# ARE DIP AND COMMITTEE COUNSEL FIDUCIARIES FOR THEIR CLIENTS' CONSTITUENTS OR THE BANKRUPTCY ESTATE? WHAT IS A FIDUCIARY, ANYWAY?

SUSAN M. FREEMAN*

## INTRODUCTION

Do counsel for a debtor-in-possession and a Committee owe fiduciary duties to anyone other than their clients? Lawyers in any case have duties to the court and certain duties to other parties (with their clients' authorization, or imposed by law). But what is the scope of such duties, and what is the import of terming them "fiduciary" duties? Can the consequences of imposing fiduciary duties be solved by employment of conflicts counsel?

The questions matter. In one 2008 case, the bankruptcy court sanctioned DIP counsel by reducing fees "in light of [DIP counsel's] failure to acknowledge the existence of a fiduciary duty to the debtor's estate" even as it found "counsel's actions have not constituted a breach of that duty."[1]

This article first summarizes case law referring to DIP and Committee counsel as fiduciaries for others than their direct clients. It next addresses the Utah District Court case analyzing the underlying theories and consequences of considering DIP counsel as a fiduciary to the bankruptcy estate, and cases expanding upon and recently rejecting its analysis. The article covers the fiduciary duties of DIP and Committee clients and how they meet their fiduciary duties while balancing such duties with their own self-interests. It continues with a discussion of the duties of all lawyers to their clients and courts, then analyzes the duties of a lawyer to her client fiduciary in bankruptcy cases. This includes avoiding conflicts of interest, meeting legal requirements, and counseling and guiding the DIP or Committee client fiduciary. It also includes maintaining confidentiality and in some situations withdrawing and making withdrawal disclosures in a manner complying with professional conduct rules. Committee counsel must also act impartially toward Committee members and ensure fair consideration of the interests of all Committee constituents.

The article then addresses lawyer duties to non-clients of a fiduciary client as found in state trust and agency law, the Model Rules of Professional Conduct and an American Bar Association formal opinion, a useful law review article by Professor Geoffrey Hazard and the Restatement (Third) of the Law Governing Lawyers. The 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. It then discusses how fiduciary principles are applied to a DIP and a Committee and to counsel for a DIP and a Committee. The article

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* Partner, Lewis and Roca LLP, Phoenix, Arizona.

[1] *In re* Hirsch, No. 1-02-17966-dem., 2008 WL 5234057, at *8 (Bankr. E.D.N.Y. Dec. 11, 2008).

posits that 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.

The article describes the impact on a lawyer's obligations to comply with professional responsibility codes and principles if DIP or Committee counsel is also deemed to be counsel for the "estate." These include issues regarding the client as decision-maker, multiple-client conflicts, meeting requirements to maintain client confidentiality and client withdrawal procedures, sanctions, and risk-averse self-interest conflicts. It sets forth the theory for and limitations on use of "conflicts counsel" to attempt to resolve DIP and Committee counsel conflicts.

The article discusses 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. 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.

## I. THE STATE OF THE CASE LAW

### *A. Inception of the Position that DIP Counsel (and Committee Counsel) Owe Fiduciary Duties to Creditors that Supersede Duties to the Client*

The Supreme Court cases cited for the position that DIP counsel and Committee counsel owe fiduciary duties to the estate and creditors are *Brown v. Gerdes*[2] and *Woods v. City Bank Co.*[3] Both concerned fee claims by lawyers where the fee payments depleted the estate.[4] In *Brown v. Gerdes*, chapter X counsel argued that the bankruptcy court had to implement a state court fee award and in *Woods*, counsel for a protective Committee furthered the interest of his indenture trustee client on the Committee, a conflict of interest.[5] The Supreme Court stated in *Brown v. Gerdes* that professionals compensated from the bankruptcy estate "are held to fiduciary standards" in general, citing *Woods*, which in turn held, as a condition of

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[2] 321 U.S. 178 (1944).
[3] 312 U.S. 262 (1941).
[4] *Gerdes*, 321 U.S. at 180–81; *Woods*, 312 U.S. at 263–64.
[5] *Gerdes*, 321 U.S. at 180; *Woods*, 312 U.S. at 263–64.

such compensation by Committee counsel, that the lawyer was obliged to provide "loyal and disinterested service in the interest of those for whom the claimant purported to act."[6] Neither referenced fiduciary duties to the bankruptcy estate.

The notion of fiduciary responsibility to the bankruptcy estate crept in through additional attorneys' fees cases, where the lawyers were claimants taking money from the estate. The first was *Arlan's Department Stores*,[7] where counsel for a chapter XI DIP failed to disclose a fee-sharing connection in a mismanaged case where professional fees would consume most estate assets.[8] The court said misrepresentations to the court breached counsel's fiduciary duty to the court as an officer of the court, held to fiduciary standards.[9] The attorney denied that he was a court appointed officer or fiduciary, saying the firm was retained by the debtor.[10] The opinion expressed the court's shock that "experienced bankruptcy attorneys would consider their relationship to the court or the estate of the debtor in such a light."[11]

Other appellate opinions followed *Arlan's* in the context of attorneys' fee claims.[12] Two cases addressed conflicts of interest on the part of DIP counsel and held that the attorney must be independent and free of conflicts so he could give sound representation and advice to the DIP, without describing DIP counsel as having fiduciary duties to the estate.[13] The first appellate case to refer to the

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[6] *Gerdes*, 321 U.S. at 182 (citing *Woods*, 312 U.S. at 267–69); *Woods*, 312 U.S. at 268–69.

[7] *In re* Arlan's Dep't Stores, Inc., 615 F.2d 925 (2d Cir. 1979).

[8] *Id.* at 932.

[9] *Id.* (finding attorney in breach of fiduciary duty due to failure to disclose agreement with another firm within application for appointment of counsel for debtor).

[10] *Id.* at 933.

[11] *Id.*

[12] *See*, *e.g.*, Cont'l Ill. Nat'l Bank & Trust Co. of Chicago v. Wooten, Ltd. (*In re* Evangeline Ref. Co.), 890 F.2d 1312, 1323 (5th Cir. 1989) ("The filing of a fraudulent fee application by a trustee or attorney for the trustee is a flagrant violation of the obligation of candor to the court and fiduciary obligations to the estate."); Pierson & Gaylen v. Creel & Atwood (*In re* Consol. Bancshares, Inc.), 785 F.2d 1249, 1255 (5th Cir. 1986) (suggesting fee claims by DIP and Committee counsel should be scrutinized by each other; conspiracy of silence on fee claims "is a violation of their duties as fiduciaries not only to their specific clients but to the interests of the debtor's estate"); Futuronics Corp. v. Arutt, Nachamie & Benjamin (*In re* Futuronics Corp.), 655 F.2d 463, 470–71 (2d Cir. 1981) (finding fee sharing arrangement "flagrantly breached [both firms'] fiduciary obligations to the bankruptcy court"), *cert. denied*, 455 U.S. 941 (1982); Shaw & Levine v. Gulf & Western Indus., Inc. (*In re* Bohack Corp.), 607 F.2d 258, 264 (2d Cir. 1979) (indicating special counsel with undisclosed conflicts was disqualified; "[a]ttorneys who are so appointed are of course officers of the court and fiduciaries"); *In re* Imperial "400" Nat'l, Inc., 456 F.2d 926, 929, 931 n.12 (3d Cir. 1972) (finding "counsel for the trustee has equivalent fiduciary responsibilities to the estate in reorganization and the creditors" and must disgorge improperly paid fees with interest; "payees of these fees were fiduciaries dealing with money belonging to the reorganization estate").

[13] Humble Place Joint Venture v. Fory (*In re* Humble Place Joint Venture), 936 F.2d 814, 819 (5th Cir. 1991) (noting actual conflict required retainer disgorgement; "counsel's loyalty to reorganizing the debtor's estate would be tested at every turn by the very real, continuing interest of his client [debtor's principal] in avoiding exposure on a guarantee"); Parker v. Frazier (*In re* Freedom Solar Ctr., Inc.), 776 F.2d 14, 18–19 (1st Cir. 1985) (remarking on DIP insider seeking to purchase estate assets: "In these situations, the debtor needs real representation and advice"; professional conduct rule on multiple employment to be interpreted by standard of fiduciary "'punctilio of an honor most sensitive'" (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928))).

concept of DIP counsel as "counsel for the estate" with fiduciary duties to the "estate" to independently determine its best interest was *Perez*,[14] in dicta. The Ninth Circuit in *Perez* chastised DIP counsel for pursuing (and confirming) a plan of reorganization paying creditors in full but without interest as a violation of the DIP's responsibilities to comply with the Bankruptcy Code:

> Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually. Counsel has an independent responsibility to determine whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor. While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate's interests, he must seek to persuade his client to take a different course or, failing that, resign. Under no circumstances, however, may the lawyer for a bankruptcy estate pursue a course of action, unless he has determined in good faith and as an exercise of his professional judgment that the course complies with the Bankruptcy Code and serves the best interests of the estate.[15]

After *Perez*, the Seventh Circuit ruled in *Taxman* that DIP counsel was required "as a fiduciary of the estate" to make a careful judgment whether the billable hours to be invested in litigation would be commensurate with the expected gain, to avoid the bankruptcy estate being consumed by professional fees — an estimate best made by the lawyer.[16] The First and Third Circuits then issued opinions referring to DIP counsel as having fiduciary duties to the debtor entity rather than the estates, and acting appropriately in filings that benefited the debtor while not violating Bankruptcy Code entitlements for creditors.[17] The Tenth Circuit cited some of the bankruptcy cases referring to DIP counsel having fiduciary duties, then held that the professional's duty is to "independently serve the [fiduciary client]," and to undertake the legal analysis of estate causes of action that might lead to recoveries

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[14] Everett v. Perez (*In re* Perez), 30 F.3d 1209 (9th Cir. 1994).

[15] *Id.* at 1219.

[16] *In re* Taxman Clothing Co., 49 F.3d 310, 314 (7th Cir. 1995).

[17] *See* Fellheimer, Eichen & Braverman, PC v. Charter Tech., Inc., 57 F.3d 1215, 1220, 1228 (3d Cir. 1995) (noting bankruptcy court had properly chastised DIP counsel for "representing the interests of [an insider] over the interests of the Debtor," for having "abandoned his fiduciary obligations as counsel to the Debtor corporation," and for actions "as an officer of the Court in violating his fiduciary duties"); Casco N. Bank v. DN Assocs., (*In re* DN Assocs.), 3 F.3d 512, 516 (1st Cir. 1993) (concurring with bankruptcy court that DIP counsel did not represent adverse interest when filing three reorganization plans provided "for creditors in a fashion consistent with chapter 11 priorities, [and] sought to adjust the rights and relations of parties-in-interest so the interests of equity interest holders could be preserved").

for the estate.[18] A Second Circuit BAP opinion referred to DIP counsel as having fiduciary duties to the estate, then described such duties as:

> [D]ebtor's attorney, while not a trustee, nevertheless is charged with the duty of counseling the debtor in possession to comply with its duties and obligations under the law. When a debtor in possession is in breach of its fiduciary obligations, counsel must advise the client "to follow a lawful course."[19]

In that case, the Second Circuit BAP also took a step beyond applicable professional conduct rules by directing a "noisy withdrawal" when the DIP refused DIP counsel's advice about its fiduciary obligations, stating that:

> [B]ecause counsel for the debtor in possession has fiduciary obligations not ordinarily foisted upon the attorney-client relationship, the attorney for the debtor in possession may not simply resign where the client refuses the attorney's advice concerning the client's fiduciary obligations to the estate and its creditors. Counsel must do more, informing the court in some manner of derogation by the debtor in possession.[20]

At the bankruptcy court level, several opinions in the 1990s applied the estate fiduciary terminology like the *Perez* dicta to address duties of DIP counsel when DIP management embezzled estate assets or otherwise breached fiduciary duties, and included broad, vague language about DIP counsel owing fiduciary duties not only to the "bankruptcy estate" but also to the "creditors."[21] In each instance, the

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[18] *See* Interwest Bus. Equip., Inc. v. U.S. Tr. (*In re* Interwest Bus. Equip., Inc.), 23 F.3d 311, 316–17 (10th Cir. 1994) ("It is the duty of counsel for the debtor in possession to survey the landscape in search of property of the estate, defenses to claims, preferential transfers, fraudulent conveyances and other causes of action that may yield a recovery to the estate. The jaundiced eye and scowling mien that counsel for the debtor is required to cast upon everyone in sight will likely not fall upon the party with whom he has a potential conflict . . . ;" fiduciary duty is of debtor in possession as trustee of estate, and professional's obligation is "to independently serve the trustee" (quoting *In re* McKinney Ranch Assocs., 62 B.R. 249, 254 (Bankr. D. Cal. 1986))); *see also In re* Adam Furniture Indus., Inc., 158 B.R. 291, 301 (Bankr. S.D. Ga. 1993) (discussing DIP counsel's responsibility to evaluate estate causes of action).

[19] Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (internal citations omitted).

[20] *Id.* at 26.

[21] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (noting professionals employed by DIP owe fiduciary duty to estate); *In re* Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) (remarking DIP is fiduciary of estate and its constituents "as is the attorney for the debtor in possession"); *In re* Adam Furniture Indus., Inc., 158 B.R. 291, 301 (Bankr. S.D. Ga. 1993) (noting DIP counsel has "fiduciary duties to the estate, including insuring that the rights of the creditors are protected"); *In re* Whitney Place Partners, 147 B.R. 619, 620 (Bankr. N.D. Ga. 1992) (positing attorney for DIP is also fiduciary to estate); *In re* United Utensils Corp., 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) (stating attorney in bankruptcy proceeding has fiduciary duty to creditors as well as to debtor); *In re* Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992) (explaining DIP counsel duties as fiduciary of estate); *In re* Doors & More, Inc., 126 B.R. 43, 46 (Bankr.

actual violation consisted of failing to advise the decision-maker DIP client. Other bankruptcy courts and a district court recognized that it is the DIP that owes fiduciary duties, and DIP counsel's job is to advise the DIP on compliance with those duties, without holding that counsel takes on direct fiduciary duties.[22]

Similarly, bankruptcy court cases concerning Committee counsel took the *Woods* language that Committee counsel seeking fees from the bankruptcy estate must provide loyal and disinterested service in the interest of those for whom the professional acted[23] into a fiduciary duty to Committee constituents in general.[24]

*B. Hansen, Jones & Leta, P.C. v. Segal and its Progeny*

The first thorough analysis of the legal theories underpinning asserted fiduciary duties of DIP counsel was issued in the 1998 district court opinion in *Hansen, Jones & Leta, P.C. v. Segal*.[25] The district court addressed a bankruptcy court's denial of all attorneys' fees sought by DIP counsel principally because the bankruptcy court had 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.[26] The district court analyzed at length DIP counsel's role, and concluded it is limited to that of an attorney owing fiduciary duties of loyalty and care to his/her client.[27]

The *Hansen, Jones & Leta* court first noted that a bankruptcy estate is created upon the petition filing; its beneficiaries include creditors and equity holders.[28] The question is whether the "estate" is a legal person, or a collection of property

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E.D. Mich. 1991) (elucidating knowledge required of counsel for DIP); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (remarking on high fiduciary duty owed to estate by DIP counsel); *In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) (noting fiduciary obligations carry over to attorneys retained by DIP), *aff'd sub nom.*, Grabill Corp. v. Pelliccioni, 135 B.R. 835 (N.D. Ill. 1991); *In re* Consupak, Inc., 87 B.R. 529, 548–51 (Bankr. N.D. Ill. 1988) (stating fiduciary duties of DIP counsel are equivalent to those of trustee).

[22] *See In re* SIDCO, Inc., 173 B.R. 194, 196 (E.D. Cal. 1994) (asserting DIP counsel owes fiduciary duty to debtor-client but not to creditors); *In re* Stamford Color Photo, Inc., 98 B.R. 135, 137–38 (Bankr. D. Conn. 1989) (holding that absent evidence of actual conflict of interest, debtor's counsel had no interest materially adverse to estate); *see also In re* Nephi Rubber Prods. Corp., 120 B.R. 477, 482 (Bankr. N.D. Ind. 1990) (noting DIP decides on bankruptcy plan through its management and directors).

[23] Woods v. City Bank Co., 312 U.S. 262, 267–69 (1941).

[24] *See infra* Section IV.E.; *In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991) ("Counsel for the [C]ommittee has a fiduciary duty to the [C]ommittee and its constituency."); *see also* Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein, PC, 42 B.R. 960, 963 (E.D. Pa. 1984) (asserting counsel to Creditors Committee has fiduciary duty to interests of entire class of creditors); *In re* Mesta Mach. Co., 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986) (acknowledging Creditors Committees and counsel are fiduciaries).

[25] Hansen, Jones & Leta, PC v. Segal, 220 B.R. 434 (D. Utah 1998).

[26] *See id.* at 436–47 (citing *In re* Bonneville Pac. Corp., 196 B.R. 868, 888 (Bankr. D. Utah 1996)) (denying DIP counsel's fees where counsel failed to disclose insider fraud in chapter 11 plan). *See generally* Charles S. Riecke, *Sections 327 to 331—Attorney Fees*, 1999-2000 NORTON ANNUAL SURVEY OF BANKRUPTCY LAW 307, 341 (1999) (discussing *Hansen, Jones & Leta* court's rationale and holding).

[27] *Hansen, Jones & Leta*, 220 B.R. at 449–54.

[28] *Id.* at 450–51.

interests. In *Bildisco*, the Supreme Court rejected the "separate entity" theory, and held that the DIP is the same entity as the pre-petition debtor, but empowered in a new manner.[29] 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.[30]

Next, the court recognized that counsel for the DIP owes duties of loyalty and duties of care to her DIP client.[31] The duty of loyalty is to maintain client confidentiality and prevent any conflict of interest, obligations that are stricter under the Bankruptcy Code than under professional conduct rules.[32] 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.[33] 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.[34]

Critically, the *Hansen, Jones & Leta* court explained that DIP counsel does not owe a duty *to estate beneficiaries*.[35] Representing a client fiduciary does not

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[29] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527–28 (1984); *see Hanson, Jones & Leta*, 220 B.R. at 452 ("[T]he Supreme Court . . . expressly rejected the new entity theory . . . ." (citing *Bildisco*, 465 U.S. at 528–29)).

[30] *See Hansen, Jones & Leta*, 220 B.R. at 453, 453 nn.24–30 (noting DIP-as-client view—rather than estate-as-client view—is consistent with sections 70 and 342 of Bankruptcy Act of 1898, 11 U.S.C. §§ 327 and 329, and I.R.C. § 1399); *see also* Mo. Dep't of Revenue v. L.J. O'Neill Shoe Co. (*In re* L.J. O'Neill Shoe Co.), 64 F.3d 1146, 1151–52 (8th Cir. 1995) (stating 11 U.S.C. § 346 and I.R.C. § 1399 do not create two separate entities); *In re* Callahan, 304 B.R. 743, 746–48 (W.D. Va. 2004) (holding I.R.C. § 1399 does not create separate entity (citing *Hansen, Jones & Leta*, 220 B.R. at 453)).

[31] *Hansen, Jones & Leta*, 220 B.R. at 454–55 ("[C]ounsel owes fiduciary duties of loyalty and care to his/her client, the debtor-in-possession.").

[32] *See id.* at 454 ("Bankruptcy Code provisions dealing with conflicts of interest are much stricter than their counterparts in the Model Rules."). *Compare* 11 U.S.C. §§ 327, 328, 329 (2006) (providing conditions for employment and compensation of attorney), *with* MODEL RULES OF PROF'L CONDUCT R. 1.6, 1.7 (2009) (addressing confidentiality and conflict of interest).

[33] *See Hansen, Jones & Leta*, 220 B.R. at 454–55 (discussing attornies' duty of care to clients); *see also, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.3 (2009) ("A lawyer shall act with reasonable diligence and promptness in representing a client.").

