁵⁴ while another held that failure to collect receivables from an affiliate breached such duties.⁵⁵ A debtor has a fiduciary duty to disclose all potential causes of action in its schedules.⁵⁶ Failure to disclose potential fraudulent transfer claims against insiders may be deemed a fraud on the court.⁵⁷ Causes of action that did not accrue prepetition need not be scheduled.⁵⁸

⁵² In re Mushroom Transportation Co., Inc., 282 B.R. 805 (E.D. Pa. 2002).

⁵³ Louisiana World Exposition v. FDIC, 858 F.2d 233 (5th Cir. 1988); see Canadian Pacific Forest Products, Ltd. v. J.D. Irving, Ltd., 66 F.3d 1436 (6th Cir. 1995); In re G-I Holdings, Inc., 313 B.R. 612 (Bankr. D.N.J. 2004); In re Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993); In re Microwave Products of America, Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989); see In re United Utensils Corp., 141 B.R. 306 (Bankr. W.D. Pa. 1992) (DIP counsel later employed by trustee to pursue DIP's principals; principals could not assert privilege and counsel had duty to assist trustee in litigation). **See note 42.**

⁵⁴ In re Roblin Industries, Inc., 52 B.R. 241 (Bankr. W.D.N.Y. 1985). See also In re Belk Properties, LLC, 421 B.R. 221 (Bankr. N.D. Miss. 2009) (empowering DIP lender with DIP rights would violate DIP fiduciary duties).

⁵⁵ In re Hampton Hotel Investors, L.P., 270 B.R. 346 (Bankr. S.D.N.Y. 2001).

⁵⁶ Cusano v. Klein, 264 F.3d 936 (9th Cir. 2001) (list all causes of action that accrued prior to bankruptcy); In re Coastal Plains, Inc., 179 F.3d 197, 207-09 (5th Cir. 1999) (non-disclosure may judicially estop estate from pursuing litigation); see also **note 544.**

⁵⁷ In re R&R Associates of Hampton, 248 B.R. 1 (Bankr. D. N.H. 2000) subsequent appeal in same adversary, 402 F.3d 257 (1st Cir. 2005).

⁵⁸ In re JZ, LLC, 357 B.R. 816 (Bankr. D. Idaho 2006).

4. DIP management breaches its fiduciary duties by diverting business to a related non-debtor company.⁵⁹ Similarly, a DIP breaches its fiduciary duty by transferring value in excess of fair consideration to an insider through a “golden parachute” or debt forgiveness.⁶⁰ Consenting to stay relief for property with significant equity, then acquiring the property upon foreclosure through an insider entity, breaches fiduciary duties.⁶¹ The duty of care also encompasses the duty not to dissipate assets by negligently continuing to operate and incur debts in a Chapter 11 when it is evident that no reorganization can succeed. Several courts have phrased their reasoning for decisions on appointing trustees in chapter 11 cases in terms of DIP breach of fiduciary duties to creditors.⁶² Obviously, this duty also encompasses not stealing from estate accounts for unauthorized purposes,⁶³ or expending funds in violation of court orders.⁶⁴

5. DIP counsel may be sanctioned, at least through non-approval of fees, for allowing a DIP to breach its duty of care in the form of using bankruptcy court protection to incur further debt that cannot be paid.⁶⁵ The same is true when

⁵⁹ In re WBE Company, Inc., 2007 Bankr. LEXIS 4250 (Bankr. D. Neb. 2007); In re V Companies, 274 B.R. 721 (Bankr. N.D. Ohio 2002).

⁶⁰ In re Bush Industries, Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004).

⁶¹ In re Brook Valley IV, 496 F.3d 892 (8th Cir. 2007).

⁶² In re V. Savino Oil & Heating Co., Inc., 99 B.R. 518 (Bankr. E.D.N.Y. 1989); In re Sharon Steel Corp., 86 B.R. 455 (Bankr. W.D. Pa. 1988); In re Parker Grande Development, Inc., 64 B.R. 557 (Bankr. S.D. Ind. 1986); In re Colby Construction Corp., 51 B.R. 113 (Bankr. S.D.N.Y. 1985); In re Van Brunt, 46 B.R. 29 (Bankr. W.D. Wisc. 1984); In re Modern Office Supply, Inc., 28 B.R. 943 (Bankr. W.D. Okla. 1983); In re E. Paul Kovacs and Co., Inc., 16 B.R. 203 (Bankr. D. Conn. 1981). See also Matter of Cajun Elec. Power Co-op, Inc., 69 F.3d 746 (5th Cir. 1995), amended on rehearing, 74 F.3d 599 (5th Cir. 1996)(when cooperative members work at cross-purposes, conflict requires appointment of trustee).

⁶³ In re Gregory, 214 B.R. 570 (S.D. Tex. 1997).

⁶⁴ In re Count Liberty, LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007).

⁶⁵ In re Blue Top Family Restaurant, Inc., 110 B.R. 777 (Bankr. W.D. Pa. 1990); In re James Contracting Group, Inc., 120 B.R. 868 (Bankr. N.D. Ohio 1990); but see In re

administrative expenses in the form of accruing attorneys' fees continue to be incurred in preparing a plan when the DIP's business is clearly deteriorating and there is no reasonable chance of an effective reorganization.⁶⁶ That reasoning has been held to preclude payment of fees in resisting conversion to chapter 7 after the DIP should have known reorganization was not a legitimate option, and use of estate assets to pay excessive executive compensation or non-estate obligations, such as attorneys' fees incurred in defending nondischargeability claims, and individual debtor living expenses.⁶⁷ Counsel has also been sanctioned through fee disallowance for allowing a DIP to operate in chapter 11 for the sole purpose of paying down secured debt and tax obligations owed personally by the principals, when it was clear from the start that unsecured creditors would receive no distribution, or otherwise assisting insiders in actions detrimental to the estate and creditors.⁶⁸ Similarly, courts

Dieringer, 132 B.R. 34 (Bankr. N.D. Cal. 1991) (DIP's attorney is not liable in tort to creditors for mishandling a bankruptcy where estate assets were dissipated, except to the extent his conduct was fraudulent or otherwise intentionally wrongful; court noted that it can sanction the attorney in such a case by virtue of its control over compensation).

⁶⁶ In re Universal Factoring Co., Inc., 329 B.R. 62 (Bankr. N.D. Okla. 2005) (counsel knew or should have known debtor's business was Ponzi scheme that could not be reorganized); In re Crown Oil, Inc., 257 B.R. 531 (Bankr. D. Mont. 2000); In re Cent. Florida Metal Fabrication, Inc., 207 B.R. 742 (Bankr. N.D. Fla. 1997); In re Anolik, 207 B.R. 34 (Bankr. D. Mass. 1997); In re R. Kaufman Jewelers, Inc., 171 B.R. 905 (Bankr. S.D. Fla. 1994); In re Barrie Reed Buick-GMC, Inc., 164 B.R. 378 (Bankr. S.D. Fla. 1994); In re Amstar Ambulance Service, Inc., 120 B.R. 391 (Bankr. N.D. W. Va. 1990); see In re Rocky Mountain Helicopters, Inc., 186 B.R. 270 (Bankr. D. Utah 1995) (must be evidence to show attorney was aware or should have been aware of lack of benefit to the estate).

⁶⁷ See In re Crown Oil, Inc., 257 B.R. 531 (Bankr. D. Mont. 2000); In re Office Products of America, Inc., 136 B.R. 983 (Bankr. W.D. Tex. 1992); In re Moffitt, 146 B.R. 364 (Bankr. S.D. Tex. 1992); In re Walter, 83 B.R. 14 (9th Cir. BAP 1988); In re E. Paul Kovacs and Co., Inc., 16 B.R. 203 (Bankr. D. Conn. 1981); In re Grabill Corp., 110 B.R. 356 (Bankr. N.D. Ill. 1990); In re Crouse Group, Inc., 75 B.R. 553 (Bankr. E.D. Pa. 1987); In re Wells, 71 B.R. 554 (Bankr. N.D. Ohio 1987); see also In re Alderson, 114 B.R. 672 (Bankr. D. S.D. 1990) (fees generated after attorney should have known conversion was foregone conclusion denied).

⁶⁸ See In re Pro-Snax Distributors, Inc., 157 F.3d 414 (5th Cir. 1998) (counsel should have known from outset that any plan would fail); In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997); In re New England Metal Co., Inc., 155

have held that no compensable value is provided to the estate by attorneys working on a reorganization that should not have been filed or cannot succeed.⁶⁹ Attorneys are also duty bound to recommend against pursuing litigation when the cost exceeds its likely value.⁷⁰

B.R. 38 (Bankr. D. R.I. 1993); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) and 196 B.R. 868 (Bankr. D. Utah 1996) (proper representation by DIP counsel would have obviated need for examiner investigation of postpetition fraud and mismanagement) rev'd in part Hansen, Jones & Leta v. Segal, 220 B.R. 434 (D. Utah 1998); In re Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991)(attorneys' fees disgorged for assisting insiders in actions detrimental to creditors); In re Kendavis Industries International, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988)(same); In re Sharon Steel Corp., 86 B.R. 455 (Bankr. W.D. Pa. 1988), aff'd, 871 F.2d 1217 (3d Cir. 1989) (court questioned whether DIP counsel met its fiduciary duties in defending against a motion for appointment of a trustee, where the DIP was accused of gross mismanagement, self-dealing, and substantial diminution of estate assets). But see In re Spanjer Bros., Inc., 191 B.R. 738 (Bankr. N.D. Ill. 1996) (opposing and losing motion to appoint trustee does not prove DIP counsel acted for benefit of insiders); In re South Beach Securities, Inc., 341 B.R. 853 (N.D. Ill. 2006) (chapter 11 case to protect insiders' tax benefits not lacking in good faith as long as not disadvantaging non-inside creditors).

⁶⁹ In re Coones Ranch, Inc., 7 F.3d 740 (8th Cir. 1993); In re Lederman Enterprises, Inc., 997 F.2d 1321 (10th Cir. 1993) and cases cited therein; compare In re DN Associates, 3 F.3d 512 (1st Cir. 1993)(value provided and fiduciary duties met despite creditors' plan being confirmed and three DIP plans rejected); In re Universal Factoring Co., Inc., 329 B.R. 62 (Bankr. N.D. Okla. 2005) (time spent on plan and disclosure statement for Ponzi scheme debtor not compensable; court had advised counsel it would not facilitate reorganization of debtor's Ponzi scheme, plans and disclosures assuming unsupported and unrealistic projections were of no benefit to the estate); In re Berg, 268 B.R. 250 (Bankr. D. Mont. 2001)(failure to exercise "professional control" over client); In re American Metallurgical Products, Inc., 228 B.R. 146 (Bankr. W.D. Pa. 1998)(evaluate from perspective of when services were performed, were they reasonably likely to benefit estate); In re Anolik, 207 B.R. 34 (Bankr. D. Mass. 1997)(when professional has reason to believe goal is unachievable but still continues to amass fees, disgorgement may be appropriate). But see In re Pow Wow River Campground, Inc., 296 B.R. 81 (Bankr. D. N.H. 2003) (fees allowed although plan did not meet absolute priority rule when only U.S. Trustee objected to fees); see also In re Williams, 378 B.R. 811 (Bankr. E.D. Mich. 2007) (Chapter 13 debtor's counsel must evaluate (1) whether post-confirmation services are likely to benefit either the debtor or estate; and (2) whether the fee burden is disproportionate to benefit to debtor) .

⁷⁰ Matter of Taxman Clothing Co., 49 F.3d 310 (7th Cir. 1995); In re Kitchen Factors, Inc., 143 B.R. 560 (9th Cir. BAP 1992); In re Bean, 251 B.R. 196 (E.D.N.Y. 2000)(breach of duty for trustee to pursue avoidance action without prior cost-benefit analysis); In re New Boston Coke Co., 299 B.R. 432 (Bankr. E.D. Mich. 2003); In re Concrete Products, Inc., 208 B.R. 1015 (Bankr. S.D. Ga. 1996); In re Keene Corp., 205 B.R. 690 (Bankr.S.D.N.Y.1997); In re Henson, 182 B.R. 588 (Bankr. N.D. Okla. 1995); In re Witts, 180 B.R. 171 (Bankr. E.D. Tex. 1995); In re Arnold, 162 B.R. 775 (Bankr. E.D. Mich. 1993); see also In re Big Rivers Elec. Corp., 233 B.R. 768 (Bankr. W.D. Ky. 1999) (no value from services in pursuit of sale agreement with "no shop" clause; collecting cases); see In re Ames Dep't. Stores, Inc., 76 F.3d

6. In general, only the DIP or trustee is empowered to file a Rule 9019 settlement motion, and must exercise fiduciary duties in evaluating whether to do so.⁷¹ Creditors and other parties affected by or interested in a particular lawsuit may have their own agendas that conflict with the best interest of the estate.⁷² However, a DIP's fiduciary duties to manage the estate for the benefit of creditors may also conflict with the DIP's own interests when a settlement of litigation is proposed, especially when it either benefits insiders or adversely affects them by paying creditors but leaving little for the equity. Any settlement with insiders must be scrutinized.⁷³ When the estate is insolvent, the views of creditors on any settlement are clearly paramount, and the court may even require a sale of the causes of action where the proposed settling party can bid for the price of settlement.⁷⁴ When there is a potential for solvency, such that the debtor has a stake in the outcome of litigation, the interests of the debtor's equity must be taken into consideration.⁷⁵ But the debtor has a conflict in weighing its own desires against its fiduciary duties to creditors, who bear the risk of continued litigation without the potential benefit of a greater return. Some courts have concluded that either a Chapter 11 trustee should be appointed or the case should be converted to Chapter 7 when that conflict cannot be

66 (2d Cir. 1996) (if services are reasonably likely to benefit estate, they should be compensable). See In re Williams, 378 B.R. 811 (Bankr. E.D. Mich. 2007)(Chapter 13).

⁷¹ In re Smart World Technologies LLC, 423 F.3d 166 (2d Cir. 2005).

⁷² Id.; see Suter v. Goedert, 504 F.3d 982 (9th Cir. 2007) (settlement via defendant purchase of lawsuit and subsequent dismissal not moot); Official Committee of Creditors of Asea Brown Boverie, 313 B.R. 219 (N.D. Ohio 2004).

⁷³ In re Foster Mortgage Corp., 68 F.3d 914 (5th Cir. 1995).

⁷⁴ Id.; In re Bowman, 181 B.R. 836 (Bankr. D. Md. 1995); see cases re sale/settlement: The Cadle Co. v. Mims, 608 F.3d 253 (5th Cir. 2010); In re Fitzgerald, 428 B.R. 872 (9th Cir. BAP 2010)(sale must meet standards of compromise when causes of action sold), In re Lahijani, 325 B.R. 282 (9th Cir. BAP 2005) (same).

⁷⁵ Matter of Central Ice Cream, 836 F.2d 1068, 1072-73 (7th Cir. 1987); In re Bowman, 181 B.R. 836 (Bankr. D. Md. 1995). See also In re Mercury, 280 B.R. 35 (Bankr. S.D.N.Y. 2002)

reconciled.⁷⁶ Because a settlement with the trustee (or DIP) binds creditors of the estate, settlement approval should not be sought without a full, independent investigation of the facts and circumstances sufficient to exercise independent business judgment.⁷⁷

7. Especially when an estate is solvent, DIP fiduciary duties may preclude a bankruptcy filing at all. Bankruptcy cannot be a tactical device for litigation leverage.⁷⁸ Counsel are ethically obligated not to file bad faith bankruptcy petitions, and may be sanctioned for doing so.⁷⁹ If a solvent debtor is not suffering any adverse financial or operational effects, a bankruptcy petition may be deemed filed in bad faith.⁸⁰ Even if the filing is proper, a solvent DIP may not use avoidance

(settlement of personal injury claim must take into account views of injured debtors).

⁷⁶ In re Eurospark Industries, Inc., 424 B.R. 621 (Bankr. E.D.N.Y. 2010); In re Bowman, 181 B.R. 836, 845 (Bankr. D. Md. 1995). The court in Bowman relied heavily on a bankruptcy court case without discussing the related appellate decision. In re Central Ice Cream, 59 B.R. 476 (Bankr. N.D. Ill. 1985), discussed in related sanctions ruling, Matter of Central Ice Cream, 836 F.2d 1068, 1072-73 (7th Cir. 1987). See also In re Kelso, 196 B.R. 363 (Bankr. N.D. Tex. 1996)(if creditors object to settlement, proper remedy is to seek a trustee); In re RJ Manufacturing, Inc., 2004 WL 764669 (Bankr. N.D. Iowa 2004)(trustee to evaluate settlement because of debtor's inherent conflict while estate bore all risk).

⁷⁷ In re Quality Beverage Co., Inc., 181 B.R. 887, 894-95 (Bankr. S.D. Tex. 1995); see In re Martin, 91 F.3d 389 (3d Cir. 1996)(trustee may opt not to support settlement if circumstances change); In re Sparks, 190 B.R. 842 (Bankr. N.D. Ill. 1996)(trustee duty to bring better offer to attention of court and creditors despite settlement agreement).

⁷⁸ E.g. In re Yorkshire, LLC, 540 F.3d 328 (5th Cir. 2008) (intent to harm through bankruptcy litigation); In re The Bridge to Life, Inc., 330 B.R. 351 (Bankr. E.D.N.Y. 2005) (tactic to obtain litigation leverage on appeal without supersedeas bond).

⁷⁹ In re Yorkshire, LLC, 540 F.3d 328 (5th Cir. 2008); In re Kile, 345 B.R. 182 (Bankr. D. Ariz. 2004). But see In re 15375 Memorial Corp., 430 B.R. 142 (Bankr. D. Del. 2010) (debtor's parent entity sanctioned for bad faith filing, but not counsel).

⁸⁰ In re Integrated Telecom Express, Inc., 384 F.3d 108 (3d Cir. 2004) (filing solely to cap landlord's damages claim was in bad faith); In re SGL Carbon Corp., 200 F.3d 154 (3d Cir. 1999); see also In re Silberkraus, 336 F.3d 864 (9th Cir. 2003) (solvent debtor forum-shopping in case where reorganization over objecting plaintiff was impossible); In re Fraternal Composite Service, Inc., 315 B.R. 247 (Bankr. N.D.N.Y. 2003); In re Liptak, 304 B.R. 820 (Bankr. N.D. Ill. 2004) (solvent individual chapter 11 debtor); compare In re Sylmar Plaza, L.P., 314 F.3d 1070 (9th Cir. 2002) (bankruptcy to avoid default interest was not in bad faith) and In re Capitol Food Corp. of Fields Corner, 490 F.3d 21 (1st Cir. 2007)(solvent debtor suddenly deprived of principal source of cash flow).

powers to obtain a windfall for the equity holders at the expense of the non-insider creditors.⁸¹

8. Timely and complete financial reporting and recordkeeping is an important element of the DIP's fiduciary duty of care.⁸² So is accurate documentation of postpetition transfers—which must be legitimate, authorized transfers, especially if the transferred assets are collateral of a creditor.⁸³ DIP fiduciary duties to protect and preserve the estate should also be taken into account in determining whether to seek court authorization for early payment of critical vendors.⁸⁴ Paying higher prices to a vendor postpetition to reduce prepetition debt results in unauthorized postpetition transfers and a violation of DIP management's

⁸¹ Dunes Hotel Associates v. Hyatt Corp., 245 B.R. 492 (D. S.C. 2000); but see In re South Beach Securities, Inc., 341 B.R. 853 (N.D. Ill. 2006) (chapter 11 case only to preserve tax benefits to insiders not proved to be in bad faith).

⁸² See In re Scott, 172 F.3d 959 (7th Cir. 1999)(duty of full disclosure in disclosure statement, in response to requests of parties in interest; duty to accurately document DIP business and preserve records); In re Sharon Steel Corp., 871 F.2d 1217 (3d Cir. 1989); In re Milford Connecticut Associates, L.P., 389 B.R. 303 (Bankr. D. Conn. 2008); In re V Companies, 274 B.R. 721 (Bankr. N.D. Ohio 2002); In re AG Service Centers, L.C., 239 B.R. 545 (Bankr. W.D. Mo. 1999); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) rev'd in part Hansen, Jones & Leta v. Segal, 220 B.R. 434 (D. Utah 1998); In re V. Savino Oil & Heating Co., Inc., 99 B.R. 518 (Bankr. E.D.N.Y. 1989); In re Modern Office Supply, Inc., 28 B.R. 943 (Bankr. W.D. Okla. 1983); In re Ford, 36 B.R. 501 (Bankr. W.D. Ky. 1983); In re Vallejo, 77 B.R. 365 (Bankr. D. P.R. 1987); In re Wells, 71 B.R. 554 (Bankr. N.D. Ohio 19897); In re Philadelphia Athletic Club, Inc., 15 B.R. 60 (Bankr. E.D. Pa. 1981).

⁸³ In re Gregory, 214 B.R. 570 (S.D. Tex. 1997); In re Count Liberty, LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007); In re Texasoil Enterprises, Inc., 296 B.R. 431 (Bankr. N.D. Tex. 2003); In re NWFEX, Inc., 267 B.R. 118 (Bankr. W.D. Ark. 2001)(pay only court-authorized attorneys); In re Honey Creek Entertainment, Inc., 246 B.R. 671 (Bankr. E.D. Okla. 2000); In re 239 Worth Ave. Corp., 236 B.R. 492 (Bankr. S.D. Fla. 1999); In re V. Savino Oil & Heating Co., Inc., 99 B.R. 518 (Bankr. E.D.N.Y. 1989); In re Wells, 71 B.R. 554 (Bankr. N.D. Ohio 1987); In re Humphreys Pest Control Franchises, Inc., 40 B.R. 174 (Bankr. E.D. Pa. 1984); In re Alvey, 56 B.R. 170 (Bankr. W.D. Ky. 1985).

⁸⁴ In re Coserv, L.L.C., 273 B.R. 487 (Bankr. N.D. Tex. 2002).

duties to all creditors.⁸⁵ Failure to comply with cash collateral and other Code restrictions may result in liability of the DIP's officers.⁸⁶

C. DIP Duties With Respect to Asset Sales.

1. A fiduciary duty of loyalty includes a duty to refrain from self-dealing with estate assets, unless the transaction is inherently fair, with the earmarks of an arm's length bargain.⁸⁷ For this reason, and because of the prohibition of the bankruptcy crimes statute, numerous courts have held that neither the Trustee, DIP nor their professionals (nor the professionals' employees) may directly or indirectly acquire estate assets, even at an auction.⁸⁸ The fiduciary is not to benefit at the expense of the estate and creditors, or use its power for personal advantage to their

⁸⁵ In re Centennial Textiles, Inc., 227 B.R. 606 (Bankr. S.D.N.Y. 1998).

⁸⁶ In re Four Seasons Marine & Cycle, Inc., 263 B.R. 764 (Bankr. E.D. Tex. 2001); In re Nelco, Ltd., 264 B.R. 790 (Bankr. E.D. Va. 1999).

⁸⁷ See cases cited at In re Schipper, 109 B.R. 832, 835 (Bankr. N.D. Ill. 1989) and In re Wilde Horse Enterprises, Inc., 136 B.R. 830, 842 (Bankr. C.D. Cal. 1991); see In re Hampton Hotel Investors, L.P., 270 B.R. 346 (Bankr. S.D.N.Y. 2001)(DIP principal collusive agreements with bidders).

⁸⁸ 18 U.S.C. § 154; In re Chuck's Const. Co., Inc., 424 B.R. 202 (Bankr. D.S.C. 2010); In re Crestview Funeral Home, Inc., 287 B.R. 832, 837-38 (Bankr. D. N.M. 2002) (auctioneer's fees ordered disgorged since he and his contract employees bought property at the auction); In re Allied Gaming Management, Inc., 209 B.R. 201 (Bankr. W.D. La. 1997)(estate accountant cannot participate in ownership of company acquiring debtor under plan); In re Sauer, 191 B.R. 402 (Bankr. D. Neb. 1995)(DIP counsel purchase of house after creditor foreclosed); In re Rahe, 178 B.R. 801 (Bankr. D. Neb. 1995)(unethical and criminal for trustee's counsel to purchase estate property); In re Q.P.S., Inc., 99 B.R. 843 (Bankr. W.D. Tenn. 1989)(DIP's accountant prohibited from buying estate car); In re Exennium, 23 B.R. 782 (9th Cir. BAP 1982), rev'd. on other grounds 715 F.2d 1401 (9th Cir. 1993)(former DIP counsel barred from purchasing lease from trustee after conversion). Creditors committee members may acquire estate assets, however, as long as they do not abuse inside information in doing so. In re Rickel & Assoc., Inc., 272 B.R. 74 (Bankr. S.D.N.Y. 2002); but see In re Brook Valley IV, 347 B.R. 662 (8th Cir. BAP 2006) (permissible if done with full disclosure and oversight), aff'd, 496 F.3d 892 (8th Cir. 2007)(court "need not adopt [bankruptcy court's] blanket rule [against insider purchases] to conclude that [insiders] violated their duties [of loyalty to the estate] here"); In re A.W. Logging, Inc., 356 B.R. 506 (Bankr. D. Idaho 2006) (court doubts wisdom of attorney purchasing product from DIP client but not disqualifying; court does not address statute).

detriment, no matter how meticulously the technical requirements for doing so are met.⁸⁹

2. The DIP's fiduciary duties are defined, at least in part, by the statutory framework that empowers the DIP to act and specifies procedures under which it must act. The Seventh Circuit held that a DIP meeting the standards of the Bankruptcy Code and Rules sufficiently meets its fiduciary obligations to creditors, at least in an asset sale context.⁹⁰ The court refused to apply to a DIP a common law trustee's duties to disclose to its beneficiaries all material facts that might affect the value of the trust's assets or the desirability of a transaction.⁹¹

3. If bankruptcy rules, orders and procedures for asset sales are not met however, especially including notice rules, the DIP may be sanctioned for breach of fiduciary duties to injured creditors.⁹² Adequate and reasonable notice is essential to enable parties in interest to judge whether the sale is in the best interest of the

⁸⁹ See Pepper v. Litton, 308 U.S. 295 (1939); In re Brook Valley IV, 496 F.3d 892 (8th Cir. 2007) (insiders secretly acquired property at foreclosure sale for discount after stipulating to stay relief); In re Simon Transportation Services, Inc., 292 B.R. 207 (Bankr. D. Utah 2003) (insider entity as stalking-horse; inadequate information improperly gave it competitive advantage over other bidders); In re Performance Nutrition, Inc., 239 B.R. 93 (Bankr. N.D. Tex. 1999); Western World Funding, 52 B.R. 743 (Bankr. D. Nev. 1985) aff'd. in relevant part 985 F.2d 1021 (9th Cir. 1993); In re Guglielmo, 30 B.R. 102 (Bankr. N.D. La. 1983).

⁹⁰ Fulton State Bank v. Schipper (In re Schipper), 933 F.2d 513 (7th Cir. 1991).

⁹¹ 933 F.2d at 516.

⁹² Tenn-Fla Partners v. First Union Nat. Bank of Fla., 229 B.R. 720 (W.D. Tenn. 1999)(sale under plan at price insufficient to pay creditors fully, re-sale post-confirmation at higher price benefitting ony equity; serious interest of second buyer hidden during case); In re Simon Transportation Services, Inc., 292 B.R. 207 (Bankr. D. Utah 2003) (inadequate notice of assets being sold; mentioned but with no reference to substantial value); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991)(failure to disclose sale was to insider); Matter of Halux, Inc., 665 F.2d 213 (8th Cir. 1981)(breach of duty to lessor whose equipment was sold without notice); In re Vallejo, 77 B.R. 365 (Bankr. D. P.R. 1987)(sales without court approval); In re Frankel, 77 B.R. 401 (Bankr. W.D.N.Y. 1987)(sale of secured inventory on credit without required secured creditor approval); In re Wells, 71 B.R. 554 (Bankr. N.D. Ohio 1987); In re Ford, 36 B.R. 501 (Bankr. W.D. Ky. 1983). See also In re Avon Townhomes Venture, 433 B.R. 269 (Bankr. N.D. Cal. 2010) (Chapter 7 debtor's duty of disclosure of

estate and in good faith, *i.e.* not the result of fraud, collusion, or any attempt to take unfair advantage of other potential purchasers.⁹³ While sales to insiders are not bad faith *per se*, full disclosure is critical if the watchful eyes of creditors are to ensure that transactions are in good faith, and the prices are reasonable.⁹⁴ Counsel may be criminally liable for obtaining sale approval without full disclosure of a side deal compensating an insider personally.⁹⁵

4. A DIP must have an articulated business justification for using, selling, or leasing estate property outside the ordinary course of business, and the transaction must be in the best interest of the estate, to satisfy the DIP's fiduciary duties to the creditors and equity holders. The bankruptcy judge is to consider all salient factors in evaluating the proposed transaction, and act to further the diverse interests of the debtor, creditors and equity holders.⁹⁶ A "no shop" clause in a sale or lease agreement has been held to violate a Chapter 11 DIP's fiduciary duties by preventing it from maximizing the estate's value.⁹⁷ A sale may be the only viable way to realize a debtor's enterprise value. If the debtor is unable to obtain capital needed to finance a stand-alone plan or other type of restructuring, the debtor meets

principal's relationship with purchaser).