[34] *See Hansen, Jones & Leta*, 220 B.R. at 455–57 (enumerating counsel's duties to bankruptcy court); *see also* MODEL RULES OF PROF'L CONDUCT R. 3.3 (2009) (requiring candor from lawyer toward tribunal). *See generally* 9 NORTON BANKRUPTCY LAW & PRACTICE 3d, § 172:6, at 172-35 (2009) (elucidating *Hansen, Jones & Leta* court's discussion of lawyers' general duties to courts and additional duties to bankruptcy courts).

[35] *Hansen, Jones & Leta*, 220 B.R. at 457 ("[C]ounsel for the debtor-in-possession would not have any fiduciary duty to the beneficiaries of the estate because they are not clients."). *See generally* 9 NORTON BANKRUPTCY LAW & PRACTICE, *supra* note 34 § 172:6, at 172-35 (discussing court's analysis in *Hansen, Jones & Leta*); Steven H. Nickles, *Behavioral Effect of New Bankruptcy Law on Management and Lawyers: Collage of Recent Statutes and Cases Discouraging Chapter 11 Bankrutcy*, 59 ARK. L. REV. 329, 400–01

impose derivative fiduciary duties on the client's counsel, and the Bankruptcy Code identifies no duty to non-clients.[36] The court noted that ethical problems arise for DIP counsel if such fiduciary duties are to be imposed, due to the inherent conflict of interest of the client DIP.[37] 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.[38] The court explained that while chapter 11 countenances this conflict for the DIP, Rules of Professional Conduct prohibit attorneys from representing such conflicting interests, as discussed in this article.[39]

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 sections 327 or 329, or failure to provide services which benefit the estate under Code section 330.[40]

Other courts have followed *Hansen, Jones & Leta*, further elaborating on the limited extent of DIP counsel fiduciary duties.[41] A well-reasoned case that is widely quoted out of context is *ICM Notes*.[42] The *ICM Notes* opinion held that DIP counsel owes certain fiduciary duties to the DIP client and the bankruptcy court,

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(2006) (recognizing fiduciary duty of debtor to multiple parties but fiduciary duty of debtor's counsel only to debtor).

[36] *See Hansen, Jones & Leta*, 220 B.R. at 457 (stating no "provision in the Bankruptcy Code [] identifies such a [fiduciary] duty" to non-clients); 9 NORTON BANKRUPTCY LAW & PRACTICE., *supra* note 34 § 172:6, at 172-35 (discussing duties of debtor-in-possession and his/her counsel); Nickles, *supra* note 35, at 401–02 (noting lawyer may breach fiduciary duty to debtor if lawyer advances interests of debtor's management over interests of debtor).

[37] *Hansen, Jones & Leta*, 220 B.R. at 460 ("[I]mposing the client's fiduciary duties on counsel directly conflicts with counsel's ethical responsibilities to the client.").

[38] *See id.* at 460.

[39] *Id.* at 461 (referring to Panel suggestion that attorney should "disclose any potential or actual conflicts with the estate") (citing *In re* Smitty's Truck Stop, Inc., 210 B.R. 844 (B.A.P. 10th Cir. 1997)).

[40] *Hansen, Jones & Leta*, 220 B.R. at 461–67.

[41] *See, e.g.*, *In re* Mushroom Transp. Co., 366 B.R. 414, 440–41 (Bankr. E.D. Pa. 2007) (finding law firm breached its fiduciary duty to client, "the chapter 11 debtor," by theft of client funds); *In re* Specialty Rest. Group, LLC, 2007 Bankr. LEXIS 1506, at *3 (Bankr. N.D. Tex. Apr. 24, 2007) (indicating DIP counsel's "client is the debtor or the debtor in possession, not the bankruptcy estate"); *In re* Metro. Envtl., Inc., 293 B.R. 871, 883 (Bankr. N.D. Ohio 2003) (noting DIP counsel owes duties to debtor, and not its shareholders, officers or directors); *In re* Water's Edge Ltd. P'ship, 251 B.R. 1, 8 (Bankr. D. Mass. 2000) (noting DIP is permitted to place its own interests above those of unsecured creditors; its bargaining and cramdown rights necessarily exclude a fiduciary duty of loyalty to unsecured creditors); Berg & Berg Enters., LLC v. Sherwood, 32 Cal. Rptr. 3d 325, 342–47 (Cal. App. 2005) (stating 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); *see also In re* Cont'l Coin Corp., 380 B.R. 1, 16 (Bankr. C.D. Cal 2007) (stating trustee's attorney does not owe fiduciary duty to creditors of the estate, but only to trustee client).

[42] ICM Notes, Ltd. v. Andrews & Kurth, LLP, 278 B.R. 117 (S.D. Tex. 2002) (indicating DIP counsel does not owe fiduciary duties to any individual creditor, and is not subject to creditor cause of action for breach of fiduciary duty), *aff'd*, 324 F.3d 768 (5th Cir. 2003).

and said that some courts have determined that DIP counsel owes fiduciary duties to the bankruptcy estate as a whole, proceeding to set forth various duties such courts have imposed upon DIP counsel in relation to counsel's fiduciary duties to the estate.[43] While that section of the opinion is widely quoted, the court went on to state that an examination of these fiduciary duties reveals that they arise either from the role of counsel as an officer of the court or the derivative nature of fiduciary obligations owed by counsel to its client, the DIP.[44] The court explained:

> The cases cited by ICM Notes do not support a finding that counsel for the debtor owes particular fiduciary duties to the estate or its creditors. The language in these cases referencing a duty to the estate or the creditors is often included without analysis or elaboration by the court and is cited in conjunction with the traditional bankruptcy concepts of a breach of counsel's fiduciary duty to the client debtor-in-possession or counsel's failure to provide services which benefit the estate . . . [or] are grounded in principles relating to the retention and compensation of bankruptcy professionals, including conflict of interest rules.[45]

The *ICM Notes* court further noted that in a bankruptcy case, the debtor, secured creditors, unsecured creditors and other parties in interest have different and competing interests and are represented by counsel.[46] If DIP counsel owed a fiduciary duty to a particular creditor, it would prevent counsel from representing his own client and would be contrary to the mandate that DIP counsel be disinterested.[47] The *ICM Notes* opinion adopts the reasoning of *Hansen, Jones & Leta* and was approved without modification by the Fifth Circuit.[48]

### *C. More Recent Opinions Holding or Assuming DIP Counsel Has Fiduciary Duties to Creditors*

The *Hansen, Jones & Leta* and *ICM Notes* opinions were widely praised,[49] and a number of opinions thereafter recognized that DIP counsel may not owe fiduciary

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[43] *Id*. at 123–24 (concluding that whereas DIP counsel "may" owe general fiduciary duty to preserve bankruptcy estate, it cannot be extended to justify imposition of fiduciary duty from DIP counsel to particular creditor to support civil action for breach of fiduciary duty).

[44] *Id.* at 124.

[45] *Id.* at 125.

[46] *Id.* at 126.

[47] *See id*. at 126.

[48] *See id*. at 123–26.

[49] *See* Nickels, *supra* note 35 at 410 n.304 (demonstrating limited scope of attorney's fiduciary duty to bankruptcy estate); *see also* David S. Kupetz, *What Creditors Should Know About Retention of Counsel by Debtors in Possession, and About Payment of their Fees*, 117 BANKING L.J. 33, 45 (2000) (praising *Hansen, Jones & Leta* court for refusal to impose undefined fiduciary duty to bankruptcy estate); Susan Pierson Sonderby & Kathleen M. McGuire, *A Gray Area in the Law? Recent Developments Relating to Conflicts of*

duties to the estate or creditors, but still must guide the client DIP in carrying out its duties.[50] However, some courts continued to include broad references to DIP counsel having fiduciary duties to the estate or creditors without referring to the analysis that disproved such asserted duties.[51] Several recent bankruptcy cases have addressed the duties of DIP counsel when DIP management diverts estate assets or otherwise breaches fiduciary duties. A few cases simply focused on counsel's duties to advise and instruct the fiduciary client, without referring to the lawyer as a fiduciary.[52] In some, 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.[53] Each court so far to be confronted with a creditor's claim for damages from an alleged breach of fiduciary duty by DIP

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*Interest and the Retention of Attorneys in Bankruptcy Cases*, 105 COM. L.J. 237, 239 (2000) (describing *Hansen, Jones & Leta* holding as support for principles guiding attorney conduct).

[50] *See In re* St. Stephen's 350 E. 116th St., 313 B.R. 161, 171 (Bankr. S.D.N.Y. 2004) (requiring debtor's attorney to counsel client regarding its legal duties) (quoting Zeisler & Zeisler, P.C. v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997)); *In re* Texasoil Enters., Inc. 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) ("[C]ounsel to a debtor in possession may not owe a duty directly to creditors . . . ."); *see also In re* Nilges, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) (emphasizing counsel's duty to instruct client properly regarding its conduct); *In re* Berg, 268 B.R. 250, 262 (Bankr. D. Mont. 2001) (including debtor's fiduciary obligations among issues attorneys must inform clients about); cases collected *supra* note 41.

[51] *See, e.g.*, Hilal v. Williams (*In re* Hilal), 534 F.3d 498, 501 (5th Cir. 2008) ("Finally, bankruptcy professionals who are to be compensated by the estate bear fiduciary responsibilities of high order to the estate and creditors."; holding challenge to trustee release in plan not equitably moot but appropriate on merits, and noting case does not address other bankruptcy professionals); Damon & Morey, LLP v. Slater, No. 97-CV-0080E(M), 91-12805K, 1998 WL 15959, at *8 (W.D.N.Y. Jan. 14, 1998) (finding attorneys failed to advise client about fiduciary duties to estate and creditors); *In re* Hirsch, No. 1-02-17966-dem, 2008 Bankr. LEXIS 3377, at *27–28 (Bankr. E.D.N.Y. Dec. 11, 2008) (finding no harm to estate from representation by DIP counsel, but nonetheless sanctioning lawyer by reducing fees because of "counsel's failure to acknowledge the existence of a fiduciary duty to the debtor's estate"; lawyer had temerity to argue that *Food Mgmt.* was wrongly decided); *In re* The Phoenix Group Corp., 305 B.R. 447, 452 (Bankr. N.D. Tex. 2003) (stating DIP counsel "cannot be expected to perform functions inconsistent with debtor's fiduciary duties and counsel's own fiduciary duties to the estate").

[52] *See In re Nilges*, 301 B.R. at 325 (stating counsel has duty to supervise debtor and instruct on appropriate conduct to ensure compliance with Bankruptcy Code); *In re Berg*, 268 B.R. at 262 (acknowledging duty of attorney to inform debtor of benefits and burdens of bankruptcy and to instruct on appropriate conduct); *see also In re* Cenargo Int'l, PLC, 294 B.R. 571, 599 (Bankr. S.D.N.Y. 2003) (describing issue of whether DIP counsel has fiduciary duty to estate and creditors versus duty to client as developing concept; indicating presence of obligation to act based on fiduciary duty or disinterestedness obligation).

[53] *See In re* Count Liberty, LLC, 370 B.R. 259, 280 (Bankr. C.D. Cal. 2007) (asserting "majority view" that DIP counsel is fiduciary of bankruptcy estate); *In re* Harrington, No. 06-60391-CIV-JORDAN, 2006 U.S. Dist. LEXIS 87133, at *4–5 (S.D. Fla. Nov. 30, 2006) (indicating DIP counsel's fiduciary duties ran to bankruptcy estate, and his ultimate client was 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, No. 07-50099-RLJ-11, 2007 Bankr. LEXIS 1743, at *12 (Bankr. N.D. Tex. 2007) (positing that DIP counsel's fiduciary duties arise from role of counsel as officer of court or derivative nature of fiduciary obligations owed by counsel to client DIP; disinterestedness determination).

counsel has denied such a claim, although one court held it may be appropriate on other facts.[54]

One of the most extensively reasoned cases, *Count Liberty*, expressly rejected the holding in *Hansen, Jones & Leta* as "contrary to the weight of authority."[55] Most of 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.[56] Rather, as explained in *Hansen, 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.[57] The post-1998 cases cited in *Count Liberty* do not say that DIP counsel has fiduciary duties to the estate, but rather that DIP counsel has a duty to instruct the debtor about its duties and not "allow a client to direct or dictate the progress or activity in a case, if such activity is inconsistent with the requirements of the law."[58]

One case following *Count Liberty* merits particular attention for advancing the discussion. In *Food Management*, the bankruptcy court looked to THE LAW GOVERNING LAWYERS section 51(4) for an analysis of duties owed by DIP counsel to non-clients, recognizing they are considerably narrower than duties owed to

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[54] *See In re Texasoil Enters*., Inc., 296 B.R. at 435 ("[C]ounsel to a debtor in possession may not owe a duty directly to creditors . . . ."); ICM Notes, Ltd. v. Andrews & Kurth, LLP, 278 B.R. 117, 123 (Bankr. S.D. Tex. 2002) (concluding DIP counsel's general fiduciary duty to bankruptcy estate should not be extended to include duty to specific creditor, which would support claim for breach); *In re* Dieringer, 132 B.R. 34, 37 (Bankr. N.D. Cal. 1991) ("[D]ebtor's attorney is not liable to creditors for mishandling a bankruptcy except to the extent that his conduct was fraudulent or otherwise intentionally wrongful.").

[55] *In re Count Liberty*, 370 B.R. at 280–81 (rejecting also *In re* SIDCO, Inc., 173 B.R. 194 (E.D. Cal. 1994)).

[56] *See id*. at 280–83 (discussing related cases preceding *Hansen, Jones & Leta*, whose fiduciary duty analyses do not necessarily conflict with holding of *Hansen, Jones & Leta*); *see also In re* Whitney Place Partners, 147 B.R. 619, 620–21 (Bankr. N.D. Ga. 1992) ("[D]ebtor's attorney must take conceptual control of the case and provide guidance for management of the debtor, not only to discern what measures are necessary to achieve a successful reorganization, but to assure that, in so doing, compliance with the Bankruptcy Code and Rules is sought rather than avoided."); *In re* Consupak, Inc., 87 B.R. 529, 548 (Bankr. N.D. Ill. 1988) (equating fiduciary duties of counsel for bankruptcy trustee with those of trustee himself). As noted in *Food Mgmt*, the district court in *Hansen, Jones & Leta* did not expressly distinguish the circuit court opinions referring to DIP counsel as having fiduciary duties to the estate, perhaps out of deference to the higher courts. *See In re* Food Mgmt. Group, LLC, 380 B.R. 677, 708 (Bankr. S.D.N.Y. 2008). The analysis applies equally to those appellate cases, however, as discussed in Section I.A..

[57] *See* Hansen, Jones & Leta, PC v. Segal, 220 B.R. 434, 461–64 (D. Utah 1998); *see also In re Whitney Place*, 147 B.R. at 622 (analyzing DIP counsel's conduct under FED. RULES. BANKR. P. 9011 rather than under breach of fiduciary duty to estate); *In re Consupak*, 87 B.R. at 548 (reasoning that despite equivalency of fiduciary duties between trustee and its counsel, "they do not perform the same functions in a bankruptcy case").

[58] *In re* Berg, 268 B.R. 250, 262 (Bankr. D. Mont. 2001); *see also In re* Nilges, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) ("As a professional, an attorney must instruct the debtor on appropriate conduct and must develop client control." (quoting *In re Berg*, 268 B.R. at 262)).

clients.[59] 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 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.[60]

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."[61] The Court further interpreted "knows" to mean "reason to know."[62] On the facts of the case, the Court found that the framework is useful and is applicable because:

> (1) The lawyer's client, DIP, is a fiduciary for the estate.
> (2) DIP counsel bears a heightened duty of care to ensure the integrity of the bankruptcy process where by definition, DIP is not disinterested, and its counsel must be disinterested—the court adding that DIP counsel must have only the best interest of the estate in mind.
> (3) The alleged misconduct by DIP in the case involved breach of fiduciary duty and fraud.
> (4) DIP counsel assisted in the alleged breach intentionally.
> (5) The court concluded that the estate could not protect itself because it had been disserved by the DIP and DIP counsel—

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[59] *In re Food Mgmt.*, 380 B.R. at 708–09 ("The scope of [fiduciary duties to the bankruptcy estate] is certainly narrower than a lawyer's duties to its client. A lawyer owes a duty to a nonclient, and can be held liable for breach, in narrower circumstances."); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (2000) (indicating extent to which lawyer owes duty of care to non-clients).

[60] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (2000).

[61] *In re Food Mgmt.*, 380 B.R. at 709–10 (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (2000)).

[62] *Id.* at 709–10 (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. h (2000)).

> without mentioning whether counsel for secured creditors, the Committee, or the U.S. Trustee could provide such protection.
> (6) The court stated that imposing this duty does not significantly impair the performance of the lawyer's obligations—without explaining the facts for this conclusion.[63]

The *Food Management* opinion describes the Restatement section 51(4) duties to non-clients as "fiduciary" duties.[64] That is an inaccurate adjective to describe such duties, as discussed *infra*.

Other courts have noted the limitations on the apparent principle that DIP counsel owes fiduciary duties to the estate.[65]

## II. DIPS AND COMMITTEES IN BANKRUPTCY REORGANIZATION CASES BALANCE FIDUCIARY DUTIES WITH SELF-INTEREST

### *A. Fiduciary Duties of the DIP*

The United States Supreme Court has repeatedly observed that a DIP and its managers owe fiduciary duties to the estate's creditors, especially the unsecured creditors.[66] Courts have sometimes described the DIP's fiduciary duties broadly but vaguely, as an obligation to act not in its own best interest, but rather in the best interest of the entire estate, including the creditors and owners of the estate.[67]

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[63] *Id.* at 709.

[64] *Id.*

[65] *See, e.g.*, *In re* Marble, No. 07-50099-RLJ-11, 2007 Bankr. LEXIS 1743, at *15–16 (Bankr. N.D. Tex. May 25, 2007) ("If gray areas emerge, i.e., there is a bonafide [sic] legal question of whether property is exempt or not (or whether a trust is a spendthrift), the duty of counsel is to the debtor personally rather than as debtor-in-possession. The Court would expect debtor's counsel to defend his client's claim of exemptions [] . . . [and] as beneficiary of a valid spendthrift trust."); s*ee also* ICM Notes, Ltd. v. Andrews & Kurth, LLP, 278 B.R. 117, 126 (Bankr. S.D. Tex. 2002) (finding DIP counsel did not owe fiduciary duty to any particular creditor). *See generally* William A. Gregory, *The Fiduciary Duty of Care: A Perversion of Words*, 38 AKRON L. REV. 181 (2005) (exploring concept of fiduciary duty, its outer limits, and common misconceptions thereof).

[66] *See, e.g.*, Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) ("[DIP's] directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee.") (citing Wolf v. Weinstein, 372 U.S. 633, 649–52 (1963)); *Wolf*, 372 U.S. at 651 (emphasizing that willingness of courts to leave debtors in possession "is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee"); Pepper v. Litton, 308 U.S. 295, 307 (1939) (noting DIP "fiduciary obligation is designed for the entire community of interests . . .—creditors as well as stockholders").

[67] *See, e.g.*, *In re* APP Plus, Inc., 223 B.R. 870, 874 (Bankr. E.D.N.Y. 1998) (remarking DIP fiduciary duty "runs to the diverse interests of the debtor, creditors and equity holders, alike" (quoting Comm. of Equity Security Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983))); *In re* Rancourt, 207 B.R. 338, 360 (Bankr. D.N.H. 1997) (indicating DIP counsel "has a duty to look to the interests of the estate and not to the interests of its principals, shareholders, officers or directors"); *In re* Doors and More, Inc., 126 B.R. 43, 46 (Bankr. E.D. Mich. 1991) (remarking on DIP counsel's obligation to provide competent representation to estate).