⁹³ In re Simon Transportation Services, Inc., 292 B.R. 207 (Bankr. D. Utah 2003); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991), and cases cited therein.

⁹⁴ Id.

⁹⁵ U.S. v. Rosen, 130 F.3d 5 (1st Cir. 1997).

⁹⁶ In re Continental Air Lines, Inc., 780 F.2d 1223 (5th Cir. 1986); In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983); In re Walter, 83 B.R. 14 (9th Cir. BAP 1988); In re Office Products of America, Inc., 136 B.R. 983 (Bankr. W.D. Tex. 1992).

⁹⁷ In re Big Rivers Elec. Corp., 233 B.R. 768, 785-87 (Bankr. W.D. Ky. 1999); but see In re Valley Health System, 429 B.R. 692 (Bankr. C.D. Cal. 2010) ("no shop" permissible in Chapter 9).

its fiduciary duties to maximize value for creditors by acquiescing in a secured creditor-negotiated asset sale.⁹⁸

D. Drafting a Reorganization Plan.

1. In the context of drafting a reorganization plan, the DIP's fiduciary responsibilities must include exercising reasonable care and diligence to restructure the company in a way that is feasible and enhances the estate's overall value. The DIP must try to balance the interests of different parties fairly, but within the structure of the Bankruptcy Code.⁹⁹ The Code's absolute priority rule restricts distributions to equity only in the event of cramdown with equity retaining an interest, however. The DIP is not precluded from bargaining for a reorganization share for equity, as long as the equity is not attempting to torpedo the reorganization or benefit itself alone at the expense of creditors.¹⁰⁰ In fact, the Code provides for the

⁹⁸ In re Chrysler, LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009)

⁹⁹ See In re Perez, 30 F.3d 1209 (9th Cir. 1994); In re DN Associates, 3 F.3d 512 (1st Cir. 1993); In re Bush Industries, Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004); In re Microwave Products of America, Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989); In re Jorgensen, 66 B.R. 104, 109 (9th Cir. BAP 1986)(interpreting requirement that plan be in good faith).

¹⁰⁰ In re Johns-Manville Corp., 801 F.2d 60 (2d Cir. 1986); In re Central Ice Cream Co., 836 F.2d 1068 (7th Cir. 1987); In re Water's Edge Ltd. Partnership, 251 B.R. 1 (Bankr. D. Mass. 2000); In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997)(negotiating a plan that provides value for equity is not a conflict if there is full disclosure of divergence in interests); Compare Tenn-Fla Partners v. First Union Nat. Bank of Fla., 229 B.R. 720 (W.D. Tenn. 1999)(sale under plan inadequate to pay creditors fully; undisclosed resale post-confirmation to benefit only equity); In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir. 1991) (bad faith filing evidenced by plan gratuitously relieving insiders of guarantee obligations; fees ordered disgorged); In re General Homes Corp., 199 B.R. 148 (S.D. Tex. 1996)(insiders profited at expense of debenture holders under proposed plan); See In re Downtown Investment Club III, 89 B.R. 59 (9th Cir. BAP 1988); In re Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) *rev'd* in part Hansen, Jones & Leta v. Segal, 220 B.R. 434 (D. Utah 1998); In re Chou-Chen Chemicals, Inc., 31 B.R. 842 (Bankr. W.D. Ky. 1983).

debtor, not the DIP, to propose a plan, and allows the debtor to confirm it over creditor objections as long as creditors receive as much as they would in chapter 7.¹⁰¹

2. A plan will not be deemed in good faith if the court cannot determine that management conflicts of interest did not affect treatment of creditors.¹⁰² The disclosure statement accompanying the plan should reflect the DIP's fiduciary duty to actively investigate and disclose all estate assets.¹⁰³ It should be based on credible projections to rehabilitate the existing business, not "incubate" an entirely new business.¹⁰⁴ A debtor cannot "park" property in bankruptcy to wait for the market to improve; it must pursue an open and expeditious plan even if that means less for equity.¹⁰⁵

E. Duties of DIP Counsel.

1. Counsel's role with respect to the DIP's fiduciary duties, and DIP management agendas, is limited but critical. Counsel should exert some or even considerable influence on bankruptcy strategy, but management still makes the final decisions.¹⁰⁶ Ethically and legally, DIP counsel can only advise the DIP's designated representative, who makes the decisions.¹⁰⁷ The DIP and its constituents are not

¹⁰¹ In re Water's Edge Ltd. Partnership, 251 B.R. 1 (Bankr. D. Mass. 2000); see In re Az-Tze Cheng, 308 B.R. 448 (9th Cir. BAP 2004) (debtor and DIP are two capacities of action).

¹⁰² In re Coram Healthcare Corp., 271 B.R. 228 (Bankr. D. Del. 2001); see In re Bush Industries, Inc., 315 B.R. 292 (Bankr. W.D. N.Y. 2004) (plan with golden parachute and insider debt forgiveness not in good faith).

¹⁰³ In re Phoenix Petroleum Co., 278 B.R. 385 (Bankr. E.D. Pa. 2001).

¹⁰⁴ In re Universal Factoring Co., Inc., 329 B.R. 62, 80 (Bankr. N.D. Okla. 2005).

¹⁰⁵ In re Milford Connecticut Associates, L.P., 389 B.R. 303 (Bankr. D. Conn. 2008).

¹⁰⁶ In re SIDCO, Inc., 173 B.R. 194 (E.D. Cal. 1994); In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995); In re Whitney Place Partners, 147 B.R. 619 (Bankr. N.D. Ga. 1992); In re Stamford Color Photo, Inc., 98 B.R. 135 (Bankr. D. Conn. 1989); In re Nephi Rubber Products Corp., 120 B.R. 477 (Bankr. N.D. Ill. 1990).

¹⁰⁷ Model Rule 1.2(a) ("A lawyer shall abide by a client's decisions concerning the objectives of representation"); Model Rule 1.4(b) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the

required to be disinterested.¹⁰⁸ Attorneys taking direction from interested insider management are not substitutes for the trustees Congress deliberately did not require, and ethically cannot be so.¹⁰⁹ But they can and should develop “client control” through advising the client on the parameters of available alternatives and remedies, and not allowing a client to dictate activity in a case inconsistent with legal requirements.¹¹⁰ Lawyers should follow up on court orders and legal requirements to

representation."); Model Rule 1.13(a) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."); Bankruptcy Rule 9001(5). Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998); In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995); In re Spanjer Bros., Inc., 191 B.R. 738 (Bankr. N.D. Ill. 1996); In re Rivers, 167 B.R. 288 (Bankr. N.D. Ga. 1994)(attorney may not make decisions for client, even if DIP is incompetent); see In re Lee Way Holding Co., 100 B.R. 950 (Bankr. S.D. Ohio 1989)(counsel breached fiduciary duty to legal system by failing to remove uncompromising influences that could have impeded professional judgment); In re Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992)(incumbent on DIP counsel to advise other DIP professionals of their responsibilities under Code and disclosures necessary to fulfill those responsibilities).

¹⁰⁸ In re Water's Edge Ltd. Partnership, 251 B.R. 1 (Bankr. D. Mass. 2000).

¹⁰⁹ Compare In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995)("reality is that debtor usually seeks to further its own interest at the expenses of its creditors. . . the real problem. . . is creditor mistrust of the debtor, and therefore of his, her or its professionals. However, unless such mistrust is sufficiently serious to warrant appointment of a trustee, requiring related debtors to change professionals, or to have different professionals, often fails to create the independent perspective which is intended by such requests"); In re Best Western Heritage Inn Partnership, 79 B.R. 736, 740 (Bankr. E.D. Tenn. 1987)("difficult to believe that Congress intended to require a disinterested attorney for a debtor-in-possession as a somewhat ineffective safeguard for the rights of creditors and investors other than management.") and In re SIDCO, Inc., 162 B.R. 299 (Bankr. E.D. Cal. 1993), aff'd, 173 B.R. 194 (E.D. Cal. 1994)(notion that DIP counsel must represent interests, not only of client but other parties whose interests may be adverse to those of client, is "flight into the absurd") with In re Al Gelato Continental Desserts, Inc., 99 B.R. 404, 409 (Bankr. N.D. Ill. 1989)(separate attorney for the DIP corporation "would focus more clearly on the interests" of the corporation than would an attorney who also represents the corporate shareholder's competing interests, even though both reported to the same decision maker); In re Freedom Solar Centers, 776 F.2d 14, 18 (1st Cir. 1985)(separate counsel for debtor and debtor's insiders purchasing estate assets from trustee required for same reasons noted in Al Gelato); and In re BH & P, Inc., 103 B.R. 556, 572 (Bankr. D. N.J. 1989)("presumptively improper to have the same management for two or more" related DIPs . . . "only acceptable solution may be to appoint a trustee for one of the estates"), aff'd, 119 B.R. 35 (D. N.J. 1990) rev'd in part 949 F.2d 1300 (3d Cir. 1991).

¹¹⁰ In re R&R Associates of Hampton, 402 F.3d 257 (1st Cir. 2005); In re Source Enterprises, Inc., 2008 Bankr. LEXIS 940 (Bankr. S.D.N.Y. 2008) (advise debtor of fiduciary duties and that creditor control of board was putting debtor in breach of duties); In re Jones, 339 B.R. 903 (Bankr. E.D. Mich. 2006) (attorney cannot file chapter 13 case simply because

confirm that client representatives and entities holding estate funds understand and are complying with such obligations.¹¹¹ Lawyers can and must take care to assure that representations to the court are accurate.¹¹² They must aggressively require clients to provide evidence supporting questionable positions on key issues.¹¹³

2. Vigorous advocacy is ethical and appropriate in bankruptcy as in other cases, as long as it meets Rule 11 standards with a good faith basis for the facts and law asserted on positions taken for reasons other than harassment or delay.¹¹⁴ In Chapter 11 cases, good faith turns in part on whether reorganization is still possible.¹¹⁵ Thus, acquiescing in and carrying out a client's "scorched earth" strategy or otherwise assisting insiders in actions detrimental to the estate and creditors, if it is shown that counsel knows reorganization is hopeless, likely would not meet the good faith standards of ethics and Bankruptcy Rule 9011.¹¹⁶ Pursuing a plan that benefits insiders, at the considerable expense of the arms-length creditors, may also exceed

client so instructs when feasibility is not reasonably arguable); In re St. Stephen's 350 East 116th St., 313 B.R. 161 (Bankr. S.D.N.Y. 2004); In re Lickman, 297 B.R. 162 (Bankr. M.D. Fla. 2003); In re Nilges, 301 B.R. 321 (Bankr. N.D. Iowa 2003); In re Texasoil Enterprises, Inc., 296 B.R. 431 (Bankr. N.D. Texas 2003); In re The Phoenix Group, Inc., 305 B.R. 447 (Bankr. N.D. Tex. 2003); In re Berg, 268 B.R. 250 (Bankr. D. Mont. 2001); see also In re Williams, 378 B.R. 811 (Bankr. E.D. Mich. 2007) (same, in Chapter 13 context).

¹¹¹ In re Count Liberty, LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007).

¹¹² Id. (lawyer represented funds were in blocked bank account without confirming); In re Dreiling, 233 B.R. 848 (Bankr. D. Colo. 1999) (lawyer is officer of the court, and statements to the court are virtually made under oath).

¹¹³ In re Needham, 279 B.R. 519 (Bankr. W.D. La. 2001).

¹¹⁴ Bankruptcy Rule 9011; Model Rule 3.1.

¹¹⁵ See Matter of Little Creek Development Co., 779 F.2d 1068 (5th Cir. 1986).

¹¹⁶ See In re Perez, 30 F.3d 1209 (9th Cir. 1994); FE&B v. Charter Technologies, Inc., 57 F.3d 1215 (3d Cir. 1995); In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re Kendavis Industries International, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988); see also In re Marathon Home Loans, 101 B.R. 216 (Bankr. E.D. Cal. 1989) (counsel for trustee wrongfully carrying out "scorched earth attrition" policy in Chapter 7 case; sanctions awarded even though each document objectively reasonable and not frivolous); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992), rev'd. in part Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998) (all fees disgorged for dereliction in duty to estate in order to protect principals); In

the boundaries of good faith in some circumstances, and be considered DIP self-dealing.¹¹⁷ Acquiescing in DIP management self-dealing,¹¹⁸ without any attempt at counseling and without full disclosure to the court and creditors of insider involvement in (and benefit from) transactions, is a breach of DIP counsel's fiduciary duties to the client and the court.¹¹⁹ Advocating a sale agreement with a "no shop" clause instead of seeking or entertaining other offers to maximize the estate's value, especially if the clause is not disclosed, may violate fiduciary duties.¹²⁰ Even continuing with a stagnant reorganization once it should be clear no plan can be confirmed may be sanctionable.¹²¹ Counsel also should not proceed with litigation

re Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991). **See notes 65-70.**

¹¹⁷ In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir. 1991); In re Kendavis Industries International, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988); In re Downtown Investment Club III, 89 B.R. 59 (9th Cir. B.A.P. 1988); In re Global International Airways Corp., 82 B.R. 520 (Bankr. W.D. Mo. 1988); In re Golden Recipe Chicken, Inc., 109 B.R. 692 (Bankr. W.D. Pa. 1990)(DIP's counsel, using estate assets, secured release of shareholder's personal liability); In re Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) rev'd. in part Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998).

¹¹⁸ A DIP's attorney or other agent also may not purchase or self-deal in estate assets, even at a fair price. 18 U.S.C. § 154; In re Lowry Graphics, Inc., 86 B.R. 74 (Bankr. S.D. Tex. 1988); In re Q.P.S., Inc., 99 B.R. 843 (Bankr. W.D. Tenn. 1989)(DIP's accountant prohibited from buying estate car); In re Exennium, 23 B.R. 782 (9th Cir. BAP 1982), rev'd. on other grounds 715 F.2d 1401 (9th Cir. 1993)(former DIP counsel barred from purchasing lease from trustee after conversion). **See note 89.**

¹¹⁹ In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997)(explaining findings needed to justify fee denial on basis that services were not reasonably likely to benefit estate); In re Hampton Hotel Investors, L.P., 289 B.R. 563 (Bankr. S.D.N.Y. 2003) (Chapter 7 trustee suit against former DIP counsel for breach of fiduciary duties and aiding and abetting DIP officers' breach of fiduciary duties by not "blowing the whistle" on their improper secret agreements and misconduct); In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997); In re Cent. Florida Metal Fabrication, Inc., 207 B.R. 742 (Bankr. N.D. Fla. 1997); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); In re Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993) ; See In re Seeburg Products Corp., 215 B.R. 175 (Bankr. N.D. Ill. 1997)(attorney incompetently handled questionable chapter 11 case).

¹²⁰ In re Big Rivers Elec. Corp., 233 B.R. 768 (Bankr. W.D. Ky. 1999); but see In re Valley Health System, 429 B.R. 692 (Bankr. C.D. Cal. 2010) ("no shop" permissible in Chapter 9).

¹²¹ See cases cited at **note 62.**

where the likely recovery will be less than the litigation cost,¹²² or file a plan that counsel knows is unconfirmable, at least without highlighting plan provisions that appear to bypass Code requirements.¹²³ Disclosure to the court of diverging interests between insiders and the DIP entity may significantly alleviate conflict concerns, since other parties could then knowingly argue for contrary treatment.¹²⁴

3. Rather than carrying out client directions exceeding good faith boundaries, the DIP's attorney has ethical obligations to counsel his DIP client with respect to its fiduciary duties.¹²⁵ As stated in the comment to Model Rule of Professional Conduct 1.6, "The lawyer is part of a judicial system charged with upholding the law. One of the lawyer's functions is to advise clients so that they avoid any violation of the law in the proper exercise of their rights."¹²⁶

Understanding bankruptcy obligations and fiduciary duties and complying with them

¹²² See cases cited at **note 70**.

¹²³ See In re Perez, 30 F.3d 1209 (9th Cir. 1209); In re Luarks, 301 B.R. 352 (Bankr. D. Kan. 2003); see also In re Williams, 378 B.R. 811 (Bankr. E.D. Mich. 2007) (Chapter 13 context).

¹²⁴ In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re Kile, 345 B.R. 182 (Bankr. D. Ariz. 2004) (litigation was frivolous, harassment, unwinnable, and absolutely unnecessary to the prosecution of a legitimate bankruptcy case); In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997) (decision on abandonment versus remediation of contaminated property should have prompted disclosure of diverging interests).

¹²⁵ CFTC v. Weintraub, 471 U.S. 343, 355, 105 S. Ct. 1986, 1994 (1985); Pepper v. Litton, 308 U.S. 295, 306 (1939); In re Perez, 30 F.3d 1209 (9th Cir. 1994); Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998); In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995); In re Silver Oak Homes, Ltd., 167 B.R. 389 (Bankr. D. Md. 1994); In re Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); In re Consupak, Inc., 87 B.R. 529 (Bankr. N.D. Ill. 1988); In re Plaza Hotel Corp., 111 B.R. 882 (Bankr. E.D. Cal. 1990).

¹²⁶ In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995); In re Whitney Place Partners, 123 B.R. 117 (Bankr. N.D. Ga. 1992); See also Model Rule 2.1 ("In representing a client, a lawyer shall exercise independent professional judgment and render candid advice."); Model Rule 1.2(e) (When a lawyer knows that a client expects assistance not permitted by the Rules of Professional Conduct or other law, the lawyer shall consult with the client regarding the relevant limitations on the lawyer's conduct.").

is not self-evident; it requires proactive counseling as well as prompt reaction to matters that may have adverse legal consequences.¹²⁷

4. If the operating head of the DIP entity fails to act in compliance with the DIP's fiduciary responsibilities, the lawyer may have to refer the matter higher up the chain of command to the chief executive officer or board of directors.¹²⁸ The lawyer is to consider the seriousness of any illegality and its consequences in deciding what to do within the organization, however, and is to minimize any disruption to the entity and the risk of revealing information to outsiders.¹²⁹ If a lawyer "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."¹³⁰ DIP counsel may in some cases be obligated to bring the DIP's breaches of fiduciary duty to the attention of the court.¹³¹

¹²⁷ See note 27 re obligation to be proactive and provide unsolicited advice.

¹²⁸ Model Rule 1.13; See In re McNar, Inc., 116 B.R. 746 (Bankr. S.D. Cal. 1990), affirmed and remanded, 133 B.R. 561 (9th Cir. BAP 1991) (attorney failed to act properly upon deadlock of corporation's two shareholders).

¹²⁹ Model Rule 1.13.

¹³⁰ In re Perez, 30 F.3d 1209, 1219 (9th Cir. 1994); In re Berg, 268 B.R. 250 (Bankr. D. Mont. 2001); In re Start the Engines, Inc., 219 B.R. 264 (Bankr. C.D. Cal. 1998). In the terminology of the Model Rules, if a client is insistent on an action that "is clearly a violation of law and is likely to result in substantial injury to the organization," the lawyer may withdraw. Model Rule 1.13; see also Model Rule 1.16; but see In re SIDCO, Inc., 173 B.R. 194 (E.D. Cal. 1994) (DIP attorney's fiduciary duty is to DIP client, not creditors and shareholders whose interests may be adverse to DIP); see Disciplinary Counsel v. O'Brien, 2008 Ohio LEXIS 3258 (Ohio 2008) (attorney suspension for disbursing funds from client trust account while aware of Chapter 7 bankruptcy case).

¹³¹ In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997); In re North Star Management, LP, 305 B.R. 312 (Bankr. D.N.D. 2003) (act affirmatively to investigate and halt misappropriation of funds, and report to court or U.S. Trustee), rev'd, 308 B.R. 906 (8th Cir. BAP 2004) (professional took appropriate steps but was undermined by wrongdoer); In re Hampton Hotel Investors, L.P., 289 B.R. 563 (Bankr. S.D.N.Y. 2003); In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995) (in serious cases such as conversion of estate property, the professionals will sometimes be obligated to report the debtor's breach to others); In re Rivers, 167 B.R. 288 (Bankr. N.D. Ga. 1994) (highest allegiance of DIP counsel is to estate and court, not client); In re Swansea Consolidated Resources, Inc., 155 B.R. 28 (Bankr. D. R.I. 1993); In re United

5. Thus, counsel is to urge the DIP to meet its fiduciary duties to creditors, but is to abide by the client's decisions as long as there is a nonfrivolous basis for doing so.¹³² If the attorney and client disagree, it is not the attorney's prerogative to act on her own as she believes best for the estate, but rather to refrain from filing bad faith or frivolous pleadings, and to withdraw if the high standards for withdrawal are met.¹³³ If the attorney fails to appropriately counsel the client and carries out an abusive client strategy, her fees may well be subject to attack—refunds of previously allowed interim payments have been mandated where the court has found unethical conduct.¹³⁴

6. A thorough analysis of the legal theories underpinning -- and delimiting -- the fiduciary duties of DIP counsel is found in Hansen, Jones & Leta, P.C. v. Segal.¹³⁵ The district court addressed a bankruptcy court's denial of all

Utensils Corp., 141 B.R. 306 (Bankr. W.D. Pa. 1992); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); In re Saturley, 131 B.R. 509 (Bankr. D.Me. 1991); In re Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993); Model Rule 1.6 Comment; ABA Formal Opinion 92-366 (August 8, 1992)(duty of "noisy withdrawal" from representation).

¹³² Model Rules 1.2, 1.13, 2.1, 3.1.

¹³³ In re The Phoenix Group Corp., 305 B.R. 447 (Bankr. N.D. Tex. 2003) (attorney properly refused to file documents requested by client that would violate client's and lawyer's ethical duties), see In re Universal Factoring Co., Inc., 329 B.R. 62 (Bankr. N.D. Okla. 2005) (attorney obliged to take direction from trustee client, not act to file plan perceived to be in interest of debtor at debtor's officer's request).

¹³⁴ See, e.g., In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir. 1991); In re Gregory, 214 B.R. 570 (S.D. Tex. 1997); In re Kile, 345 B.R. 182 (Bankr. D. Ariz. 2004); In re Mercury, 280 B.R. 35 (Bankr. S.D.N.Y. 2002); In re Berg, 268 B.R. 250 (Bankr. D. Mont. 2001); In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) rev'd in part Hansen, Jones & Leta v. Segal, 220 B.R. 434 (D. Utah 1998); In re Diamond Mortgage Corp. of Illinois, 135 B.R. 78 (Bankr. N.D. Ill. 1990); In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); In re Thompson, 54 B.R. 311, 318 (Bankr. N.D. Ohio 1985). In Kendavis, over \$2 million was required to be repaid. 91 B.R. at 746, 762. See section III I, and section IIB. Further, counsel may be subject to a claim for damages by a successor Chapter 7 trustee. In re Food Management Group, LLC, 380 B.R. 677 (Bankr. S.D.N.Y. 2008).

¹³⁵ 220 B.R. 434 (D. Utah 1998). See the further analysis of this case and its progeny in

attorneys' fees sought by DIP counsel principally because it concluded that the attorneys served the interests of the principals by failing to disclose insider fraud in a plan, and seeking an injunction to delay litigation against the DIP's principals pending confirmation or rejection of the plan. The district court undertook the first serious analysis in any reported case of DIP counsel's role: An attorney owes fiduciary duties of loyalty and care to his/her client. Is the client in a chapter 11 case the DIP client entity, or is that just the decision-making constituent of the client estate?

7. The Hansen, Jones & Leta court first noted that a bankruptcy estate is created upon the petition filing; its beneficiaries include creditors and equity holders. The question is whether the "estate" is a legal person, or a collection of property interests? In Bildisco, the Supreme Court rejected the "separate entity" theory, and held that the DIP is the same entity as the prepetition debtor, but empowered in a new manner.¹³⁶ The property of the debtor remains vested in the debtor, which assumes new rights, duties and responsibilities as DIP. The client is thus the DIP rather than the estate. This is consistent with the former Bankruptcy Act, other Code provisions and the Internal Revenue Code.¹³⁷

8. Next, the court recognized that counsel for the DIP owes duties of loyalty and duties of care to her DIP client. The duty of loyalty is to maintain client confidentiality and prevent any conflict of interest, obligations that are stricter under

Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway? 17 Amer. Bankr. L. Inst. C. Rev., 291 (Winter 2009).

¹³⁶ NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528-29 (1984), discussed in Hansen, Jones & Leta, 220 B.R. at 452.

¹³⁷ Hansen, Jones & Leta, 220 B.R. at 453

the Bankruptcy Code than under professional conduct rules. The duty of care, applicable to all lawyers, includes abiding by the client's decisions regarding legal objectives of the representation; acting competently and with reasonable diligence; zealously representing the client; keeping the client reasonably informed as to the representation; exercising independent judgment; and rendering candid advice about the DIP's fiduciary duties.¹³⁸ Counsel for the DIP owes duties to the bankruptcy court, as well. These include the duty of candor, with additional disclosure duties imposed by the Bankruptcy Code and Bankruptcy Rules, and Bankruptcy Rule 9011 duties.¹³⁹

9. Critically, the Hansen, Jones & Leta court explained that DIP counsel does not owe a duty to estate beneficiaries. Representing a client fiduciary does not impose derivative fiduciary duties on the client's counsel, and the Bankruptcy Code identifies no duty to non-clients.¹⁴⁰ Importantly, ethical problems arise for DIP counsel if such fiduciary duties were to be imposed, due to the inherent conflict of interest of the client DIP. The DIP runs the business and decides what assets to sell and what contracts to reject and what claims to avoid, differentiating among classes of beneficiaries, and making decisions which benefit some claimants over others, a conflict-ridden fiduciary position. Management further has to balance its own interests while promoting the best interests of all parties with an interest in the estate, including both creditors and equity.¹⁴¹

¹³⁸ Id. at 454-55.

¹³⁹ Id. at 454-57.

¹⁴⁰ Id. at 457-58.

¹⁴¹ Id. at 458-59.

10. The court explained that while Chapter 11 countenances this conflict for the DIP, Rules of Professional Conduct prohibit attorneys from representing such conflicting interests. Attorneys can not zealously represent conflicting interests. The duties of a lawyer for a fiduciary run only to the fiduciary client and not the fiduciary's beneficiaries.¹⁴² The fiduciary client is entitled to attorney confidentiality and other protections of Professional Conduct Rules. And if DIP counsel owed fiduciary duties to estate beneficiaries, any breach of the DIP's duties theoretically would expose DIP counsel to liability to those non-client beneficiaries.¹⁴³

11. Instead of imposing an undefined fiduciary duty to the estate and its beneficiaries on DIP counsel, which is confusing, unhelpful and unnecessary, the Hansen, Jones & Leta opinion points out that courts can reach the same results by finding a breach of counsel's fiduciary duty to the client DIP, violations of Bankruptcy Code §§ 327 or 329, breach of duties to the court, or failure to provide services which benefit the estate under Code § 330.¹⁴⁴

12. Other courts have followed Hansen, Jones & Leta, further elaborating on DIP and DIP counsel fiduciary duties.¹⁴⁵ However, several recent

¹⁴² ABA Comm. on Ethics and Prof. Resp. Formal Op. 380 (1994), cited in Hansen, Jones & Leta, 220 B.R. at 460-61.

¹⁴³ Hansen, Jones & Leta, 220 B.R. at 461.

¹⁴⁴ Id. at 461-67.

¹⁴⁵ E.g. Berg & Berg Enterprises, LLC v. Sherwood, 131 Cal. App. 4th 802; 32 Cal. Rptr. 3d 325, 342-47 (Cal App. 2005) (attorney for assignee for benefit of creditors does not owe duty to beneficiaries, analyzing estate and trust law as well as bankruptcy law and professional responsibility rules); In re Specialty Restaurant Group, LLC, 2007 Bankr. LEXIS 1506 *3 (Bankr. N.D. Tex. 2007) (DIP counsel's "client is the debtor or the debtor in possession, not the bankruptcy estate"); In re Mushroom Transp. Co., 366 B.R. 414, 440- 41 (Bankr. E.D. Pa. 2007), on remand from 382 F.3d 325 (3d Cir. 2004) (law firm breached its fiduciary duty to client, "the chapter 11 debtor," by theft of client funds); In Re Metropolitan Environmental, Inc., 293 B.R. 871, 883 (Bankr. N.D. Ohio 2003) (DIP counsel owes duties

bankruptcy cases have addressed the duties of DIP counsel when DIP management embezzles estate assets or otherwise breaches fiduciary duties. In each, the courts have held that DIP counsel breached counsel's own fiduciary duties, and some have further reasoned that DIP counsel's duties are owed to the estate, and not just the DIP.¹⁴⁶ This is a new development, since most courts stopped ruling that DIP counsel duties are owed to the "estate" after the thorough analysis of a Utah district court in 1998 in Hansen, Jones & Leta.¹⁴⁷

13. One of the most extensively reasoned cases, Count Liberty, expressly rejected the holding in Hansen, Jones & Leta as "contrary to the weight of authority."¹⁴⁸ The cases cited by the Count Liberty court, however, precede Hansen, Jones & Leta, and have broad, vague language about fiduciary duties that do not conflict with the analysis or holding in that case.¹⁴⁹ Rather, as explained in Hansen,

to debtor, and not its shareholders, officers or directors); In re Water's Edge Ltd. Partnership, 251 B.R. 250 (Bankr. D. Mass. 2000); ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117 (S.D. Tex. 2002), aff'd, 324 F.3d 768 (5th Cir. 2003) (DIP counsel does not owe fiduciary duties to any individual creditor, and is not subject to a creditor cause of action for breach of fiduciary duty). See also In re Continental Coin Corp., 380 B.R. 1 (Bankr. C.D. Cal. 2007) (trustee's attorney does not owe fiduciary duty to creditors of the estate); Braunstein v. McCabe, 571 F.3d 108 (1st Cir. 2009) (trustee's counsel does not owe legal duties to creditors, as such duties would conflict with those owed to the client trustee); In re Tocfibi, Inc., 413 B.R. 523 (Bankr. N.D. Tex. 2009) (failing to give appropriate advice and ignoring a client's improper acts is a failure to exercise due care in execution of attorney's services and is malpractice, not a breach of fiduciary duty.).

¹⁴⁶ In re Hilal, 534 F.3d 498 (5th Cir. 2008); In re Count Liberty LLC, 370 B.R. 259 (Bankr. C.D. Cal. 2007) (DIP counsel is a fiduciary of the bankruptcy estate); In re Harrington, 2006 U.S. Dist. LEXIS 87133 (S.D. Fla. 2006) (DIP counsel's fiduciary duties ran to the bankruptcy estate, and his ultimate client was the bankruptcy estate; court quoted In re Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) which actually held that attorney must take directions from competent DIP client and not make decisions for DIP); see also In re Marble, 2007 Bankr. LEXIS 1743 *12 (Bankr. N.D. Tex. 2007) (DIP counsel's fiduciary duties arise from role of counsel as officer of the court or derivative nature of fiduciary obligations owed by counsel to the client DIP).

¹⁴⁷ Hansen, Jones & Leta P.C. v. Segal, 220 B.R. 434 (D. Utah 1998).

¹⁴⁸ Count Liberty, 370 B.R. at 279-80, also rejecting In re SIDCO, Inc., 173 B.R. 194 (E.D. Cal. 1994).

¹⁴⁹ E.g. Brown v. Gerdes, 321 U.S. 178, 182 (1944) (simply holding that professionals

Jones & Leta, these cases actually concern breaches of duties owed to clients, violations of Bankruptcy Code conflict of interest provisions, and duties to the court, and they fail to address Supreme Court case law rejecting the concept of the “estate” as an entity and applicable professional conduct rules that prohibit a lawyer from representing interests adverse to his client. Notably, the ICM Notes opinion, which adopts the reasoning of Hansen, Jones & Leta and which was approved wholesale by the Fifth Circuit, was cited with approval in the Count Liberty case.¹⁵⁰

14. In Food Management, the bankruptcy court looked to LAW GOVERNING LAWYERS §51(4) for an analysis of duties owed by DIP counsel to non-clients, recognizing they are considerably narrower than duties owed to clients.¹⁵¹

Section 51(4) provides that a lawyer owes a duty of care, and may be liable for breach:

(4) to a non client when and to the extent that:

- (a) the lawyer's client is a trustee, guardian, executor, or fiduciary acting primarily to perform similar functions for the nonclient;
- (b) the lawyer knows that appropriate action by the lawyer is necessary with respect to a matter within the scope of the representation to prevent or rectify the breach of a fiduciary duty owed by the client to the

compensated from the bankruptcy estate “are held to fiduciary standards” in general, citing Woods v. City Bank Co., 312 U.S. 262, 269 (1941) (requiring, as a condition of such compensation by committee counsel, “loyal and disinterested service in the interest of those for whom the claimant purported to act”)); In re Taxman Clothing Co., 49 F.3d 310, 314-15 (7th Cir. 1995) (lawyer’s fees disapproved; client decision-maker recused himself from the suit, and the court did not analyze the lawyer’s duties to advise about cost-effective litigation and conserving the estate’s net assets); In re Evangeline Refining Co., 890 F.2d 1312, 1323 (5th Cir. 1989) (chapter XI debtor’s lawyer’s flagrantly false fee application violated his duty of candor to the court as an officer of the court, and “as such...high fiduciary standards of conduct.”); In re Consol. Bancshares, Inc., 785 F.2d 1249, 1256 and n. 7 (5th Cir. 1986) (actual conflict of interest warranted denial of compensation under Bankruptcy Code § 328(c); further stated broadly that court-appointed attorneys are officers of the court and fiduciaries, and not entitled to fees when holding a conflict of interest).

¹⁵⁰ Count Liberty, 370 B.R. at 280 n. 54, 281.

¹⁵¹ In re Food Management Group, LLC, 380 B.R. 677 (Bankr. S.D.N.Y. 2008); RESTATEMENT OF THE LAW GOVERNING LAWYERS §51(4) (2000).

nonclient, where (i) the breach is a crime or fraud or (ii) the lawyer has assisted or is assisting the breach

(c) the nonclient is not reasonably able to protect its rights; and

(d) such a duty would not significantly impair the performance of the lawyer's obligations to the client.

The Food Management court found that this duty arises “when the lawyer knows that appropriate action by the lawyer is necessary to prevent or mitigate a breach of the client's fiduciary duty.” The Court further interpreted “knows” to mean “reason to know.”

15. Notably, RESTATEMENT § 51(4) provides that only a duty of care is owed, to exercise normal competence and diligence, not a duty of loyalty, and that the duty of care is not a “fiduciary” duty of the lawyer.¹⁵² It also specifies that duties to non-client beneficiaries of fiduciaries only apply to certain types of fiduciary clients, not including those for which fiduciary responsibilities are part of a larger role, such as management of a business (in or out of Chapter 11).¹⁵³ The DIP is much more akin to a corporate manager or partner, directing operation of a business and having its own conflicting rights and interests. In most Chapter 11 cases, secured creditors, Committees, the U.S. Trustee and their counsel are able to protect the rights of other parties in interest – such parties are not incapacitated. The DIP is often litigating with such parties, exercising judgments that will benefit one party in interest at the expense of another (*e.g.* by contract assumption, sales, etc.), or litigating or negotiating with them over matters that affect the debtor as well as the creditors.

¹⁵² See LAW GOVERNING LAWYERS § 51, cmt. h (“[V]iolations of duties of loyalty by a fiduciary are ordinarily considered breaches of fiduciary duty, while violations of duties of care are not.”).

¹⁵³ Id.

16. It is unfortunate that some courts are again rendering decisions with broad language about DIP counsel having fiduciary duties to the bankruptcy “estate” rather than the DIP. Indeed, one court sanctioned DIP counsel for contending that the firm did not owe fiduciary duties to the estate, even while it found no breach of duties.¹⁵⁴ The actual duties the courts have imposed, however, are consistent with professional conduct rules, and in fact reflect duties owed by counsel to the DIP client fiduciary and to the court.¹⁵⁵ Thus, the Count Liberty and Food Management opinions acknowledges that counsel’s duty “may not rise to the level of a policeman for the debtor’s post-petition conduct,” but he or she must advise the DIP of its responsibilities under the Code and assist its management in discharging those responsibilities.¹⁵⁶ Other authorities referring to DIP counsel having fiduciary duties to the “estate” likewise ultimately hold that DIP attorneys must independently evaluate the DIP’s proposed actions, proactively counsel the DIP to meet its fiduciary duties, and provide guidance for management on how to reorganize while complying with Code obligations.¹⁵⁷

17. A recent article discusses at length the legal theories and case law underlying the Hansen, Jones and Leta and the Count Liberty and Food Management

¹⁵⁴ In re Hirsch, 2008 Bankr. LEXIS 3377 (Bankr. E.D.N.Y. 2008).

¹⁵⁵ See In re Brook Valley VII, 496 F.3d 892, 900-01(8th Cir. 2007) regarding the DIP’s fiduciary duties. See also Miller v. Simpson, 325 Fed. Appx. 25 (2d Cir. 2009) (DIP counsel breached fiduciary duties to court by violating escrow order requiring segregation of funds when paying himself without court authorization).

¹⁵⁶ Count Liberty, 370 B.R. at 281-82; Food Management, 380 B.R. at 708.

¹⁵⁷ Id., 370 B.R. at 281-82, and cases cited therein, including In re Perez, 30 F.3d 1209, 1219 (9th Cir. 1994); In re Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992); see also In re Nosek, 386 B.R. 374 (Bankr. D. Ma. 2008) (creditor’s counsel’s duty to investigate client representations for accuracy).

decisions.¹⁵⁸ Seminal to the analysis is the dual role of DIP and debtor. The DIP is also the debtor (§ 1101(1)), need not be disinterested, need not investigate the debtor's actions (§ 1107(a)), and may bargain for equity and seek cram-down under a plan. Individual debtors may use estate property for personal needs. Yet the DIP has fiduciary duties to creditors and the estate, and must meet fiduciary duties while balancing such duties with its own self-interests.¹⁵⁹ If the debtor/DIP is a single client with fiduciary duties, one firm can represent it. If the estate is considered the client, the debtor client does not disappear and its interests are not always aligned with those of the estate. A lawyer cannot represent multiple clients, even with consent, when negotiating or litigating between them.¹⁶⁰ 18. In addition to the conflict issues addressed in the Hansen, Jones and Leta case, if the "estate" is considered as DIP counsel's client, it also raises problems with the lawyer's fundamental role. A lawyer is an agent speaking for a client principal. She advises her client who directs her, and cannot act without client direction.¹⁶¹ Property interests cannot provide such direction, nor can creditors or the United States Trustee. As a fiduciary to her client, a lawyer must be able to advise the client in confidence before taking direction, and if to be held liable for breach of fiduciary duties, must be

¹⁵⁸ Susan M. Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway?, 17 Amer. Bankr. L. Inst. L. Rev. 291 (Winter 2009).

¹⁵⁹ See In re Water's Edge Ltd. Partnership, 251 B.R. 1, 6-7 (Bankr. D. Mass. 2000) (describing "dichotomy in the obligations of a [DIP] and its counsel"); In re Rancourt, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (noting attorney representing DIP in Chapter 11 proceeding "always faces the prospect of some conflict between the ultimate interests of the individual debtor and those of the bankruptcy estate created by the reorganization proceeding")

¹⁶⁰ Model Rule 1.7, cmts. 28, 29.

¹⁶¹ Model Rules 1.2, 1.4, 1.14, 3.3 (2009); In re Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) ("Although the line separating advice or assistance in performing duties from the actual performance of those duties is not always bright, the line exists, and a professional has

able to consult with the client, which is impossible with the “estate.” DIP counsel similarly cannot preserve client privileges if the estate is treated as the client, and would be unable to undertake the consultation needed before she could withdraw.

19. Lawyer duties to non-clients of a fiduciary client are found in state trust and agency law,¹⁶² the Model Rules of Professional Conduct¹⁶³ and an American Bar Association formal opinion,¹⁶⁴ useful law review articles by Professor Geoffrey Hazard¹⁶⁵ and the RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, including particularly RESTATEMENT § 51(4)¹⁶⁶ discussed in the Food Management case as the basis for its conclusion that DIP counsel owes fiduciary duties to estate creditors as non-clients. As noted above, that provision actually says lawyers for some types of fiduciaries owe some duties to their client’s beneficiaries. It narrows the duties to those in a trustee-type context, where the chief end of the relationship to protect specific property for the benefit of specific persons, and not in the context of partner duties to partners or corporate officer duties to shareholders, because the latter contexts entail conflicting considerations arising from other responsibilities, and fiduciary responsibilities are only part of broader role. There is no duty to beneficiaries if it would create conflicting or inconsistent duties impairing the lawyer’s duties to his client to assist in an open dispute with beneficiaries or negotiations on matters affecting the fiduciary’s interest or in assisting the fiduciary

no business making decisions that are the responsibility of the fiduciary.”)

¹⁶² See Freeman article, Section V.A.

¹⁶³ Model Rule 1.2 cmt. 11, Rule 1.7 cmt. 27, Rule 1.14 cmt. 4.

¹⁶⁴ ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 94-380 (1994) (addressing lawyer’s obligations to beneficiaries where lawyer represents fiduciary).

¹⁶⁵ Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 GEO. J. LEGAL ETHICS 15 (1987); Geoffrey C. Hazard, Jr., *The Privity Requirement Reconsidered*, 37 S. TEX. L. REV. 967, 970 (1996).

client with the exercise of judgment on benefiting one beneficiary at the expense of another. Further, liability under this section only applies where the beneficiary can't reasonably protect his rights, *e.g.* for reasons of youth or incapacity. A Chapter 11 DIP, operating a business and negotiating a plan, with creditor beneficiaries that have their own counsel, committee, and United States Trustee support, is clearly distinguishable.

20. RESTATEMENT § 51(4) follows the Model Rules in providing that lawyer duties to non-clients apply only where a client's breach of duty amounts to crime, fraud, or the lawyer is assisting in the breach of duty.¹⁶⁷ It expressly says a lawyer can assume compliance with the law and generally must follow his client fiduciary's instructions. Duties only arise if the lawyer knows or has reason to know of such wrongdoing, and neither assumes nor requires a duty of inquiry. Importantly, the only duties lawyers have to non-clients even in these circumstances are duties of care, measured by a negligence standard. There is no duty of loyalty to the client's beneficiaries, and there are no fiduciary duties.

21. The Freeman article proceeds to analyze the law of fiduciary duties, including the historical derivation of the concept, and the central principles of the duties of loyalty, care and impartiality.¹⁶⁸ A fiduciary is a substitute for the beneficiary with power to act for the beneficiary, and fiduciary law is to protect from abuse of that power. In one way or another, a fiduciary takes on responsibilities for beneficiaries, including a lawyer speaking in court and negotiating for her client. The oft-stated general rule is that a fiduciary has a duty of loyalty to act solely in

¹⁶⁶ RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 (2000).

¹⁶⁷ *Id.* cmt. h.

beneficiary's interest, including by preserving the beneficiary's confidential financial and other information, and avoiding conflicts of interest and self-dealing.

22. Importantly, even in the context of a guardian/ward, fiduciary law recognizes that the fiduciary has his own interests, including in getting paid. It's not that the fiduciary may have no personal benefit, but only no improper personal benefit. The means of ensuring there is nothing improper is to fully disclose and get ratification or approval, *e.g.* in the context of a corporate transaction with a board member, by having the deal ratified by independent board members after full disclosure. Meeting the duty of care, duty of loyalty, and duty of impartiality when there are multiple beneficiaries is guided by the trust instrument.

23. In the context of a bankruptcy case, compliance with fiduciary duties while furthering legitimate self-interest can be accomplished through fiduciary mechanisms of disclosure, court ratification, and use of the Bankruptcy Code and Rules as the equivalent of a trust instrument guiding parties on the parameters of their responsibilities. Thus, bargaining in a plan for equity is fine; the DIP not investigating debtor actions is fine; and an insider can even buy estate assets as long as all Bankruptcy Rule-required disclosures are made.¹⁶⁹ Disclosures to creditors, committees and courts and getting approval of actions outside the ordinary course are the equivalent of a corporate board member's deal being approved by independent board members after full disclosure.

24. The same principles apply readily to DIP counsel with respect to her personal interests, such as asserting a right to be paid as a condition of plan

¹⁶⁸ See Freeman article at 338.

¹⁶⁹ In re Schipper, 933 F.2d 513 (7th Cir. 1991).

confirmation or negotiating a fee carve-out, as well as avoiding allegations that a lawyer is benefiting insider management and in effect serving two masters. For example, even if deemed fiduciary duties, they would be met when all parties understand that DIP counsel is openly negotiating with adverse Committee counsel for a smaller new value contribution by equity owners within the boundaries of bankruptcy law and subject to court approval of the result as fair and not overreaching.

25. The article describes theories for imposing the concept of “fiduciary” status on lawyer duties to the beneficiaries of client fiduciaries such as the DIP and Committee. These include the derivative client theory, trust fund doctrine, concept of “counsel for the estate,” officer of the court, and use of fiduciary language to heighten sensitivity and vigilance of the lawyer to the client fiduciary.¹⁷⁰ The article discusses third party liability consequences of deeming lawyers’ duties to their clients’ beneficiaries to be “fiduciary.” It concludes with the point that the numerous cases calling DIP and Committee counsel fiduciaries for the “estate” or for their clients’ beneficiaries can be achieved, without the adverse legal and professional responsibility ramifications, by focusing on counsel’s fiduciary duties to the client DIP or Committee, violations of Bankruptcy Rule 9011, failures to meet requirements of Bankruptcy Code sections 327, 329 or 330, or breaches of professional conduct codes or rules.

¹⁷⁰ See Freeman article at 369.

III. Representation of Creditors and Committees.

A. Conflicts of Interest With Bankruptcy Estates.

1. The bankruptcy court has authority to disqualify counsel appearing before it for ethical violations. Counsel who previously represented a DIP may be asked to advise the people with whom she dealt, the company's insiders, after a trustee takes control. If the estate through the trustee sues the insiders, counsel may be disqualified from representing them if there is a substantial relationship between the litigation and the former estate representation.¹⁷¹ Because DIP counsel represented the bankruptcy estate, a successor chapter 7 trustee (or creditors committee bringing avoidance actions under a plan) may raise a conflict and disqualify the attorney from any substantially related representation in the case, such as representation of preference defendants.¹⁷² Prepetition communications with a

¹⁷¹ In re Rossana, 395 B.R. 697 (Bankr. D. Nev. 2008); In re Teknek, LLC, 394 B.R. 884 (Bankr. N.D. Ill. 2008); In re Marks & Goergens, Inc., 199 B.R. 922 (Bankr. E.D. Mich. 1996); see In re Jaeger, 213 B.R. 578 (Bankr.C.D. Cal. 1997) (difference if individual chapter 7 debtor); compare In re Estates of Dublin Securities, Inc., 208 B.R. 683 (Bankr. S.D. Ohio 1997) (trustee failed to prove counsel formerly represented debtor, although debtor paid attorneys' fees). See also In re Allboro Waterproofing Corp., 224 B.R. 286 (Bankr. E.D.N.Y. 1998) (trustee cannot consent to waiver, but court can allow involuntary chapter 7 debtor's counsel to withdraw and represent only insider defendants); In re PGH Intern. Inc., 222 B.R. 401 (Bankr. D. Conn. 1998) (counsel who represented affiliate and debtor prepetition could not represent affiliate in lawsuit by DIP); see In re Berger McGill, Inc., 242 B.R. 413 (Bankr. S.D. Ohio 1999) (disqualified to represent trustee against former creditor client); In re Mercury, 280 B.R. 35 (Bankr. S.D.N.Y. 2002) (debtor's counsel in personal injury case could not represent trustee and settle case); see also In re North American Deed Co., 334 B.R. 443 (Bankr. D. Nev. 2005) (debtor's prepetition corporate law firm could not represent former inside counsel and president in suit by trustee).

¹⁷² See In re I Successor Corp., 321 B.R. 640 (Bankr. S.D.N.Y. 2005) (former DIP counsel disqualified from representing former officers and directors in post-confirmation litigation by committee); Estates of Dublin Securities, Inc., 214 B.R. 310 (Bankr. S.D. Ohio 1997); In re Jaeger, 213 B.R. 578 (Bankr.C.D. Cal. 1997); In re Peck Foods, 196 B.R. 434 (Bankr. E.D. Wis. 1996); see In re Prarie Central Ry., 209 B.R. 232 (Bankr. N.D. Ill. 1997) (chapter 7 trustee only party who could consent to conflict of former chapter 11 trustee); but see In re Restaurant Development Group, Inc., 402 B.R. 282 (Bankr. N.D. Ill. 2009) (conflict of former chapter 7 debtor counsel representing insiders in trustee litigation waived by trustee);

debtor may result in a disqualifying conflict precluding representation of a creditor, even if there is no actual engagement to represent the debtor.¹⁷³

2. Several courts have held that a creditor filing a § 727 discharge objection assumes fiduciary duties to act in the best interest of the bankruptcy estate with respect to that litigation.¹⁷⁴ Some courts have held the creditor cannot settle that litigation through payment of a § 523 claim to the litigating creditor alone without violating fiduciary duties.¹⁷⁵

B. Representation of Multiple Creditors.

1. A single lawyer or firm may not represent one client if that representation will be directly adverse to another client, or may be materially limited by the lawyer's responsibilities to another client, unless the lawyer reasonably believes the representation will not adversely affect the relationship with each client and each consents after consultation.¹⁷⁶ The consultation required for consent entails explaining to each client the implications of the common representation and the advantages and risks involved.¹⁷⁷ Common representation of persons having similar interests is generally proper if the risk of adverse effect is minimal and the informed consent requirements are met. If the parties have antagonistic positions in the same

In re Southern Kitchens, Inc., 216 B.R. 819, 833 (Bankr. D. Minn. 1998) (conflict prevented firm from representing trustee after representing debtor's insiders on related issues, but DIP and successor chapter 7 estate are different clients for conflict purposes).

¹⁷³ In re Modanlo, 342 B.R. 230 (D. Md. 2006) (debtor's motion to disqualify counsel for creditor due to previous communications as prospective counsel for debtor).

¹⁷⁴ See cases discussed in In re DeArmond, 240 B.R. 51, 56-57 (Bankr. C.D. Cal. 1999).

¹⁷⁵ Id.; In re Bates, 211 B.R. 338 (Bankr. D. Minn. 1997).

¹⁷⁶ Model Rule 1.7. If a lawyer not personally involved in creditor one's representation leaves the firm, he may represent creditor two adverse to creditor one. In re ProEducation Int'l, Inc., 587 F.3d 296 (5th Cir. 2009).

¹⁷⁷ Model Rule 1.7 comment.

bankruptcy case, however, it is generally improper to represent both.¹⁷⁸

2. Representation of more than one unsecured creditor would usually be acceptable, as long as there are no questions of preferential treatment, receipt of a fraudulent conveyance, or comparable distinction. Similarly, representation of several creditors wholly secured by separate assets would ordinarily be appropriate. But an unsecured creditor may well be adverse to a secured creditor, for example, especially if the secured creditor is also extending post-petition financing with the usual imposition of cross-collateralization requirements, security interest acknowledgements, etc.¹⁷⁹ The bankruptcy court may prevent an attorney from representing a creditor when the firm already represents another client in the same case and the two clients have a conflict of interest.¹⁸⁰ Bankruptcy courts have the power and responsibility to enforce professional responsibility requirements over all attorneys appearing before them, whether or not their employment is court-approved.¹⁸¹ Thus, one creditor can object to its current or former counsel's appearance for another creditor and obtain an order of disqualification if there is an unwaived conflict of interest.¹⁸²

3. The client consultation required for meaningful consent should

¹⁷⁸ Model Rule 1.7 comment.

¹⁷⁹ See Locks v. U.S. Trustee, 157 B.R. 89 (W.D. Pa. 1993) for another example of an attorney trying to advocate for interests of one client in a bankruptcy case adverse to the interests of another client; court denied attorney right to be heard. See also In re Whitman, 101 B.R. 37 (Bankr. N.D. Ind. 1989)(cannot represent creditors' committee and committee member holding both secured and unsecured deficiency claim because of conflict between secured and unsecured creditors).

¹⁸⁰ Id.; In re Griffin, 310 B.R. 610 (8th Cir. BAP 2004).

¹⁸¹ See Baron & Budd, P.C. v. Unsecured Asbestos Claimants, 321 B.R. 147 (D. N.J. 2005), and § I.

¹⁸² In re Meridian Auto. Systems Composite Operations, 340 B.R. 740 (Bankr. D. Del. 2006).

include an agreement that counsel can withdraw whenever she believes it unethical to continue, without disclosing the reasoning for that belief. Information learned from one client about bases for disqualifying its claim would be privileged.¹⁸³ There must be some agreement in advance as to continued representation of one or the other, or withdrawal from representation of both, in the event the creditors' interests diverge. It is only sensible that such an agreement be clearly documented in advance, and signed by the creditor clients.

4. Bankruptcy Rule 2019 requires that counsel representing more than one creditor or equity security holder file a verified statement identifying them, the nature and amount of their claims or interests, the pertinent facts and circumstances of counsel's employment, and other details.¹⁸⁴ Any material changes are to be disclosed in supplemental statements. Failure to comply may result in inability to be heard in the case, and invalidity of reorganization plan ballots or other documents filed on behalf of the creditors by the attorney.¹⁸⁵ At least two courts have applied this rule to representation of an ad hoc committee of creditors or equity

¹⁸³ Model Rule 1.6. But see discussion of joint defense doctrine limitations on attorney-client privilege at § VII D.

¹⁸⁴ Baron & Budd, P.C. v. Unsecured Asbestos Claimants, 321 B.R. 147 (D. N.J. 2005); In re Kaiser Aluminum Corp., 327 B.R. 554 (D. Del. 2005); In re Milacron, Inc., 436 B.R. 515 (Bankr. S.D. Ohio 2010) (2019 required even though entity represented only its members); In re North Bay Gen. Hosp., Inc., 404 B.R. 443 (Bankr. S.D. Tex. 2009); In re CF Holding Corp., 145 B.R. 124 (Bankr. D. Conn. 1992)(court required counsel to file copies of written engagement letters, but not to disclose owners of represented entities).

¹⁸⁵ Bankruptcy Rule 2019(b). In In re Oklahoma P.A.C. First Ltd. Partnership, 122 B.R. 387 (Bankr. D. Az. 1990), the court refused to allow one firm to represent junior and senior lien creditors secured by the same asset in a lift stay adversary proceeding. It found the firm could not vigorously represent the interests of both. Several courts have refused to allow class proofs of claim filed by counsel who failed to comply with Rule 2019. Reid v. White Motor Corp., 886 F.2d 1462 (6th Cir. 1989) and cases cited therein; contra Wilson v. Valley Electric Membership Co-operative, 141 B.R. 309 (E.D. La. 1992).

holders.¹⁸⁶

C. Fiduciary Duties of Creditors' Committee Members.

1. Committees have fiduciary duties to the constituent creditors or equity they represent, with obligations of fidelity, undivided loyalty, and impartial service in the interests of all their constituents.¹⁸⁷ They are not fiduciaries for the debtor or the bankruptcy estate in general.¹⁸⁸ Committees do not owe duties to

¹⁸⁶ In re Washington Mutual, Inc., 419 B.R. 271 (Bankr. D. Del. 2009); In re Northwest Airlines Corp., 363 B.R. 701 (Bankr. S.D.N.Y. 2007); contra In re Philadelphia Newspapers, LLC, 422 B.R. 553 (Bankr. E.D. Pa. 2010); and In re Premier International Holdings, Inc., 423 B.R. 58 (Bankr. D. Del. 2010).