In agency, trust and corporate law generally, the duties of a fiduciary to its beneficiaries are a duty of care, a duty of loyalty, and when there are multiple beneficiaries, a duty of impartiality among beneficiaries.[68] In the context of a chapter 11 case, courts have applied those concepts as follows:

> Duty of loyalty
> (1) The DIP is to forego from self-dealing at the expense of creditors,[69] unless the transaction is inherently fair, with "the earmarks of an arm's length bargain."[70] For this reason, and because of the prohibition of the bankruptcy crimes statute[71], some courts have held that neither the Trustee, DIP nor their

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[68] *See* RESTATEMENT (SECOND) OF TRUSTS §§ 170, 174, 183 (1957); *see also* UNIF. PRINCIPLE AND INCOME ACT § 103(b) (1997) ("[A] fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries."); RESTATEMENT (SECOND) OF AGENCY §§ 379, 387 (1959) (noting agents have duties of care, skill, and loyalty to principals). Included within these over-arching fiduciary duties are duties of good faith and full disclosure of known facts to decision-makers to enable informed voting. *See generally* David H. Cook, *The Emergence of Delaware's Good Faith Fiduciary Duty: In re Emerging Communications, Inc. Shareholders Litigation*, 43 DUQ. L. REV. 91 (2004) (discussing directors' duty of good faith and its relationship to duties of loyalty and care); Jack F. Williams, *Scrutiny of Board Conduct Intensifies Expanded Fiduciary Duties Targeted*, TMA J. OF CORP. RENEWAL, Mar. 1, 2002, http://www.turnaround.org/Publications/Articles.aspx?objectID=1142.

[69] *E.g.*, Lange v. Schropp (*In re* Brook Valley VII, Joint Venture), 496 F.3d 892, 900–01 (8th Cir. 2007) (chastising insiders who secretly acquired valuable asset from estate instead of using it for creditors); *see e.g.*, Bezanson v. Thomas (*In re* R&R Assocs. of Hampton), 402 F.3d 257, 266 (1st Cir. 2005) (discussing undisclosed asset transfers from partnership estate to partners); *In re* WBE Co., Inc., No. BK06-80006, 2007 Bankr. LEXIS 4250, *9–10 (Bankr. D. Neb. Dec. 19, 2007) (diverting business improperly to related company); *In re* Bush Indus., Inc., 315 B.R. 292, 305–06 (Bankr. W.D.N.Y. 2004) (transferring value in excess of fair consideration to an insider through a "golden parachute" or debt forgiveness); *In re* Simon Transp. Servs., Inc., 292 B.R. 207, 218 (Bankr. D. Utah 2003) (repining that DIP omissions gave insiders competitive advantage in section 363 sale); *In re* V Cos., 274 B.R. 721, 739 (Bankr. N.D. Ohio 2002) (misappropriating business to related company); *In re* Hampton Hotel Investors, LP, 270 B.R. 346, 353–62 (Bankr. S.D.N.Y. 2001) (disapproving of failure to collect receivables from partners' affiliate and collusive agreement on asset sales); *In re* Honey Creek Entm't, Inc., 246 B.R. 671, 692 (Bankr. E.D. Okla. 2000) (criticizing unauthorized transfers to non-debtor companies controlled by DIP management); *In re* Performance Nutrition, Inc., 239 B.R. 93, 111–12 (Bankr. N.D. Tex. 1999) (admonishing that officer's self-interest took priority over debtor corporation's interests in sale of assets); *see also* Tenn.-Fla. Partners v. First Union Nat'l Bank of Fla., 229 B.R. 720, 736 (W.D. Tenn. 1999) (rebuking insider's hidden interest in entity acquiring estate property at below-market value); *In re* Gen. Homes Corp., 199 B.R. 148, 151 (S.D. Tex. 1996) (categorizing as improper self-dealing actions of directors who substantially increased their own compensation just before order for relief); *In re* 239 Worth Ave. Corp., 236 B.R. 492, 495 (Bankr. S.D. Fla. 1999) (decrying use of estate assets for personal expenses in disregard of creditors' interests); *In re* Colby Const. Corp., 51 B.R. 113, 116 (Bankr. S.D.N.Y. 1985) (breaching fiduciary duties through undocumented loans to insiders).

[70] *See In re* Schipper, 109 B.R. 832, 835–36 (Bankr. N.D. Ill. 1989) (collecting cases), *aff'd*, 933 F.2d 513 (7th Cir. 1991); *see also In re* Wilde Horse Enters., Inc., 136 B.R. 830, 842 (Bankr. C.D. Cal. 1991) (positing interested debtor asset sale might not violate fiduciary loyalty duty where full disclosure was provided).

[71] 18 U.S.C. § 154 (2000) (providing any "custodian, trustee, marshal, or other officer of the court" knowingly involved with an estate property purchase "shall be fined . . . and shall forfeit . . . office").

professionals (nor the professionals' employees) may directly or indirectly acquire estate assets, even at an auction.[72]
(2) The DIP may not improperly favor the debtor's management in a reorganization plan.[73]

Duty of care[74]
(1) The DIP must obey Code restrictions and court orders.[75]
(2) The DIP must protect and maximize the return on estate assets.[76] The duty to maximize estate assets has been held to

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[72] *See, e.g.*, Karbach Enters. v. Exennium, Inc. (*In re* Exennium Inc.), 23 B.R. 782, 786–88 (B.A.P. 9th Cir. 1982) (barring former DIP counsel from purchasing lease from trustee after conversion), *rev'd on other grounds*, 715 F.2d 1401 (9th Cir. 1993); *In re* Crestview Funeral Home, Inc., 287 B.R. 832, 837–39 (Bankr. D.N.M. 2002) (disgorging auctioneer's fees since he and his contract employees bought property at auction); *In re* Allied Gaming Mgmt., Inc., 209 B.R. 201, 203 (Bankr. W.D. La. 1997) (asserting estate accountant cannot participate in ownership of company acquiring debtor under plan); *In re* Sauer, 191 B.R. 402, 411 (Bankr. D. Neb. 1995) (admonishing DIP counsel for purchase of house after creditor foreclosed); *In re* Rahe, 178 B.R. 801, 802 (Bankr. D. Neb. 1995) (labeling as unethical and criminal trustee's counsel's purchase of estate property); *In re* QPS, Inc., 99 B.R. 843, 844–45 (Bankr. W.D. Tenn. 1989) (prohibiting DIP's accountant from buying estate car). *But see* Lange v. Schropp (*In re* Brook Valley IV, Joint Venture), 347 B.R. 662, 676 (B.A.P. 8th Cir. 2006) (calling debtor's purchase of property from its own bankruptcy estate permissible if done with full disclosure and oversight), *aff'd*, 496 F.3d 892, 901 (8th Cir. 2007) ( "[This 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* AW Logging, Inc., 356 B.R. 506, 514 (Bankr. D. Idaho 2006) (doubting wisdom of attorney's purchasing product from DIP client but not disqualifying; court does not address statute).

[73] *See, e.g.*, *In re* Milford Conn. Assocs., LP, 389 B.R. 303, 308 (Bankr. D. Conn. 2008) (positing debtor cannot "park" property in bankruptcy to wait for market to improve; it must pursue an open and expeditious plan even if that means less for equity); *In re* Bush Indus., Inc., 315 B.R. 292, 305–06 (Bankr. W.D.N.Y. 2004) (describing plan with golden parachute and insider debt forgiveness as not in good faith); *In re* Coram Healthcare Corp., 271 B.R. 228, 239–40 (Bankr. D. Del. 2001) (deeming plan not in good faith when court could not determine that management conflicts of interest did not affect treatment of creditors).

[74] As noted in Section V, Part F, *infra*, while this is a duty of a fiduciary, it may not be a fiduciary duty. However, some "duties of care" also implicate the duty of loyalty not to favor insiders. *See, e.g.*, La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 252 n.19 (5th Cir. 1988) (allowing Creditors Committee to prosecute avoidance actions against management); *In re* IT Group Inc., No. 02-10118, 2005 WL 3050611, at *10 n.12 (D. Del. Nov. 15, 2005) (indicating that duty of care claims against insiders are, in fact, duty of loyalty claims); *In re* Engman, 395 B.R. 610, 626 (Bankr. W.D. Mich. 2008) (noting insider trading implicates fiduciary duties of both loyalty and care); *In re* Hampton Hotel Investors, LP, 270 B.R. 346, 353 (Bankr. S.D.N.Y. 2001) (holding failure to collect receivables from affiliate constitutes breach of fiduciary duty).

[75] *See, e.g.*, Thompson v. Margen (*In re* McConville), 110 F.3d 47, 49–50 (9th Cir. 1997) (finding breach of fiduciary duty where debtor obtained post-petition secured financing without section 364 court authorization); *In re* Count Liberty, LLC, 370 B.R. 259, 279 (Bankr. C.D. Cal. 2007) (addressing expending of funds in violation of court orders); *In re* Four Seasons Marine & Cycle, Inc., 263 B.R. 764, 772 (Bankr. E.D. Tex. 2001) (holding cash collateral accounting failure violated Bankruptcy Code); *In re* Honey Creek Entm't, Inc., 246 B.R. 671, 689–92 (Bankr. E.D. Okla. 2000) (rejecting post-petition non-ordinary course transfers without court authorization); *In re* 239 Worth Ave. Corp., 236 B.R. 492, 495 (Bankr. S.D. Fla. 1999) (criticizing payment of pre-petition debt and obtaining post-petition financing without court orders).

[76] *See* Bezanson v. Thomas (*In re* R&R Assocs. of Hampton), 402 F.3d 257, 266 (1st Cir. 2005) (acknowledging duty to pursue partners for estate contribution); United States v. Aldrich (*In re* Rigden), 795 F.2d 727, 733 (9th Cir. 1986) (including preservation of estate's value among trustee's duties); *In re* James River Assocs., 156 B.R. 494, 498 (E.D. Va. 1993) (asserting existence of fiduciary duty to preserve value of estate by collecting rent due); *In re* Coserv, LLC, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) (stating duties

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).[77] The DIP is obliged not to dissipate assets by negligently (or deliberately) operating in a Chapter 11 when it is evident that no reorganization can succeed.[78]

(3) The DIP must comply on a complete and timely basis with financial reporting, recordkeeping, and disclosure requirements.[79]

(4) The 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.[80]

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to protect and preserve estate should also be taken into account in determining whether to seek court authorization for early payment of critical vendors).

[77] *See* Canadian Pac. Forest Prods., Ltd. v. J.D. Irving, Ltd. (*In re* Gibson Group), 66 F.3d 1436, 1441 (6th Cir. 1995) (deeming DIP's refusal to pursue viable avoidance action unjustified); La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 246 (5th Cir. 1988) (indicating DIP had duty to bring action against corporate officers and directors for gross negligence, breach of fiduciary duty, or mismanagement where such action would maximize estate value); *In re* G-I Holdings, Inc., 313 B.R. 612, 643 (Bankr. D.N.J. 2004) (granting Creditors Committee leave to challenge DIP's unjustified refusal to file fraudulent transfer action); *In re* Granite Sheet Metal Works, Inc., 159 B.R. 840, 848 (Bankr. S.D. Ill. 1993) (concluding failure to investigate questionable conveyance of assets in connection with stock redemption transaction was dereliction of DIP's duties); *In re* Microwave Prods. of Am., Inc., 102 B.R. 666, 673–76 (Bankr. W.D. Tenn. 1989) (granting extraordinary remedy of appointing trustee after consideration of DIP's failure to take action that would, if successful, substantially benefit estate).

[78] *See, e.g.*, Andrews & Kurth, LLP v. Family Snacks, Inc. (*In re* Pro-Snax Distribs., Inc.), 157 F.3d 414, 426 (5th Cir. 1998) (finding counsel should have known from outset that any plan would fail); *In re* Universal Factoring Co., Inc., 329 B.R. 62, 84 (Bankr. N.D. Okla. 2005) (asserting 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, 540 (Bankr. D. Mont. 2000) (finding professionals knew early on that reorganization was not feasible).

[79] *See In re* Scott, 172 F.3d 959, 967 (7th Cir. 1999) (discussing 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, 1228–29 (3d Cir. 1989) (finding DIP's failure to keep proper financial records or close pre-petition books justified assignment of trustee); *In re* Milford Conn. Assocs., LP, 389 B.R. 303, 308 (Bankr. D. Conn. 2008) ("Debtor has seriously neglected its reporting and other administrative responsibilities as a Chapter 11 debtor-in-possession."); *In re* Phoenix Petroleum Co., 278 B.R. 385, 405 (Bankr. E.D. Pa. 2001) (indicating disclosure statement accompanying plan should reflect DIP's fiduciary duty to actively investigate and disclose all estate assets); *In re* Modern Office Supply, Inc., 28 B.R. 943, 944–45 (Bankr. W.D. Okla. 1983) (explaining DIP has pervasive reporting and disclosure duties).

[80] *See, e.g.*, *In re* Cont'l Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) (noting DIP needs court approval for transactions outside ordinary course of business); Comm. of Equity Security Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983) (asserting that mere appeasement of creditors was not sufficient justification for transactions outside ordinary course); Walter v. Sunwest Bank (*In re* Walter), 83 B.R. 14, 19 (B.A.P. 9th Cir. 1988) (requiring business justification for non-ordinary-course transactions in order for trustee to satisfy fiduciary duty to debtor, creditors, and equity holders); *In re* Office Prods. of Am., Inc., 136 B.R. 983, 987 (Bankr. W.D. Tex. 1992) (noting DIP has duties of trustee when acting for creditors' benefit).

(5) The DIP must accurately document post-petition transfers—which must be legitimate, authorized transfers, especially if the transferred assets are collateral of a creditor.[81]

Duty of impartiality

(1) The DIP is obliged to treat all constituents "fairly"[82] and resolve conflicts among them. The DIP cannot advocate the perspective of equity alone, with a creditors-be-damned attitude.[83] Likewise, courts have cautioned that the interests of equity must not be overlooked in focusing on the interests of creditors.[84]

(2) Particular creditors must not be favored to the detriment of others.[85]

(3) When there are different factions of equity holders, the DIP must refrain from taking part in disputes and advance the best interest of the corporation.[86]

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[81] *See supra* cases cited at note 53; *see also In re* Gregory, 214 B.R. 570, 573 (S.D. Tex. 1997) (finding debtor's use of net proceeds from DIP account for unauthorized purchases was in violation of bankruptcy court orders); *In re* Count Liberty, LLC, 370 B.R. 259, 276 (Bankr. C.D. Cal. 2007) ("Corporate officers, as fiduciaries, must protect and preserve estate assets held in trust for the benefit of creditors."); *In re* Texasoil Enters., Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (discussing DIP counsel's duty to guide DIP in managing post-petition estate); *In re* Centennial Textiles, Inc., 227 B.R. 606, 612 (Bankr. S.D.N.Y. 1998) (explaining that paying higher prices to a vendor post-petition to reduce pre-petition debt results in unauthorized post-petition transfers and a violation of DIP management's duties to all creditors).

[82] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355–56 (1985) (stating DIP has obligation to treat all interested parties fairly); Pepper v. Litton, 308 U.S. 295, 306 (1939) (explaining fiduciary obligations in bankruptcy to protect interests of both corporation creditors and stockholders); *In re* Bellevue Place Assocs., 171 B.R. 615, 624 (Bankr. N.D. Ill. 1994) (indicating DIP cannot surrender control over decisions to single creditor, but must be fair to all).

[83] *See* Andrew v. Coopersmith (*In re* Downtown Inv. Club III), 89 B.R. 59, 65 (B.A.P. 9th Cir. 1988) (voiding order modifying chapter 11 plan because no notice of hearing was given to unsecured creditor); *In re* Marathon Home Loans, 101 B.R. 216, 220 (Bankr. E.D. Cal. 1989) (questioning trustee's motives for removal since DIP alleged no funds would remain for unsecured creditors if case was removed); *In re* Kendavis Indus. Int'l, Inc., 91 B.R. 742, 762 (Bankr. N.D. Tex. 1988) (concluding DIP counsel had conflict of interest, failed to disclose fees, and provided services of only dubious benefit to estates).

[84] *See In re* Cent. Ice Cream Co., 836 F.2d 1068, 1072 (7th Cir. 1987) (finding although both creditors and shareholders had entitlements, DIP wrongfully gave preference to creditor's rights); *In re Lionel*, 722 F.2d at 1071–72 (holding creditors' insistence upon sale was not adequate reason for approval, and proof offered by Equity Committee to buttress opposition to sale was adequate); *In re* Bush Indus. Inc., 315 B.R. 292, 306 (Bankr. W.D.N.Y. 2004) (denying confirmation of debtor's improperly pro-creditor chapter 11 plan based upon objection of Equity-holders' Committee); *In re* Water's Edge Ltd. P'ship, 251 B.R. 1, 7 (Bankr. D. Mass. 2000) (examining how debtor may confirm plan even if certain classes of creditors object); *In re* Philadelphia Athletic Club, Inc., 15 B.R. 60, 63 (Bankr. E.D. Pa. 1981) (finding appointment of trustee was in best interest of debtor's equity security holders and all other parties involved).

[85] *See In re* Big Rivers Elec. Corp., 233 B.R. 768, 785–87 (Bankr. W.D. Ky. 1999) (holding "no shop" clause in a sale or lease agreement violated DIP's fiduciary duties by preventing it from maximizing estate's value), *aff'd*, 355 F.3d 415 (6th Cir. 2004); *In re* Harp, 166 B.R. 740, 747 (Bankr. N.D. Ala. 1993) ("[T]he debtor in possession has a fiduciary duty to act *not in its own best interest, but rather in the best interest of the entire estate, including secured and unsecured creditors*."); *In re* Roblin Indus., Inc., 52 B.R. 241, 243 (Bankr. W.D.N.Y. 1985) (disapproving of waiver of all claims against a proposed DIP lender, without sufficient investigation).

> (4) The DIP must draft plan provisions that balance the interests of different parties fairly, but within the structure of the Bankruptcy Code.[87]

When the DIP is an entity, it obviously acts through people. Failure to comply with these duties, including cash collateral and other Code restrictions, may result in liability of the DIP's officers.[88]

*B. The DIP is also a Debtor*

The DIP is not only a fiduciary. A DIP "wears two hats," particularly in the context of a reorganization plan.[89] A debtor and DIP are one and the same in a chapter 11 case, as long as no trustee has been appointed.[90] Congress did not

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[86] *See, e.g.*, *In re* Entm't, Inc., 225 B.R. 412, 423 (Bankr. N.D. Ill. 1998) (forbidding DIP to pursue plan for one faction against competing faction's plan); *see also* Metro-Goldwyn-Mayer v. Tracinda Corp., 43 Cal. Rptr. 2d 327, 333 (Cal. App. 2d Dist. 1995) ("Corporate counsel should of course, refrain from taking part in any controversies or factional differences among shareholders as to control of the corporation, so that he or she can advise the corporation without bias or prejudice."); Goldstein v. Lees, 120 Cal. Rptr. 253, 258 (Cal. App. 2d Dist. 1975) (noting corporate counsel must remain nonbiased in disagreement between shareholders).

[87] *See* Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1213 (9th Cir. 1994) (acknowledging DIP has affirmative duty to set forth plan meeting requirements of Bankruptcy Code); Casco N. Bank, N.A. v. DN Assocs. (*In re* DN Assocs.), 3 F.3d 512, 516 (1st Cir. 1993) (categorizing plan as appropriately balancing competing interests); Humble Place Joint Venture v. Fory (*In re* Humble Place Joint Venture), 936 F.2d 814, 818–19 (5th Cir. 1991) (disgorging fees due to bad faith filing; bad faith was evidenced by plan gratuitously relieving insiders of guarantee obligations); Jorgensen v. Fed. Land Bank of Spokane (*In re* Jorgensen), 66 B.R. 104, 109 (B.A.P. 9th Cir. 1986) (interpreting requirement plan be made in good faith); *In re* Gen. Homes Corp., 199 B.R. 148, 151 (S.D. Tex. 1996) (criticizing plan allowing insiders to profit at expense of debenture holders); *In re Bush Indus.*, Inc., 315 B.R. at 295 ("The bankruptcy process allows no room for self-dealing by officers and directors of a publicly traded enterprise."); *In re* Microwave Prods. of Am., Inc., 102 B.R. 666, 676 (Bankr. W.D. Tenn. 1989) (granting motion to appoint disinterested trustee due to debtor's failure adequately to balance competing interests).