¹⁸⁷ Woods v. City National Bank & Trust Co., 312 U.S. 262 (1941); In re Iridium Operating, LLC, 478 F.3d 452 (2d Cir. 2007)(fiduciary duty to maximize their recovery of estate's assets); Westmoreland Human Opportunities, Inc. v. Walsh, 246 F.3d 233 (3d Cir. 2001); In re PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000); In re Bohack Corp., 607 F.2d 258 (2d Cir. 1979); Official Committee of Unsecured v. Qwest Commun., 405 B.R. 234 (E.D. Mich. 2009); In re Gadzooks, Inc., 352 B.R. 796 (Bankr. N.D. Tex. 2006); In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2005); In re Artra Group, Inc., 308 B.R. 851 (Bankr. N.D. Ill. 2003); In re Greystone Holdings, LLC, 305 B.R. 456 (Bankr. N.D. Ohio 2003); In re Spiegel, 292 B.R. 748 (Bankr. S.D.N.Y. 2003); In re Dow Corning Corp., 212 B.R. 258 (Bankr. E.D. Mich. 1997) *aff'd*, 255 B.R. 445 (E.D. Mich. 2000); Locks v. U.S. Trustee, 157 B.R. 89 (W.D. Pa. 1993); In re Venturelink Holdings, Inc., 299 B.R. 420 (Bankr. N.D. Texas 2003); In re Fas Mart Convenience Stores, Inc., 265 B.R. 427 (Bankr. E.D. Va. 2001); In re Pierce, 237 B.R. 748 (Bankr. E.D. Cal. 1999); In re Granite Partners, L.P., 210 B.R. 508 (Bankr. S.D.N.Y. 1997); In re Circle K Corp., 199 B.R. 92 (Bankr. S.D.N.Y. 1996); In re Celotex Corp., 123 B.R. 917 (Bankr. M.D. Fla. 1991); In re Microboard Processing, Inc., 95 B.R. 283 (Bankr. D. Conn. 1989); In re Tucker Freight Lines, Inc., 62 B.R. 213 (Bankr. W.D. Mich. 1986); PBGC v. Pincus, Verlin, etc., 42 B.R. 960 (E.D. Pa. 1984); In re Mesta Machine Co., 67 B.R. 151 (Bankr. W.D. Pa. 1986); In re Johns-Manville Corp., 26 B.R. 919 (Bankr. S.D.N.Y. 1983); see In re Continental Airlines, Inc., 57 B.R. 839 (Bankr. S.D. Tex. 1985); In re National Equipment & Mold Corp., 33 B.R. 574 (Bankr. N.D. Ohio 1983) (cannot use committee to promote individual creditor's interest). See Pozen and Mencher, Chinese Walls for Creditors' Committees, 48 Bus. Lawyer 747 (1993) discussing caselaw on the ability of committee members to trade in the debtor's securities, in light of such fiduciary duties.

¹⁸⁸ In re Adelphia Communications Corp., 544 F.3d 420, 424 n.1 (2d Cir. 2008) (committee owes fiduciary duty to class it represents, but not debtor, other classes or the estate); In re Smart World Techs, LLC, 423 F.3d 166, 175 (2d Cir. 2005) (same); In re SPM Mfg. Corp., 984 F.2d 1305 (1st Cir. 1993) (duty to constituents, not entire estate); In re Commercial Mortgage and Finance Co., 414 B.R. 389 (Bankr. N.D. Ill. 2009); In re TSIC, Inc., 393 B.R. 71 (Bankr. D. Del. 2008); In re Life Service Systems, Inc., 279 B.R. 504 (Bankr. W.D. Pa. 2002) (committee is partisan adversary of debtor, not impartial arbitrator between debtor and creditors).

particular creditors, and may take action adverse to certain creditors.¹⁸⁹ However, a committee should not prefer a subgroup of constituent creditors over another.¹⁹⁰

2. In the event of a conflict between a committee member's own interests and the interests of its constituent group, most courts have held that the creditors' committee member's obligation to all creditors need not take priority over its own claim, as long as the member is not taking advantage of inside information learned as a committee member or violating court orders.¹⁹¹ Committee members do

¹⁸⁹ In re Dow Corning Corp., 255 B.R. 445 (E.D. Mich. 2000) (fiduciary duty extends to class as a whole, not individual members); In re Life Service Systems, Inc., 279 B.R. 504 (Bankr. W.D. Pa. 2002) (committee member breached fiduciary duty in attempting to take debtor's opportunity); In re Rickel & Assoc., Inc., 272 B.R. 74 (Bankr. S.D.N.Y. 2002); In re Granite Partners, L.P., 210 B.R. 508 (Bankr. S.D.N.Y. 1997); In re Circle K Corp., 199 B.R. 92 (Bankr. S.D.N.Y. 1996) aff'd, 1997 WL 31197 (S.D.N.Y. 1997).

¹⁹⁰ In re Nutritional Sourcing Corp., 398 B.R. 816, 836 (Bankr. D. Del. 2008) (plan negotiated by committee provided for some unsecured creditors to receive 100% and some 13.2% of claims).

¹⁹¹ See Westmoreland Human Opportunities, Inc. v. Walsh, 246 F.3d 233 (3d Cir. 2001) (issue on remand whether committee member can be held to breach fiduciary duties in transaction not involving estate property), on remand, 327 B.R. 561 (W.D. Pa. 2005) (committee member may have fiduciary duties even with respect to property not included in estate); In re Rickel & Assoc., Inc., 272 B.R. 74 (Bankr. S.D.N.Y. 2002) (cause of action stated for committee member's use of inside information to advance personal interest to detriment of other creditors); In re El Paso Refinery, L.P., 196 B.R. 58 (Bankr. W.D. Tex. 1996) (courts should not decree that whenever a committee member's business interests conflict with committee interests the duties to the committee prevail, or committee participation will be chilled); In re American Federation of Television and Radio Artists, 30 B.R. 772, 776 (Bankr. S.D.N.Y. 1983) (committee member may take positions contrary to committee positions in filings on its own behalf; committee member could oppose exclusivity extension despite committee non-opposition); In re Seascapes Cruises, Ltd., 131 B.R. 241 (Bankr. S.D. Fla. 1991) (committee member's stay lift motion not a breach of fiduciary duty). See In re Nationwide Sports Distributors, Inc., 227 B.R. 455 (Bankr. E.D. Pa. 1998) (settlement benefitting committee members more than other creditors disapproved); In re Haskell-Dawes, Inc., 188 B.R. 515 (Bankr. E.D. Pa. 1995) (member duty not to use committee position to advance own interests); see In re Dow Corning Corp., 212 B.R. 258 (E.D. Mich. 1997) (member must place the collective interest of the class above its personal stake in the case); In re Johns-Manville, 26 B.R. 919 (Bankr. S.D.N.Y. 1983) (committee member abused position and violated stay and court orders); In re Farmer Bros. Company v. Huddle Enterprises, Inc., 366 F.2d 143 (9th Cir. 1966) (committee member who participated in negotiating Chapter XI estopped to seek foreclosure of his trust deed after confirmation); In re Electrical Materials Co., 160 B.R. 1018 (Bankr. W.D. Mo. 1993) (committee member participating in decision for committee to request right to file preference actions estopped from

not enjoy absolute immunity for their actions, and may be liable for actions outside the scope of committee authority, or for willful misconduct, which may include actions taken without honest care to be accurate.¹⁹² Some courts may allow committee members to trade in the debtor's securities while serving on the committee, but only upon a detached factual record of the specific factual circumstances surrounding the request, including with respect to screening confidential information.¹⁹³ A committee member seeking to deal with nonstate property that could impact positively or negatively the creditors' recovery should notify the committee and decline to proceed unless disinterested committee members approve the transaction.¹⁹⁴ A committee member's counsel cannot represent another

claiming committee lack of standing to sue that member for preference).

¹⁹² In re PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000)(release of committee in plan, excepting liability for willful misconduct or gross negligence, reflects no change in standard of liability); Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561 (W.D. Pa. 2005) (damages assessed against committee member for breach of fiduciary duty); In re Dow Corning Corp., 255 B.R. 445, 485 (E.D. Mich. 2000); Luedke v. Delta Air Lines, Inc., 159 B.R. 385 (S.D.N.Y. 1993)(complaint against committee and its members by former debtor employees stated a cause of action; committee allegedly usurped DIP role in sale negotiations and manipulated reorganization; committee allegedly assumed a duty to all parties in reorganization case by becoming joint sponsor and proponent of joint plan) ; In re Rickel & Assoc., Inc., 272 B.R. 74 (Bankr. S.D.N.Y. 2002)(cause of action stated for committee member's use of inside information); In re Granite Partners, L.P., 210 B.R. 508 (Bankr. S.D.N.Y. 1997) (immunity where no willful misconduct or ultra vires activities); In re General Homes Corp. and FGMC, Inc., 181 B.R. 870 (Bankr. S.D. Tex. 1994), reconsideration denied, 181 B.R. 898 (Bankr. S.D. Tex. 1995) (committee members sanctioned for filing complaint in violation of stay; immunity does not protect willful misconduct); In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717 (Bankr. S.D.N.Y.) aff'd, 140 B.R. 347 (S.D.N.Y. 1992) (plan could release committee members from any liability in connection with reorganization except claims arising from willful misconduct); In re L.F. Rothschild Holdings, Inc., 163 B.R. 45 (S.D.N.Y. 1994) (same); In re Tucker Freight Lines, Inc., 62 B.R. 213 (Bankr. W.D. Mich. 1986) (shareholder sued committee, alleging letter urging vote against DIP plan included false and misleading statements); In re REA Holdings Corp., 8 B.R. 75 (Bankr. S.D.N.Y. 1980) (actionable breach of fiduciary duty as committee member to divert business from debtor to member).

¹⁹³ In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2006); In re Spiegel, 292 B.R. 748 (Bankr. S.D.N.Y. 2003).

¹⁹⁴ Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561 (W.D. Pa. 2005).

client with interests adverse to the constituents of the committee.¹⁹⁵

3. Committee members must be able to comply with their fiduciary duties, or they will be disqualified; the committee may be reconstituted if the members cannot meet their obligations to their constituents as the case develops.¹⁹⁶ Several courts have allowed creditors with conflicting interests to serve on committees, however, if the conflict was speculative and there was no specific evidence they had not breached or were likely to breach their fiduciary duties to their constituents.¹⁹⁷ A member should be disqualified, however, upon evidence that it has breached or is likely to breach fiduciary duties through litigation that would have a substantial negative impact on the prospects of a distribution to unsecured

¹⁹⁵ Locks v. U.S. Trustee, 157 B.R. 89 (W.D. Pa. 1993)(counsel for a committee member held to lack standing to advocate for another client's position contrary to interests of committee and its constituency; lawyer for committee member held to have fiduciary duty to committee constituency); In re Johns-Manville, 26 B.R. 919 (Bankr. S.D.N.Y. 1983).

¹⁹⁶ In re Pierce, 237 B.R. 748 (Bankr. E.D. Cal. 1999) (if member is unable or unwilling to exercise fiduciary duties, U.S. Trustee should remove him from creditors' committee; disagreement over strategy or objections not per se a conflict mandating removal); In re Penn-Dixie Industries, Inc., 9 B.R. 936 (S.D.N.Y. 1981) (member will be disqualified if evidence that it's economic interest is sufficiently adverse that it is unable to represent class members as fiduciary); In re Allied Delivery Systems Co., 52 B.R. 85 (Bankr. N.D. Ohio 1985) (conflicting loyalties of union); In re Swolsky, 55 B.R. 144 (Bankr. N.D. Ohio 1985) (insider removed from committee); In re Wilson Foods Corp., 33 B.R. 272 (Bankr. W.D. Okla. 1983) (debtor's competitor disqualified); but see In re MH Corp., 30 B.R. 266 (Bankr. S.D. Ohio 1983) (stated opposition to any debtor's plan that might be filed insufficient to disqualify); In re McLean Industries, Inc., 70 B.R. 852 (Bankr. S.D.N.Y. 1987); In re Continental Airlines, Inc., 57 B.R. 839 (Bankr. S.D. Tex. 1985). A party in interest may challenge a committee member's ability to fairly and adequately represent the class. 11 U.S.C. § 1102(b).

¹⁹⁷ E.g. In re Altair Airlines, Inc., 727 F.2d 88 (3d Cir. 1984) (union asserting wage claim); In re Value Merchants, Inc., 202 B.R. 280 (E.D. Wis. 1996) (indenture trustee); In re Dana Corp., 344 B.R. 35 (Bankr. S.D.N.Y. 2006) (fact that committee members have variety of views does not require appointment of separate committees unless ability of committee to reach consensus is impaired) In re Seascope Cruises, Ltd., 131 B.R. 241 (Bankr. S.D. Fla. 1991); In re Caldor, Inc.-NY, 193 B.R. 165 (Bankr. S.D.N.Y. 1996); In re MAP Intern., Inc., 105 B.R. 5 (Bankr. E.D. Pa. 1989); In re Microboard Processing, Inc., 95 B.R. 283 (Bankr. D. Conn. 1989); In re Walat Farms, Inc., 64 B.R. 65 (Bankr. E.D. Mich. 1986); In re Plant Specialities, Inc., 59 B.R. 1 (Bankr. W.D. La. 1986).

creditors.¹⁹⁸ One court has held that an appearance of a breach of fiduciary duty should likewise mandate disqualification, and further that as a matter of public policy, former officers and directors should not serve on committees because their actions as fiduciaries will be analyzed by the committee.¹⁹⁹ While committee members whose claims are satisfied during the case generally resign from committee membership, and are replaced by creditors with viable claims, failure to resign has been held not to necessarily invalidate the committee's action because members participate as fiduciaries, not as individual claim holders.²⁰⁰ Courts were divided with respect to the bankruptcy court's power to review the U.S. Trustee's decisions on committee membership, but the 2005 amendments to the Bankruptcy Code expressly authorize the bankruptcy court to order changes to committee membership.²⁰¹

¹⁹⁸ In re Fas Mart Convenience Stores, Inc., 265 B.R. 427 (Bankr. E.D. Va. 2001).

¹⁹⁹ In re Venturelink Holdings, Inc., 299 B.R. 420 (Bankr. N.D. Texas 2003).

²⁰⁰ Official Committee of Unsecured v. Qwest Communication, 405 B.R. 234 (E.D. Mich. 2009).

²⁰¹ 11 U.S.C. §1102(a)(4); In re Venturelink Holdings, Inc., 299 B.R. 420 (Bankr. N.D. Texas 2003); In re Enron Corp., 279 B.R. 671 (Bankr. S.D.N.Y. 2002) (factors relevant to appointment of additional committees); In re Fas Mart Convenience Stores, Inc., 265 B.R. 427 (Bankr. E.D. Va. 2001) (inherent power to review U.S. Trustee decisions for abuse of discretion); In re Mercury Finance Co., 240 B.R. 270 (N.D. Ill. 1999) (comparing lines of authority; U.S. Trustee lacked power to appoint committee of both equity and creditors); In re Mission Health, Inc., 242 B.R. 527 (Bankr. M.D. Fla. 1999); In re Pierce, 237 B.R. 748 (Bankr. E.D. Cal. 1999) (court authorized to appoint and remove if U.S. Trustee abuse of discretion); In re Dow Corning Corp., 212 B.R. 258 (E.D. Mich. 1997) (court does not have role in appointment or modification of committee members); In re Value Merchants, Inc., 202 B.R. 280 (E.D. Wis. 1996) (if no U.S. Trustee abuse of discretion, court may only order additional committees to be appointed by U.S. Trustee; if abuse of discretion, court may order which members may sit on existing committee); In re Lykes Bros. S.S. Co., Inc., 200 B.R. 933 (M.D. Fla. 1996) (§ 105 power to expand a committee if U.S. Trustee acted arbitrarily and capriciously in appointing); In re Barney's, Inc., 197 B.R. 431 (Bankr. S.D.N.Y. 1996) (same); In re Victory Markets, Inc., 196 B.R. 1 (Bankr. N.D.N.Y. 1995) (creditor's only remedy is to request appointment of additional committees); In re Wheeler Technology, 139 B.R. 235 (9th Cir. BAP 1992) (congressional deletion of former § 1102(c) removes court authority over U.S. Trustee decisions); In re Columbia Gas System, Inc., 133 B.R. 174 (Bankr. D.Del. 1991) (court cannot substitute its judgment for U.S. Trustee, but can review decisions for abuse of discretion); see Bankruptcy Rule 2020 (proceeding to contest any act by U.S. Trustee governed by Rule 9014).

4. Even if the creditor's conflicts with other committee members are insufficient to disqualify her, she may be excluded from some discussions.²⁰² If proposed committee action affects a member, she should disclose her interest and abstain from voting.

D. Committee Counsel's Fiduciary Duties.

1. Professionals for a committee are bound by the same fiduciary responsibilities as committee members.²⁰³ Committee counsel must use due care in the performance of duties assumed, seeing to it that creditors' interests are considered fairly.²⁰⁴ Committee counsel undertakes to represent the interests of the entire class, not just the committee members.²⁰⁵ Committee counsel may pursue litigation against a constituent individual creditor, as long as counsel acquires no confidential

²⁰² In re Yellowstone Mountain Club, LLC, 415 B.R. 769 (Bankr. D. Mont. 2009) (committee member properly abstained from voting); In re Electrical Materials Co., 160 B.R. 1016 (Bankr. W.D. Mo. 1993) (committee member sued for preference to abstain from attending portion of meeting and voting on any issue pertaining to preference action, or resign); In re Vermont Real Estate Investment Trust, 20 B.R. 33 (Bankr. D. Vt. 1982) (married to former CEO of debtor, and joint defendant with him in adversary proceeding by trustee, not to participate in discussions of that suit).

²⁰³ See extensive analysis of Committee and Committee counsel fiduciary duties in Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway? 17 Amer. Bankr. L. Inst. C. Rev., 291 (Winter 2009); In re Greystone Holdings, LLC, 305 B.R. 456 (Bankr. N.D. Ohio 2003) (fiduciary duty to committee); In re J.F.D. Enterprises, Inc., 223 B.R. 610 (Bankr. D. Mass. 1998)(duty to committee, not debtor or individual creditors); In re Celotex Corp., 123 B.R. 917 (Bankr. M.D. Fla. 1991); In re Mesta Machine Co., 67 B.R. 151 (Bankr. W.D. Pa. 1986); PBGC v. Pincus, Verlin, etc., 42 B.R. 960 (E.D. Pa. 1984); Arlans Department Stores, Inc., 615 F.2d 925 (2d Cir. 1979); In re Johns-Manville, 26 B.R. 919 (Bankr. S.D.N.Y. 1983); Cf. In re Allegheny International Inc., 100 B.R. 244 (Bankr. W.D. Pa. 1989) (committee's investment banker a fiduciary).

²⁰⁴ PBGC v. Pincus, Verlin, etc., 42 B.R. 960 (E.D. Pa. 1984). The debtor has no standing to pursue breach of duty claims against creditors' committee counsel, because the fiduciary duties are owed to the creditors, not the debtor or the estate. In re Overmyer Telecasting Co., 47 B.R. 823 (Bankr. N.D. Ohio 1985). See In re ABC Automotive Products Corp., 210 B.R. 437 (Bankr. E.D. Pa. 1997) on the duties of committees and committee counsel, and the need to choose counsel fairly.

²⁰⁵ In re EBP, Inc., 171 B.R. 601 (Bankr. N.D. Ohio 1994); In re General Homes Corp. and FGMC, Inc., 181 B.R. 870 (Bankr. S.D. Tex. 1994). The committee's constituents do not

information from that creditor nor takes any improper advantage through representation of the committee.²⁰⁶ Committee counsel may in some cases object to a plan even though the majority of the class members voting on the plan voted for it.²⁰⁷ Counsel for an ad hoc committee assumes fiduciary duties to the class he purports to represent and must deal fairly and honestly with class members.²⁰⁸

2. Meeting fiduciary duties and avoiding conflicts of interest encompasses a duty on the part of committee counsel to elicit and ensure consideration of the views of all committee members. In the Fibermark case, an examiner's report describes one committee member's domination of and disrespect for other committee members, and criticizes committee counsel for facilitating and doing nothing to rectify such behavior.²⁰⁹ The report asserts that committee counsel failed to provide adequate guidance to committee members on the exercise of their fiduciary duties, rarely consulted with some members, and became an advocate for the dominant member instead of the independent, impartial attorney for the full committee. The examiner recommended a significant portion of committee counsel's compensation be disallowed. Without admitting liability, the firm agreed with the

thereby become clients, however. In re Circle K Corp., 199 B.R. 92 (Bankr. S.D.N.Y. 1996).

²⁰⁶ In re Electrical Materials, Co., 160 B.R. 1016 (W.D. Mo. 1993); In re Buffalo Coal Co., 2008 Bankr. LEXIS 1259 (Bankr. N.D. W. Va. 2008)(committee counsel as special counsel for estate cannot use conflicts information learned as committee counsel against former committee member); In re Levy, 54 B.R. 805 (Bankr. S.D.N.Y. 1985); see Picciotto v. Schreiber, 260 B.R. 242 (D. Mass. 2001) (committee counsel owes no duty to individual creditors); In re USN Communications, Inc., 280 B.R. 573 (Bankr. D. Del. 2002) (former committee counsel may represent liquidating trustee under plan in litigation against individual creditors).

²⁰⁷ In re EBP, Inc., 171 B.R. 601 (Bankr. N.D. Ohio 1994).

²⁰⁸ In re Mirant Corp., 334 B.R. 789 (Bankr. N.D. Tex. 2005) (misleading statements in solicitation of plan rejections enjoined).

²⁰⁹ See Report of Harvey R. Miller as Examiner, U.S. Bankr. D. Vt. No. 04-10463 (Dkt. 1805) and In re Fibermark, Inc., 330 B.R. 480 (Bankr. D. Vt. 2005). See also In re Dana Corp., 344 B.R. 35 (Bankr. S.D.N.Y. 2006) (fact that committee members have variety of viewpoints does not require appointment of separate committees unless ability of committee

debtors and the U.S. Trustee to reduce its fees by approximately one-third.

3. Committee counsel, like DIP counsel, is to meet its responsibilities in a manner that will not waste estate assets through excessive and inefficient work, or engagement of duplicative and unnecessary professionals.²¹⁰ For example, efforts should be directed toward facilitating discussion and resolution of plan issues instead of preparing numerous committee draft plans and objections to debtor plans and disclosures.²¹¹ When a debtor is aggressive or deleterious, committee counsel may need to file competing plans to negotiate better treatment for committee constituents, however.²¹² Generally, the committee's professionals should not involve themselves in every minute aspect of the DIP's business, incurring excessive fees that inappropriately drain the estate.²¹³ Nor should they act as mere spectators, however, failing to review debtor filings with "fresh eyes" or even to contribute little or nothing to benefit the creditors, while reaping the estate's cash for their fees.²¹⁴ When issues arising in the case have a significant impact on creditor

to reach consensus is impaired).

²¹⁰ In re Dunkin's Diamonds, Inc., 420 B.R. 883 (Bankr. M.D. Fla. 2009); In re Energy Partners, Ltd., 409 B.R. 211 (Bankr. S.D. Tex. 2009).

²¹¹ In re TAK Communications, Inc., 154 B.R. 514 (Bankr. W.D. Wis. 1993) (cost-efficient representation also entails adequate use of local counsel); see In re Thrifty Oil Co., 205 B.R. 1009 (Bankr. S.D. Cal. 1997) (committee accountants not paid for excessive time spent on liquidating plan to prompt another plan from DIP); In re Keene Corp., 205 B.R. 690 (Bankr. S.D.N.Y. 1997) (excessive and unnecessary committee litigation).

²¹² In re Rey, 324 B.R. 449 (Bankr. E.D.N.Y. 2005).

²¹³ In re Cumberland Farms, Inc., 154 B.R. 9 (Bankr. D. Mass. 1993); In re Wang Laboratories, Inc., 154 B.R. 392 (Bankr. D. Mass. 1993); see also In re General Homes Corp. and FGMC, Inc., 181 B.R. 870 (Bankr. S.D. Tex. 1994)(counsel sanctioned for filing unauthorized lawsuit). See also In re Dow Corning Corp., 199 B.R. 896 (Bankr. E.D. Mich. 1996)(committee is only authorized to perform services within the bankruptcy case in the interest of its constituents).

²¹⁴ In re Shechan Memorial Hospital, 380 B.R. 299 (Bankr. W.D.N.Y. 2007)(excessive committee counsel time monitoring file and no committee position on important topics such as plan; apparent churning of file); In re SONCiblue, 2007 Bankr. LEXIS 1057 (Bankr. N.D. Cal. 2007) (committee counsel failed to review settlement agreement carefully, and committee

distributions, committee counsel should undertake a factual and legal analysis and bring the conclusions to the court.²¹⁵ But once it becomes reasonably obvious that unsecured creditors will not receive a distribution, committee counsel must scale back services.²¹⁶

4. Professionals employed by one committee generally may not serve another committee in the same case or in a related case to avoid breaching fiduciary duties.²¹⁷ A single creditors' committee and its counsel may be appointed, however, in related, jointly administered cases.²¹⁸

5. An attorney representing a creditors' committee may not represent any other entity having an adverse interest in connection with the case.²¹⁹

members' counsel included provisions benefiting themselves at expense of unsecured creditors); In re New England Metal Co., Inc., 155 B.R. 38 (Bankr. D. R.I. 1993).

²¹⁵ In re Rancourt, 207 B.R. 338 (Bankr. D.N.H. 1997); In re Wilson Foods Corp., 31 B.R. 272 (Bankr. W.D. Okl. 1983).

²¹⁶ In re Shechan Memorial Hospital, 380 B.R. 299 (Bankr. W.D.N.Y. 2007)(initial file review reveals impossibility of any material distribution to unsecured creditors, committee counsel should scale down involvement); In re Gadzooks, Inc., 352 B.R. 796 (Bankr. N.D. Tex. 2006)(committee counsel's services were reasonable until fair notice that efforts to reorganize and benefit constituents were futile); In re Channel Master Holdings, Inc., 309 B.R. 855, 861 (Bankr. D.De. 2004) ("we do not think that chapter 11 is a license to perform services and generate fees in a vacuum without considering the possibilities of recovery for the professional's constituents"); In re Auto Parts Club, Inc., 211 B.R. 29 (9th Cir. BAP 1997), on remand 224 B.R. 445 (Bankr. S.D. Cal. 1998); see In re Veltri Metal Products, Inc., 189 Fed. Appx. 385 (6th Cir. 2006)(committee counsel fees may be reasonable and necessary even though unsecured creditors unlikely to receive distribution).

²¹⁷ In re Saxon Industries, Inc., 29 B.R. 320 (Bankr. S.D.N.Y. 1983)(equity committee entitled to consult with own accountant, despite access to information compiled by creditors' committee's accountant for this reason); In re Proof of the Pudding, Inc., 6 BCD 338 (Bankr. S.D.N.Y. 1980) (related case); In re Lee, 94 B.R. 172 (Bankr. C.D. Cal. 1988) (presumption against service in related cases) but see In re Lion Capital Group, 44 B.R. 684 (Bankr. S.D.N.Y. 1984) (same firm appointed to represent two committees where their interests aligned). But see In re Caldor, Inc.-NY, 193 B.R. 165 (Bankr. S.D.N.Y. 1996)(committee professionals also represented committee in bankruptcy case of competitor).

²¹⁸ In re McLean Industries, Inc., 70 B.R. 852, 861-862 (Bankr. S.D.N.Y. 1987), and cases cited therein; In re Orfa Corp. of Philadelphia, 121 B.R. 294 (Bankr. E.D. Pa. 1990) (analysis of appointing a single committee and committee counsel in related cases, with compilation of citations).

²¹⁹ In re Firstmark Corp., 132 F.3d 1179 (7th Cir. 1997) (committee counsel resigned from

But representation of one or more creditors of the same class represented by the committee is not considered an adverse interest *per se*.²²⁰ The ability to represent creditors and the creditors' committee simultaneously was not authorized until the 1984 BAFJA amendments to the Bankruptcy Code. Prior representation of another party in interest may be disqualifying if it results in an actual conflict of interest.²²¹

representation of creditor when discovered during case); See In re Greystone Holdings, LLC, 305 B.R. 456 (Bankr. N.D. Ohio 2003) (applying disinterestedness standard, court disqualified a committee financial advisor because it was wholly owned by the committee's law firm); In re Carlton House, 1996 Bankr. LEXIS 170, 28 BCD 777 (Bankr. C. Mass. 1996)(committee counsel suspended from bankruptcy practice for one year due to nondisclosure of representation of secured creditor); Daido Steel v. Official Committee of Unsecured Creditors, 178 B.R. 129 (N.D. Ohio 1995)(committee counsel may simultaneously represent party adverse to estate on matters unrelated to the bankruptcy); contra In re Calabrese, 173 B.R. 61 (Bankr. D. Conn. 1994); In re Electro-Optix, U.S.A., Inc., 130 B.R. 621 (Bankr. S.D. Fla. 1991) (cannot represent administrative expense claimant while representing creditors' committee); In re Whitman, 101 B.R. 37 (Bankr. N.D. Ind. 1989)(cannot represent committee and client committee member because it holds secured and unsecured claim); In re Grant Broadcasting of Philadelphia, Inc., 71 B.R. 655 (Bankr. E.D. Pa. 1987).