[88] *See In re* Four Seasons Marine & Cycle, Inc., 263 B.R. 764, 771 (Bankr. E.D. Tex. 2001) (determining section 105(a) "authorizes [the] court to enforce the cash collateral restrictions of the Code by issuing a monetary assessment against . . . former corporate officers"); *In re* Nelco, Ltd., 264 B.R. 790, 812 (Bankr. E.D. Va. 1999) ("An officer or director of the [DIP] may be held personally liable for the losses suffered by the debtor when the officer acts willfully and deliberately, disregarding the estate's best interest"); *In re* Adams Labs., Inc., 3 B.R. 495, 497 (Bankr. E.D. Va. 1980) (noting officers of corporations "occupy a fiduciary relationship to the corporation" and are "often denominated a trustee . . . [and are therefore] held accountable in equity as such").

[89] *See In re Water's Edge*, 251 B.R. at 6–7 (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"); *see also* Internal Revenue Serv. v. Energy Res. Co., Inc. (*In re* Energy Res. Co., Inc.), 871 F.2d 223, 229 (1st Cir. 1989) (addressing DIP's dual roles in tax liability context).

[90] 11 U.S.C. § 1101(1) (2006) ("'[D]ebtor in possession' means debtor except when [a trustee is appointed]."); *see, e.g.*, *In re* Dieckhaus Stationers of King of Prussia, Inc., 73 B.R. 969, 971 (Bankr. E.D. Pa. 1987) (reading plain language of section 1101(1) to assert "debtor is still a debtor in possession" when no trustee is appointed in chapter 11 case). *But see In re* Winom Tool and Die, Inc., 173 B.R. 613, 624 (Bankr.

require the DIP or its constituents to be disinterested, unlike a trustee, and the structure of the Bankruptcy Code provides an adversary system with the means for competing creditors' interests to be protected by their own counsel, the Creditors Committee and the U.S. Trustee.

The chapter 11 debtor acquires rights and assumes most responsibilities of a trustee,[91] and most Code provisions applicable to a DIP simply refer to a trustee. In the context of a preparation of bankruptcy schedules and a plan, however, the Bankruptcy Code does not use the term "trustee" at all, and refers instead to the "debtor" or "plan proponent."[92] The Code sets forth disclosure requirements in section 1125, but imposes no fiduciary obligations in plan negotiations with creditors to disclose the maximum that equity interests might pay or to subordinate equity desires to creditor best interests.[93] If creditors disagree with the debtor's plan proposal, the debtor can place its interest ahead of creditors and force its plan over creditor objections by meeting "cramdown" standards.[94] Courts have held that 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.[95]

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E.D. Mich. 1994) (positing there "is no sound basis for inferring that the debtor's identity is completely merged into that of the debtor in possession").

[91] 11 U.S.C. § 1106 (2006) (enumerating duties of trustee); 11 U.S.C. § 1107 (2006) ("[D]ebtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under [chapter 11]."); *see* Wolf v. Weinstein, 372 U.S. 633, 649 (1962) (likening DIP concept to "a 'receivership without a receiver'"); *see also In re* Bame, 251 B.R. 367, 373 (Bankr. D. Minn. 2000) ("The DIP is a fiduciary for the bankruptcy estate and assumes virtually all of the rights and responsibilities of a bankruptcy trustee.").

[92] 11 U.S.C. §§ 521, 1106, 1121, 1127, 1129, 1142, 1144 (2006) (referring to DIP as "plan proponent" or "debtor" but not "trustee"); *see In re Water's Edge*, 251 B.R. at 7 (suggesting Code's drafters chose this particular language intentionally).

[93] *See In re Water's Edge*, 251 B.R. at 7; *see In re* Radco Props., Inc., 402 B.R. 666, 682 (Bankr. E.D.N.C. 2009) (emphasizing disclosure statement should be clear, and "adequate information was vaguely defined by Congress" so bankruptcy courts can view circumstances on case-by-case basis); *see also In re* PC Liquidation Corp., 383 B.R. 856, 865 (E.D.N.Y. 2008) ("A Chapter 11 disclosure statement must contain 'adequate information,' as that term is defined in section 1125(a)(1) of the Code, in order to be approved by the bankruptcy court.").

[94] *See* 11 U.S.C. § 1129(b) (stating court shall confirm plan even if creditors disagree with debtor's plan proposal if "plan does not discriminate un-fairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan"); *In re Water's Edge*, 251 B.R. at 7 ("A debtor may, as here, confirm a plan over the objection of a class of creditors if the plan gains the acceptance of at least one class of impaired claims and satisfies the other requirements for a so-called 'cramdown' plan."); *see also In re* DN Assocs., 144 B.R. 195, 200 n.22 (Bankr. D. Me. 1992) ("The cram down provisions of the Code are an expression of congressional intent regarding the importance of reorganization values even in the face of considerable creditor opposition, provided those creditors' interests are appropriately protected.").

[95] *See, e.g.*, Manville Corp. v. Equity Sec. Holders Comm. (*In re* Johns-Manville Corp.), 801 F.2d 60, 66–67 (2d Cir. 1986); *see In re* Cent. Ice Cream Co., 836 F.2d 1068, 1073 (7th Cir. 1987) (allowing shareholders to pursue compromise of litigation without approval from trustee when trustee fails to "adequately represent" interests of the shareholders); *In re Water's Edge* 251 B.R. at 7 (listing ability to confirm plan over objections of class of creditors among rights of debtor); *In re* Rancourt, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (finding no conflict when negotiating plan providing value for equity if there is full disclosure of divergence in interests).

In a sale context, as long as bankruptcy rules, orders and procedures for asset sales are met in full, some courts have held that a DIP can sell to an insider of the debtor, even though a trustee might not be able to do so.[96] Sales to insiders are not bad faith *per se*, so that with full disclosure, the watchful eyes of creditors and the court can ensure that transactions are in good faith, and the prices are reasonable.[97]

In an individual chapter 11 case, DIP rights to place personal interests ahead of creditor interests are particularly stark. The individual debtor needs money for groceries and other living expenses; his income is nonetheless property of the estate.[98] If the debtor's proposed retention of post-confirmation income or even exempt property under a plan is deemed too rich, and not "close to the best offer of payment to creditors," his plan may be deemed in bad faith.[99]

### *C. Creditors Committee Members Balance Fiduciary Duties and Self-Interest*

Committees have fiduciary duties to the constituent creditors or equity they represent.[100] They are not fiduciaries for the debtor or the bankruptcy estate in

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[96] *See, e.g.*, Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 516 (7th Cir. 1991) (refusing to extend more exacting fiduciary duties of trustees to DIPs); *see also* RESTATEMENT (SECOND) TRUSTS § 170(2), 173 (1959) (explaining trustee's duty to surrender complete and accurate information regarding trust property upon beneficiary's request).

[97] *See* 11 U.S.C. § 363(m) (2006) (allowing courts to void sales not completed in good faith); *In re Schipper*, 933 F.2d at 516 (positing even sales that "at first blush . . . smack of fraud" can be approved by court upon inspection of surrounding circumstances); Gekas v. Pipin (*In re* Met-L-Wood Corp.), 861 F.2d 1012, 1018 (7th Cir. 1988) (explaining even though appeal of sale for lack of notice or hearing is moot, court can overturn sale upon finding of fraud).

[98] *See* 11 U.S.C. § 1115 (a)(2) (2006) (changing pre-BAPCPA law); *see also In re Rancourt*, 207 B.R. at 358 ("It is natural that an individual as debtor will seek to negotiate a plan that provides for as much value down to his equity position as is possible—preferably on a consensual basis with the creditors who have claims superior to his equity position."); *In re* Harp, 166 B.R. 740, 746–47 (Bankr. N.D. Ala. 1993) (discussing "special burden on debtors such as the Harps to ensure that the resources that flow through the debtor-in-possession's hands are used to benefit the unsecured creditors and other parties in interest").

[99] *See, e.g.*, *In re* Harman, 141 B.R. 878, 889 (Bankr. E.D. Pa. 1992); *see In re* Henderson, 321 B.R. 550, 560 (Bankr. M.D. Fla. 2005) (explaining creditors' right to block plan proposed by debtor if it attempts to "abuse the system" by failing to comply with section 1129(a)); *In re* Weber, 209 B.R. 793, 798–99 (Bankr. D. Mass. 1997) (explaining relevance of even non-estate property to good faith determinations); *In re* Kemp, 134 B.R. 413, 414–15 (Bankr. E.D. Cal. 1991) (citing decisions holding there must be "reasonable likelihood" plan would achieve result in harmony with purposes of Bankruptcy Code in order to be considered in good faith); *see also* 11 U.S.C. §§ 1123(a), 1129(a)(15) (2006) (importing variant of chapter 13 disposable income test into chapter 11).

[100] *See, e.g.*, *In re* Dow Corning Corp., 212 B.R. 258, 261 (E.D. Mich. 1997), *aff'd*, 255 B.R. 445 (E.D. Mich. 2000); *In re* Gadzooks, Inc., 352 B.R. 796, 811–12 (Bankr. N.D. Tex. 2006); *In re* Refco, Inc., 336 B.R. 187, 195 (Bankr. S.D.N.Y. 2006); *In re* Artra Group, Inc., 308 B.R. 851, 857 (Bankr. N.D. Ill. 2003); *In re* Spiegel, 292 B.R. 748, 751 (Bankr. S.D.N.Y. 2003); *see also, e.g.*, Locks v. U.S. Tr., 157 B.R. 89, 93 (W.D. Pa. 1993); *In re* Venturelink Holdings, 299 B.R. 420, 423 (Bankr. N.D. Tex. 2003) (citing cases holding Committee members must be removed from Committee in event conflict of interest rises to breach of fiduciary duty to creditor constituency); *In re* Fas Mart Convenience Stores, 265 B.R. 427, 432 (Bankr. E.D. Va. 2001) (including "undivided loyalty" and "impartial service" to creditors among fiduciary duties of Committee members); *In re* Pierce, 237 B.R. 748, 758 (Bankr. E.D. Cal. 1999) (quoting and adopting *In re Fas Mart*'s *Convenience Stores* language explaining fiduciary duties of Committee members); *In re* Granite Partners, LP, 210 B.R. 508, 516 (Bankr. S.D.N.Y. 1997) (clarifying Committee does not owe duty to any *specific* creditor or

general.[101] Committees do not owe duties to particular creditors, and may take action adverse to specific constituent creditors.[102]

Committee fiduciary duties have been discussed in reported cases as follows:

> Duty of loyalty
> (1) Like a DIP, Committee members' duty of loyalty entails impartial service without conflicts of interest.[103]
> (2) Committee members may not take advantage of their Committee membership to further their self-interest at the expense of their constituency.[104]
>
> Duty of care
> (1) The Committee's determinations must be arrived at honestly and with care to be accurate.[105]

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any party other than *entire class* of creditors); *In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991) (stating Committee member's fiduciary duty cannot be altered or overridden by interests of other parties); *In re Johns-Manville Corp.*, 26 B.R. at 924–25 (concluding expansive, crucial duties of Committee toward creditors mandates members have "undivided loyalty and allegiance to constituents").

[101] *See* Unsecured Creditors Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1315–16 (1st Cir. 1993) (indicating duty runs to constituents, not entire estate); *In re* TSIC, Inc., 393 B.R. 71, 78 (Bankr. D. Del. 2008) (emphasizing Committee's fiduciary duties do not extend past constituent creditors to debtors or estate generally); *In re* Life Serv. Sys., Inc., 279 B.R. 504, 510 (Bankr. W.D. Pa. 2002) (Committee is partisan adversary of debtor, not impartial arbitrator between debtor and creditors), *aff'd*, Westmoreland Human Opportunities., Inc. v. Walsh, 327 B.R. 561, 578 (W.D. Pa. 2005).

[102] *See In re Dow Corning*, 255 B.R. at 485 (stating fiduciary duty extends to class as whole, not individual members); *In re Granite Partners*, 210 B.R. at 516 (noting Committee members "do not . . . owe a fiduciary duty to any particular creditor"); *In re* Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 722 (Bankr. S.D.N.Y. 1992) ("The [fiduciary] duty extends to the class as a whole, not to its individual members.").

[103] *See* Woods v. City Nat'l Bank & Trust Co. of Chicago, 312 U.S. 262, 268–69 (1941); *Locks*, 157 B.R. at 94 (analyzing attorney member of Committee's conflict in representing non-constituent with interests adverse to Committee); *In re* Venturelink Holdings, Inc., 299 B.R. 420, 423 (Bankr. N.D. Tex. 2003) (noting conflict of interest that amounts to breach of fiduciary duty to constituent creditors requires Committee member disqualification; allegations of member breach of fiduciary duties to debtor created disqualifying conflict); *In re Fas Mart Convenience Stores*, 265 B.R. at 432 (indicating Committee member's pursuit of secured creditor status is disqualifying conflict).

[104] *See* Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561, 572 (W.D. Pa. 2005) (finding Committee member's self-serving actions adversely affected estate property to detriment of constituent creditors) *affirming In re* Life Serv. Sys., Inc., 279 B.R. 504 (Bankr. W.D. Pa. 2002); *In re Refco*, 336 B.R. at 196 (indicating Committee members have fiduciary duty not to profit from non-public information obtained as result of Committee membership); *In re* Spiegel, 292 B.R. 748, 750–51 (Bankr. S.D.N.Y. 2003) (noting potential "appearance of impropriety" in allowing Committee members to trade in the securities of the Debtor regardless of screening mechanism); *In re* Rickel & Assocs., Inc., 272 B.R. 74, 101 (Bankr. S.D.N.Y. 2002) (holding Committee member's misrepresentation and monopolization of negotiations amounted to improper pursuit of personal interest to detriment of other creditors); *In re Johns-Manville Corp.*, 26 B.R. at 926 (finding attorney misused fiduciary capacity as Committee member to further interest of client); *In re* Nat'l Equip. & Mold Corp., 33 B.R. 574, 575–76 (Bankr. N.D. Ohio 1983) (asserting Committee cannot be used to promote individual creditor's interest).

[105] *See In re* Gen. Homes Corp., 181 B.R. 870, 882 (Bankr. S.D. Tex. 1994) ("The fiduciary duty that exists between the members of the Unsecured Creditors Committee and the other unsecured creditors includes the duty to act in good faith and to insure to the greatest extent possible its actions are based on 'accurate and correct' information."); *In re* Tucker Freight Lines, Inc., 62 B.R. 213, 216 (Bankr. W.D. Mich.

(2) The Committee has a duty to maximize value for constituent creditors.[106]
(3) A Committee needs to engage experts when necessary to accomplish its responsibilities competently.[107]
(4) Committee members must comply with the requirements of the Bankruptcy Code and court orders, and not act outside the scope of their authority.[108]
(5) Committee members must preserve the confidentiality of information obtained in Committee service, while meeting obligations to communicate with Committee constituents.[109]

Duty of impartiality
(1) The Committee should not represent or advocate for individual constituents of the Committee vis-à-vis each other.[110]
(2) The Committee is to protect the rights of minority as well as majority creditors.[111]

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1986) ("At a minimum, this fiduciary duty requires that the Committee's determinations must be honestly arrived at, and, to the greatest degree possible, also accurate and correct.").

[106] *See, e.g.*, Motorola v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating, LLC), 478 F.3d 452, 466 (2d Cir. 2007) (remanding to determine whether plan provision met fiduciary duty to maximize recovery of estate's assets); *see In re* Nationwide Sports Distribs., Inc., 227 B.R. 455, 463 (Bankr. E.D. Pa. 1998) ("In general, the purpose of such Committees is to represent the interests of unsecured creditors and to strive to maximize the bankruptcy dividend paid to that class of creditors."); *In re* Haskell-Dawes, Inc., 188 B.R. 515, 519 (Bankr. E.D. Pa. 1995) ("The creditors' [C]ommittee is responsible for representing the interests of its constituents and maximizing their recovery.").

[107] *See In re* Mesta Mach. Co., 67 B.R. 151, 163–64 (Bankr. W.D. Pa. 1986).

[108] *See* Luedke v. Delta Air Lines, Inc., 159 B.R. 385, 392–93 (S.D.N.Y. 1993); *see also In re Mesta Mach Corp.*, 67 B.R. at 166 (denying fees where Committee members and counsel compensated themselves without complying with court requirements); *In re Tucker Freight*, 62 B.R. at 217–18 (finding tortious acts of Creditors Committee members were not within scope of authority for purposes of determining whether members were immune from liability).

[109] *See In re Refco*, 336 B.R. at 196–97 (indicating 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, and maintaining confidentiality is necessary to preserve Committee's attorney-client privilege); *see also In re* Swolsky, 55 B.R. 144, 146 (Bankr. N.D. Ohio 1985) (disqualifying Committee member due to confidentiality risks from spouse's insider status); *In re* Daig Corp., 17 B.R. 41, 42 (Bankr. D. Minn. 1981) (concluding insider relationship of potential member would imperil confidentiality of Committee communications).

[110] *See In re* Cont'l Airlines, Inc., 57 B.R. 839, 841 (Bankr. S.D. Tex. 1985); *see also* Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein, PC 42 B.R. 960, 963–64 (E.D. Pa. 1984) (explaining interests of individual creditors are often adverse and stressing Committee cannot maximize individual creditors' interests but must distribute funds in compliance with law); *In re* Realty Assocs. Sec. Corp., 56 F. Supp. 1008, 1009 (E.D.N.Y 1944) (indicating Creditors Committee owes allegiance and loyalty to everyone it represents and must act in every creditor's interest).

[111] *See* Bohack Corp. v. Gulf & W. Indus., Inc. (*In re* Bohack Corp.), 607 F.2d 258, 262 n.4 (2d Cir. 1979) (requiring Committee to safeguard minority and majority creditors because Committee owes fiduciary duty to both); *see also Pension Benefit Guar. Corp*., 42 B.R. at 963 (asserting Committee's function is to advise creditors of rights and to fairly represent entire class); *In re* Spiegel, 292 B.R. 748, 750 (Bankr. S.D.N.Y. 2003) (indicating Committee represents and stands as fiduciary to entire class of creditors).

Committee members are also creditors (or equity holders). They are entitled to take action in their own self-interest while meeting fiduciary duties, like the DIP.[112] However, when they use their Committee status and take advantage of business opportunities or inside information learned as a Committee member, they must comply with fiduciary duties and fully and accurately disclose proposed transactions and show their fairness to the estate.[113] Some courts have even allowed 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 requested activity, including with respect to screening confidential information obtained as a Committee member.[114]

## III. LAWYER DUTIES IN EVERY CASE TO CLIENTS AND COURTS

An evaluation of the responsibilities of DIP counsel and Committee counsel starts with the duties that all lawyers owe to their clients and to courts, whatever the client's status or business.

### *A. Duties of Every Lawyer to Her Clients*

The RESTATEMENT OF THE LAW GOVERNING LAWYERS summarizes the duties of a lawyer to her client as follows:

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[112] *See In re* Fas Mart Convenience Stores, Inc., 265 B.R. 427, 432 (Bankr. E.D. Va. 2001) (noting Committee members have different viewpoints due to conflicting personal interests); *In re* Dow Corning Corp., 212 B.R. 258, 261 (Bankr. E.D. Mich. 1997) (allowing individual with personal claim to be Committee member but emphasizing law prioritizes collective interest of class), *aff'd*, 255 B.R. 445, 485 (E.D. Mich. 2000); *In re* El Paso Refinery, LP, 196 B.R. 58, 74 (Bankr. W.D. Tex. 1996) (positing that courts should not decree that whenever Committee member's business interests conflict with Committee interests, duties to Committee prevail, or Committee participation will be chilled); *In re* Seaescape Cruises, Ltd., 131 B.R. 241, 243 (Bankr. S.D. Fla. 1991) (adjudging Committee member's stay-lift motion not breach of fiduciary duty); *In re* Am. Fed'n of Television & Radio Artists, 30 B.R. 772, 775–76 (Bankr. S.D.N.Y. 1983) (indicating 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).