²²⁰ 11 U.S.C. § 1103(b); In re National Century Financial Enterprises, Inc., 298 B.R. 112 (Bankr. S.D. Ohio 2003) (attorney could represent committee and members where separate counsel will represent committee on any matter where interests of that member may be adverse); and 298 B.R. 118 (Bankr. S.D. Ohio 2003) (no violation if representing an entity with an adverse interest in matter unrelated to bankruptcy case or that predates representation of committee); In re Walnut Equipment Leasing Co., Inc., 213 B.R. 285 (Bankr. E.D. Pa. 1997) (counsel represented committee and member, with agreement counsel would not be adverse to member or litigate against it); In re Whitman, 101 B.R. 37 (Bankr. N.D. Ind. 1989) (client committee member must hold only unsecured claim). Neither the creditors' committee nor its counsel was allowed to represent individual creditors for claims allowance purposes, however, the court deeming efforts to maximize some claims at the expense of others a conflict. In re Continental Airlines, Inc., 57 B.R. 839 (Bankr. S.D. Tex. 1985). Likewise, committee counsel may not represent a committee member with respect to matters adverse to the estate, such as a SEC investigation of involvement in debtor misconduct. In re National Liquidators, Inc., 171 B.R. 819 (Bankr. S.D. Ohio 1994). Creditors' committee counsel may not simultaneously represent secured creditors, even on unrelated matters, according to In re Calabrese, 173 B.R. 61 (Bankr. D. Conn. 1994); contra Daido Steel v. Official Committee of Unsecured Creditors, 178 B.R. 129 (N.D. Ohio 1995) (committee counsel may simultaneously represent party adverse to estate on matters unrelated to the bankruptcy).

²²¹ In re Plant Insulation Co., 414 B.R. 646 (Bankr. N.D. Cal. 2009) (committee representation approved with restrictions on certain services to avoid conflict with former client); In re Buran, 363 B.R. 358, 360 (Bankr. W.D.N.Y. 2007) (prior representation of creditor was not basis for disqualification); In re Meridian Auto Systems-Composite Operations, 340 B.R. 740 (Bankr. D. Del. 2006) (representation of secured creditor on substantially related matters); In re Pittsburgh Corning Corp., 308 B.R. 716 (Bankr. W.D. Pa.

Prior interviews for committee representation may also result in disqualification, especially if confidential information is imparted.²²² Any committee solicitation must comply with applicable professional responsibility rules.²²³

6. Courts evaluate potential conflicts between duties to the committee and duties to a separate creditor client on a case-by-case basis. Counsel for creditors can proceed to represent the creditors committee without continuing to represent the creditor clients in connection with the case.²²⁴ Pursuing litigation for individual creditors potentially adverse to the committee, constituent creditors, or other committee members has been held to require disqualification as committee counsel.²²⁵ A remote, speculative possibility of a future dispute over a creditor client's claim or a possible cause of action against that client does not disqualify

2004) (prior representation of shareholder).

²²² See Ass'n of the Bar of the City of New York, Committee on Professional and Judicial Ethics Formal Opinion 2006-2 (April 2006) (interviewing lawyer not prohibited from representing client with material adverse interest even if lawyer obtained confidential information if (1) confidences not likely to be significantly harmful; (2) lawyer obtained informed advance waiver before "beauty contest"; (3) prospective client revealed confidences for purpose of disqualification with no intention of hiring attorney; and if attorney is disqualified, firm may rebut presumption of shared confidences with sufficient evidence of effective ethical screen of that attorney); see also In re Modanlo, 342 B.R. 230 (D. Md. 2006) (debtor's motion to disqualify counsel for creditor due to previous communications as prospective counsel for debtor).

²²³ See Model Rules 7.1, 7.2, 7.3; Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447 (1978); In re ABC Automotive Products Corp., 210 B.R. 437 (Bankr. E.D. Pa. 1997).

²²⁴ In re Buran, 363 B.R. 358 (Bankr. W.D.N.Y. 2007).

²²⁵ In re 3DFX Interactive, Inc., 2007 Bankr. LEXIS 1941 (Bankr. N.D. Cal. 2007) (special counsel for committee represented adverse interest by also representing committee chair in defending fraudulent conveyance action); In re Oliver's Stores, Inc., 79 B.R. 588 (Bankr. D. N.J. 1987); In re Grant Broadcasting of Philadelphia, Inc., 71 B.R. 655 (Bankr. E.D. Pa. 1987); see also In re Whitman, 101 B.R. 37 (Bankr. N.D. Ind. 1989) (committee representation disallowed for counsel representing an insurance company sought to be retained by the committee); In re Rusty Jones, Inc., 107 B.R. 161 (Bankr. N.D. Ill. 1989) (committee counsel also representing individual creditors in suit against debtor and third parties); In re Technology for Energy Corp., 53 B.R. 32 (Bankr. E.D. Tenn. 1985) (attorney for two shareholders appointed as committee special counsel).

committee counsel.²²⁶ Even though the interests of the committee and an individual creditor client may diverge in part, their interests may be aligned in connection with specific litigation, warranting employment of the attorney as special counsel to the committee for a specific purpose.²²⁷ In some instances, a member's counsel may act on behalf of the entire committee, and be entitled to fee payment by the estate.²²⁸

7. While there is no statutory privilege with respect to communications by the DIP to the creditors' committee and its counsel, a duty of confidentiality must be implied, and upheld, if the committee is to carry out effectively its function of investigating the debtor and operation of its business, and other matters relevant to the case and formulation of a plan.²²⁹ Recognition of the need to protect the confidentiality of debtor disclosures to the committee has led courts to insulate sensitive information from competitors.²³⁰ The 2005 amendments to the Bankruptcy Code include requirements that committees provide access to information for creditors who hold claims of the kind represented by the committee but are not committee members, solicit and receive comments from such constituents,

²²⁶ In re Walnut Equipment Leasing Co., Inc., 213 B.R. 285 (Bankr. E.D. Pa. 1997) (committee counsel retained with agreement it would not represent committee in suing member/client); In re National Liquidators, Inc., 182 B.R. 186 (S.D. Ohio 1995) (creditor's intention to invoke Fifth Amendment with respect to an investigation of the debtor held not to take possibility of a dispute or discord out of the realm of mere conjecture).

²²⁷ Special counsel need not be disinterested, but is required only not to represent or hold any adverse interest on the matter on which he is to be employed. See 11 U.S.C. § 327(e); In re Arochem Corp., 176 F.3d 610 (2d Cir. 1999); In re Technology for Energy Corp., 53 B.R. 32 (Bankr. E.D. Tenn. 1985); Fondiller v. Robertson, 15 B.R. 890 (9th Cir. BAP 1981), appeal dismissed, 707 F.2d 441 (9th Cir. 1983).

²²⁸ First Merchants Acceptance Corp. v. J.C. Bradford & Co., 198 F.3d 394 (3d Cir. 1999); In re Worldwide Direct, Inc., 259 B.R. 56 (Bankr. D. Del. 2001).

²²⁹ 11 U.S.C. § 1103 (c)(2); In re Wilson Foods Corp., 31 B.R. 272 (Bankr. W.D. Okla. 1983) (duties of committee require it to dig deep into all aspects of debtor and its business).

²³⁰ In re Handy Andy Home Imp. Centers, Inc., 199 B.R. 376 (Bankr. N.D. Ill. 1996) (power under Code § 107(b) and Bankruptcy Rule 9018 to enter confidentiality order without showing of good cause required by Fed. R. Civ. P. 26(c)); In re Texaco, Inc., 79 B.R. 560 (Bankr.

and be subject to a court order that compels any additional report or disclosure to them.²³¹ The court may require that to be done through a committee-hosted website.²³²

8. An early and influential opinion analyzing the committee communication provision, Refco, analogized it to the Code requirement that trustees furnish information to creditors, section 704(7), and cases interpreting that provision.²³³ The court discussed the duties and functions of committees. It noted that committee members' fiduciary duties require them to receive and retain information in confidence, and securities laws impose confidentiality obligations as well for committees of publicly-traded debtors. Further, maintaining confidentiality is necessary to preserve the committee's attorney-client privilege. An order incorporated into the Refco opinion was held to achieve the required balance between such confidentiality concerns and statutory communication requirements.

IV. Client Misconduct and Improper Requests.

A. Prepetition Counseling.

1. While debtor clients outside of Chapter 11 are not quasi-trustees with fiduciary duties to their creditors, debtor counsel still has ethical duties to guide and counsel her client on compliance with bankruptcy legal obligations, and duties to the court of competency, good faith, candor and accuracy.²³⁴ The 2005 amendments to Bankruptcy Code § 111 require a prospective consumer debtor to

S.D.N.Y. 1987).

²³¹ 11 U.S.C. §1102(b)(3); see In re Refco, Inc. 336 B.R. 187 (Bankr. S.D.N.Y. 2006) (protocol to protect committee privilege while providing access to information).

²³² In re S&B Surgery Center, Inc., 421 B.R. 546 (Bankr. C.D. Cal. 2009).

²³³ In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2005).

²³⁴ In re Sanford, 403 B.R. 834 (Bankr. D. Nev. 2009); In re Cochener, 360 B.R. 542, 577,

undergo credit counseling before filing the bankruptcy petition. State professional responsibility ethics opinions are divided on the ethical propriety of attorneys receiving referral fees from such entities.²³⁵ Fee sharing may also be illegal under 18 U.S.C. § 155. Clients need to understand what to expect of the credit counseling process required under the 2005 amendments to the Bankruptcy Code, and that they may need to bear the additional cost to access the bankruptcy system.

2. Attorneys must explain the benefits, burdens and consequences of bankruptcy to their clients to the extent reasonably necessary to permit informed decisions about the case.²³⁶ Attorneys are to render candid advice to their clients, referencing moral, economic and other factors relevant to the situation.²³⁷ They must explain that bankruptcy in any of its forms has serious repercussions for any client. Credit agencies will be informed, and can disclose the fact of any filing as long as ten years after the order for relief is entered.²³⁸ A debtor's post-bankruptcy insurers and lenders may consider a prior bankruptcy in evaluating the prospect of extending insurance coverage or a loan.²³⁹ The Code only protects against certain types of

581 (Bankr. S.D.Tex. 2007).

²³⁵ See Joint Formal Opinion of the Philadelphia and Pennsylvania Bar Association Opinion 2000-100 (2000) (acceptable under limited circumstances); Board of Commissioners on Grievances and Discipline of the Supreme Court of Ohio Opinion 2000-1 (2000) (ethically improper for lawyer to accept a fee from a financial services group); Model Rule 1.5. See also In re Zuniga, 332 B.R.760 (Bankr. S.D. Tex. 2005) (fee sharing with client counseling firm unethical, and non-disclosure violated Bankruptcy Code and Rules).

²³⁶ Model Rule 1.4(b); see In re Jones, 236 B.R. 38 (D. Colo. 1999); In re Bancroft, 204 B.R. 548 (Bankr.C.D. Ill. 1997) (generally discussing legal consultation required before petition should be filed); In re Arthur, 15 B.R. 541 (Bankr. E.D. Pa. 1981) (same); In re Davila, 210 B.R. 727 (Bankr. S.D. Tex. 1996).

²³⁷ Model Rule 2.1.

²³⁸ Fair Credit Reporting Act Section 605(a)(1), 15 U.S.C. § 1681(c); In re Northern Energy Products, 7 B.R. 473 (Bankr. N.M. 1980) (Better Business Bureau may report filing).

²³⁹ In re Goldrich, 771 F.2d 28 (2d Cir. 1985) (permissible to non-discriminatorily consider effect of bankruptcy on future financial responsibility); In re Douglas, 18 B.R. 813 (Bankr. W.D. Tenn. 1982) (insurance cancellation).

discriminatory treatment resulting from bankruptcy.²⁴⁰ The debtor must realize that in return for the protections of the bankruptcy laws, he must disclose his financial affairs in minute detail, fully and accurately, or he will be denied a discharge.²⁴¹ The court may require conversion of a chapter 11 case to a chapter 7 liquidation, which the debtor cannot prevent through voluntary dismissal, or appointment of a trustee.²⁴² The debtor's counsel must advise the client that once a chapter 7 case has been filed, it cannot be dismissed without court approval, and creditors may successfully object to dismissal when it is in their best interest to have a trustee remain in control of the debtor's causes of action and other assets. Further, the debtor must comply with all requirements of reporting, appearance and cooperation with U.S. Trustee pending dismissal.²⁴³

3. Prospective debtors must be informed about the alternatives to bankruptcy, the options they have under various chapters of the Code, and what is required of them in each.²⁴⁴ Professional conduct rules require that a lawyer, not a

²⁴⁰ 11 U.S.C. § 525.

²⁴¹ U.S. v. Van Allen, 524 F.3d 814 (7th Cir. 2008) (criminal conviction for failure to disclose interest in unincorporated business upheld); In re Coastal Plains, Inc., 179 F.3d 197 (5th Cir. 1999)(disclose potential causes of action on schedules); In re Guttman, 237 B.R. 643 (Bankr. E.D. Mich. 1999) (same); In re Colvin, 288 B.R. 477 (Bankr. E.D. Mich. 2003); In re Sharp, 244 B.R. 889 (Bankr. E.D. Mich. 2000)(extensive case citations); In re McLaren, 236 B.R. 882 (Bankr. D. N.D. 1999)(disclose whatever ownership interest held; discharge denied due to falsehoods on schedules); In re Guajardo, 215 B.R. 739 (Bankr. W.D. Ark. 1997); In re Matthews, 154 B.R. 673 (Bankr. W.D. Tex. 1993); see U.S. v. Ellis, 50 F.3d 419 (7th Cir. 1995) (bankruptcy fraud conviction in part based on omissions in schedules); U.S. v. Dolan, 120 F.3d 856 (8th Cir. 1997) (attorney convicted of conspiracy and aiding and abetting client in filing false schedules); see U.S. v. Matthews, 124 F.3d 1330 (10th Cir. 1997) (debtor convicted of bankruptcy fraud despite informing attorney of asset omitted from schedules where disclosure to attorney was inadequate).

²⁴² Tradex Corp. v. Morse, 339 B.R. 823 (D. Mass. 2006); In re Camden Ordnance Mfg. Co. of Arkansas, Inc., 245 B.R. 794 (E.D. Pa. 2000).

²⁴³ In re Cochener, 360 B.R. 542 (Bankr. S.D. Tex. 2007).

²⁴⁴ 11 U.S.C. § 342; Official Bankruptcy Form 1, Exhibit B; 11 U.S.C. § 1325(b) (client must realize that his projected disposal income for three years must be committed to paying

paralegal, must undertake this counseling through direct client contact.²⁴⁵ Counsel has a duty to fully explain the scope and reach of terms used in bankruptcy schedules, such as “transfer.”²⁴⁶ Even if schedules are initially prepared by a paralegal, they must be reviewed by the attorney with the client before filing.²⁴⁷

4. The 2005 Bankruptcy Code amendments define lawyers providing consumer bankruptcy assistance in return for compensation in certain circumstances as “debt relief agencies.”²⁴⁸ The amendments impose restrictions on debt relief agencies that include specific requirements for advising clients about valuation of assets, compilation of creditor lists, determination of exemptions, determination of types of income, etc. and providing specific written notices.²⁴⁹ Fee agreements must be in writing and clear to a consumer debtor.²⁵⁰ The restrictions include not making untrue or misleading statements, or advising clients to make such statements, and not misrepresenting the services to be provided or the benefits and risks of filing bankruptcy, which the Supreme Court has construed in a way not to violate constitutional rights.²⁵¹ All fees may be ordered disgorged as a penalty for

creditors under a Chapter 13 plan); see In re Arthur, 15 B.R. 541, 546 (Bankr. E.D. Pa. 1981) (complex analysis and trained legal judgment necessary to advise as to bankruptcy alternatives); In re Davila, 210 B.R. 727 (Bankr. S.D. Tex. 1996) (describing inadequacies in mill firm); In re Pinkins, 213 B.R. 818 (Bankr. E.D. Mich. 1997) (ethical violation to have all client contact through paralegal; compiling cases on unauthorized practice of law in bankruptcy cases).

²⁴⁵ See Id. and In re Sledge, 352 B.R. 742 (Bankr. E.D. N.C. 2006); In re Diaz, 348 B.R. 752 (Bankr. S.D. Tex. 2006); In re Pinkins, 213 B.R. 818 (Bankr. E.D. Mich. 1997).

²⁴⁶ In re Caise, 359 B.R. 152 (Bankr. E.D. Ky. 2006); In re Whitehead, 278 B.R. 589 (Bankr. M.D.Fla. 2002).

²⁴⁷ In re Light, 357 B.R. 23 (Bankr. N.D.N.Y. 2006).

²⁴⁸ 11 U.S.C. § 101(3), (4A), (12A). See note 14, *supra*.

²⁴⁹ 11 U.S.C. §§ 342, 527.

²⁵⁰ 11 U.S.C. § 528(a)(1); In re Robinson, 368 B.R. 496 (Bankr. N.D. Cal. 2006).

²⁵¹ 11 U.S.C. § 526(a); see Milavetz, Gallop & Milavetz, P.A. v. U.S., ___ U.2. ___, 130 S.Ct. 1324 (2010).

noncompliance.²⁵²

5. All too often, courts have dismissed bankruptcy filings on bad faith grounds, including those intended solely for delay, with no realistic possibility of reorganizing a debtor under Chapter 11, filings merely to resolve two-party disputes, and repeated filings. Section 707(b) of the Code specifically authorizes the court to dismiss petitions by consumer debtors that are considered a “substantial abuse” of Code provisions. Counsel are ethically obliged not to file such petitions, and may be sanctioned for doing so.²⁵³ Counsel may likewise be sanctioned if the debtor is ineligible for chapter 13, but counsel excludes debts from the schedules or deliberately reduces scheduled amounts to show apparent eligibility,²⁵⁴ or files a chapter 13 case simply because the client so instructs, when the lawyer knows

²⁵² In re Gutierrez, 356 B.R. 496 (Bankr. N.D. Cal. 2006).

²⁵³ See In re Silberkraus, 336 F.3d 864 (9th Cir. 2003); Matter of Maurice, 69 F.3d 830 (7th Cir. 1995); Cinema Service Corp. v. Edbee Corp., 774 F.2d 584 (3rd Cir. 1985) (sanctions upheld against filing attorneys); Rubner & Kutner, P.C. v. U.S. Trustee (In re Lederman Enterprises, Inc.), 997 F.2d 1321 (10th Cir. 1993) (counsel fees disallowed for bad faith chapter 11); In re Coones Ranch, Inc., 7 F.3d 740 (8th Cir. 1993) (same); In re Rainbow Magazine, Inc., 136 B.R. 545 (9th Cir. BAP 1992) (sanctions to be allocated between client and counsel according to their relative culpability); In re Villa Madrid, 110 B.R. 919 (9th Cir. BAP 1990); In re Kile, 345 B.R. 182 (Bankr. D. Ariz. 2004); In re Weaver, 307 B.R. 834 (Bankr. S.D. Miss. 2002) (attorney should check PACER to confirm accuracy of client’s statements about prior bankruptcy filings); In re Start the Engines, Inc., 219 B.R. 264 (Bankr. C.D. Cal. 1998) (\$10,000 sanctions against attorney and client, jointly and severally); In re Armwood, 175 B.R. 779 (Bankr. N.D. Ga. 1994); see Matter of Coastal Nursing Center, Inc., 162 B.R. 918 (Bankr. S.D. Ga. 1993) (bad faith filing did not require disgorgement of fees paid by third party); In re Yellow Cab Co-op Ass’n, 144 B.R. 505 (D. Colo. 1992); In re Cohoes Indus. Terminal, Inc., 103 B.R. 480 (Bankr. S.D.N.Y. 1989); In re Silver, 46 B.R. 772 (D. Colo. 1985); In re Bayport Equities Corp., 36 B.R. 575 (Bankr. C.D. Cal. 1983) (sanctions against attorney and debtor for fees of secured creditors stayed by filings); In re Jones, 41 B.R. 263 (Bankr. C.D. Cal. 1984) (sanctions against attorney who filed six petitions for sole purpose of delaying secured creditor); In re McFarland, 17 B.R. 242 (Bankr. N.D. Ga. 1982) (counsel for prospective Chapter 13 debtor whose prior case had been dismissed should “closely inquire and determine the true intent and honesty of purpose of the debtor’s new petition and financial capacity to consummate a plan and overcome the prior reasons for termination of the stay and/or dismissal”); Model Rule 1.2(d); Bankruptcy Rule 9011.

²⁵⁴ In re Thomas, 223 Fed. Appx. 310 (5th Cir. 2007); In re Nikoloutsos, 199 F.3d 233 (5th Cir. 1999); In re Pettey, 288 B.R. 14 (Bankr. D. Mass. 2003).

feasibility of a chapter 13 plan is not reasonably arguable.²⁵⁵

6. Efforts to stave off a bankruptcy filing may have resulted in preferences or fraudulent conveyances. In some cases, transfers to defeat provisions of the Bankruptcy Code or give a creditor advantages in consideration of promises in connection with the case may be illegal.²⁵⁶ Counsel may not assist a client in any fraudulent conveyance, including by suggesting spending assets before filing without any discussion of restrictions,²⁵⁷ and must withdraw if the client persists in going forward with such a scheme.²⁵⁸ Counsel must persuade the client to disclose any fraudulent conveyances to the court, at least where requested on the debtor's schedules and statement of affairs, and seek to recover them if possible before the petition filing.²⁵⁹ Unlike other client communications, such illegality is not protected by client confidentiality restrictions, and if the client refuses to allow such disclosure,

²⁵⁵ In re Jones, 339 B.R. 903 (Bankr. E.D. Mich. 2006).

²⁵⁶ 18 U.S.C. § 152; United States v. Ballard, 779 F.2d 287 (5th Cir.) cert. denied 106 S. Ct. 1519 (1986) (attorney required to testify about transfers not disclosed on bankruptcy schedules; violation of 18 U.S.C. § 152); United States v. Rogers, 722 F.2d 557 (9th Cir. 1983) cert. denied 105 S. Ct. 129 (1984) (transfer of assets on eve of bankruptcy).

²⁵⁷ United States v. Franklin, 837 F.Supp. 916 (N.D. Ill. 1993) (criminal sentence increased for attorney who used his knowledge of bankruptcy law and bankruptcy system to help client hide assets and file a fraudulent petition); In re Rice, 109 B.R. 405 (Bankr. E.D. Cal. 1989); Townsend v. State Bar of California, 32 Cal. 2d 592, 197 P.2d 326 (1948) (three year suspension for advising client to convey property fraudulently); In re Pfingst, 53 App. Div. 2d 268, 385 N.Y.S. 2d 806 (1976) (attorney disbarred for participation in fraudulent conveyance in contemplation of bankruptcy); Matter of Moss, 61 App. Div. 2d 1020, 403 N.Y.S.2d 53 (1978) (same); see In re Environmental Research & Development, 46 B.R. 774 (S.D.N.Y. 1985) (trustee sued debtor's prepetition counsel for malpractice, allegedly arising out of prepetition fraudulent transfers); see also U.S. v. Goodstein, 883 F.2d 1362, 1371 (7th Cir. 1989) (attorney convicted of bankruptcy fraud for role as DIP counsel in postpetition unauthorized transfers).

²⁵⁸ Model Rules 1.2(d) and 1.16.

²⁵⁹ Model Rules 3.3, 3.4, 4.1; In re Adeeb, 787 F.2d 1339 (9th Cir. 1986) (discharge denied unless full disclosure and recovery of property before filing); but see In re Davis, 911 F.2d 560 (11th Cir. 1990) (transfer of debtor's interest in home to wife upon advice of counsel warrants denial of discharge, even though interest recovered for estate before petition filing on advice of bankruptcy counsel).

the attorney must withdraw from the representation.²⁶⁰

7. The 2005 Bankruptcy Code amendments require that lawyers providing consumer bankruptcy assistance in return for compensation, “debt relief agencies”, not advise a client to incur more debt in contemplation of filing a bankruptcy petition or to pay bankruptcy attorneys’ fees or petition preparer’s fees.²⁶¹

8. The prospective debtor may wish to transfer assets into exempt types of assets to protect them from creditor access in the bankruptcy court. Some courts have held that a potential debtor may transfer assets into exempt forms so long as it is done for reasons other than the express intent of keeping the assets from creditors.²⁶² When prospective debtors have deliberately transferred assets from one form into another exempt form (even on advice of counsel) in anticipation of bankruptcy, some courts have denied the debtor a discharge.²⁶³ Factors considered in evaluating denial of discharge include (1) the amount exempted, comparing (a) the

²⁶⁰ Model Rules 3.3(a)(2), 1.6(a), 4.1, 1.16; United States v. Ballard, 779 F.2d 287 (5th Cir.) cert. denied 106 S. Ct. 1519 (1986). See notes 562-63 on disclosures that may be necessary upon withdrawal.

²⁶¹ 11 U.S.C. § 526(a)(4). See note 519.

²⁶² "As under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a petition. The practice is not fraudulent as to creditors and permits the debtor to make full use of the exemptions to which he is entitled under the law." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 360-1 (1977); Matter of Moreno, 892 F.2d 417 (5th Cir. 1990); but see Matter of Chastant, 873 F.2d 89 (5th Cir. 1989)(intent to defraud inferred from circumstances).

²⁶³ In re Addison, 540 F.3d 805 (8th Cir. 2008); In re Warren, 512 F.3d 1241 (10th Cir. 2008); Matter of Bower, 916 F.2d 1051, 1056 (5th Cir. 1990) on rehearing, discharge approved, 932 F.2d 1100 (5th Cir. 1991); In re Reed, 700 F.2d 986 (5th Cir. 1983); Ford v. Poston, 773 F.2d 52 (4th Cir. 1985); In re Adeeb, 787 F.2d 1339 (9th Cir. 1986) (fraudulent conveyance on advice of counsel); Matter of Smiley, 864 F.2d 562 (7th Cir. 1989); Norwest Bank Nebraska v. Tveton, 848 F.2d 871 (8th Cir. 1988); Matter of Chastant, 873 F.2d 89 (5th Cir. 1989); McCormick v. State Security Bank, 822 F.2d 806 (8th Cir. 1987); In re McLaren, 236 B.R. 882 (Bankr. D. N.D. 1999); In re Rice, 109 B.R. 405 (Bankr. E.D. Cal. 1989)(attorney suggestion to spend money before filing); In re Beckman, 104 B.R. 866 (Bankr. S.D. Ohio 1989)(extensive collection of case citations); In re Summers, 85 B.R. 121 (Bankr. D. Or. 1988); In re Porter, 37 B.R. 56 (Bankr. E.D. Va. 1984).

amount of the debt the exempted assets would have repaid, (b) the amount of the debt the remaining estate assets would repay, (c) the amount of income which is not property of the estate available to meet the purposes of the exemption statutes;²⁶⁴ (2) whether the transfer was made when the debtor had financial troubles or just after an event resulting in substantial liability; (3) the use of business assets to pay individual debts secured by exempt property; (4) secrecy; (5) use of borrowed funds for the transfer; (6) “sharp dealing,” such as arranging with creditors for a repayment moratorium while income is used for exemptions; and (7) whether the transfers to exempt property rendered the debtor insolvent.²⁶⁵ The guidelines between permissible and impermissible pre-bankruptcy exemption planning are fact-driven, finely drawn, and varied between the circuits and even within the circuits.²⁶⁶ The consequences for the client, defeat of the primary purpose of bankruptcy by losing a discharge, are so severe that attorneys must take special care to be knowledgeable, not advise or participate in deliberate concealment of assets from creditors, and insure that the client is well informed of the problems and risks inherent in any transfer.²⁶⁷

²⁶⁴ 11 U.S.C. § 541(a)(6) provides that post-petition wages are not estate property. Exemptions are intended to enable the debtor and her family to survive during bankruptcy and get a fresh start thereafter.