[113] *See* Westmoreland Human Opportunities, Inc. v. Walsh, 246 F.3d 233, 258 (3d Cir. 2001) (remanding to determine whether Committee member can be held to breach fiduciary duties in transaction not involving estate property), *on remand*, 327 B.R. 561, 70 (W.D. Pa. 2005) (finding Committee member may have fiduciary duties even with respect to property not included in estate); Farmer Bros. Co. v. Huddle Enters., Inc., 366 F.2d 143, 147–48 (9th Cir. 1966) (stating Committee member who participated in negotiating chapter XI was estopped from seeking foreclosure of his trust deed after confirmation); *In re* Rickel & Assocs., Inc., 272 B.R. 74, 100–01 (Bankr. S.D.N.Y. 2002) (recognizing cause of action for Committee member's use of inside information to advance personal interest to detriment of other creditors); *In re* Nationwide Sports Distribs., Inc., 227 B.R. 455, 463–64 (Bankr. E.D. Pa. 1998) (disapproving settlement benefitting Committee members more than other creditors); *In re* Haskell-Dawes, Inc., 188 B.R. 515, 522 (Bankr. E.D. Pa. 1995) (asserting members have duty not to use Committee position to advance own interests).

[114] *See In re Refco*, 336 B.R. at 196; *see also In re Spiegel*, 292 B.R. at 751 (expressing concerns with Committee members' trading even if information-blocking procedures adopted); *In re* Federated Dep't Stores, No. 1-90-00130, 1991 WL 79143, at *1 (Bank. S.D. Ohio Mar. 7, 1991) (allowing Committee members to trade in debtor's securities, subject to applicable securities laws and screening of personnel engaged in trading from personnel involved in Committee work).

To the extent consistent with the lawyer's other legal duties and subject to the other provisions of this Restatement, a lawyer must, in matters within the scope of the representation:

> (1) proceed in a manner reasonably calculated to advance a client's lawful objectives, as defined by the client after consultation;
> (2) act with reasonable competence and diligence;
> (3) comply with obligations concerning the client's confidences and property, avoid impermissible conflicting interests, deal honestly with the client, and not employ advantages arising from the client-lawyer relationship in a manner adverse to the client; and
> (4) fulfill valid contractual obligations to the client.[115]

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 or Committee client's fiduciary duties.[116]

*B. Duties of Every Lawyer to the Court*

Counsel for the DIP and Committee owe 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.[117]

Officers of the court must comply with the court's rules and procedures, and may not assert frivolous positions.[118] Lawyers may not knowingly make a false

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[115] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (2000); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. [1] (2009) (requiring attorney dedication to client's interests); MODEL RULES OF PROF'L CONDUCT R. 1.7 (2009) (mandating attorney must provide competent information and cannot represent client if there is conflict of interest).

[116] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 cmt. d (2000); *see also* Hansen, Jones & Leta, PC v. Segal, 220 B.R. 434, 454–55 (D. Utah 1998) (noting that Bankruptcy Code does not exempt any attorney from abiding by Model Rules).

[117] *See Hansen, Jones & Leta*, 220 B.R. at 455–57 (explaining Bankruptcy Code requires additional disclosures by attorneys concerning conflicts of interest); MODEL RULES OF PROF'L CONDUCT R. 3.3 cmt. [2] (2009) (commenting that advocate has "duty of candor to the tribunal"); Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 GEO. J. LEGAL ETHICS 15, 23 (1987) [hereinafter Hazard, *Triangular Lawyer Relationships*] (stating lawyers have duty of candor as "officers of the court"); *see also In re* The Phoenix Group Corp., 305 B.R. 447, 452–53 (Bankr. N.D. Tex. 2003) (finding attorney properly refused to file documents requested by client that would violate client's and lawyer's ethical duties); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 120 (2000) (describing duties owed to court).

[118] *See* MODEL RULES OF PROF'L CONDUCT R. 3.1 (2009); *see also* FED. R. CIV. P. 11(b)(2) ("[C]laims, defenses, and other legal contentions are warranted by existing law or by a *nonfrivolous* argument for extending, modifying, or reversing existing law or for establishing new law.") (emphasis added); Hazard, *Triangular Lawyer Relationships*, *supra* note 117, at 23 (noting this is part of duty attorney owes to court, besides what attorney owes to client).

statement of material fact or law to a tribunal, or fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client.[119] Lawyers can and must take care to assure that representations to the court are accurate.[120] They must aggressively require clients to provide evidence supporting questionable positions on key issues.[121]

The standard of behavior for lawyers regarding conflicts of interest has been described using fiduciary phrasing of "the punctilio of an honor the most sensitive."[122]

## IV. LAWYER DUTIES TO A CLIENT FIDUCIARY IN BANKRUPTCY CASES

When the client is a fiduciary operating in the context of a chapter 11 bankruptcy case, including a DIP or Committee, additional duties are imposed on the lawyer to the client.

### *A. DIP Counsel Must Avoid Conflicts of Interest and Meet Statutory and Rule Disclosure Requirements*

While all lawyers must avoid conflicts of interest, the Bankruptcy Code and Rules impose heightened duties on DIP counsel not to hold or represent any interest adverse to the estate and to be disinterested.[123]

The Bankruptcy Code provides that representation of a creditor does not *per se* require disqualification of DIP counsel; an objection must be raised and the court

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[119] *See* MODEL RULES OF PROF'L CONDUCT R. 3.3 (2009); *see also* Carl A. Pierce, *Client Misconduct in the 21st Century*, 35 U. MEM. L. REV. 731, 857, 889 (2005) (stating there is "clear consensus in the states" attorneys should not assist clients with criminal or fraudulent conduct; lawyers cannot make statements of false material fact or of law to judges).

[120] *See* MODEL RULES OF PROF'L CONDUCT R. 3.3 cmt. [2] (2009); *see also In re* Count Liberty, LLC, 370 B.R. 259, 283–84 (Bankr. C.D. Cal. 2007) (discussing lawyer who represented funds were in blocked bank account without confirming); *In re* Dreiling, 233 B.R. 848, 870 (Bankr. D. Colo. 1999) (indicating lawyer is officer of court, and statements to court are "virtually made under oath").

[121] *See In re* Needham, 279 B.R. 519, 522 (Bankr. W.D. La. 2001).

[122] Parker v. Frazier (*In re* Freedom Solar Ctrs.), 776 F.2d 14, 19 (1st Cir. 1985) (quoting Meinhard v. Salmon, 164 N.E. 545, 546 (1928)); *see In re* Arlan's Dep't Stores, Inc., 615 F.2d 925, 933, 937, 943–44 (2d Cir. 1979) (citing *Meinhard v. Salmon*, 164 N.E. at 546); ASARCO, LLC v. Americas Mining Corp., 404 B.R. 150, 166 (S.D. Tex. 2009) (quoting *Meinhard v. Salmon*, 164 N.E. at 546).

[123] *See* 11 U.S.C. § 327(a) (2006) (restricting use of attorneys, accountants, appraisers, auctioneers, or other professional persons to individuals who do not hold interests adverse to estate); 11 U.S.C. § 330(a)(3) (2006) (articulating criteria for compensation of such professionals); FED. R. BANKR. P. 9014 (addressing contested matters); FED. R. BANKR. P. 9016 (applying Rule 45 FED. R. CIV. P. to cases under Bankruptcy Code); *see also* Michel v. Eagle-Picher Indus., Inc. (*In re* Eagle-Picher Indus., Inc.), 999 F.2d 969, 972 (6th Cir. 1993) (construing section 1107(b) exception narrowly and asserting DIP counsel must be disinterested like trustee counsel); *In re* Martin, 817 F.2d 175, 179 (1st Cir. 1987) (noting Bankruptcy Code defines disinterested person as one who "is not a creditor, an equity security holder, or an insider . . . ."); *In re* Lee Way Holding Co., 100 B.R. 950, 954–61 (Bankr. S.D. Ohio 1989) (concluding counsel breached fiduciary duty to legal system by failing to remove uncompromising influences that could have impeded professional judgment).

must find an actual conflict of interest.[124] The duty to prevent any conflict of interest comes particularly to the forefront in cases where DIP counsel appears to favor insider interests over those of the DIP entity.[125]

*B. Duties to Counsel and Guide the Client DIP*

Bankruptcy courts and appellate courts in bankruptcy cases repeatedly have held that lawyers for the DIP must counsel and guide the DIP to comply with the DIP's fiduciary obligations. 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.[126]

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[124] 11 U.S.C. § 327(c); *see* Tri-State Financial, LLC v. Lovald, 525 F.3d 649, 655–56 (8th Cir. 2008) (allowing attorney retained by bankruptcy trustee to collect fees despite conflict of interest vis-a-vis attorney's representation of both trustee and unsecured creditor). *But see* Snipper, Wainer & Markoff v. U.S. Tr. (*In re* Internet In a Mall), No. 98-56688, 2000 WL 472766, at *1 (9th Cir. Apr. 24, 2000) (finding conflict of interest where firm representing two major creditors sought employment as bankruptcy counsel).

[125] *See* Bezanson v. Thomas (*In re* R&R Assocs. of Hampton), 402 F.3d 257, 272 (1st Cir. 2005) (finding lawyer helped partners transfer partnership estate assets to themselves, breaching duty of loyalty to partnership client DIP); Fellheimer, Eichen & Braverman, PC v. Charter Techs., Inc., 57 F.3d 1215, 1228–29 (3d Cir. 1995) (determining lawyer abandoned fiduciary obligation to debtor corporation by advocating for its president); Humble Place Joint Venture v. Fory (*In re* Humble Place Joint Venture), 936 F.2d 814, 819 (5th Cir. 1991) (finding actual conflict of interest in representation by counsel of both insider and DIP); *In re* Downtown Inv. Club III, 89 B.R. 59, 64–65 (B.A.P. 9th Cir. 1988) (holding lawyer's representation of both debtor and partnership entity created actual conflict of interest); *In re* Bonneville Pac. Corp., 147 B.R. 803, 806–07 (Bankr. D. Utah 1992) (identifying impermissible conflict where attorney represented both DIP entity and principals thereof), *rev'd in part by* Hansen, Jones & Leta PC v. Segal, 220 B.R. 434 (D. Utah 1998); *In re* Rusty Jones, Inc., 134 B.R. 321, 343 (Bankr. N.D. Ill. 1991) (describing as "well established" that simultaneous representation of both debtor and debtor's shareholders may create conflict of interest); *In re* Golden Recipe Chicken, Inc., 109 B.R. 692, 693 (Bankr. W.D. Pa. 1990) (discussing DIP counsel's use of estate assets to secure release of shareholder's personal liability); *In re* Kendavis Indus. Int'l, Inc., 91 B.R. 742, 754 (Bankr. N.D. Tex. 1988) (indicating conflict of interest arises when lawyer begins representing debtor entity as well as principals thereof).

[126] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1984) (asserting fiduciary duty of trustee in bankruptcy runs to shareholders and creditors); Pepper v. Litton, 308 U.S. 295, 306–07 (1939) (stating claims presented by officer, director, or stockholder against will be scrutinized to determine if arms length transaction took place under fiduciary duty to corporation); Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) (reminding counsel, "his responsibility is to help lead estate on a just, speedy, inexpensive and lawful path out of bankruptcy"); Zeisler & Zeisler v. Prudential Inc. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997) (indicating in bankruptcy context, lawyer for DIP may not simply resign when client refuses lawyer's advice, but rather must inform court of DIP's derogation of responsibilities); *Hansen, Jones & Leta*, 220 B.R. at 454–55 (emphasizing DIP counsel is not only bound by Model Rules of Professional Conduct but also must possess sufficient expertise in bankruptcy to satisfy requirements of Bankruptcy Code); *In re* Cochener, 382 B.R. 311, 350 (S.D. Tex. 2007) (noting same duty to counsel debtor applies in context of chapter 7 debtor-client); *In re* Williams, 378 B.R. 811, 827 (Bankr. E.D. Mich. 2007) (denying attorney's fees for failing properly to counsel chapter 13 debtor); *In re* Count Liberty, LLC, 370 B.R. 259, 281–82 (Bankr. C.D. Cal. 2007) (remarking DIP counsel must proactively render candid advice and must not ignore matters that may adversely impact estate); *In re* St. Stephen's 350 East 116th St., 313 B.R. 161, 171 (Bankr. S.D.N.Y. 2004) (citing *In re JLM*, 210 B.R. at 25); *In re* Texasoil Enters., Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (stating DIP counsel has "an obligation to ensure debtor properly maintains estate"); *In re* Whitney Place Partners, 147 B.R. 619, 620–21 (Bankr. N.D. Ga. 1992) ("The unique circumstances which

One of the comments to Model Rule 2.1 shows this is an obligation of all attorneys:

> In general, a lawyer is not expected to give advice until asked by the client. However, *when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to a client*, duty to a client under Rule 1.4 may require that the lawyer act if the client's course of action is related to the representation . . . . A lawyer ordinarily has no duty to initiate investigation of a client's affairs or to give advice that the client has indicated is unwanted, but a lawyer may initiate advice to a client *when doing so appears to be in the client's interest*.[127]

Compliance with DIP fiduciary duties is not easy, especially given competing self-interests, and courts have accordingly held that counsel in bankruptcy cases 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.[128] The lawyer cannot make decisions for

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surround insolvency and the filing of a Chapter 11 case place the attorney for the debtor in possession in the unusual position of sometimes owing a higher duty to the estate than to his client."); *In re* Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992) (indicating DIP counsel has "duty to oversee disposition of assets of estate to assure that the rights of debtor's creditors are protected"); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (pointing out DIP counsel owes fiduciary duty to estate of debtor entity, not to debtor entity's principals); *In re* Consupak, Inc., 87 B.R. 529, 551 (Bankr. N.D. Ill. 1988) (finding violation of ethical obligations where lawyer failed to offer legal advice, client was unaware of adverse legal consequences, and advice would have been in client's best interest); *see also* MODEL RULES OF PROF'L CONDUCT R. 2.1 (2009) (stating lawyer shall exercise independent professional judgment and render candid advice); MODEL RULES OF PROF'L CONDUCT D.R. 7-101, E.C. 7-8 (1980) (stating lawyer should advise client of possible effects of decision, assist client in reaching decision, and point out factors for client to consider).

[127] MODEL RULES OF PROF'L CONDUCT R. 2.1 cmt. [5] (2009) (emphasis added).

[128] *See In re* Source Enters., Inc., No. 06-11707, 2008 Bankr. LEXIS 940, at *45 (Bankr. S.D.N.Y. Mar. 27, 2008) (stating lawyer had duty to advise debtor of fiduciary duties and that creditor control of board was putting debtor in breach of duties); *In re Count Liberty*, 370 B.R. at 281–83 (finding DIP counsel failed to ensure that DIP took appropriate steps to safeguard funds); *In re* Jones, 339 B.R. 903, 904 (Bankr. E.D. Mich. 2006) (indicating attorney cannot file chapter 13 case simply because client so instructs when feasibility is not reasonably arguable); *In re St. Stephen's*, 313 B.R. at 171–72 (deeming DIP counsel's failure adequately to supervise paralegals a breach of fiduciary duty); *In re* Nilges, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) (indicating DIP counsel must instruct debtor on appropriate conduct); *In re* The Phoenix Group Corp., 305 B.R. 447, 450–52 (Bankr. N.D. Tex. 2003) (discussing situation where DIP counsel determined that DIP as fiduciary should not pursue action and moved to withdraw, citing demand to pursue strategies firm believed were legally and/or ethically improper); *In re Texasoil*, 296 B.R. at 435 (noting that while DIP counsel may not owe duty directly to creditors, DIP counsel does have obligation to ensure debtor properly maintains estate); *In re* Berg, 268 B.R. 250, 262 (Bankr. D. Mont. 2001) (stating lawyer must inform debtor of both benefits and burdens of bankrutpcy); *In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (indicating DIP counsel's professional obligations sometimes go so far as requiring DIP counsel to report debtor's breach of fiduciary duty to others); *In re Sky Valley*, 135 B.R. at 938 (indicating it is incumbent on DIP counsel to advise other DIP professionals of their responsibilities under Code and disclosures necessary to fulfill those responsibilities); *In re Consupak*, 87 B.R. at 549 (stating attorney for trustee must take initiative to inform client of need for preventative or corrective action to comply with Bankruptcy Rules and

the client, but rather make sure the client representatives and entities holding estate funds understand and are complying with fiduciary obligations.[129] Where the client's proposed action is a borderline judgment call, courts stress the importance of disclosure to enable all parties in interest to weigh in on the acceptability of the action.[130]

### *C. Duty to Maintain Confidentiality During Representation*

One aspect of any lawyer's duty of loyalty to her client is the safeguarding of sensitive client information, with limited exceptions.[131] In bankruptcy cases, clients must be advised of Code and Rule requirements of full disclosure of extensive financial information, however.[132] If clients fail to fully and accurately disclose

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duties, there to invest estate funds in interest bearing account; broader fiduciary duty to estate to advise and counsel not met by just giving legal advice when asked).

[129] *See* MODEL RULES OF PROF'L CONDUCT R. 1.4(b) (2009) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."); *see also In re* SIDCO, Inc., 173 B.R. 194, 196–97 (E.D. Cal. 1994) (noting attorney advises DIP, who makes decisions); *In re* ABC Auto. Prods. Corp., 210 B.R. 437, 441–42 (Bankr. E.D. Pa. 1997) (asserting bankruptcy process is compromised when Committee counsel does not take direction from creditor members and effectively counsel controls Committee); *In re* Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) (remarking attorney may not make decisions for client, even if DIP is incompetent); *In re* Nephi Rubber Prods. Corp., 120 B.R. 477, 482 (Bankr. N.D. Ind. 1990) (acknowledging attorney takes direction from DIP management and board).

[130] *See In re* Rancourt, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (indicating natural desire of individual DIP to negotiate plan providing maximum value for equity does not represent conflict for DIP counsel "*provided that* full disclosure is made as to any divergence of interests in that regard that may be appropriate for the creditors and the Court itself to consider in context"); *see also* Browning Mfg. v. Mims (*In re* Coastal Plains, Inc.), 179 F.3d 197, 208 (5th Cir. 1999) (stressing importance of disclosure generally); *In re* McKain, 325 B.R. 842, 849 (Bankr. D. Neb. 2005) ("Th[e] requirement [of full disclosure by debtor] enables the trustee and creditors to rely on the information supplied by the debtors.") (quoting *In re* Peterson, 323 B.R. 512, 517 (Bankr. N.D Fla. 2005).

[131] *See* RESTATEMENT OF THE LAW: THE LAW GOVERNING LAWYERS § 16 cmt. e (2000) ("A lawyer may not use or disclose sensitive information about the client, except in appropriate circumstances . . . ."); *see also* E.F. Hutton & Co. v. Brown, 305 F. Supp. 371, 394 (S.D. Tex. 1969) (noting lawyer's ethical duty not to disclose confidences is necessary to encourage clients to disclose information to their lawyers); Brad B. Erens & Kelly M. Neff, *Confidentiality in Chapter 11*, 22 EMORY BANKR. DEV. J. 47, 77 (2005) ("Attorneys have an ethical obligation to safeguard information relating to the representation of a client.").

[132] *See* Browning Mfg. v. Mims (*In re* Coastal Plains, Inc.), 179 F.3d 197, 207–08 (5th Cir. 1999) (describing disclosure requirement for potential causes of action on schedules); *In re* McKain, 325 B.R. 842, 849–51 (Bankr. D. Neb. 2005) (discussing duty of debtor and debtor's attorney to make full disclosures on their bankruptcy schedules and statement of financial affairs); *In re* Sharp, 244 B.R. 889, 891–92 (Bankr. E.D. Mich. 2000) (emphasizing necessity of debtor's complete disclosure; collecting cases extensively); *In re* McLaren, 236 B.R. 882, 893–94, 898 (Bankr. D.N.D. 1999) (denying discharge due to falsehoods on schedules; asserting requirement of disclosure for whatever ownership interest held); *In re* Dreiling, 233 B.R. 848, 877–79 (Bankr. D. Colo. 1999) (addressing consequences of debtor's active concealment of material facts); *In re* Davila, 210 B.R. 727, 729, 733 (Bankr. S.D. Tex. 1996) (denying attorney's fees due to inaccurate disclosures in schedules on behalf of his clients). Knowingly filing false schedules also is criminal. *See* 18 U.S.C. § 152 (2006); *see also* United States v. Van Allen, 524 F.3d 814, 824–25 (7th Cir. 2008) (affirming criminal conviction for failure to disclose interest in unincorporated business); United States v. Webster, 125 F.3d 1024, 1027–28, 1036 (7th Cir. 1997) (affirming conviction for aiding and abetting false schedules); United States v. Dolan, 120 F.3d 856, 866–71 (8th Cir. 1997) (affirming conviction of attorney for conspiracy and aiding and abetting client in filing false schedules).

their assets and their use and disposition of bankruptcy estate property, inapplicability of the attorney-client privilege to client information intended for disclosure and the crime-fraud exception to the privilege mean that client communications may not be protected from disclosure.[133]

*D. Duties of Withdrawal and Withdrawal Disclosures*

Under Model Rule 1.16, a lawyer must withdraw if the representation will result in violation of the Rules of Professional Conduct or other law, unless the court orders continued representation.[134] A lawyer has the option to withdraw if (i) "the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;" (ii) "the client has used the lawyer's services to perpetrate a crime or fraud;" (iii) "the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has fundamental disagreement;" or (iv) "other good cause for withdrawal exists."[135]

Only "knowing and fraudulent" concealment of assets, misrepresentations to the court, and the like are criminal.[136] "Fraud" for purposes of the withdrawal rules means actual fraud, not constructive fraud.[137] Counsel must decide whether a

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[133] *See* United States v. White, 950 F.2d 426, 430–31 (7th Cir. 1991) (explaining there is no intent for information to be kept in confidence when it is disclosed on publicly-filed bankruptcy petition and schedules); *In re* Myers, 382 B.R. 304, 309 (Bankr. S.D. Miss. 2008) (indicating attorney-client privilege is narrowed in bankruptcy context and debtor has no expectation information will be kept confidential); *In re* Wilkerson, 393 B.R. 734, 742–43 (Bankr. D. Colo. 2007) (explaining information is not privileged when provided to complete bankruptcy schedules because there is no reasonable expectation of confidentiality; holding debtor waived privilege with respect to handwritten comments and questions on draft schedules which otherwise would have been privileged); *In re* Eddy, 304 B.R. 591, 596, 600 (Bankr. D. Mass. 2004) (concluding "the attorney-client privilege is inapplicable to communications between the Debtor and her attorneys with respect to their retention or compensation for services rendered during the pendency of [the] bankruptcy case"). *But see* United States v. Bauer, 132 F.3d 504, 509–10 (9th Cir. 1997) (recognizing *White* but holding attorney statement to client about full disclosure when preparing schedules to be privileged); *In re* Stoutamire, 201 B.R. 592, 596–97 (Bankr. S.D. Ga. 1996) (deeming intake interview questions privileged).

[134] MODEL RULES OF PROF'L CONDUCT R. 1.16(a) (2009).

[135] MODEL RULES OF PROF'L CONDUCT R. 1.16(b)(2), (3), (4), (7) (2009). Other subsections not relevant here are not quoted.

[136] 18 U.S.C. § 152 (2006) ("A person who— (1) knowingly and fraudulently conceals . . . any property belonging to the estate of a debtor . . . shall be fined under this title, imprisoned not more than 5 years, or both."); 18 U.S.C. § 153 (2006) ("A person . . . who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both."); 18 U.S.C. § 3284 (2006) ("The concealment of assets of a debtor in a case under title 11 shall be deemed to be a continuing offense until the debtor shall have been finally discharged or a discharge denied, and the period of limitations shall not begin to run until such final discharge or denial of discharge."). *See generally* Mary Jo Heston, *The United States Trustee: The Missing Link of Bankruptcy Crime Prosecutions*, 6 AM. BANKR. INST. L. REV. 359 (1998) (examining "U.S. Trustee's role in the identification, investigation, referral, and prosecution of bankruptcy-related crimes").

[137] MODEL RULES OF PROF'L CONDUCT R. 1.0(d) (2009) ("'Fraud' or 'fraudulent' denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive.").

judgment call by a client that a court might deem to breach fiduciary duties is outright "repugnant" or a matter on which counsel has a "fundamental disagreement."[138] Doubts about whether a proposed course of action "in fact serves the estate's interest" is a more lenient threshold for withdrawal than crime, fraud, repugnancy or a disagreement that is fundamental, and may not suffice to justify withdrawal.[139]

For example, a not-uncommon situation involves a client's owner desiring to cause the entity to pay a debt the owner guaranteed before filing a bankruptcy petition for the entity. A preference is not illegal, although it may be subject to avoidance. Does it violate the client's fiduciary duty to other creditors?[140] A court considering that question might look to the Bankruptcy Code and determine such an action is within the parameters of legal acceptability, and thus not a breach of fiduciary duty.[141] But it likely would not "serve the best interest" of the estate in the form of the overall creditor body. Imposing a fiduciary duty on DIP counsel to withdraw from representation in such circumstances would violate professional conduct standards.

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[138] MODEL RULES OF PROF'L CONDUCT R. 1.16(b)(4) (2009) ("[A] lawyer may withdraw from representing a client if . . . the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement."); *see, e.g.*, *In re* Engh, No. 04-00128-JW, 2007 Bankr. LEXIS 3771, at *6–7 (Bankr. D.S.C. Oct. 30, 2007) (reasoning lawyer's "fundamental disagreement" with plaintiff's proposed course of action and "deterioration" of relationship between parties permitted lawyer's withdrawal from representation); *In re* Davis, 258 B.R. 510, 513 (Bankr. D. Fla. 2001) (noting requirement for withdrawal that counsel establish "good cause, affecting the relationship between attorney and client," which includes insistence by client to pursue repugnant objective).

[139] *Compare* MODEL RULES OF PROF'L CONDUCT R. 1.16(b)(2)–(4) (2009) ("[A] lawyer may withdraw from representing a client if . . . the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent; the client has used the lawyer's services to perpetrate a crime or fraud; the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement."), *with In re* Perez, 30 F.3d 1209, 1219 (9th Cir. 1994) (acknowledging lawyer must take instructions from client if in best interest of estate and proposed action complies with Bankruptcy Code, but lawyer has independent duty to determine best interest of estate). *See generally* Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997) (reasoning counsel in bankruptcy position cannot "simply resign" if he or she disagrees with client, but "cannot pursue a course of action unless it is in the best interest of the estate"); *In re* Count Liberty, LLC, 370 B.R. 259, 283 (Bankr. C.D. Cal. 2007) ("If the attorney and client disagree, counsel must refrain from filing bad faith or frivolous pleading and ultimately withdraw if the high standard for withdrawal is met.").

[140] *See* Bruce A. Markell, *The Folly of Representing Insolvent Corporations: Examining Lawyer Liability and Ethical Issues Involved in Extending Fiduciary Duties to Creditors*, 6 J. BANKR. L. & PRAC. 403, 426–27 (1997) (suggesting lawyer may be in difficult situation where client prefers to pay debts which he or she personally guaranteed before others); *see also* Appleton v. Turnbull, 24 A. 592, 592 (Me. 1891) (stating bankruptcy policy is to pay each creditor equal shares of remaining assets if assets are not enough to pay full debts). *But see* Amussen v. Quaker City Corp., 156 A. 180, 181 (Del. Ch. 1931) (recognizing and permitting use of common law rule allowing debtor to pay creditors according to preference).

[141] *See, e.g.*, Wheeler v. Matthews, 70 So. 416, 418 (Sup. Ct. Fla. 1915) (describing creditor preference as neither fraudulent nor illegal); *see also* Markell, *supra* note 140, at 426 (noting it is not criminal for client to "distribute the proceeds from any sale of corporate assets to those creditors whose debts the insider has personally guaranteed"). For discussion on using the Bankruptcy Code as the equivalent of a trust instrument guideline for acceptable conduct by the fiduciary, see *infra* Section VI.B.3.

If the operating head of the DIP entity fails to act in compliance with the DIP's fiduciary responsibilities, professional conduct rules may require counsel to refer the matter to the chief executive officer or board of directors.[142] The lawyer is to consider the seriousness of the misconduct and its consequences in deciding what to do within the organization, and is to minimize any disruption to the entity and the risk of revealing information to outsiders.[143]

A critical determination for DIP counsel is whether she is obligated to bring the DIP's breaches of fiduciary duty to the attention of the court in some way. Several courts have stated that disclosure is required.[144] While the opinions tend to use broad "any fiduciary duty" terminology, however, the cases deal with hypothetical breaches or embezzlement or similar serious crime or fraud, and tend not to specify how disclosure is to be accomplished.[145] For example, the Second Circuit BAP

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[142] *See* MODEL RULES OF PROF'L CONDUCT R. 1.13 (2009); *see also In re* McNar, Inc., 116 B.R. 746, 752–53 (Bankr. S.D. Cal. 1990), *aff'd and remanded*, 133 B.R. 561 (B.A.P. 9th Cir. 1991) (criticizing attorney for failing to act properly upon deadlock of corporation's two shareholders). *See generally* Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS U.L.J. 989, 1030–31 (2006–2007) (describing Model Rule 1.13(b) as having "up-ladder reporting obligation").

[143] *See* MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. [4] (2009).

[144] *See In re* Ward, 894 F.2d 771, 776 (5th Cir. 1990) (noting that had attorney for debtor known of existence of unscheduled judgment against estate, "as an officer of the court, [the attorney] would certainly have had a duty to inform the court"); *In re JLM, Inc.*, 210 B.R. at 26 (holding attorney for DIP must inform "the court in some manner of derogation by the debtor in possession"); United States v. Thomas, 342 B.R. 758, 761–62 (S.D. Tex. 2005) (indicating once lawyer discovers omission in schedules, he has duty to court and opposing counsel to notify, amend and formally correct effect of omission); *In re* Gregory, 214 B.R. 570, 576 (S.D. Tex. 1997) (noting duty to disclose client defalcation); *In re* N. Star Mgmt., LP, 305 B.R. 312, 320 (Bankr. D.N.D. 2003) (describing requirement of trustee to act affirmatively to investigate and halt misappropriation of funds, and report to court or U.S. Trustee ), *rev'd on other grounds*, 308 B.R. 906 (B.A.P. 8th Cir. 2004) (finding professional took appropriate steps but was undermined by wrongdoer); *In re* Hampton Hotel Investors, LP, 289 B.R. 563, 577–78 (Bankr. S.D.N.Y. 2003) (holding cause of action against DIP counsel for failing to reveal to DIP breach of fiduciary duty survived motion to dismiss); *In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (mentioning in dicta that in serious cases such as conversion of estate property, professionals will sometimes be obligated to report debtor's breach to others); *In re* Rivers, 167 B.R. 288, 301 (Bankr. N.D. Ga. 1994) (noting highest allegiance of DIP counsel is to estate and court, not client, and asserting attorney's duty to inform court of DIP's incapacity); *In re* Swansea Consol. Res., Inc., 155 B.R. 28, 38 n.14 (Bankr. D.R.I. 1993) (noting as officer of court, attorney had "absolutely no choice *but to disclose* the fact of the missing $64,000 [of DIP funds]"); *In re* United Utensils Corp., 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) (noting former DIP counsel hired by trustee was obliged to disclose to trustee his information about estate assets; "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" (quoting *In re* Wilde Horse Enters., 136 B.R. 830, 847 (Bankr. C.D. Cal. 1991))); *In re Wilde Horse*, 136 B.R. at 847 (indicating that upon suspicion of dishonesty or neglect of fiduciary duty to estate, attorney must ask probing questions and demand fully and reasonably corroborated responses, and if still unsatisfied or ethically uncomfortable, immediately bring unresolved concerns to court's attention by way of motion to be relieved as counsel or in some other way); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [4] (2009) (noting lawyer will sometimes be required to disclose confidential information); ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 92-366 (1992) (discussing duty of "noisy withdrawal" from representation).

[145] *See supra* note 144 (collecting cases); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.6 (2009) (noting "lawyer may reveal information" with no mention about how disclosure should be accomplished); MODEL RULES OF PROF'L CONDUCT R. 1.16 (2009) (requiring lawyer to "comply with applicable law requiring notice to or permission of a tribunal" without mentioning method of disclosure); MODEL RULES OF PROF'L CONDUCT

stated in the oft-cited *JLM* case that the DIP's fiduciary duties require DIP counsel to bring fiduciary breaches to the court's attention—somehow:

> …because counsel for the debtor in possession has fiduciary obligations not ordinarily foisted upon the attorney-client relationship, the attorney for the debtor in possession may not simply resign where the client refuses the attorney's advice concerning the client's fiduciary obligations to the estate and its creditors. Counsel must do more, informing the court in some manner of derogation by the debtor in possession.[146]

Ideally, the client will agree with his counsel to rectify the situation by supplemental filings mailed to affected parties.[147] If the client is unwilling to do so and the attorney concludes it is necessary to remedy the situation, he may withdraw or disaffirm any document in conjunction with a withdrawal request, *e.g*. 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.[148] Even then, the lawyer must abide by ethical duties not to reveal client confidences. The cases that mention the procedure for notification of the court and creditors about client misconduct state that the lawyer should withdraw in accordance with state ethics rules in a manner to instigate the U.S. Trustee to investigate.[149] By stating in the withdrawal motion that

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R. 3.3 (2009) (noting lawyer "shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal" with no mention of how disclosure should be done).

[146] *In re JLM*, 210 B.R. at 26 (remanding case for fact-finding; counsel had refused to follow direction of new owners to dismiss case to enable owners to perfect security interest in assets, which would have harmed other creditors).

[147] MODEL RULES OF PROF'L CONDUCT R. 3.3 cmt. [10] (2009) (explaining lawyer should seek client's cooperation and permission to inform court of situation); *see* FED. R. BANKR. P. 1009 (2009) (explaining debtor has general right to amend statements any time before case ends); MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2009) (stating procedures for attorney when client is an organization); *see also* United States v. Thomas, 342 B.R. 758, 760–62 (S.D. Tex. 2005) (positing 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, 834 (Bankr. D.N.M. 2004) (discussing attorney's ethical violation by failing to advise client to amend schedules promptly upon learning of inaccuracy, and advising instead to wait until after 341 meeting).

[148] *See* MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. [8] (2009) (explaining attorney may disclose information relating to representation to remedy fraud); *see also In re* Matthews, 154 B.R. 673, 680–81 (Bankr. W.D. Tex. 1993) (explaining duty to 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); *In re* Saturley, 131 B.R. 509, 519 (Bankr. D. Me. 1991) (indicating attorney's prerogative to inform trustee that schedules are incomplete if concerned about client's candor, thus prompting trustee investigation).

[149] *See In re Matthews*, 154 B.R. at 680; *In re Saturley*, 131 B.R. at 519 (explaining withdrawal may be appropriate course of action for attorney); *see also In re Wilde Horse*, 136 B.R. at 847 (positing that upon suspicion of debtor's dishonesty or neglect of fiduciary duty to the estate, attorney has duty to ask probing questions, demand full and reasonably corroborated responses, and if "still unsatisfied or ethically

continued representation is inconsistent with applicable ethics rules or would result in a violation of those rules, a lawyer can "wave a red flag" without disclosing a specific client confidential communication.[150] Depending on the facts and circumstances, the motion can recite the applicable rules, which clearly illustrate the underlying reasons for withdrawal and the need for additional inquiry without directly divulging client confidences. The motion may be accompanied by a filing stating that counsel disavows or withdraws particular fraudulent documents, thereby accomplishing the "noisy withdrawal."

*E. Committee Counsel's Duties to Avoid Conflicts, Guide Committee Members, and Maintain Committee Confidences and Privileges.*

1. Conflicts of Interest

Like DIP counsel, Committee counsel has fiduciary duties to the Committee and has also been held to bear such duties to the Committee's constituency.[151] Committee counsel may not hold or represent an interest adverse to its Committee's constituency.[152] A reference to Committee counsel in Bankruptcy Code section 328(c) appears to provide that Committee counsel must also be disinterested and not hold or represent an interest adverse to the interest of the estate.[153] The Committee is by its nature adverse to the interest of the estate in that its constituency is seeking

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uncomfortable, immediately bring the unresolved concerns to the Court's attention by way of a motion to be relieved as counsel of record or in some other way").

[150] *See* MODEL RULES OF PROF'L CONDUCT R. 1.16 cmt. [3] (2009); ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 92-366 (1992); *see also* C.R. Bowles, Jr., *Noisy Withdrawals: Urban Bankruptcy Legend or Invaluable Ethical Tool?*, 20 AM. BANKR. INST. J. 26, 26–27 (Oct. 2001) (explaining debtor's attorney owes greater duty to court than to debtor and duty to court will "override his duty to maintain client confidentiality" when seeking withdrawal).

[151] *See In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991); *In re* Mesta Mach. Co., 67 B.R. 151, 157–58 (Bankr. W.D. Pa. 1986) (detailing Committee counsel's fiduciary duties to Committee and constituents). The Committee's constituents do not thereby become clients, however. *In re* Circle K Corp., 199 B.R. 92, 100 (Bankr. S.D.N.Y. 1996) (stating constituents do not become clients and explaining problems would ensue if constituents were considered clients).

[152] 11 U.S.C. § 1103(b) (2006). "Representation of one or more creditors of the same class as represented by the [C]ommittee shall not per se constitute the representation of an adverse interest." *Id*.