²⁶⁵ In addition, the Fifth Circuit found “a presumption of actual fraudulent intent necessary to bar a discharge arises when property is either transferred gratuitously or is transferred to relatives.” Matter of Chastant, 873 F.2d 89, 91 (5th Cir. 1989).

²⁶⁶ Compare cases cited in **note 531** with In re Johnson, 880 F.2d 78 (8th Cir. 1989); Hanson v. First National Bank, 848 F.2d 866 (8th Cir. 1988); Matter of Moreno, 892 F.2d 417 (5th Cir. 1990); In re Carey, 96 B.R. 336, 340 (Bankr. W.D. Okla.) aff’d. 112 B.R. 401 (W.D. Okla. 1989), aff’d., 938 F.2d 1073 (10th Cir. 1991)(amount of transfers “perilously close to failing” test of fraudulent transfer, but not quite sufficient to deny discharge). See In re Crater, 286 B.R. 756 (Bankr. D. Ariz. 2002) (through analysis of distinctions among cases on this topic and applicable tests).

²⁶⁷ Model Rule 1.1 (lawyer must provide requisite expertise in representing a client); Model Rules 1.2 and 4.1 (lawyer shall not make false statements or omissions, or assist in fraudulent conduct); Model Rules 1.2 and 1.4 (lawyer shall consult with client).

B. Illegal Client Conduct During a Bankruptcy Case.

1. Counsel is obligated both ethically and as an officer of the court not to file schedules and other disclosure documents he believes inaccurate, let alone motions.²⁶⁸ Thus, courts have cautioned that before filing a petition, schedules, etc., it is incumbent upon counsel to “take all possible steps to assure himself that the information listed in his client’s petition is correct . . . inquire as to amounts owed [secured by any assets] and to explain the requirements of full disclosure”²⁶⁹ The 2005 Bankruptcy Code amendments provide that by signing a bankruptcy petition (presumably) in chapter 7 cases only, because referenced only in new § 707, the lawyer certifies that he has no knowledge after an inquiry that the information in the schedules filed with the petition is incorrect.²⁷⁰ The amendments incorporate into the Bankruptcy Code a variation on Bankruptcy Rule 9011 that is harsher than the current rule, and applies to every attorney’s signature on a petition, certification, pleading or written motion.²⁷¹ Among other things, the new Code language requires

²⁶⁸ Bankruptcy Rule 9011; Model Rules 1.2, 1.4, 8.4; In re Cochener, 360 B.R. 542 (Bankr. S.D. Tex. 2007)(motion to dismiss chapter 7 erroneously said it would be in best interest of creditors, instead of saying debtor determined she no longer needed discharge or dismissal was in debtor’s best interest); In re McKain, 325 B.R. 842 (Bankr. D. Neb. 2005); In re Dreiling, 233 B.R. 848 (Bankr. D. Colo. 1999); In re Davila, 210 B.R. 727 (Bankr. S.D. Tex. 1996). Knowingly filing false schedules also is criminal. 18 U.S.C. § 152; United States v. Webster, 125 F.3d 1024 (7th Cir. 1997)(aiding and abetting false schedules); United States v. Franklin, 837 F.Supp. 916 (N.D. Ill. 1993); Coughlan v. United States, 147 F.2d 233 (8th Cir.), cert. denied 325 U.S. 888, reh. denied 326 U.S. 805 (1945)(predecessor statute); Ruby v. United States, 61 F.2d 617 (6th Cir. 1932), cert. denied 288 U.S. 617 (1933)(same).

²⁶⁹ In re Martinez, 22 B.R. 419, 421 (Bankr. D. N.M. 1982); see also, In re Bellows-Fairchild, 322 B.R. 675 (Bankr. D. Or. 2005) (lawyer permanently enjoined from practicing in bankruptcy court due to actions with respect to debtors and schedules); In re Stebel, 54 B.R. 199 (Bankr. D. Vt. 1985). See In re Cossey, 172 B.R. 597 (Bankr. E.D. Ark. 1994) (counsel sanctioned for not fully disclosing insurance settlement on schedules). The lawyer cannot delegate schedule preparation entirely to a paralegal. In re Hessinger & Assoc., 192 B.R. 211 (N.D. Cal. 1996); In re Davila, 210 B.R. 727 (Bankr. S.D. Tex. 1996).

²⁷⁰ 11 U.S.C. § 707(b)(4)(D).

²⁷¹ 11 U.S.C. § 707(b)(4)(C).

that all factual contentions be “well grounded” instead of having “evidentiary support,” and that all legal arguments be made in “good faith,” instead of being “nonfrivolous.”²⁷² Bankruptcy Rule 9011 may also be amended to expressly extend its reach to all documents, including schedules, submitted to the court or a trustee, even if the lawyer does not sign them, to comply with the “sense of Congress” in the 2005 Bankruptcy Code amendments.²⁷³ Even if that does not happen, some courts have applied Rule 9011 obligations to counsel’s “filing” of schedules.²⁷⁴ Counsel should check bankruptcy records by PACER or otherwise to confirm that the debtor’s statements about prior bankruptcy cases are accurate.²⁷⁵

2. The duty to disclose assets on schedules includes disclosure of all potential causes of action.²⁷⁶ The attorney likewise must take care not to file a disclosure statement overlooking known assets, or a plan counsel knows the debtor cannot fund or that counsel knows is unconfirmable.²⁷⁷ On the other hand, the

²⁷² 11 U.S.C. § 707(b)(4)(C).

²⁷³ 109 P.L. 8 § 319.

²⁷⁴ E.g. In re Withrow, 2008 Bankr. LEXIS 2125 (Bankr. D. Ma. 2008).

²⁷⁵ In re Weaver, 307 B.R. 834 (Bankr. S.D. Miss. 2002).

²⁷⁶ See Ajaka v. BrooksAmerica Mortgage Corp., 453 F.3d 1339 (11th Cir. 2006); In re R&R Associates of Hampton, 402 F.3d 257 (1st Cir. 2005); Cusano v. Klein, 264 F.3d 936 (9th Cir. 2001); In re Coastal Plains, Inc., 179 F.3d 197 (5th Cir. 1999); Cargo v. Kansas City So. Ry. Co., 408 B.R. 631 (W.D. La. 2009); Rose v. Beverly Health & Rehabilitation Services, 356 B.R. 18 (E.D. Cal. 2006); In re Guttman, 237 B.R. 643 (Bankr. E.D. Mich. 1999). This obligation does not include causes of action arising postpetition (chapter 7) or post-confirmation of a plan (chapter 11 or 13) that accordingly are not property of the estate. In re Batten, 351 B.R. 256 (Bankr. S.D. Ga. 2006); In re JZ, LLC, 371 B.R. 412 (9th Cir. BAP 2007)..

²⁷⁷ In re Scott, 172 F.3d 959 (7th Cir. 1999); In re Luarks, 301 B.R. 352 (Bankr. D. Kan. 2003) (counsel is ethically obligated to inform court if aware of provisions that render plan unconfirmable, and highlight provisions that appear to bypass Code requirements); In re Stoutamire, 201 B.R. 592 (Bankr. S.D. Ga. 1996); In re Ligon, 50 B.R. 127 (Bankr. M.D. Tenn. 1985) (sanctions against attorney); In re Jones, 41 B.R. 263 (Bankr. C.D. Cal. 1984) (same); In re Bonneville Pacific Corp., 147 B.R. 803 (Bankr. D. Utah 1992) *rev’d in part*, Hansen, Jones & Leta v. Segal, 220 B.R. 434 (D. Utah 1998) (all fees ordered disgorged where DIP counsel found to have aided misconduct by insiders, and disclosure statement and plan were wholly

creditors should not have to pay more for an incompetent or deceptive debtor through increased counsel fees.²⁷⁸ Two courts have suggested guidelines for counsel working with debtors on disclosure to resolve this tension.²⁷⁹ Another has cautioned that DIP counsel should take heed of objections and motions by creditors, which may disclose serious problems and concerns with the DIP's operations and representations to counsel.²⁸⁰

3. It is not uncommon, unfortunately, for prospective chapter 11 clients to seek counsel just before a foreclosure or other deadline requiring immediate action. That situation has been held not to excuse the attorney from asking probing questions and demanding full and reasonably corroborated responses.²⁸¹ As the Ninth Circuit BAP stated:

The importunities of a desperate client do not relieve an attorney of the affirmative duty of reasonable inquiry imposed by Rule 9011. The evident warning flags and the inadequate time available to make such inquiry should have impelled [the attorney] to consider the ever-

irreconcilable with examiner's report, schedules and monthly reports).

²⁷⁸ In re Matthews, 154 B.R. 673 (Bankr. W.D. Tex. 1993); In re Huerta, 137 B.R. 356 (Bankr. C.D. Cal. 1992); In re Saturley, 131 B.R. 509 (Bankr. D. Me. 1991) (diligent and thorough effort to assist debtor in assembling, presenting and filing required date is part of counsel's job; expending large sums to test the accuracy and completeness through a title search is not appropriate).

²⁷⁹ In re Matthews, 154 B.R. at 680 and In re Huerta, 137 B.R. at 379:

1. Explain the requirement of full, complete, accurate and honest disclosure of all information required of the debtor;
2. Ask probing and pertinent questions designed to elicit full, complete, accurate and honest disclosure from the debtor;
3. Check the debtor's responses in the petition, statements and schedules to be sure they are internally and externally consistent, and follow up if they are not;
4. Demand of the client full, complete, accurate and honest disclosure of all information required by the debtor prior to the attorney's signature being placed upon the document;
5. Seek relief from the court of the client representation in the event that the attorney learns he has been misled by the client.

²⁸⁰ In re Alderson, 114 B.R. 672 (Bankr. D. S.D. 1990)(duty of DIP counsel to ascertain and present debtor's true financial condition).

²⁸¹ In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991).

present option of declining a questionable engagement.²⁸²

4. The attorney is to explain legal requirements to the extent reasonably necessary to permit the client to make informed decisions.²⁸³ But the lawyer may not follow client instructions if they would operate to defraud,²⁸⁴ and may not knowingly make or affirm a false statement of material fact or law to others or fail to disclose a material fact necessary to avoid defrauding others.²⁸⁵ A disclosure statement, motion to approve a settlement or sale, or the like may well entail an evaluation of facts and law for use by third persons often unrepresented themselves. Counsel is to disclose any limitations on information used in making the valuation, and not state or imply that the lawyer is disinterested rather than the advocate of her DIP client.²⁸⁶ The lawyer's duties to third parties and malpractice liability to them in this context may be judged by the standards applicable to other attorney evaluations for unrepresented third parties, such as opinions given in tax shelter and securities offering contexts.²⁸⁷

5. Despite her diligence, an attorney nonetheless may discover that her client has committed perjury on his schedules and statement of affairs by concealing assets or asset transfers, or deliberately omitting creditors or misrepresenting important facts. Counsel also may learn that the client has lied in

²⁸² In re Villa Madrid, 110 B.R. 919 (9th Cir. BAP 1990).

²⁸³ Model Rule 1.4(b).

²⁸⁴ Model Rules 1.2, 8.4.

²⁸⁵ Model Rule 4.1. Disclosure may be prohibited by the obligation to preserve client confidences set forth in Model Rule 1.6. In that case counsel must withdraw instead of countenancing an improper course of action. Model Rule 1.16(b). See In re Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991).

²⁸⁶ Model Rules 2.3, 4.3 and official comments.

²⁸⁷ See In re Rexplore, Inc. Securities Litigation, 685 F. Supp. 1132, 1146 (N.D. Cal. 1988); Koehler v. Pulvers, 614 F. Supp. 829, 849 (S.D. Cal. 1985); (same); C. Wolfram, Modern Legal Ethics 709-710 (1986); ABA Comm. on Ethics and Professional Responsibility, Formal

testimony, or misrepresented facts to the attorney that were the basis of positions taken on his behalf. The attorney must preserve client confidences, but not to the extent of implicitly sanctioning illegality.²⁸⁸ Counsel may not further the illegal purpose, including by suggestions of concealment, nor may counsel continue assisting in conduct discovered to be criminal or fraudulent.²⁸⁹ If counsel holds debtor funds that were not disclosed, the money may not be released to the debtor or at the debtor's direction, but only to the trustee.²⁹⁰ The client must be warned that he may forfeit his discharge, be liable under the bankruptcy crimes statute and criminal perjury statute, and that a trustee will likely be appointed if not already serving.²⁹¹ The client must also be warned that the attorney-client privilege does not protect criminal plotting or statements made to counsel about it, and that counsel may be

Opinion 346 (Revised) (1982) (tax law opinions in tax shelter investment offerings).

²⁸⁸ Model Rules 1.6, 3.3; see United States v. Cherek, 734 F.2d 1248 (7th Cir. 1984) cert. denied 105 S. Ct. 2016 (1984)(criminal liability under 18 U.S.C. § 152; debtor required to disclose existence of assets even if debtor's ownership status is questionable); United States v. Kaldenberg, 429 F.2d 161 (9th Cir. 1970) cert. denied 400 U.S. 929 (1970)(failure to report rentals from estate property).

²⁸⁹ Model Rule 1.2. See U.S. v. Goodstein, 883 F.2d 1362, 1371 (7th Cir. 1989)(DIP counsel guilty of bankruptcy fraud for role in unauthorized postpetition transfers); U.S. v. Dolan, 120 F.3d 856 (8th Cir. 1997)(counsel guilty of bankruptcy fraud, conspiracy, aiding and abetting client's bankruptcy fraud); U.S. v. Rosen, 130 F.3d 5 (1st Cir. 1997)(counsel guilty of mail fraud in deceiving bankruptcy court with undisclosed side deal in connection with estate asset sale).

²⁹⁰ Disciplinary Counsel v. O'Brien, 2007 Ohio LEXIS 3258 (Ohio 2008).

²⁹¹ 11 U.S.C. § 727; 18 U.S.C. §§ 152, 1621; 11 U.S.C. § 1104(a)(1); In re Olson, 916 F.2d 481 (8th Cir. 1990)(denial discharge for failure to disclose interest in asset nominally owned by spouse and of questionable value on schedules); In re Calder, 907 F.2d 953 (10th Cir. 1990)(denial discharge for failures to disclose assets on schedules); In re Chalik, 748 F.2d 616 (11th Cir. 1984)(denial discharge for omissions on schedules even though concealed information may not have revealed assets available for creditors); In re Arcuri, 116 B.R. 873 (Bankr. S.D.N.Y. 1990)(discharge may be denied for overstating obligation to family enterprise and value of interest in it; amendment of schedules an admission that original listing false; amendment is slight inference of innocent intent when it occurs after trustee or creditors uncovered false statement); In re Ligon, 50 B.R. 127 (Bankr. M.D. Tenn. 1985)(trustee appointed and sanctions imposed against counsel after filing of misleading disclosure statement).

obliged to turn over all books and records.²⁹²

6. The client should be counseled to rectify the situation as much as possible, such as by supplemental filings mailed to affected parties.²⁹³ If the client is unwilling to do so, the attorney must withdraw and, if necessary to remedy the situation or the attorney cannot withdraw, he may have to reveal the misrepresentations to the court.²⁹⁴ Counsel may withdraw or disaffirm any document, which would probably be deemed necessary to remedy the filing of a misleading document with his signature, such as a disclosure statement, and perhaps also to remedy the filing of fraudulent schedules and statements of affairs signed by the client.²⁹⁵ A debtor's attorney may be sanctioned along with his client if he

²⁹² Model Rules 1.6(c), 3.3; United States v. Ballard, 779 F.2d 287, 292-93 (5th Cir.) cert. denied, 106 S.Ct. 1519 (1986); 11 U.S.C. § 542(e).

²⁹³ Model Rule 3.3 Comment; see Model Rule 1.13(b) regarding procedures when the client is an organization; Bankruptcy Rule 1009; U.S. v. Thomas, 342 B.R. 758 (S.D. Tex. 2005) (once debtor's lawyer learns of omission, he must notify, amend, and otherwise factually correct effects of omission in civil case, including bankruptcy); In re Eppers, 311 B.R. 826 (Bankr. D.N.M. 2004) (attorney ethical violation by failing to advise client to amend schedules promptly upon learning of inaccuracy, and advising instead to wait until after 341 meeting).

²⁹⁴ Model Rules 1.6, 1.16, 3.3; In re Gregory, 214 B.R. 570 (S.D. Tex. 1997) (duty to disclose client defalcation); In re Swansea Consolidated Resources, Inc., 155 B.R. 28 (Bankr. D. R.I. 1993) (as an officer of the court, DIP counsel "had absolutely no choice but to disclose" unauthorized diversion of \$64,000 of DIP funds to a foreign bank); see also In re Brennan, 187 B.R. 135 (Bankr. D.N.J. 1995) (in serious cases such as conversion of estate property, the professionals will sometimes be obligated to report the debtor's breach to others); In re United Utensils Corp., 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) ("If the debtor is not fulfilling its fiduciary obligation to the estate, it is the responsibility and duty of Debtor's counsel to bring such matters to the attention of the court"); In re Wilde Horse Enterprises, 136 B.R. 830, 847 (Bankr. C.D. Cal. 1991); ABA Formal Opinion 92-366 (Aug. 8, 1992) (ethical obligations of "noisy withdrawal"); ABA Formal Opinion 93-376 (Aug. 6, 1993) (lawyer's obligation where client lies in response to civil discovery request).

²⁹⁵ Model Rule 1.6 Comment; see In re Saturley, 131 B.R. 509 (Bankr. D. Me. 1991) (inform trustee that schedules are incomplete if concerns about client's candor, to prompt trustee investigation); In re Matthews, 154 B.R. 673 (Bankr. W.D. Tex. 1993) (same; alert U.S. Trustee, court, or another interested party that schedules are incomplete or inaccurate; failure to withdraw contributed to debtor's dishonesty by not setting up early alarm that something was amiss); ABA Formal Opinion 92-366 (Aug. 8, 1992) (ethical obligation of "noisy withdrawal"); C.R. Bowles Jr., "Noisy Withdrawals: Urban Bankruptcy Legend or Invaluable Ethical Tool?" 20-8 ABI Journal 26 (October 2001).

counsels the debtor not to cooperate with the trustee or not to appear at a Section 341 meeting.²⁹⁶

7. Client failures to communicate or otherwise cooperate with counsel, insistence on pursuing an objective the lawyer considers improper, or client conduct which renders effective representation unreasonably difficult may also warrant a court request for withdrawal.²⁹⁷ It may also become clear that there are insufficient unencumbered assets to pay counsel, making the representation unreasonably financially burdensome. Counsel may not simply refuse to appear at hearings for their clients.²⁹⁸ Although the ethical rules authorize a request for withdrawal in such circumstances, it may not be allowed.²⁹⁹ In the event of withdrawal, counsel must take reasonable steps to protect the client's interests, such as giving the client notice and an opportunity to employ other counsel, turning over the client's papers and property, and refunding unearned retainers.³⁰⁰

V. Litigation Tactics and Defenses.

A. Attorney-Client Privilege and Ethics.

1. Ethical rules are broader than the attorney-client privilege with respect to the types of information required to be kept confidential.³⁰¹ Ethical rules

²⁹⁶ In re Cochener, 360 B.R. 542 (Bankr. S.D. Tex. 2007).

²⁹⁷ Model Rule 1.16; In re Alderson, 114 B.R. 672 (Bankr. D. S.D. 1990).

²⁹⁸ In re Berg, 356 B.R. 378 (Bankr. E.D. Pa. 2006).

²⁹⁹ Model Rule 1.16; In re Meyers, 120 B.R. 751 (Bankr. S.D.N.Y. 1990) and cases cited therein; see **note 226**.

³⁰⁰ Model Rule 1.16(d). The court may order turnover of the attorney's files regardless of any charging lien rights. 11 U.S.C. § 542(e).

³⁰¹ Model Rule 1.6 (lawyer shall not reveal information "relating to representation of a client" without client informed consent or as impliedly authorized to carry out the representation, and as required by way of candor to the tribunal under Model Rule 3.3). See discussion at section VI B, *supra*. See also United States v. Ballard, 779 F.2d 287, 293 (5th Cir. 1986), cert. denied, 475 U.S. 1109 (1986) ("The attorney-client privilege exists apart from, and is not coextensive with, the ethical confidentiality precepts").

permit the disclosure of otherwise confidential information in some circumstances.³⁰²

2. The attorney-client privilege continues to exist, even after a client files a bankruptcy petition.³⁰³ Federal Rule of Evidence 501 is applicable in bankruptcy, and provides that the availability of privileges turns on federal common law where federal law provides the rule of decision (*e.g.* most bankruptcy issues), and on state law where state law supplies the rule of decision (*e.g.* on some claims issues).³⁰⁴ Counsel for a debtor may be required to turnover files to the estate, but only subject to applicable privileges.³⁰⁵ Counsel must also abide by ethical restrictions on any such disclosure. Information provided to compile bankruptcy schedules may not be privileged, because it was intended to be disclosed.³⁰⁶ The existence of an attorney-client relationship and compensation arrangements are not privileged.³⁰⁷

B. Trustee Power to Waive the Debtor's Privilege.

1. The client, not the attorney, holds the attorney-client privilege and can waive it; the client likewise may consent to disclosure of confidential

³⁰² Model Rules 1.6, 1.16, 3.3.

³⁰³ In re OPM Leasing Services, Inc., 670 F.2d 383 (2d Cir. 1982).

³⁰⁴ Bankruptcy Rule 9017; In re Asia Global Crossing, Ltd., 322 B.R. 247 (Bankr. S.D.N.Y. 2005); In re Carter, 62 B.R. 1007 (Bankr. C.D. Cal. 1986); In re Carmean, 153 B.R. 985 (Bankr. S.D. Ohio 1993) (state spousal privilege applicable in § 544 fraudulent conveyance suit).

³⁰⁵ 11 U.S.C. § 542(e). The work product doctrine is applicable in bankruptcy, however. In re Financial Corp. of America, 119 B.R. 728 (Bankr. C.D. Cal. 1990).

³⁰⁶ U.S. v. White, 950 F.2d 426 (7th Cir. 1991); In re Wilkerson, 393 B.R. 734 (Bankr. D. Colo. 2007); In re Myers, 382 B.R. 304 (Bankr. S.D. Miss. 2008); In re Eddy, 304 B.R. 591 (Bankr. D. Mass. 2004); compare In re Stoutamire, 201 B.R. 592 (Bankr. S.D. Ga. 1996) with In re French, 162 B.R. 541 (Bankr. D.S.D. 1994). See U.S. v. Bauer, 132 F.3d 504 (9th Cir. 1997) (recognizing White but holding attorney statement to client about full disclosure when preparing schedules to be privileged).

³⁰⁷ In re Eddy, 304 B.R. 591 (Bankr. D. Mass. 2004).

information.³⁰⁸ A trustee in bankruptcy steps into the shoes of the debtor in many respects, taking over management of a corporate debtor. The Supreme Court has held that a bankruptcy trustee is empowered to waive the attorney-client privilege of a corporate debtor just as prior corporate management could waive it.³⁰⁹ A partnership is an entity, like a corporation, and its bankruptcy trustee may waive the partnership's privilege.³¹⁰ Once in bankruptcy, only the trustee, not the shareholders, controls the privilege.³¹¹

2. Until and unless a trustee is appointed, the DIP controls the attorney-client privilege; it does not pass to the bankruptcy estate for a required waiver in favor of the creditors committee.³¹² However, the Garner filing exception to the privilege may apply and warrant turnover of privileged documents to a committee.³¹³

³⁰⁸ Model Rule 1.6.

³⁰⁹ Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343 (1985). The court also reasoned that reposing the privilege in the trustee would promote maximization of estate value by facilitating the trustee's investigation of prior management's conduct, and noted that the privilege must be exercised in accordance with the trustee's fiduciary duties to both creditors and shareholders. See In re Gold & Appel Transfer S.A., 342 B.R. 386 (Bankr. D. D.C. 2006) (liquidator of foreign debtor controls privilege in § 304 proceeding); In re ANR Advance Transportation Co., Inc., 288 B.R. 208 (Bankr. E.D. Wis. 2002) (maximizing the estate is not a precondition of trustee's ability to waive the privilege). The Weintraub case concerned a chapter 7 bankruptcy. The reasoning is equally applicable to chapter 11 cases. In re Michigan Boiler & Engineering Co., 87 B.R. 465 (Bankr. E.D. Mich. 1988). An examiner may also assume so many of the DIP's functions (in conjunction with the creditors' committee) that he may control exercise of the privilege as well. In re Boileau, 736 F.2d 503 (9th Cir. 1984). The same is true of a liquidating trustee appointed under a reorganization plan. In re Hechinger Inv. Co. of Del., 285 B.R. 601 (D. Del. 2002). In re Hardwood P-G, Inc., 403 B.R. 445 (Bankr. W.D. Tex. 2009) (successor to debtors and committee). A trustee appointed under the SIPA is empowered to waive the debtor's privilege. Securities Investor Protection Corp. v. Strattoon Oakmont, Inc., 213 B.R. 433 (Bankr. S.D.N.Y. 1997).

³¹⁰ United States v. Campbell, 73 F.3d 44 (5th Cir. 1996); Meoli v. American Medical Service of San Diego, 287 B.R. 808 (S.D. Cal. 2003).

³¹¹ In re A&T Paramus Co., Inc., 253 B.R. 606 (Bankr. D. N.J. 1999).

³¹² Official Committee of Asbestos Claimants v. Hyman, 342 B.R. 416 (S.D.N.Y. 2006).

³¹³ Id. (applying multiple factor test of Garner v. Wolfenbarger, 430 F.2d 1093 (5th Cir.

3. There is a split of authority on whether the attorney-client privilege always passes by operation of law to the bankruptcy trustee, so that the trustee may unilaterally waive the privilege of an individual debtor. The Supreme Court expressly declined to rule on the issue, but pointed out that since individuals do not act through agents like corporations, the rationale of taking over management's privilege rights would not apply, and other reasons would have to support any trustee waiver of an individual debtor's privilege.³¹⁴ Some courts hold the trustee always may waive;³¹⁵ some that the trustee may never waive.³¹⁶ A growing trend holds that the trustee's power to waive the attorney-client privilege depends on the facts and circumstances of the case.³¹⁷ As one court analyzed the cases, the individual debtor alone should hold privilege waiver power when potential harm to or control over his person may exist from a disclosure; the trustee should hold waiver power when he is only seeking to discover and recover assets for the estate.³¹⁸ And as the Tenth Circuit noted, that means the court must actually analyze the harm to the debtor and balance

1970)).

³¹⁴ CFTC v. Weintraub, 471 U.S. at 356-57.

³¹⁵ In re Smith, 24 B.R. 3 (Bankr. S.D. Fla. 1982); see In re Fairbanks, 135 B.R. 717 (Bankr. D. N.H. 1991)(chapter 7 debtor left state and could not act for himself; trustee could waive privilege).

³¹⁶ McClarty v. Gudenau, 166 B.R. 101 (E.D. Mich. 1994); In re Tippy Togs of Miami, Inc., 237 B.R. 236 (Bankr. S.D. Fla. 1999); In re Hunt, 153 B.R. 445 (Bankr. N.D. Tex. 1992); In re Silvio de Lindegg Ocean Developments of America, Inc., 27 B.R. 28 (Bankr. S.D. Fla. 1982).

³¹⁷ In re Foster, 188 F.3d 1259 (10th Cir. 1999), reversing and remanding 217 B.R. 631 (Bankr. D. Colo. 1997); In re Wilkerson, 393 B.R. 734 (Bankr. D. Colo. 2007); In re Pearlman, 381 B.R. 903 (Bankr. M.D. Fla. 2007); In re Courtney, 372 B.R. 519 (Bankr. M.D. Fla. 2007); In re Bame, 251 B.R. 367 (Bankr. D. Minn. 2000); In re Miller, 247 B.R. 704 (Bankr. N.D. Ohio 2000); In re Bazemore, 216 B.R. 1020 (Bankr. S.D. Ga. 1998); In re Williams, 152 B.R. 123 (Bankr. N.D. Tex. 1992); see In re Rice, 224 B.R. 464 (Bankr. D. Or. 1998) (trustee may not waive privilege if debtor continues to hold interest in litigation through exemption).