[153] 11 U.S.C. § 328(c) (2006) ("[T]he court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under . . . 1103 of this title if, at any time during such professional person's employment under . . . 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed."); *see In re* Greystone Holdings, LLC, 305 B.R. 456, 460 (Bankr. N.D. Ohio 2003) (asserting section 328(c) will not allow compensation of professional retained under section 1103 if professional is not disinterested or holds interest adverse to interest of estate); G. Ray Warner, *Of Grinches, Alchemy and Disinterestedness: The Commission's Magically Disappearing Conflicts of Interest*, 5 AM. BANKR. INST. L. REV. 423, 428 n.21 (1997) ("[T]he courts have relied upon section 328(c) to apply the disinterestedness standard to [C]ommittee-employed professionals." (citing *In re* Caldor, Inc., 193 B.R. 165, 170–71 (Bankr. S.D.N.Y. 1996))). *But see* Richard Lieb, *The Section 327(a) Disinterestedness Requirement—Does a Pre-petition Claim Disqualify an Attorney for Employment by a Debtor in Possession?*, 5 AM. BANKR. INST. L. REV. 101, 108 (1997) (arguing Congress could not have intended to impose requirement of disinterestedness in section 1103 "through the back door of section 328(c)").

to collect indebtedness from estate assets, but some courts have applied a disinterestedness standard to Committee professionals, replacing the word "estate" with the word "Committee" in the disinterestedness definition.[154]

Representation of one or more creditors of the same class represented by the Committee is not considered an adverse interest *per se*.[155] However, Committee counsel may not actually advance the interests of a single creditor adversely to the interests of the class of all such creditors, even through claim allowance, and even when that creditor is a Committee member.[156] Because Committee counsel has

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[154] 11 U.S.C. § 328(c); *see In re Greystone Holdings*, 305 B.R. at 462 (applying disinterestedness standard, court disqualified Committee financial advisor because it was wholly owned by Committee's law firm); *In re* Caldor, Inc., 193 B.R. 165, 170–71 (Bankr. S.D.N.Y. 1996) (concluding professionals already representing rival competitor could not also represent Caldor Committee due to conflict of interest); *see also In re* Firstmark Corp., 132 F.3d 1179, 1181–82 (7th Cir. 1997) (noting Committee counsel appropriately resigned from representation of creditor when discovered during case); Daido Steel v. Official Comm. of Unsecured Creditors, 178 B.R. 129, 131–32 (N.D. Ohio 1995) (stating Committee counsel may simultaneously represent party adverse to estate on matters unrelated to the bankruptcy); *In re* Carlton House of Brockton, Inc., No. 93-21122-CJK, 1996 Bankr. LEXIS 170, at *15–16 (Bankr. D. Mass. 1996) (suspending Committee counsel from bankruptcy practice for one year due to nondisclosure of representation of secured creditor). *Contra In re* Calabrese, 173 B.R. 61, 63 (Bankr. D. Conn. 1994) (finding conflict existed where professional representing Creditors Committee also represented secured creditor in matters unrelated to estate); *In re* Electro-Optix, U.S.A., Inc., 130 B.R. 621, 622–23 (Bankr. S.D. Fla. 1991) (asserting attorney cannot represent administrative expense claimant while representing Creditors Committee); *In re* Celotex Corp., 123 B.R. at 921–23 (indicating litigation counsel for creditor group cannot also represent Committee); *In re* Whitman, 101 B.R. 37, 38–39 (Bankr. N.D. Ind. 1989) (asserting attorney cannot represent Committee and client Committee member because it holds secured and unsecured claim); *In re* Oliver's Stores, Inc., 79 B.R. 588, 597 (Bankr. D.N.J. 1987) (noting Committee counsel could not also represent individual creditors in suit against debtor's accountant); *In re* Grant Broad. of Philadelphia, Inc., 71 B.R. 655, 662–63 (Bankr. E.D. Pa. 1987) (finding attorney representing group of creditors seeking immediate payment could not represent Committee).

[155] 11 U.S.C. § 1103(b); *see In re* Buran, 363 B.R. 358, 360 (Bankr. W.D.N.Y. 2007) ("[Section 1103(b)] advises that representation of specific unsecured creditors 'shall not per se constitute the representation of an adverse interest.'"); *In re* Nat'l Century Fin. Enters., Inc., 298 B.R. 112, 118 (Bankr. S.D. Ohio 2003) (holding attorney could represent Committee and members where separate counsel will represent Committee on any matter where interests of that member may be adverse); *In re* Walnut Equip. Leasing Co., 213 B.R. 285, 287–92 (Bankr. E.D. Pa. 1997) (permitting counsel to represent Committee and member, with agreement counsel would not be adverse to member or litigate against it); *In re Whitman*, 101 B.R. at 39 (holding client Committee member must hold only unsecured claim). Creditors Committee counsel may not simultaneously represent secured creditors, even on unrelated matters, according to *In re Calabrese*, 173 B.R. at 63. *Contra Daido Steel*, 178 B.R. at 131–32 (asserting Committee counsel may simultaneously represent party adverse to estate on matters unrelated to bankruptcy).

[156] *See In re* 3DFX Interactive, Inc., No. 02-55795-RLE, 2007 Bankr. LEXIS 1941, at *11–13 (Bankr. N.D. Cal. Jan. 19, 2007) (noting special counsel for Committee represented adverse interest by also representing Committee chair in defending fraudulent conveyance action); *In re* Nat'l Liquidators, Inc., 171 B.R. 819, 826–27 (Bankr. S.D. Ohio 1994) (concluding Committee counsel may not represent Committee member with respect to SEC investigation of involvement in debtor misconduct); *In re Oliver's Stores*, 79 B.R. at 597 (stressing need for totally independent Creditors Committees); *In re Grant Broad. of Philadelphia*, 71 B.R. at 663 (concluding law firm already represented interests adverse to at least some other creditors of debtor and therefore was disqualified from acting as counsel to Creditors Committee); *In re* Cont'l Airlines, Inc., 57 B.R. 839, 841 (Bankr. S.D. Tex. 1985) (holding Committee counsel not allowed to represent individual creditors for claims allowance purposes, since efforts to maximize some claims at expense of others a conflict); *see also In re Whitman*, 101 B.R. at 39 (disallowing Committee representation for counsel representing insurance company sought to be retained by Committee); *In re* Tech. for Energy

fiduciary duties only to the Committee members in their Committee capacity and Committee constituents as a whole, Committee counsel may pursue litigation against a Committee member or constituent individual creditor, as long as counsel acquires no confidential information from that creditor nor takes any improper advantage through representation of the Committee.[157]

2. Care and Attention to Preservation of Estate Assets

Committee counsel, like DIP counsel, is to meet its responsibilities in a manner that will not waste estate assets through excessive and inefficient work.[158] Thus, courts have stated that Committee counsel's 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.[159] While Committee counsel should not involve themselves in every minute aspect of the DIP's business, nor should they act as mere spectators, failing to review debtor filings with "fresh eyes" or to actively benefit the creditors.[160] When issues arising in the case have a significant impact on creditor distributions, Committee counsel

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Corp., 53 B.R. 32, 34–35 (Bankr. E.D. Tenn. 1985) (permitting attorney for two shareholders to be appointed as Committee special counsel).

[157] *See In re* Elec. Materials, Co., 160 B.R. 1016, 1018 (W.D. Mo. 1993) (holding no conflict in Committee counsel's representation of estate in preference action against Committee member); *In re* Buffalo Coal Co., No. 06-366, 2008 Bankr. LEXIS 1259, at *23–24 (Bankr. N.D.W. Va. Apr. 30, 2008) (recognizing 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, 808 (Bankr. S.D.N.Y. 1985) (noting Creditors Committee counsel able to pursue objection to individual creditor's claim because there was no evidence of counsel obtaining confidential information as result of representation of Creditors Committee); *see also* Picciotto v. Schreiber, 260 B.R. 242, 245 (D. Mass. 2001) (asserting Committee counsel owes no duty to individual creditors); *In re* USN Commc'ns, Inc., 280 B.R. 573, 600 (Bankr. D. Del. 2002) (stating former Committee counsel may represent liquidating trustee under plan in litigation against individual creditors); *In re* EBP, Inc., 171 B.R. 601, 602 (Bankr. N.D. Ohio 1994) (recognizing Committee counsel represents interests of entire class of Committee constituents).

[158] *See, e.g.*, *In re* Cumberland Farms, Inc., 154 B.R. 9, 12 (Bankr. D. Mass. 1993) (finding Committee's management consultants' fees excessive); *In re* Wang Labs., Inc., 154 B.R. 392, 396 (Bankr. D. Mass. 1993) (disallowing fees attributed to work beyond authorized scope of employment as accountants); *see also In re* Dow Corning Corp., 199 B.R. 896, 900 (Bankr. E.D. Mich. 1996) (noting Committee is only authorized to perform services within the bankruptcy case in the interest of its constituents); *In re* Gen. Homes Corp., 181 B.R. 870, 882 (Bankr. S.D. Tex. 1994) (sanctioning counsel for filing unauthorized lawsuit).

[159] *See, e.g.*, *In re* TAK Commc'ns, Inc., 154 B.R. 514, 523 (Bankr. W.D. Wis. 1993) (addressing Committee counsel's development of eight plans without negotiation; cost-efficient representation also entails adequate use of local counsel); *see In re* Thrifty Oil Co., 205 B.R. 1009, 1020 (Bankr. S.D. Cal. 1997) (holding Committee accountants shall not be paid for excessive time spent on liquidating plan to prompt another plan from DIP); *In re* Keene Corp., 205 B.R. 690, 696 (Bankr. S.D.N.Y. 1997) (deeming Committee litigation excessive and unnecessary).

[160] *See In re* Sheehan Mem'l Hosp., 380 B.R. 299, 306–07 (Bankr. W.D.N.Y. 2007) (finding excessive Committee counsel time monitoring file and no Committee position on important topics such as plan; apparent churning of file); *In re* SONICblue, Inc., Nos. 03-51775, 03-51776, 03-51777, 03-51778-MM, 2007 Bankr. LEXIS 1057, at *37–38 (Bankr. N.D. Cal. Mar. 26, 2007) (noting Committee counsel failed to review settlement agreement carefully, and Committee members' counsel included provisions benefiting themselves at expense of unsecured creditors); *In re* New England Metal Co., 155 B.R. 38, 41 (Bankr. D.R.I. 1993) (discussing counsel's specific applications filed for allowance of professional fees).

should undertake a factual and legal analysis and bring the conclusions to the court.[161] But if it becomes reasonably obvious that unsecured creditors will not receive a distribution, Committee counsel must scale back services.[162]

3. Providing Professional Guidance

Committee counsel has fiduciary responsibilities to Committee members and their constituents to guide Committee members in carrying out Committee responsibilities.[163] For example, while not representing Committee members in their individual capacities, Committee counsel may need to advise them in their Committee capacities on disclosure of transactions with the debtor, refraining from participation on Committee decisions directly adverse to their personal interests such as pursuit of preference claims, and the need for screening walls if any trading in claims or debtor shares is to take place.[164]

4. Impartiality Toward Committee Members and Constituents

Meeting fiduciary duties and avoiding conflicts of interest encompasses a duty on the part of Committee counsel to elicit and ensure fair consideration of the views of all Committee members and constituent creditors' interests.[165] In the *Fibermark* case, an examiner's report describes one Committee member's domination of and

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[161] *E.g.*, *In re* Rancourt, 207 B.R. 338, 357–58 (Bankr. D.N.H. 1997) (reducing attorney compensation for services provided because attorneys failed to bring possible abandonment of property issue before Court).

[162] *See* Lorel & Opera v. U.S. Tr. (*In re* Auto Parts Club, Inc.), 211 B.R. 29, 34 (B.A.P. 9th Cir. 1997) (failing to scale back services prompted court to reduce fees); *In re Sheehan Mem'l Hosp.*, 380 B.R. at 305 (asserting that where 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, 811 (Bankr. N.D. Tex. 2006) (finding 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. Del. 2004) ("[W]e 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.").

[163] *See In re* Greystone Holdings, LLC, 305 B.R. 456, 460 (Bankr. N.D. Ohio 2003) (discussing fiduciary duty to Committee); *In re* JFD Enters., Inc., 223 B.R. 610, 623 (Bankr. D. Mass. 1998) (reasoning that duty is to Committee, not debtor or individual creditors); *In re* Celotex Corp., 123 B.R. 917, 920 (Bankr. M.D. Fla. 1991) ("Counsel for the [C]ommittee has a fiduciary duty to the [C]ommittee and its constituency."); *In re* Mesta Mach. Co., 67 B.R. 151, 156 (Bankr. W.D. Pa. 1986) (acknowledging Creditors Committees and counsel are fiduciaries); *see also* Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein, PC, 42 B.R. 960, 963 (E.D. Pa. 1984) (asserting counsel to Creditors Committee has fiduciary duty to interests of entire class of creditors).

[164] *See In re* Elec. Materials Co., 160 B.R. 1016, 1018 (W.D. Mo. 1993) (indicating Committee member sued by Committee counsel for preference recovery should abstain from portion of meeting or voting on issue pertaining to that adversary); *see also In re* Refco Inc., 336 B.R. 187, 197 (Bankr. S.D.N.Y. 2006) (warning disclosure of information could reasonably have effect of waiving privilege); *see In re* ABC Auto. Prods. Corp., 210 B.R. 437, 441–42 (Bankr. E.D. Pa. 1997) (discussing duties of Committees and Committee counsel, and need to choose counsel fairly).

[165] *See Pension Benefit Guar. Corp.*, 42 B.R. at 964 (noting duty to see creditors' interests considered fairly); *In re* Mirant Corp., 334 B.R. 789, 793–94, 800 (Bankr. N.D. Tex. 2005) (enjoining misleading statements in solicitation of plan rejections).

disrespect for other Committee members, and criticizes Committee counsel for facilitating and doing nothing to rectify such behavior.[166] 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.[167] The examiner recommended a significant portion of Committee counsel's compensation be disallowed.[168] Without admitting liability, the firm agreed with the debtors and the U.S. Trustee to reduce its fees by approximately one-third.[169]

5. Preservation of Confidences and Privileges

Committees and their counsel have generally been held entitled to assert the attorney-client privilege.[170] The privilege may be absolute with respect to disclosures sought by those not represented by the Committee, with a narrower construction of the privilege utilized when a Committee's constituent seeks information.[171] The Committee and its counsel are also obliged to protect the confidentiality of communications by the DIP to the Committee and its counsel, to enable the Committee 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.[172] The obligation to solicit comments from Committee constituents and

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[166] *In re* Fibermark, Inc., 330 B.R. 480, 488 (Bankr. D. Vt. 2005) (referring to REP. OF HARVEY R. MILLER, AS EXAMINER, U.S. Bankr. D. Vt. No. 04-10463, at 3–4 (Dkt. 1805) (2005), *available at* https://ecf.vtb.uscourts.gov/doc1/1841593124); *see In re* Hills Stores Co., 137 B.R. 4, 7–8 (Bankr. S.D.N.Y. 1992) (discussing creditors who are consistently outvoted; no evidence of alleged discrimination against Committee members); *see also In re* Dana Corp., 344 B.R. 35, 38–39 (Bankr. S.D.N.Y. 2006) (indicating fact that Committee members have variety of viewpoints does not require appointment of separate Committees unless ability of Committee to reach consensus is impaired).

[167] REP. OF HARVEY R. MILLER, *supra* note 166, at 315–19.

[168] *Id.* at 26.

[169] *Id.* at 76–77.

[170] Marcus v. Parker (*In re* Subpoenas Duces Tecum Dated Mar. 16, 1992), 978 F.2d 1159, 1161 (9th Cir. 1992) (concluding attorney-client privilege applies to Creditors Committee); *In re* Refco, Inc., 336 B.R. 187, 197 (Bankr. S.D.N.Y. 2006) (discussing protocol to protect privilege); *see In re* The Circle K Corp., 199 B.R. 95–100 (Bankr. S.D.N.Y. 1996) (holding disclosure of opinions to Committee constituent did not waive work product privilege, although constituent is not client of Committee counsel).

[171] *See In re* Baldwin-United Corp., 38 B.R. 802, 805 (Bankr. S.D. Ohio 1984) (adopting reasoning from shareholder derivative suits (citing Garner v. Wolfinbarger, 280 F.2d 1093, 1103–04 (5th Cir. 1970))); *In re* Christian Life Center, 16 B.R. 35, 37–38 (Bankr. N.D. Cal. 1981) (recognizing no privilege where claim was that Committee counsel breached duties); *see also In re Subpoenas Duces Tecum*, 978 F.2d at 1161 (adopting *Baldwin-United Corp.* rationale regarding privilege).

[172] 11 U.S.C. § 1103(c)(2) (2006); *see In re Refco*, 336 B.R. at 196–97 (noting Committee must keep communications with debtor confidential, not only to uphold its fiduciary duty to creditors, but also to facilitate obtaining information necessary to properly perform its functions); *In re* Wilson Foods Corp., 31 B.R. 272, 272 (Bankr. W.D. Okla. 1983) (indicating duties of Committee require it to dig deep into all aspects of debtor and its business; competitor could abuse debtor if appointed to Committee); *see also In re* Handy Andy Home Improvement Cents., Inc., 199 B.R. 376, 380–82 (Bankr. N.D. Ill. 1996) (discussing court's power under Code section 107(b) and Bankruptcy Rule 9018 to enter confidentiality order without showing of good cause required by Fed. R. Civ. P. 26(c)).

provide them with information about the case does not justify Committee members or Committee counsel waiving the Committee's privileges or releasing confidential information.[173]

## V. LAWYER DUTIES TO NON-CLIENTS OF A FIDUCIARY CLIENT

### *A. State Trust Law*

There are differences from state to state, but the majority rule is that representation of a fiduciary does not impose on the lawyer obligations toward the beneficiaries that a lawyer would not otherwise have to third parties.[174] Most states hold that no attorney-client relationship is imposed between the trustee's lawyer and the trust beneficiaries, but the lawyer nonetheless has certain duties to the beneficiaries.[175]

A minority of state courts have held that a lawyer retained by a trustee for overall trust administration purposes actually represents the trust *and* its beneficiaries.[176] These cases and rules do not address fiduciary obligations of a

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[173] 11 U.S.C. § 1102(b)(3) (2006); *see In re Refco* 336 B.R. at 197 ("[O]ne should proceed cautiously concerning the disclosure of information that could reasonably have the effect of waiving the attorney-client or other privilege."); *see also* Anupama Yerramalli, Note, *Deciphering the Statutory Language of 11 U.S.C. Section 1102(b)(3): Information Disclosure Requirements Imposed upon Creditors' Committees*, 15 AM. BANKR. INST. L. REV. 361, 367–69 (2007) (stating ambiguity in section 1102(b)(3) raises serious privilege and confidentiality issues for Committee and its counsel, and judicial intervention is necessary to avert waiver of attorney-client privilege).

[174] *See* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 94-380 (1994) (addressing lawyer's obligations to beneficiaries where lawyer represents fiduciary); *see also* Succession of Wallace, 574 So. 2d 348, 357 (Sup. Ct. La. 1991) (collecting cases); Steinway v. Bolden, 460 N.W.2d 306, 307 (Ct. App. Mich. 1990) (reflecting minority view that attorney represents estate, construing state statutory provision); Charleson v. Hardesty, 839 P.2d 1303, 1306–07 (Sup. Ct. Nev. 1992) (concluding attorney representing trustee owes fiduciary duty to beneficiaries).

[175] *See* Morales v. Field, 160 Cal. Rptr. 239, 244 (Cal. Ct. App. 1979) (asserting trustee's attorney owes duty to beneficiary and "assumes a relationship with the beneficiary akin to that between trustee and beneficiary"; required to disclose conflicts when beneficiaries were unrepresented); *see also Charleson*, 839 P.2d at 1306–07 (adopting reasoning in *Morales*). *But see* Berg & Berg Enters., LLC v. Sherwood Partners, Inc., 32 Cal. Rptr. 3d 325, 342–43 (Cal. Ct. App. 2005) (distinguishing *Morales* from numerous other California authorities). In *Morales*, the attorneys for the trustee and executor blurred the attorney-client relationships by telling the beneficiary that she need not take any action on her part, promising to keep her advised should anything unusual arise, and reassuring her that her interests would be protected. *Morales*, 160 Cal. Rptr. at 241.