³¹⁸ Bazemore, 216 B.R. at 1025; Foster, 217 B.R. at 638 (privilege passes to trustee to recover estate assets in nature of prepetition civil actions); see also In re Eddy, 304 B.R. 591 (Bankr. D. Mass. 2004) (chapter 7 trustee may waive privilege of individual formerly Chapter 11 DIP with respect to communications relating to administration of property of the

it against the trustee's need for information.³¹⁹ The court may direct measures to protect the debtor while allowing the trustee to obtain privileged documents, *e.g.* directing counsel to redact statements or documents which could expose the debtor to criminal liability and providing them to the court for an *in camera* review, with the court balancing their relevance against likelihood of harm to the debtor.³²⁰

4. An additional theory to support a waiver argument may be found in the DIP's obligation to exercise the privilege in a manner consistent with his fiduciary duties, which may include duties to pursue causes of action against the DIP's personal interests.³²¹ When postpetition communications are at issue, the court should evaluate whether they were made with the DIP in its DIP capacity (most communications – waivable by the trustee), or in its debtor capacity (limited principally to plan proposals – not waivable).³²² Communications in furtherance of crime or fraud are exceptions to the attorney-client privilege.³²³

5. It is not uncommon for a single firm to represent both a corporation and its individual officers or directors. The corporate debtor's privilege may be waived by its bankruptcy trustee, while the individual may retain the right to assert the privilege on her own behalf.³²⁴ In order to assert such a privilege, the

estate).

³¹⁹ Foster, 188 F.3d at 1268-69.

³²⁰ In re Courtney, 372 B.R. 519 (Bankr. M.D. Fla. 2007).

³²¹ See In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007), on remand, 392 B.R. 561 (Bankr. D. Del. 2008); In re Williams, 152 B.R. at 127; In re Hendrick, 56 B.R. 280 (Bankr. M.D. La. 1985)(applying criteria of Garner v. Wolfenbarger, 430 F.2d 1093 (5th Cir. 1970) cert. denied, 401 U.S. 974 (1971)); see Louisiana World Exposition v. FDIC, 858 F.2d 233 (5th Cir. 1988) (duty to pursue claims adverse to DIP management).

³²² In re Bame, 251 B.R. 367 (Bankr. D. Minn. 2000).

³²³ See In re Myers, 382 B.R. 304 (Bankr. S.D. Miss. 2008).

³²⁴ Citibank N.A. v. Andros, 666 F.2d 1192 (8th Cir. 1981); In re Boileau, 736 F.2d 503 (9th Cir. 1984); In re Pearlman, 381 B.R. 903 (Bankr. M.D. Fla. 2007); In re Indiantown Realty Partners Ltd. Partnership, 270 B.R. 532 (Bankr. S.D. Fla. 2001); In re National Trade Corp., 76

individual must establish there existed an attorney-client relationship with her as an individual.³²⁵

C. Creditors' Committee Exercise of Privilege.

1. The creditors' committee has generally been held entitled to assert the attorney-client privilege.³²⁶ But while the privilege may be absolute with respect to disclosures sought by those not represented by the committee, a narrower construction of the privilege is utilized where a committee's constituent seeks information.³²⁷

2. Attorney communications with the committee that are directed at advancing or reconciling the needs of individual committee members, rather than protecting the interests of the committee or its constituents, may be considered

B.R. 646 (N.D. Ill. 1987); In re Carter, 62 B.R. 1007 (Bankr. C.D. Cal. 1986); see Odmark v. Westside Bancorporation, Inc., 636 F.Supp. 552 (W.D. Wash. 1986)(FSLIC receiver).

³²⁵ In In re Bevill, Bresler & Schulman Asset Management Corp., 805 F.2d 120 (3d Cir. 1986) the court described a 5-factor test for establishing such a relationship: (1) the individual approached counsel for legal advice; (2) the individual made it clear she was seeking advice in her individual capacity; (3) counsel communicated with her as an individual, knowing a conflict could arise; (4) the conversations with counsel were confidential; and (5) the substance of the conversations with counsel did not concern matters regarding the general affairs of the company. See also In re Braniff, Inc., 153 B.R. 941 (Bankr. M.D. Fla. 1991)(but individuals entitled to discovery of privileged documents prepared by, addressed to, or copied to them); In re United Utensils Corp., 141 B.R. 306 (Bankr. W.D. Pa. 1992); In re Carter, 62 B.R. 1007 (Bankr. C.D. Cal. 1986); In re Michigan Boiler & Engineering Co., 87 B.R. 465 (Bankr. E.D. Mich. 1988); In re Standard Financial Management Corp., 77 B.R. 324 (Bankr. D. Mass. 1987).

³²⁶ Marcus v. Parker (In re Subpoenas Duces Tecum Dated March 16, 1992), 978 F.2d 1159 (9th Cir. 1992); In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2006) (protocol to protect privilege); In re Baldwin-United Corp., 38 B.R. 802 (Bankr. S.D. Ohio 1984); PBGC v. Pincus, 42 B.R. 960 (E.D. Pa. 1984)(attorney-client relationship between committee counsel and each creditor); but see In re Christian Life Center, 16 B.R. 35 (Bankr. N.D. Cal. 1981)(no privilege recognized where claim that committee counsel breached duties).

³²⁷ Baldwin United, 38 B.R. at 804-05 (reasoning from shareholder derivative suits); Christian Life Centers, *supra*; Cf. In re Tucker Freight Lines, Inc., 62 B.R. 213 (Bankr. W.D. Mich. 1986) (committee members lack absolute immunity from creditor's lawsuit charging solicitation of rejection of debtor's plan with allegedly fraudulent representations). See In re Circle K Corp., 199 B.R. 92 (Bankr. S.D.N.Y. 1996) (disclosure of opinions to committee constituent did not waive work product privilege, although constituent is not client of committee counsel).

business advice and assistance to committee members instead of the committee client, and thus not protected by the committee's attorney-client privilege.³²⁸

3. As in other cases, the presence of outsiders, including other committee advisors, may destroy the privilege.³²⁹ If the financial advisor's presence is necessary or useful to effective consultation between lawyer and client, it does not destroy the privilege in some circuits.³³⁰

4. The 2005 amendments to the Bankruptcy Code include requirements that committees provide access to information for creditors who hold claims of the kind represented by the committee but are not committee members, solicit and receive comments from such constituents, and be subject to a court order that compels any additional report or disclosure to them.³³¹ Caselaw with respect to disqualifying a committee member from discussion of issues on which that member has a conflict and withholding information from a committee member-competitor of the debtor should apply to committee constituents too.³³²

5. Committee counsel need not disclose privileged documents on account of the constituent disclosure provisions of Section 1102(b)(3), as explained by the court in Refco.³³³ If there is a question or dispute on the right to withhold such information, committee counsel should consider seeking a court order on notice to committee constituents restricting sharing of information as needed to protect the

³²⁸ In re Fibermark, Inc., 330 B.R. 480 (Bankr. D. Vt. 2005).

³²⁹ Cf. In re F.A. Potts & Company, 30 B.R. 708 (Bankr. E.D. Penn. 1983)(rule applied to debtor); but see In re Mortgage & Realty Trust, 212 B.R. 649 (Bankr. C.D. Cal. 1997)(non-waiver of debtor privilege by communication to committee under joint defense doctrine).

³³⁰ In re Fibermark, Inc., 330 B.R. 480, 499 (Bankr. D. Vt. 2005).

³³¹ 11 U.S.C. §1102(b)(3).

³³² See notes 470, 498

³³³ In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2005), discussed at note 474, *supra*.

privilege, referencing the seminal Refco opinion and caselaw on insulating sensitive information from competitors.³³⁴

D. The Joint Defense or Common Interest Doctrine in Bankruptcy.

1. Communications between an individual and an attorney for another, or between attorneys for two parties, are protected by the privilege where they are part of an on-going and joint effort to set up a common litigation strategy. The communications must have been made in the course of a joint defense (or prosecution) effort, designed to further that effort, and not be in a context in which the privilege otherwise was waived or inapplicable.³³⁵ The parties' common interest must be identical, not similar, and must be legal, not commercial.³³⁶ Thus, a debtor and a committee may share a common interest in preserving and maximizing an asset for payment of creditors even though they are adverse in negotiating plan treatment.³³⁷ Courts are divided on whether this privilege applies to several parties represented by the same lawyer.³³⁸ A joint defense privilege generally cannot be

³³⁴ Id.; In re Handy Andy Home Improvement Centers, Inc., 199 B.R. 376 (Bankr. N.D. Ill. 1996).

³³⁵ In re Bevill, Bresler & Schulman Asset Management Corp., 805 F.2d 120 (3d Cir. 1986); In re Hardwood P-G, Inc., 403 B.R. 445 (Bankr. W.D. Tex. 2009); In re Asia Global Crossing, Ltd., 322 B.R. 247 (Bankr. S.D.N.Y. 2005); In re Mortgage & Realty Trust, 212 B.R. 649 (Bankr. C.D. Cal. 1997); see In re Cumberland Inv. Corp., 120 B.R. 677 (Bankr. D. R.I. 1990)(privilege dissolved upon showing of fraud by one party); In re Michigan Boiler and Engineering Co., 87 B.R. 465 (Bankr. E.D. Mich. 1988). For a thorough discussion of the doctrine, see Stone, Hodapp & Sauro, The Common Interest or Pooled Information Privilege, 20 Colo. Lawyer 225 (Feb. 1991).

³³⁶ In re Pittsburgh Corning Corp., 308 B.R. 716 (Bankr. W.D. Pa. 2004).

³³⁷ In re Leslie Controls, Inc., 437 B.R. 493 (Bankr. D. Del. 2010).

³³⁸ Compare In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007) (extensive analysis of co-client privilege and common interest privilege) and In re Benun, 339 B.R. 115 (Bankr. D. N.J. 2006) (applying common interest doctrine to attorney for two parties); In re Indiantown Realty Partners Ltd. Partnership, 270 B.R. 532 (Bankr. S.D. Fla. 2001); Securities Investor v. R.D. Kushnir & Co., 246 B.R. 582 (Bankr. N.D. Ill. 2000).

waived without the consent of all parties sharing the privilege.³³⁹ The Third Circuit extensively analyzed the requirements of the common interest privilege in Teleglobe.³⁴⁰

2. If the joint defense ceases, and the interests of the joint parties become adverse, the privilege no longer protects the communications previously made as between the formerly-aligned parties.³⁴¹ Similarly, when a single lawyer represented both parent and subsidiary, the subsidiary's bankruptcy trustee may obtain documents and testimony on matters where they collectively consulted counsel about their common interest from the lawyer for both, unimpeded by claims of privilege once the two entities are adverse.³⁴² Indeed, a bankruptcy trustee may destroy a joint defense privilege with another separately-represented party at the stage of investigating claims against that party as well as at the point of suit.³⁴³ The joint defense doctrine may be used as a sword, to obtain information from another party's counsel on the basis that the attorney was jointly representing the deposing party.³⁴⁴

³³⁹ S.I.P.C. v. Stratton Oakmont, 213 B.R. 433 (Bankr. S.D.N.Y. 1997).

³⁴⁰ In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007), on remand, 392 B.R. 561 (Bankr. D. Del. 2008).

³⁴¹ In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007) (corporate parent subsidiary context); In re Ducane Gas Grills, Inc., 320 B.R. 312 (Bankr. D.S.C. 2004); S.I.P.C. v. Stratton Oakmont, 213 B.R. 433 (Bankr. S.D.N.Y. 1997); In re Michigan Boiler and Engineering Co., 87 B.R. 465 (Bankr. E.D. Mich. 1988); In re Blier Cedar Co., Inc., 10 B.R. 993 (Bankr. D. Me. 1981).

³⁴² In re Tri-River Trading, LLC, 329 B.R. 252 (8th Cir. BAP 2005); In re Brownsville Gen. Hosp., Inc., 380 B.R. 385 (Bankr. W.D. Pa. 2008); In re Mirant Corp., 326 B.R. 646 (Bankr. N.D. Tex. 2005); In re Indiantown Realty Partners Ltd. Partnership, 270 B.R. 532 (Bankr. S.D. Fla. 2001); In re Santa Fe Trail Transportation Co., 121 B.R. 794 (Bankr. N.D. Ill. 1990); see In re Sunrise Securities Litigation, 130 F.R.D. 560 (E.D. Pa. 1989); but see Meoli v. American Medical Service of San Diego, 287 B.R. 808 (S.D. Cal. 2003) (trustee waived privilege only as to debtor entity; not as to affiliate also represented by that lawyer).

³⁴³ In re Mirant Corp., 326 B.R. 646 (Bankr. N.D. Tex. 2005); S.I.P.C. v. Stratton Oakmont, 213 B.R. 433 (Bankr. S.D.N.Y. 1997).

³⁴⁴ Pryor v. Schneider, 106 B.R. 352 (E.D.N.Y. 1989) (former shareholder of debtor corporation named as defendant in fraudulent transfer action entitled to depose attorney who

The privilege would continue, however, as to third parties, and even when the joint defendants simply have a falling-out or divergence of interests, as long as they do not actually oppose each other in litigation.³⁴⁵ Even the trustee-successor to one of the former joint defendants may not unilaterally waive the privilege to enable access to third parties.³⁴⁶

3. As an ethical matter, a lawyer acting as an intermediary between clients must consult in advance with each concerning the implications of common representation, including the effect on the attorney-client privileges, and obtain the consent of each to common representation.³⁴⁷ In a common representation, an attorney must keep both clients adequately informed and maintain confidentiality of information relating to the representation, which requires a delicate balance. Both clients must be informed that if litigation eventuates between them, the privilege will not protect that communication.³⁴⁸

VI. Abusive Litigation Tactics.

A. Standards Under Rule 9011 and Related Rules.

1. Bankruptcy Rule 9011 was amended in 1997 to conform to 1993 changes to Federal Rule of Civil Procedure 11. Not only documents signed by an attorney, but also documents he “presents” by “filing” or “later advocating” entail the lawyer’s certification of proper purpose, warranted by law or a nonfrivolous

represented him and the corporation in the transaction at issue); In re Hendrick, 56 B.R. 280 (Bankr. M.D. La. 1985).

³⁴⁵ Matter of Grand Jury Subpoena, etc., Nov. 16, 1974, 406 F. Supp. 381 (S.D.N.Y. 1975); Ortho-Sealy Mattress Mfg. Co. v. Kaplan, 90 F.R.D. 21 (N.D. Ill. 1980).

³⁴⁶ In re Madison Management Group, Inc., 212 B.R. 894 (Bankr. N.D. Ill. 1997).

³⁴⁷ Model Rule 2.2(a); In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007), on remand, 392 B.R. 561 (Bankr. D. Del. 2008).

³⁴⁸ Model Rule 2.2 Official Comment.

argument for extension or reversal of the law, and evidentiary factual support. Ethics rules are in accord.³⁴⁹ Bankruptcy Rule 7037 sanctions failure to cooperate in discovery, and Bankruptcy Rule 7016 sanctions failure to comply with court scheduling and pretrial orders or cooperate in discovery and pretrial practice. 28 U.S.C. § 1927 also prohibits unreasonable and vexatious litigation.³⁵⁰ The bankruptcy court may also exercise its inherent power to sanction counsel misconduct whether or not other rules or statutes authorize sanctions.³⁵¹

2. Both creditors' and debtors' counsel may be guilty of abusive litigation in a bankruptcy context. The number of cases cited at West Bankruptcy Digest Keynote 2187, "frivolity or bad faith; sanctions," is appallingly lengthy.³⁵² Debtors' counsel may file cases in bad faith voluntarily,³⁵³ and creditors' counsel may file cases in bad faith involuntarily or bad faith, unauthorized adversary

³⁴⁹ See Model Rule 3.1 (lawyer shall not bring or defend any action or assert or controvert an issue without nonfrivolous basis for doing so including good faith argument for any position contrary to existing law); Model Rule 3.2 (make reasonable efforts to expedite litigation consistent with client interests); Model Rule 3.3 (lawyer shall not knowingly make false statement of material or fact or law, fail to disclose material fact except as required by law, or fail to disclose legal authority in controlling jurisdiction); Model Rule 3.4 (lawyer shall not willfully obstruct another party's access to evidence; make a frivolous discovery request or fail to make reasonably diligent efforts to comply with proper discovery, allude to irrelevant material at trial, or obstruct others from giving relevant information to another party in most cases).

³⁵⁰ But see Regensteiner Printing Co. v. Graphic Color Corp., 142 B.R. 815 (N.D. Ill. 1992)(bankruptcy court lacks jurisdiction to impose sanctions under § 1927 since it is not a "court of the United States").

³⁵¹ In re Steffen, 406 B.R. 148 (Bankr. N.D. Fla. 2009); In re Kozich, 406 B.R. 949 (Bankr. S.D. Fla. 2009).

³⁵² See In re TCI Ltd., 769 F.2d 441 (7th Cir. 1985)(discussing Rule 9011 and 28 U.S.C. § 1927).

³⁵³ In re Start the Engines, Inc., 219 B.R. 264 (Bankr. C.D. Cal. 1998); In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991); Midwest Properties No. 2 The Big Hill Investment Company, 93 B.R. 357, 362-63 (N.D. Tex. 1988); In re Cohoes Industrial Terminal, Inc., 103 B.R. 480 (Bankr. S.D.N.Y. 1989), on rehearing, 105 B.R. 243 (Bankr. S.D.N.Y. 1989); In re Little Creek Development Company, 779 F.2d 1068, 1073 (5th Cir. 1986); Matter of King, 83 B.R. 843, 847-848 (Bankr. N.D. Ga. 1988).

proceedings, or proofs of claim or stay relief motions they lack standing to pursue or know are unsupported.³⁵⁴ Debtor plaintiffs have been sanctioned for frivolous adversary proceeding complaints,³⁵⁵ and defendants have been sanctioned for raising meritless defenses,³⁵⁶ and using pre-signed or unreviewed and inaccurate certifications.³⁵⁷ Counsel have been sanctioned for bad faith objections,³⁵⁸ frivolous motions and appeals,³⁵⁹ and failing to cooperate with discovery requests.³⁶⁰ Burdensome, unnecessary discovery requests may likewise be deemed sanctionable. And counsel for the debtor all too often acquiesces in his client's request to list all claims as disputed on the schedules, or file blanket objections to claims, which

³⁵⁴ In re Hill, 437 B.R. 503 (Bankr. W.D. Pa. 2010) (creditor's motion with false statements tempered by word "believes," and failure to advise debtor of inaccuracy while negotiating settlement was sanctionable); In re Sanford, 403 B.R. 831 (Bankr. D. Nev. 2009); In re Nosek, 386 B.R. 374 (Bankr. D. Mass. 2008) (creditor pursuing claim was no longer holder of note with standing; counsel may not rely on client representations without reviewing documents and probing for accurate information); In re Lee, 408 B.R. 893 (Bankr. C.D. Cal. 2009) (same); In re Computer Dynamics, Inc., 252 B.R. 50 (Bankr. E.D. Va. 1997); In re Tarasi & Tighe, 88 B.R. 706, 708-09 (Bankr. W.D. Pa. 1988); In re General Homes Corp. and FGMC, Inc., 181 B.R. 870 (Bankr. S.D. Tex. 1994), reconsideration denied, 181 B.R. 898 (Bankr. S.D. Tex. 1995).

³⁵⁵ FE & B v. Charter Technologies, Inc., 57 F.3d 1215 (3d Cir. 1995); In re Peoro, 793 F.2d 1048 (9th Cir. 1986); In re Chronopoulos, 36 B.R. 364 (Bankr. N.D. Ill. 1984), aff'd. sub nom., In re TCI, Ltd., 769 F.2d 441 (7th Cir. 1985); In re Excello Press, Inc., 967 F.2d 1109 (7th Cir. 1992) (before pursuing preference action, counsel ordinarily should examine whether any obvious defenses bar case, but no *per se* rule).

³⁵⁶ Citicorp Venture Capital v. Creditors Committee, 323 F.3d 228 (3d Cir. 2003); In re SMS, Inc., 15 B.R. 496 (Bankr. D. Kan. 1981).

³⁵⁷ In re Hague, 395 B.R. 799 (Bankr. S.D. Fla. 2008); In re Rivera, 342 B.R. 435 (Bankr. D.N.J. 2006), on remand, 369 B.R. 193 (Bankr. D.N.J. 2007).

³⁵⁸ In re Arkansas Communities, Inc., 827 F.2d 1219 (8th Cir. 1987); In re Edmonds, 110 B.R. 38 (D. Kan. 1989); In re Webre, 88 B.R. 242 (9th Cir. BAP 1988).

³⁵⁹ In re Eisen, 14 F.3d 469 (9th Cir. 1994); McLaughlin v. McPhail, 707 F.2d 800 (8th Cir. 1983); Dreamlite Holdings Ltd. v. Kraser, 890 F.2d 1147 (Fed. Cir. 1989); In re Cloud, 107 B.R. 156 (N.D. Ill. 1989); In re B-K of Kansas, Inc., 98 B.R. 549 (D. Kan. 1989); see Townsend v. Holman Consulting Corp., 914 F.2d 1136 (9th Cir. 1990) (non-bankruptcy case, upholding sanctions for filing frivolous claims within pleadings containing non-frivolous claims).

³⁶⁰ Matter of MacMeekin, 722 F.2d 32 (3d Cir. 1983); In re Rubin, 769 F.2d 611 (9th Cir. 1985); In re Ashton-Nevada Ltd. Partnership, 391 B.R. 84 (Bankr. D. Nev. 2006); In re Victor Intern. Inc., 278 B.R. 67 (Bankr. D. N.J. 2002); In re Dubrowsky, 206 B.R. 30 (Bankr. E.D.N.Y. 1997); In re Bernard, 85 B.R. 864, 865 (Bankr. D. Colo. 1988).

creditors may not dispute only because economically infeasible to do so.³⁶¹

Strategies designed to make opponents capitulate because litigation is prohibitively expensive may result in sanctions against counsel as well as adverse consequences to clients.³⁶² Incompetent representation, not complying with the Bankruptcy Code, Rules, or orders, or counseling the client not to do so, may likewise be sanctioned.³⁶³ Obnoxious and abusive behavior toward opposing counsel and parties may likewise be sanctioned.³⁶⁴ Indeed, one court has expressly held that “stupidity – acting without sufficient forethought – is a legitimate basis for imposing sanctions upon an attorney.”³⁶⁵ Another sanctioned counsel for refusing to stipulate to correction of a mistake, on the client’s direction.³⁶⁶

³⁶¹ In re Robinson Foundry, Inc., 347 B.R. 781 (Bankr. M.D. Ala. 2006) (genuine question whether blanket listing of all claims as disputed was in good faith, citing In re Rite Autotronics Corp., 27 B.R. 599, 603 (9th Cir. BAP 1982)).

³⁶² See In re St. Johnsbury Trucking Co., Inc., 184 B.R. 446 (Bankr. D. Vt. 1995), motion for stay denied, Winthrop, Stimson v. St. Johnsbury Co., 186 B.R. 53 (D. Vt. 1995); In re French Bourekas, Inc., 175 B.R. 517 (Bankr. S.D.N.Y. 1994), sanctions order, 183 B.R. 695 (Bankr. S.D.N.Y. 1995); In re Talmo, 185 B.R. 637 (Bankr. S.D. Fla. 1995); In re Marathon Home Loans, 101 B.R. 216, 222 (Bankr. S.D. Cal. 1989) (sanctioning harassment in the form of “a procedural war of scorched-earth attrition,” even though each “motion or paper may be objectively reasonable and, thus, not frivolous”). See also In re Hensley, 249 B.R. 318 (Bankr. W.D. Okla. 2000) (intentionally including language in chapter 13 plans in hope that creditors will fail to object and be bound by res judicata violates counsel’s ethical obligations).

³⁶³ Hale v. U.S. Trustee, 509 F.3d 1139 (9th Cir. 2007) (failure to perform critical and necessary services or obtain informed consent to limited representation); In re Phillips, 597 Ariz. Adv. Rep. 19 (Ariz. 2010) (managing partner of high-volume consumer debtor firm suspended for improper case management and policies); In re Cochener, 382 B.R. 311 (S.D. Tex. 2007) (counsel advised against cooperation with trustee pending ruling on motion to determine bank case); In re Mattison, 2010 WL 4102293 (Bankr. N.D. Ga. 2010); In re Sanford, 403 B.R. 831 (Bankr. D. Nev. 2009); In re Ashton-Nevada Ltd. Partnership, 391 B.R. 84 (Bankr. D. Nev. 2006), rev’d as excessive sanction, 2010 WL 4877819 (9th Cir. 2010); In re Cummings, 381 B.R. 810 (S.D. Fla. 2007) (IRS counsel failed to comply with prior representations and rulings and presented erroneously narrow form of order to court); In re Chase, 372 B.R. 142 (Bankr. S.D.N.Y. 2007) (creditor’s lawyer failed to appear at trial without court approval of withdrawal); In re Alvarado, 363 B.R. 484 (Bankr. E.D. Va. 2007); In re Seeburg Products Corp., 215 B.R. 175 (Bankr. N.D. Ill. 1997).

³⁶⁴ In re First City Bancorporation of Texas, Inc., 270 B.R. 807 (N.D. Tex. 2001).

³⁶⁵ In re Hein, 341 B.R. 903, 905 (Bankr. N.D. Ind. 2006).

³⁶⁶ In re Martinez, 393 B.R. 27 (Bankr. D. Nev. 2008).

B. Obtaining Sanctions.

1. Until the 1997 modification of Rule 9011, upon any violation the court was required to impose an appropriate sanction; it exercised discretion only in deciding what sanction was appropriate under the circumstances.³⁶⁷ Now, sanctions are discretionary, and there is a safe harbor procedure for serving a sanctions motion and giving an opportunity to withdraw the offensive document before filing the motion.³⁶⁸ There is no safe harbor for filing a bankruptcy petition violating Rule 9011 standards, however, including as an electronic filing without an original debtor's signature, which warrants sanctions no matter what the perceived emergency.³⁶⁹ While some courts have applied a "supervisory rule" to restrict sanctions motions to those filed before a case is dismissed, that rule may not apply to a Rule 9011 sanctions motion for an abusive bankruptcy petition, and the rule does not apply to a sanctions motion under §28 U.S.C. 1927 for vexatious litigation.³⁷⁰ The Circuits are split on whether the bankruptcy court is a "court of the United

³⁶⁷ In re Gioioso, 979 F.2d 956 (3d Cir. 1992) (the dissent discusses whether bankruptcy courts also have inherent power to sanction misconduct under Chambers v. NASCO, 111 S.Ct. 2123 (1991)); see also In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991); In re Omega Trust, 110 B.R. 665 (Bankr. S.D.N.Y. 1990), aff'd in part, remanded in part, 120 B.R. 265 (S.D.N.Y. 1990). Changes to Federal Rule of Civil Procedure 11 are not incorporated by reference in Bankruptcy Rule 9011. In re Dubrowsky, 206 B.R. 30 (Bankr. E.D.N.Y. 1997).

³⁶⁸ In re Pratt, 524 F.3d 580 (5th Cir. 2008)(counsel's warning letter did not meet Rule 9011 requirement to serve advance copy of sanctions motion); In re Evergreen Sec., Ltd., 391 B.R. 184 (M.D. Fla. 2008)(court may impose sanctions under inherent powers despite safe harbor violation); In re Walker, 532 F.3d 1304 (11th Cir. 2008)(motion must be filed before offending document is ruled upon).

³⁶⁹ Rule 9011(c). In re Wenk, 296 B.R. 719 (Bankr. E.D. Va. 2002) (citing cases; emergency does not justify such a filing); In re Phillips, 433 F.3d 1068 (8th Cir. 2006) (violation to file petition without original client signature, even with good intentions); but see In re Koliba, 338 B.R. 48 (Bankr. N.D. Ohio 2006) (fee disgorgement too harsh a sanction for promptly corrected, good faith violation of electronic signature rules).

³⁷⁰ In re Schaefer Salt Recovery, Inc., 542 F.3d 90 (3d Cir. 2008).

States” for purposes of §1927.³⁷¹

2. The 2005 Bankruptcy Code amendments include specific remedies that may be imposed if the debtor’s lawyer violates Bankruptcy Rule 9011 and the case is dismissed or converted under Bankruptcy Code § 707(b).³⁷² The amendments authorize civil penalties for any Rule 9011 violation.³⁷³ The amendments further incorporate into the Bankruptcy Code a variation on Bankruptcy Rule 9011 that is harsher than the current rule, and applies to every attorney’s prosignature on a petition, pleading or written motion.³⁷⁴ Among other things, the new Code language requires that all factual contentions be “well grounded” instead of having “evidentiary support,” and that all legal arguments be made in “good faith,” instead of being “nonfrivolous.”³⁷⁵ Bankruptcy Rule 9011 may also be amended to expressly extend its reach to all documents, including schedules, submitted to the court or a trustee, even if the lawyer does not sign them, to comply with the “sense of Congress” in the 2005 Bankruptcy Code amendments.³⁷⁶

3. Sanctions generally take the form of attorneys’ fees awards to opponents; in some cases attorneys and clients have been held jointly liable for the opponent’s fees and doubled costs, or additional monetary amounts.³⁷⁷ Sanctions

³⁷¹ In re Schaefer Salt Recovery, Inc., 542 F.3d 90 (3d Cir. 2008) (yes); In re Cohoes Industrial Terminal Inc., 931 F.2d 222 (2nd Cir. 1991) (yes); Adair v. Sherman, 230 F.3d 890 (7th Cir. 2000) (yes); In re Perroton, 22 BCD 1152 (9th Cir. 1992) (no); In re Courtesy Inns Ltd., 26 BCD 355 (10th Cir. 1994) (no); In re Davis, 899 F.2d 1136 (11th Cir. 1990) (no); See also In re Ashton-Nevada Ltd. Partnership, 391 B.R. 84 (Bankr. D. Nev. 2006)(OSC kept case open after dismissal to investigate propriety of sanctions), rev’d on other grounds of excessive sanction, 2010 WL 4877819 (9th Cir. 2010).

³⁷² 11 U.S.C. § 707(b)(4)(A), (5)(A).

³⁷³ 11 U.S.C. § 707(b)(4)(B).

³⁷⁴ 11 U.S.C. § 707(b)(4)(C), (D).

³⁷⁵ 11 U.S.C. § 707(b)(4)(C).

³⁷⁶ 109 P.L. 8 § 319.

³⁷⁷ Dreamlite Holdings Ltd. v. Kraser, 890 F.2d 1147 (Fed. Cir. 1989) (refusing to accept

may also include disgorgement of retainers or interim fees previously awarded to DIP counsel.³⁷⁸ Other possible sanctions include a reprimand, reference to bar disciplinary authorities, an order precluding the introduction of evidence or litigation of certain issues, default judgment or dismissal, injunctive relief limiting future access to the courts to a party or attorney, or mandatory legal education.³⁷⁹ Rule 9011 now includes a provision on the nature and limitations of sanctions.³⁸⁰ The range of sanctions may be expanded if counsel's improper action was driven by improper motives.³⁸¹ If evidence shows that improper actions were not taken in bad faith, sanctions must be less severe and cannot be punitive.³⁸²

4. The party seeking sanctions has a duty to mitigate its damages by using reasonable efforts to resolve disputes by inexpensive means, but need not

further filings on behalf of clients or their attorney until award of fees and double costs paid in full and satisfactory proof furnished to court); In re Salter & Co., Ltd., 99 B.R. 327 (E.D. La. 1989) (fees and double costs); In re Beugen, 99 B.R. 961 (9th Cir. BAP 1989) (same); In re Film Ventures Intern., Inc., 89 B.R. 80 (9th Cir. BAP 1988)(sanctions of \$3,135 for attorneys' fees incurred in opposing attempt to dismiss counterclaims, depositions and motion for summary judgment); In re Arkansas Communities, Inc., 827 F.2d 1219 (8th Cir. 1987); In re Start the Engines, Inc., 219 B.R. 264 (Bankr. C.D. Cal. 1998) (\$100,000 awarded against attorney and client, jointly and severally); In re Marathon Home Loans, 101 B.R. 216 (Bankr. E.D. Cal. 1989)(court set lodestar fees for counsel from California Rural Legal Assistance for purposes of shifting fees, to make billing more equivalent to private practice); In re Cohoes Industrial Terminal, Inc., 103 B.R. 480 (Bankr. S.D.N.Y. 1989), on rehearing, 105 B.R. 243 (Bankr. S.D.N.Y. 1989) (explanation of \$60,145 fee award for bad faith Chapter 11 filing).

³⁷⁸ In re Kendavis Industries International, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988); see In re Koliba, 338 B.R. 48 (Bankr. N.D. Ohio 2006) (discussing when harsh sanction of fee disgorgement is not appropriate).

³⁷⁹ In re Lehtinen, 564 F.3d 1052 (9th Cir. 2009) (3 month suspension from bankruptcy court practice); In re Creative Desperation, Inc., 415 B.R. 882 (Bankr. S.D. Fla. 2009) (all fees disgorged; over \$92,000 assessed against counsel, suspended from bankruptcy practice 180 days, possible reapplication to practice must show 80 hours ethics CLE post-suspension); In re Evergreen Sec., Ltd., 384 B.R. 882 (Bankr. M.D. Fla. 2008); In re Omega Trust, 110 B.R. 665 (Bankr. S.D.N.Y. 1990)(citing numerous cases), aff'd in part, remanded in part, 120 B.R. 265 (S.D.N.Y. 1990); see also In re Placid Oil Co., 158 B.R. 404 (N.D. Tex. 1993)(fee disgorgement and disbarment for violation of court orders).

³⁸⁰ Bankruptcy Rule 9011(c)(2).

³⁸¹ In re Sanford, 403 B.R. 831 (Bankr. D. Nev. 2009).

³⁸² In re Aston-Nevada Ltd. P'ship, 2010 WL 4877819 (9th Cir. 2010).

take actions that would impair its rights.³⁸³

5. Counsel is entitled to a meaningful opportunity to explain his conduct before sanctions are awarded, generally but not necessarily at a “show cause” hearing.³⁸⁴ While good intentions will not stop a violation of Rule 9011, they may save the attorney from onerous sanctions.³⁸⁵ A sanctions award must specify how the fees and expenses were calculated, and how they were caused by the conduct of the parties sanctioned, so the appellate court has sufficient basis to review the decision.³⁸⁶ The court may take into account prior conduct in other cases when determining what sanction is appropriate to deter further misconduct.³⁸⁷ Adequate notice is important before any sanctions hearing, but especially important if the severe sanction of

³⁸³ In re Film Ventures Intern., Inc., 89 B.R. 80 (9th Cir. BAP 1988).

³⁸⁴ Bankruptcy Rule 9011(c); In re Lehtinen, 564 F.3d 1052 (9th Cir. 2009); In re Stein, 127 F.3d 292 (2d Cir. 1997) (notice and opportunity to be heard, but not full evidentiary hearing); In re Big Rapids Mall Associates, 98 F.3d 926 (6th Cir. 1996)(briefs with opportunity for affidavits sufficient); FE&B v. Charter Technologies, Inc., 57 F.3d 1215 (3d Cir. 1995)(sanction motion was sufficient notice of conduct at issue); In re Taylor, 884 F.2d 478 (9th Cir. 1989); see Donaldson v. Clark 819 F.2d 1551 (11th Cir. 1987)(discussion of sanction procedure in non-bankruptcy case); In re Cooper, 153 B.R. 898 (D.Colo. 1993)(sanctions imposed based on written submissions).

³⁸⁵ In re Phillips, 433 F.3d 1068 (8th Cir. 2006); see, e.g. In re Whitney Place Partners, 123 B.R. 117 (Bankr. N.D. Ga. 1992)(sanctions directed and OSC set); 147 B.R. 619 (Bankr. N.D. Ga. 1992) (evidence showed errors to be the result of counsel's lack of bankruptcy expertise; sanctions not imposed).

³⁸⁶ In re Gioioso, 979 F.2d 956 (3d Cir. 1992); In re Lane, 991 F.2d 105 (4th Cir. 1993) (factors to be considered in determining sanctions); In re Rainbow Magazine, Inc., 136 B.R. 545 (9th Cir. BAP 1992); Midwest Properties No. Two v. Big Hill Inv. Co., 93 B.R. 357, 364 (N.D. Tex. 1988); In re Omega Trust, 110 B.R. 665 (Bankr. S.D.N.Y. 1990), aff'd in part, remanded in part, 120 B.R. 265 (S.D.N.Y. 1990) (detailed discussion of Rule 9011 types of sanctions and factors that may be considered in determining which sanctions to impose); see White v. General Motors Corp., 908 F.2d 675 (10th Cir. 1990) (non-bankruptcy case explaining requirement that sanctions be minimum necessary to deter future misconduct, that fault be allocated, and that finding all actions to have been tainted is sufficiently specific); but see In re Fitzsimmons, 920 F.2d 1468 (9th Cir. 1990) (egregious circumstances warranted departure from usual requirement of explicit consideration of relative fault and alternative sanctions).

³⁸⁷ In re Brooks-Hamilton, 329 B.R. 270 (9th Cir. BAP 2005), aff'd in part, rev'd in part, 271 Fed. Appx. 654 (9th Cir. 2008); In re Brown, 408 B.R. 509 (Bankr. D. Idaho 2009); In re West, 338 B.R. 906 (Bankr. N.D. Okla. 2006).

suspension or disbarment from the bankruptcy court is to be considered.³⁸⁸ The factors and standards to be used in determining appropriate attorney discipline are set forth in ABA Standards, which are a useful structure to be followed when the bankruptcy court imposes such discipline instead of referring it to another court or State Bar authority.³⁸⁹

6. Rule 11 motions for sanctions, like all other motions, must be filed in good faith. Rule 11 does not mandate punishment just because an adversary's theory is rejected at trial, and is not intended to "kill an attorney's enthusiasm or creativity."³⁹⁰ Courts generally evaluate whether a "colorable" basis for the attorney's contentions was asserted, in deciding on sanctions requests,³⁹¹ or an "objective reasonableness" standard for a competent attorney.³⁹² Sanctions may not be imposed against counsel merely because the court finds the client's testimony not credible.³⁹³ Cause for imposition of sanctions must be proved by evidence that is

³⁸⁸ In re Reeves, 372 B.R. 525 (Bankr. N.D. Ga. 2007); In re Engel, 246 B.R. 784 (Bankr. M.D. Pa. 2000); In re MPM Enterprises, Inc., 231 B.R. 500 (E.D.N.Y. 1999).

³⁸⁹ In re Lehtinen, 332 B.R. 404 (9th Cir. BAP 2005) aff'd on other grounds, 564 F.3d 1052 (9th Cir. 2009); In re Sanford, 403 B.R. 831 (Bankr. D. Nev. 2009).

³⁹⁰ In re Oak Grove Village, Ltd., 90 B.R. 246, 249 (Bankr. W.D. Tex. 1988); In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991); In re Kanak, 85 B.R. 43, 46 (Bankr. N.D. Ill. 1988). On the other hand, ignorance of bankruptcy law and failure to adequately investigate standards for relief is no defense to a Rule 11 violation. In re Chicago Midwest Donut, Inc., 82 B.R. 943, 945-46 (Bankr. N.D. Ill. 1988); but see In re Whitney Place Partners, 147 B.R. 619 (Bankr. N.D. Ga. 1992).

³⁹¹ In re Hall's Motor Transit Co., 889 F.2d 520 (3d Cir. 1989); Matter of McGuirt, 879 F.2d 182 (5th Cir. 1989); Sea Harvest Corp. v. Riviera Land Co., 868 F.2d 1077 (9th Cir. 1989); Dreamlite Holdings Ltd. v. Kraser, 890 F.2d 1147 (Fed. Cir. 1989); White v. General Motors, 908 F.2d at 680; but see In re Marathon Home Loans, 101 B.R. 216, 222 (Bankr. S.D. Cal. 1989)(each filing not frivolous, but sanctionable as part of persistent pattern of abusive litigation activity).

³⁹² In re Grantham Bros., 922 F.2d 1438 (9th Cir. 1991); In re Brooks-Hamilton, 329 B.R. 270 (9th Cir. BAP 2005), aff'd in part, rev'd in part, 271 Fed. Appx. 654 (9th Cir. 2008).

³⁹³ In re Big Rapids Mall Associates, 98 F.3d 926 (6th Cir. 1996).

clear and convincing or substantial, not just a preponderance of the evidence.³⁹⁴

7. A motion for sanctions on account of a frivolous, bad faith bankruptcy petition under Rule 9011 or 28 U.S.C. § 1927 needs to be filed before the petition is dismissed, while the court has supervisory jurisdiction over the case.³⁹⁵

C. Reporting Bankruptcy Misconduct.

1. Apart from duties to disaffirm misleading documents or reveal misrepresentations of former clients,³⁹⁶ counsel may learn of misconduct by non-clients, including what may be bankruptcy crimes.³⁹⁷ The U.S. Trustee's duties include notifying the appropriate U.S. Attorney of matters which may constitute bankruptcy crimes.³⁹⁸ Any judge, receiver or trustee having reasonable grounds for believing a bankruptcy crime has been committed, or an investigation in connection with such a belief should be undertaken, must report to the appropriate U.S. Attorney.³⁹⁹ Any known or suspected criminal violation committed against a national bank or involving a financial transaction conducted through a national bank must be reported by the bank to the Office of the Comptroller of Currency, and the bank is strongly encouraged to report to the appropriate law enforcement authorities as well, where the facts provide a reasonable basis for concluding any violation of law has occurred.⁴⁰⁰ When a sanctioned lawyer's conduct is illegal or violates the ethical

³⁹⁴ E.g. In re Bird, 353 F.3d 636 (8th Cir. 2003); In re St. Stephen's 350 East 116th St., 313 B.R. 161 (Bankr. S.D.N.Y. 2004)

³⁹⁵ See notes **638-39**, supra.

³⁹⁶ See notes **562-63**, supra.

³⁹⁷ 18 U.S.C. § 152.

³⁹⁸ 28 U.S.C. § 586(a)(3)(F).

³⁹⁹ 18 U.S.C. § 3057; In re Stockbridge Funding Corp., 153 B.R. 654 (Bankr. S.D.N.Y. 1993)(trustee, like judge, protected from discovery efforts by bankruptcy crimes investigation privilege).

⁴⁰⁰ 12 C.F.R. § 21.11.

rules governing his practice of law in a manner that raises a substantial question as to the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, that lawyer and other lawyers knowing of it are obligated to report that conduct to the applicable state bar disciplinary authorities.⁴⁰¹ That obligation to report confers standing on counsel for other parties in a bankruptcy case to object to actions taken by an attorney with apparent conflicts.⁴⁰² Judges have a comparable reporting obligation.⁴⁰³

2. In Congoleum, the Third Circuit recognized concerns about tactical use of disqualification motions. While the court explicitly did not decide if a non-creditor's (insurer's) lawyer had a duty to disclose a conflict of interest on the part of special counsel, it held counsel had standing, and the right to raise the issue of a conflict under state Rules of Professional Conduct, and require adjudication of the conflict issue by the court.⁴⁰⁴ The court went on to state that counsel has a responsibility, if not a duty, to alert the court to ethical conflicts on the part of other counsel.⁴⁰⁵ The court cited Model Rule 8.3 to explain its ruling in a case where a lawyer had a conflict of interest from inadequately disclosed representation of creditors and the debtor in possession as special counsel.⁴⁰⁶ The court further found written client waivers granted by primary counsel inadequate for lack of informed

⁴⁰¹ Model Rule 8.3; In re Black, 116 B.R. 818 (Bankr. W.D. Okl. 1990); In re Himmel, 533 N.E. 2d 790 (Ill. 1988) (lawyer suspended for one year for failing to report another lawyer's misconduct).

⁴⁰² In re Congoleum Corp., 426 F.3d 675 (3d Cir. 2005); In re Fischer, 202 B.R. 341 (E.D.N.Y. 1996).

⁴⁰³ Model Code of Judicial Conduct 3D(2).

⁴⁰⁴ Congoleum, 426 F.3d at 687.

⁴⁰⁵ Id. at 686.

⁴⁰⁶ Id.

consent.⁴⁰⁷

D. Judicial Disqualification.

1. A bankruptcy judge is disqualified from presiding over the adversary proceeding or contested matter in which a disqualifying circumstance arises, or if appropriate, is disqualified from presiding over the entire bankruptcy case.⁴⁰⁸ There are two categories of disqualifying circumstances: (a) any proceeding in which the judge's impartiality might reasonably be questioned;⁴⁰⁹ and those matters specifically enumerated in 28 U.S.C. § 455(b).⁴¹⁰ Only the first category of disqualifying circumstances may be waived by the parties.⁴¹¹

2. The ability of courts to limit disqualification just to a contested

⁴⁰⁷ *Id.* at 690-91.

⁴⁰⁸ 28 U.S.C. § 455; Bankruptcy Rule 5004. Disqualification from the entire case rather than a single dispute depends on whether the disqualifying circumstances are pervasive, or isolated to a single dispute within the case. 1983 Advisory Committee Note to Bankruptcy Rule 5004.

⁴⁰⁹ 28 U.S.C. § 455(a).

⁴¹⁰ (1) where the judge has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

(2) where in private practice, the judge served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or lawyer has been a material witness concerning it;

(3) where the judge has served in governmental employment and in such capacity participated as counsel, adviser or material witness concerning the merits of the particular case in controversy;

(4) where the judge knows that she, individually or as a fiduciary, or her spouse or minor child residing in her household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;

(5) where the judge or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

(a) is a party to the proceeding, or an officer, director, or trustee of a party;

(b) is acting as a lawyer in the proceeding;

(c) is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding;

(d) is to the judge's knowledge likely to be a material witness in the proceeding.

§ 455(b). The various terms are defined in § 455(d).

⁴¹¹ 28 U.S.C. § 455(e). However, if the disqualification arises under § 455(b)(4) and the judge discovers the financial interest after spending substantial judicial on the matter, and that interest would not be substantially affected by the outcome, the judge may continue with the

bankruptcy proceeding as distinguished from the entire bankruptcy case recognizes the unique nature of a bankruptcy case as an umbrella under which a number of distinct, varied controversies are resolved.⁴¹² The relationship of the judge to a creditor or an attorney in the case may disqualify the judge from handling litigation involving that creditor or attorney, but require disqualification from the entire case only if that creditor or attorney took a substantial and ongoing role in the overall case.⁴¹³

3. The standard for disqualification under the non-specific provisions of § 455(a) is an objective one, determined by what a reasonable person knowing all the relevant facts would think about the impartiality of the judge rather than what the judge estimates to be his own ability to impartially hear a case.⁴¹⁴ A reasonable, factual basis to doubt the impartiality or fairness of the judge must be shown by some kind of probative evidence, generally through testimony and affidavits.⁴¹⁵ In some cases the court has conducted a hearing on the facts; in other

matter upon divestiture of the interest. § 455(f).

⁴¹² In re Apex Oil Co., 981 F.2d 302 (8th Cir. 1992). The concept has been recognized repeatedly in the context of bankruptcy appeals, and the liberal concept of finality used by the appellate courts. Id.

⁴¹³ In re Apex Oil Co., *supra*; In re Norton, 119 B.R. 332 (N.D. Ga. 1990)

⁴¹⁴ In re Kensington International, Ltd., 368 F.3d 289 (3d Cir. 2004); Matter of Johnson, 921 F.2d 585 (5th Cir. 1991); In re Continental Airlines Corp., 901 F.2d 1259 (5th Cir. 1990); In re Olson, 20 B.R. 206 (D. Neb. 1982)(appearance of possible lack of impartiality in the mind of the average person is enough to warrant recusal); In re Forty-Eight Insulations, Inc., 84 B.R. 129 (Bankr. N.D. Ill. 1988); In re Olcese, 86 B.R. 916 (Bankr. N.D. Ohio 1988). That court cites the legislative history of § 455 for the point that "Litigants ought not [to] have to face a judge where there is a reasonable question of impartiality, but they are not entitled to judges of their own choice." H.R. 1453, 93rd Cong., 1st Sess., reprinted in 1974 U.S. Code Cong. & Admin. News, 6351, 6355. 86 B.R. at 920. In re Martin-Trigona, 573 F.Supp. 1237 (D. Conn. 1983)(right to an impartial judge does not permit judge-shopping); In re Krisle, 54 B.R. 330 (Bankr. D. S.D. 1985)(same).

⁴¹⁵ In re Olcese, 86 B.R. at 920. Although 28 U.S.C. § 144 does not apply to disqualification of bankruptcy judges (see numerous cases cited in In re Norton, 119 B.R. at 334), that statute's procedure for filing an affidavit stating the facts and reasons for the party's belief in grounds for

cases the court has assumed for purposes of judicial recusal only that allegations contained in affidavits in support of the disqualification motion are true.⁴¹⁶

4. In most circuits, a judge's adverse ruling during the course of a case or proceeding is not "reasonable" grounds for recusal; disqualification must stem from an extra-judicial source, not information gained in the course of the proceeding.⁴¹⁷ Nor is an apparent antagonism by the judge towards an attorney grounds for recusal.⁴¹⁸ Prior acquaintance with, experience litigating against, or even former partnership with counsel for one of the parties is not *per se* disqualifying, nor

disqualification is a sound one for raising disqualification concerns. In re Olson, 20 B.R. 206 (D. Neb. 1982)(finding § 144 mechanism appropriate in bankruptcy context); see In re Chandler's Cove Inn, Ltd., 74 B.R. 772 (Bankr. E.D.N.Y. 1987)(conclusory statements and unsupported beliefs of no effect).

⁴¹⁶ In re Olson, 20 B.R. 206 (D. Neb. 1982) (court duty bound to take affidavit allegations as true for this purpose); In re Olcese, 86 B.R. 916 (Bankr. N.D. Ohio 1988) (court deemed facts alleged in affidavit to be true, but considered other facts apparent in record of case at hearing on disqualification); In re Norton, 119 B.R. 332 (Bankr. N.D. Ga. 1990) (court considered motion, briefs, affidavit of judge, testimony of debtor and judge's former law partner, record of adversary proceeding and entire case); In re Krisle, 54 B.R. 330 (Bankr. D. S.D. 1985) (evidentiary hearing); In re Apex Oil Co., 23 BCD 1069, 1992 WL 322032 (8th Cir. 1992) (court considered movant's affidavit as true, but also considered facts known by judge).

⁴¹⁷ See extensive citations and discussion of caselaw in In re Jeffrey Grossman, 147 B.R. 903 (Bankr. N.D. Ill. 1992); other bankruptcy cases include: American Ready Mix, Inc. v. Lopez, 14 F.3d 1497 (10th Cir. 1994); In re Chandler's Cove Inn, Ltd., 74 B.R. 772 (Bankr. E.D.N.Y. 1987); In re Krisle, 54 B.R. 330 (Bankr. D. S.D. 1985); In re Olcese, *supra*; In re Forty-Eight Insulations, Inc., 84 B.R. 129 (Bankr. N.D. Ill. 1988) (appearance of bias must be based on extra-judicial activities); Matter of Pritchard & Baird, Inc., 16 B.R. 16 (Bankr. D. N.J. 1981). The Ninth Circuit applied this principle in In re Manoa Finance Co., Inc., 781 F.2d 1370 (9th Cir. 1986), but cautioned that because bankruptcy judges retain an administrative role in bankruptcy cases, although less under the Bankruptcy Code than the prior Act, bankruptcy judges should "be especially solicitous in maintaining both the appearance and reality of impartiality when adjudicating matters with which they have had close involvement, erring on the side of recusing themselves when appropriate." 781 F.2d at 1373. See In re Alpern, 246 B.R. 578 (Bankr. N.D. Ill. 2000) (no recusal for refusal to respond after hearing concluded).

⁴¹⁸ In re Forty-Eight Insulations, Inc., 84 B.R. 129, 132 (Bankr. N.D. Ill. 1988) (discussing circuit court non-bankruptcy cases, and concluding that "[a]n apparent antagonism towards an attorney must be of such character and apparent intensity to warrant a reasonable belief that the judge might not be able to impartially consider the arguments of that attorney in the case before the court." Generally, there must be a showing of bias against the party, not the attorney. But see Matter of Johnson, 921 F.2d 585 (5th Cir. 1991) (judge acknowledged prejudice from what he considered a personal affront by counsel).

is the fact that one counsel is a judge's former clerk or even a friend.⁴¹⁹ If the judge is confident of his ability to be even-handed, he has a duty not to grant a meritless recusal motion.⁴²⁰

5. Under most circumstances, a motion to disqualify is heard by the challenged judge. There are a number of reported decisions where the motion to disqualify was transferred to a different judge for decision.⁴²¹

6. Several factors have been applied by the courts in determining whether violations of the disqualification statute require orders to be set aside, or whether the error is harmless: (1) the risk of injustice to the parties in the particular case; (2) the risk that the denial of relief will produce injustice in other cases; and (3) the risk of undermining the public's confidence in the judicial process.⁴²² In evaluating these factors, courts have considered the timing of the motion—at the beginning of the case or after an adverse decision was rendered.⁴²³

7. The same disqualifying circumstance, *i.e.* the judge agreeing to

⁴¹⁹ In re Cooke, 160 B.R. 701 (Bankr. D. Conn. 1993)(lengthy citations); In re Olcese, 86 B.R. 916 (Bankr. N.D. Ohio 1988); In re Johnson-Allen, 68 B.R. 812 (Bankr. E.D. Pa. 1987) lists several cases in which pre-bench contacts of judges with litigants, their counsel and the issues have not been deemed bases for recusal.

⁴²⁰ In re Evergreen Sec., Ltd., 363 B.R. 267 (Bankr. M.D. Fla. 2007), *aff'd*, 391 B.R. 184 (M.D. Fla. 2008).

⁴²¹ In re Norton, 119 B.R. 332, 333 n.1 (Bankr. N.D. Ga. 1990) recites cases where the challenged judge did and did not hear the disqualification motions. It also cites a Seventh Circuit case noting the difficulty of applying the nonspecific § 455(a) criterion when the judge must apply the standard both as interpreter and object of interpretation, SCA Services, Inc. v. Morgan, 557 F.2d 110, 116 (7th Cir. 1977) and several articles where commentators argue the better procedure is to transfer a motion to disqualify under § 455 to another judge. *See also* In re Olcese, 86 B.R. 916 (Bankr. N.D. Ohio 1988) (challenged judge heard the motion; statute is self-executing and judge has an independent duty to recuse himself if appropriate).

⁴²² In re Continental Airlines Corp., 901 F.2d 1259, 1262-63 (5th Cir. 1990), *citing* Liljeberg v. Health Service Acquisition Corp., 486 U.S. 847, 108 S.Ct. 2194 (1988). That case was also cited in In re Apex Oil Co., 981 F.2d 302 (8th Cir. 1992), and In re Norton, 119 B.R. at 340.

⁴²³ In re Tri-State Financial, LLC v. Lovald, 525 F.3d 649 (8th Cir. 2008) (recusal motion months after challenged event was untimely); In re Kensington International, Ltd., 368 F.3d

join DIP counsel's law firm shortly after entering the challenged rulings, was held by the Fifth Circuit to result in harmless error with respect to one ruling and reversible error as to another. A summary judgment on allowability of damages was held to leave (1) little risk of injustice to the parties because it was reviewed *de novo*, (2) little injustice in other cases, especially given a caution to other judges contemplating retirement, and the status of the plan, and (3) an appellate ruling of judicial violation of §455 was deemed to restore some of any public confidence lost as a result of the violation.⁴²⁴ On the other hand, the risk of injustice to the parties was held greater with respect to a claim estimation order, because it is reviewable on an abuse of discretion standard. And the risk of undermining public confidence in the legal system was deemed greater in such a discretionary matter, where the public should trust that the parties' welfare will take priority over convenience or ease of disposing of the parties' claims. Injustice to other Continental creditors from delay at that point in the case would be minimal due to a plan, and the increased risk of injustice to the parties and undermining public confidence in the judicial process "far outweighs any decrease in the risk of injustice to other parties in denying relief from the bankruptcy court's estimation order."⁴²⁵ The court remanded an order estimating claims for determination by a new bankruptcy judge.⁴²⁶

8. An order denying a motion to disqualify or recuse a judge is interlocutory and not immediately appealable.⁴²⁷ Appellate review of such a ruling

289 (3d Cir. 2004); *In re Apex Oil Co.*, *supra*; *In re Norton*, *supra*.

⁴²⁴ *In re Continental Airlines Corp.*, 901 F.2d at 1263.

⁴²⁵ *In re Continental Airlines*, 981 F.2d 1450, 1463 (5th Cir. 1993).

⁴²⁶ *Id.*

⁴²⁷ *American Ready Mix, Inc. v. Lopez*, 14 F.3d 1497 (10th Cir. 1994); *Alexander v. Primerica Holdings, Inc.*, 10 F.3d 155 (3d Cir. 1993).

may be sought by a mandamus petition, where the standard of review is a “clear and indisputable” right to relief.⁴²⁸

⁴²⁸ American Ready Mix, Inc. v. Lopez, 14 F.3d 1497 (10th Cir. 1994).