[176] *See, e.g.*, Comegys v. Glassell, 839 F. Supp. 447, 448–49 (E.D. Tex. 1993) (finding, under Texas law, "beneficiaries are the real clients because the trust was created for their benefit"); Riggs Nat'l Bank v. Zimmer, 355 A.2d 709, 714 (Del. Ch. 1976) (concluding trust beneficiaries were clients of trustees' attorney "as much as the trustees were, and perhaps more so"); Pizel v. Zuspann, 795 P.2d 42, 51 (Kan. 1990) (adopting California approach and allowing beneficiaries to bring malpractice action against settlor's attorney); Steinway v. Bolden, 460 N.W.2d 306, 307 (Mich. Ct. App. 1990) (concluding attorney retained by fiduciary represents estate, per state statute); *Charleson*, 839 P.2d at 1308 (finding trustee's attorney may be held liable for breach of duty to beneficiaries and remanding for fact-finding); Jenkins v. Wheeler, 316 S.E.2d. 354, 357 (N.C. Ct. App. 1984) (finding attorney representing estate has duty to protect beneficiaries' interests and can be held liable to beneficiaries for malpractice); Trask v. Butler, 872 P.2d 1080, 1085 (Wash. 1994) (noting personal representative of estate owes fiduciary duty to beneficiaries to act in best

corporate officer or other business manager with a balance of personal interests and multiple constituent stakeholders. One state court held that an attorney for a probate personal representative represents the probate "estate," but it interpreted the statute authorizing such representation, which was uniquely phrased to authorize employment on behalf of the estate.[177]

Without owing any fiduciary duties to a trustee's beneficiary, a third party (lawyer) may be liable to a beneficiary if she knowingly participates in the fiduciary's breach or gives substantial assistance or encouragement to the fiduciary in breaching his duty.[178] Knowing participation is key to liability, realizing that the contemplated act is a breach and that counsel's actions will assist the fiduciary in the breach.[179]

*B. Lawyer as Agent*

Professor Geoffrey Hazard has suggested that at least in the transactional lawyer context, applying the law of agency and recognizing the lawyer is agent for the client as principal is a coherent approach to determining duties to third parties.[180] When a lawyer speaks for a client, he may not make statements known to be misleading or give opinions inconsistent with facts known or available.[181] Similarly, a lawyer may not assist wrongful acts of other agents of the client. Thus,

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interest of estate); *see also* Deutsch v. Cogan, 580 A.2d 100, 105 (Del. Ch. 1990) (interpreting *Riggs* as limited to instances involving express trusts); Blair v. Ing, 21 P.3d 452, 458 (Haw. 2001) (recognizing emerging trend of allowing malpractice action by beneficiaries in estate planning context). *But see, e.g.*, Barcelo v. Elliott, 923 S.W.2d 575, 579 (Tex. 1996) (refusing to extend fiduciary duty of attorney to trust beneficiaries); Thompson v. Vinson & Elkins, 859 S.W.2d 617, 623 (Tex. Ct. App. 1993) (emphasizing trust is not legal entity "that can sue or be sued").

[177] *Steinway*, 460 N.W.2d at 307.

[178] *See* Robert W. Tuttle, *The Fiduciary's Fiduciary: Legal Ethics in Fiduciary Representation*, 1994 U. ILL. L. REV. 889, 900–01 (positing personal representative's lawyer is liable to beneficiaries only when he knowingly participates in fiduciary's breach); *see also Morales*, 160 Cal. Rptr. at 243–44 (finding attorney who actively participates in client's breach of trust is accountable to beneficiary; attorney's relationship with beneficiary is "akin to that between trustee and beneficiary"); RESTATEMENT (SECOND) OF TORTS §§ 874, 876 (1965) (asserting attorney will be subject to liability if he knowingly gives "substantial assistance or encouragement" to personal representative's breach of fiduciary duty); RESTATEMENT (SECOND) OF AGENCY § 326 (1958) (indicating personal representative's attorney becomes liable to beneficiary when both know personal representative to be incompetent). Some states go further. *See, e.g.*, Fickett v. Superior Court, 558 P.2d 988, 990 (Ariz. Ct. App. 1976) (asserting attorney was responsible for ensuring that guardian understood his obligations and that correct procedures existed for required accountings; "If, as is contended here, petitioners knew or should have known that the guardian was acting adversely to his ward's interests, the possibility of frustrating the whole purpose of the guardianship became foreseeable as did the possibility of injury to the ward. In fact, we conceive that the ward's interests overshadow those of the guardian"); *see also infra* Part VIII.A. for further discussion of *Fickett*; *Charleson v. Hardesty*, 839 P.2d at 1306–07 (Nev. 1992) (noting trustee's attorney assumes duty of care and fiduciary duties to beneficiaries as matter of law).

[179] *See* Tuttle, *supra* note 178, at 901 (citing RESTATEMENT (SECOND) OF TRUSTS § 326 (1959)); *see also Morales*, 160 Cal. Rptr. at 243–44 (proffering test for attorney liability to third parties not in privity).

[180] Geoffrey C. Hazard, Jr., *The Privity Requirement Reconsidered*, 37 S. TEX. L. REV. 967, 970 (1996) [hereinafter Hazard, *The Privity Requirement*].

[181] *See id.* at 972; MODEL RULES OF PROF'L CONDUCT R. 4.1 (2009) ("In the course of representing a client a lawyer shall not knowingly [] make a false statement of fact or law to a third person . . . .").

when the lawyer knows or should know that the conduct of a corporate officer is exposing the entity to liability, the lawyer risks liability himself unless he protects the interest of the organizational client.[182] In a chapter 11 case, Hazard notes that the heightened duties of management expose the lawyer to heightened attentiveness in fulfilling duties to the DIP entity client outlined in Model Rule 1.13.[183]

Under the law of agency, an agent is liable on the following bases that apply to lawyers, clients and third parties:

> [1] To the agent's principal, for assisting someone other than the principal in committing a legal wrong against the principal. This covers situations where the lawyer for a corporation, partnership, or other organization assisted someone, such as an officer or a partner, in a course of action constituting a wrong against the corporation. It would also cover a lawyer who assists in such wrongful conduct against an individual client, situations typically, but not exclusively, involving representation of conflicting interests where the conduct of one client inflicts legal harm on the other.
> [2] To the agent's principal for assisting, or failing to interdict conduct of which the agent is aware and which is within his domain of responsibility, on the part of someone purporting to act for the principal in a course of action that results in the principal's being held legally liable to some third party. This covers situations where the lawyer for an organization assists a corporate officer in such conduct, or fails to intercept such conduct when it has come to the lawyer's attention. The same proposition holds for conduct unfaithful to an individual client.
> [3] To a third person, for providing substantial assistance in fraudulent or otherwise tortious conduct on the part of the principal.
> [4] To a third person, directly or by way of subrogation to the right of the principal, for negligently or intentionally failing to carry out an undertaking on behalf of the principal that was intended to benefit the third person.[184]

Under these principles, while an agent has fiduciary duties to the principal, his duties to others are not considered fiduciary. These agency law principles are

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[182] *See* Hazard, *The Privity Requirement*, *supra* note 180, at 975–77 (discussing agency relationship between corporation and its officers and attorney's duty to act reasonably when other agents' imputable conduct is known); *see also* FDIC v. O'Melveny & Myers, 969 F.2d 744, 746–47 (9th Cir. 1992) (addressing law firm that allegedly failed to follow accepted practice in due diligence, enabling officers to breach their duty in securities offering by corporation), *rev'd*, 512 U.S. 79 (1994), *modified*, 61 F.3d 17 (9th Cir. 1995); MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2009) (stating organization's lawyer is under duty to act in best interest of organization when lawyer knows officer's inappropriate conduct will likely result in injury to organization).

[183] Hazard, *The Privity Requirement*, *supra* note 180, at 978.

[184] *Id.* at 993 (citing RESTATEMENT (SECOND) OF AGENCY §§ 391, 343 (1958)).

helpful to explain, without a fiduciary overlay, lawyer duties and concomitant liabilities in dealing with third parties.

*C. Applicable Model Rules Provisions*

The Model Rules address fiduciary representation in a few instances. A comment to Model Rule 1.2 on the scope of representation states that "Where the client is a fiduciary, the lawyer may be charged with special obligations in dealing with a beneficiary."[185] A comment on Model Rule 1.7 concerning current client conflicts of interest states:

> [I]n estate administration the identity of the client may be unclear under the law of a particular jurisdiction. Under one view, the client is the fiduciary; under another view the client is the estate or trust, including its beneficiaries. The lawyer should make clear the relationship to the parties involved.[186]

Finally, a comment to Model Rule 1.14 regarding a client under a disability states: "If the lawyer represents the guardian as distinct from the ward, and is aware that the guardian is acting adversely to the ward's interest, the lawyer may have an obligation to prevent or rectify the guardian's misconduct."[187]

Third parties are always entitled to the protection of the law of fraud and criminal law; a lawyer may not assist a client in perpetrating a crime or fraud against a third person.[188]

*D. ABA Formal Opinion 94-380*

The American Bar Association Ethics and Professional Responsibility Committee evaluated the legal and ethical standards for representation of fiduciaries and set forth its conclusions in ABA Formal Opinion 94-380.[189] The ABA Committee opined that the fiduciary is the lawyer's only client and the lawyer owes the beneficiaries only those duties owed to third parties in general:

> The fact that the fiduciary client has obligations toward the beneficiaries does not impose parallel obligations on the lawyer, or

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[185] MODEL RULES OF PROF'L CONDUCT R. 1.2 cmt. [11] (2009).
[186] MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [27] (2009).
[187] MODEL RULES OF PROF'L CONDUCT R. 1.14 cmt. [4] (2009).
[188] *See* MODEL RULES OF PROF'L CONDUCT R. 1.2 (2009) (noting, however, lawyer can discuss consequences of proposed courses of conduct with clients); *see also In re* Austern, 524 A.2d 680, 683 (D.C. Ct. App. 1987) (sanctioning attorney for furtherance of client's fraudulent transaction); Hazard, *The Privity Requirement*, *supra* note 180, at 26 (asserting lawyer may liable under tort law for such infraction).
[189] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 94-380 (1994).

> otherwise expand or supersede the lawyer's responsibilities under the Model Rules of Professional Conduct.[190]

ABA Opinion 94-380 explains that the lawyer's duty of confidentiality is not lessened when the client is a fiduciary. The lawyer can only disclose confidential information if the fiduciary plans to commit a crime that poses a serious threat of injury or death to the beneficiaries or other third party, although the lawyer may withdraw if the fiduciary insists on continuing a course of fraudulent or criminal conduct where the lawyer's services will be involved.[191]

*E. Hazard's Triangular Relationship Theory*

Professor Geoffrey Hazard proposed a different approach to lawyer duties to fiduciary clients' beneficiaries in an oft-cited 1987 article.[192] In some cases, a lawyer represents a client who owes a fiduciary duty to a third party (lawyer → guardian → ward), and in some cases, a lawyer and a third party owe fiduciary duties to the lawyer's client, but the lawyer deals principally with the third party (lawyer → corporation ← officer).[193] Hazard posits that in both three-party relationships, the lawyer may appropriately consider both "relevant others" as the client, and in some circumstances be held to have legal duties to both.[194] For the first type of triangle, Hazard cites an Arizona case in which a lawyer was held liable to the ward of his client guardian because the lawyer's inattention had made guardian defalcations possible.[195] The court reasoned that the lawyer "assumed a relationship not only with the guardian but also with the ward," and the ward's interests "overshadowed" those of the guardian when the guardian acted adversely to the ward's interests and frustrated the whole purpose of the guardianship.[196] Hazard's example of the second triangle was a derivative lawsuit by union members for an accounting by the union's president for misused funds.[197] General counsel for the union initially represented by the union and the president, as the firm had done for years in a non-adversary context, but was held to have a conflict of interest once a plausible charge of fraud on the organization was made.[198] The court reasoned that the entity's institutional interests needed to be represented by non-aligned counsel.[199]

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[190] *Id*.
[191] *See id*.
[192] *See generally* Hazard, *Triangular Lawyer Relationships*, *supra* note 117.
[193] *See id*. at 15–16.
[194] *See id*. at 40–41.
[195] *Id.* at 17, 17 n.1 (citing Fickett v. Superior Court, 558 P.2d 988, 991–92 (Ariz. Ct. App. 1976)).
[196] *Id.* at 17–18 (citing *Fickett*, 558 P.2d at 990).
[197] *Id.* at 19–20 (citing Yablonski v. United Mine Workers, 448 F.2d 1175 (D.C. Cir. 1971)).
[198] *Id.* at 19–20 (citing *Yablonski*, 448 F.2d at 1179).
[199] *Yablonski*, 448 F.2d at 1179.

Hazard explains that the law needs to recognize a nuance for the lawyer's relationship to the third party in these cases between "friend" and "foe."[200] When the client is openly adverse to the third party, as in a ward's lawsuit to surcharge or remove the guardian, or the guardian's negotiations over compensation, the lawyer should represent the client and may be openly adverse to the third party.[201] When the lawyer is representing the guardian in taking care of the ward or the guiding corporate officers to take care of the entity's institutional interests, Hazard contends the representation is more akin to joint representation, where the lawyer may serve both as long as their interests are not adverse.[202] But, he notes, this unofficial joint representation ceases when there is open adversity, *i.e.* in a litigation or open negotiation situation[203] which there is in a chapter 11 case.

Further, in a chapter 11 context, instead of a single "ward" beneficiary, there are usually numerous secured creditors, unsecured creditors, bondholders, employees, landlords, other parties to executory contracts and shareholders of different classes with allegiances shifting issue by issue. The debtor is openly negotiating and litigating with them over their rights and treatment. The harmony of interests between the fiduciary and the beneficiary on which Professor Hazard's analysis depends is absent.[204]

### *F. Law Governing Lawyers Section 51(4)*

THE RESTATEMENT OF THE LAW GOVERNING LAWYERS explains that lawyers may assume a duty of care to non-clients when, for example, they execute opinion letters to opposing parties or assume the responsibility to record security interest documentation in connection with a client's transaction.[205] As noted by the

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[200] *See* Hazard, *Triangular Lawyer Relationships*, *supra* note 117, at 29–30.

[201] *See id.* at 33–36 (noting if lawyer has relationship with client and with "'relevant other'" and relationship becomes openly adverse, lawyer's sole duty is to client); *see also* Eugene R. Gaetke & Robert G. Schwemm, *Government Lawyers and Their Private "Clients" Under the Fair Housing Act*, 65 GEO. WASH. L. REV. 329, 359 (1997) (noting representation in triangular situations is prohibited if client's interests are "directly adverse" to another).

[202] Hazard, *Triangular Lawyer Relationships*, *supra* note 117, at 36–39 (noting lawyers may serve "two or more" clients if clients' interests are not adverse); *see* Gerald W. Boston, *Liability of Attorneys to Nonclients in Michigan: A Re-examination of* Friedman v. Dozorc *and a Rule of Limited Liability*, 68 U. DET. L. REV. 307, 355 (1991) (discussing duty to avoid conflicts of interest in joint representation); *see also* Michael R. H. Post, *Representing A Tax Matters Partner: Who Is The Client?*, 6 GEO. J. LEGAL ETHICS 527, 538 (1993) (noting attorney unable to represent client "if the representation of that client will be directly adverse to another client").

[203] *See* Hazard, *Triangular Lawyer Relationships*, *supra* note 117, at 38–39 (noting "multiple representation concept" ceases when triangular relationship collapses).

[204] *See* Neal v. Baker, 551 N.E.2d 704, 705 (Ill. App. Ct. 1990) (noting income beneficiary cannot be understood as client of trustee's attorney because of reality of conflict with remaindermen); *see also* Tuttle, *supra* note 178, at 912 (citing Goldberg v. Frye, 266 Cal. Rptr. 483, 489–90 (Cal. Ct. App. 1990)) (noting conflicts among beneficiaries and between individual beneficiaries and fiduciary's duty to whole estate).

[205] *See* Stock W. Corp. v. Taylor, 942 F.2d 655, 666 (9th Cir. 1991) (mentioning attorneys have been held liable for "negligent issuance of opinion letters" to non-clients); *see also* McCamish v. F.E. Appling Interests, 991 S.W.2d 787, 793 (Tex. 1999) (noting opinion letters to non-clients can be basis for liability for negligent misrepresentation); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. e

bankruptcy court in *Food Management*, the RESTATEMENT also recognizes that lawyers for certain fiduciary clients also owe duties of care to their clients' beneficiaries.[206] The RESTATEMENT provides, however, that only a duty of care is owed, not a duty of loyalty, and that the duty of care is not a "fiduciary" duty of the lawyer.[207]

The RESTATEMENT 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):

> The duty recognized by Subsection (4) is limited to lawyers representing only a limited category of the persons described as fiduciaries – trustees, executors, guardians, and other fiduciaries acting primarily to fulfill similar functions. Fiduciary responsibility, imposing strict duties to protect specific property for the benefit of specific, designated persons, is the chief end of such relationships. The lawyer is hence less likely to encounter conflicting considerations arising from other responsibilities of the fiduciary-client than are entailed in other relationships in which the fiduciary duty is only part of a broader role. Thus, Subsection (4) does not apply when the client is a partner in a business partnership, a corporate officer or director, or a controlling stockholder.[208]

Other important considerations discussed in the LAW GOVERNING LAWYERS and bearing on applicability of this legal principle to DIP clients are:

> (1) This duty arises only when the lawyer knows that appropriate action by the client is necessary to prevent or mitigate a breach of the client's fiduciary duty. "Knows" denotes actual knowledge; it is "functionally the same" as "has reason to know" but is not the same as "should know" and "neither assumes nor requires a duty of inquiry."

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(2000) (noting lawyers owe non-clients duty of care when performing certain tasks, such as writing opinion letters).

[206] *See In re* Food Management Group LLC, 380 B.R. 677, 709 (Bankr. S.D.N.Y. 2008); *see also* Mateti v. Activus Fin., LLC, No. DKC 2008-0540, 2009 WL 2507423, at *13 (D. Md. Aug. 14, 2009) (noting, under Maryland law, attorney owes duty to third party beneficiaries).

[207] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51, cmt. h (2000) ("[V]iolations of duties of loyalty by a fiduciary are ordinarily considered breaches of fiduciary duty, while violations of duties of care are not.").

[208] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. h (2000); *see also* Wanetick v. Mel's of Modesto, Inc., 811 F. Supp. 1402, 1409 (N.D. Cal. 1992) ("Attorneys for limited partnerships do not owe fiduciary duties to limited partners."); Morin v. Trupin, 711 F. Supp. 97, 103 (S.D.N.Y. 1989) (noting lawyer owed no fiduciary duty to limited partners).

> (2) Generally, the lawyer must follow his client-fiduciary's instructions and may assume compliance with the law.
> (3) The duty in Subsection (4) only applies to breaches constituting crime or fraud or breaches in which the lawyer has assisted or is assisting the fiduciary.
> (4) Liability under this subsection exists only when the beneficiary is not reasonably able to protect its rights, *e.g.* "for reasons of youth or incapacity."
> (5) A lawyer owes no duty to a beneficiary if recognizing a duty would create conflicting or inconsistent duties that might significantly impair the lawyer's performance of duties to his client, including (a) assisting the fiduciary in an open dispute with a beneficiary; (b) assisting the fiduciary in exercising its judgment that would benefit one beneficiary at the expense of another; or (c) representing the fiduciary in a dispute or negotiation with the beneficiary with respect to a matter affecting the fiduciary's interest.
> (6) A lawyer is not liable for failing to disclose confidences he reasonably believes are forbidden by professional conduct rules.
> (7) The lawyer's duty under this section is only the duty of care consisting of exercising the competence and diligence normally exercised by lawyers in similar circumstances.[209]

Applicability of Law Governing Lawyers Section 51(4) to DIP representation is not as clear as indicated in *Food Management*. 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, than it is like a guardian to a ward. 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.[210] 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.

Even if the Section 51(4) duty does apply to DIP counsel, it is a duty of care, to exercise normal competence and diligence, and not a fiduciary duty of loyalty.[211] It

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[209] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. h (2000).

[210] *See In re* Am. Express Warehousing, Ltd., 525 F.2d 1012, 1014 (2d Cir. 1975) (explaining Creditors Committee played "leading role" in protecting interests and rights of those involved in chapter 11 proceeding); *see also In re* S & S Indus., Inc., 30 B.R. 395, 397–98 (Bankr. E.D. Mich. 1983) (stating committee protects interests of other creditors and performs services in interest of those involved); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. h. (2000) ("Liability under Subsection (4) exists only when the beneficiary of the client's fiduciary duty is not reasonably able to protect its rights.").

[211] *See* Capitol Indem. Corp. v. Fleming, 58 P.3d 965, 966–67 (Ariz. Ct. App. 2002) (explaining section 51 generally imposes "duty of care" and not fiduciary duty on lawyer).

does not impose a duty to police the client, and does not require disclosure of client confidences that may not be disclosed under applicable professional conduct rules. In many states, that includes confidences from clients that do not rise to the level of a crime or actual (not constructive) fraud.

## VI. THE MEANING OF "FIDUCIARY" DUTIES

There is no clear definition of "fiduciary" duties. Courts have employed lofty language to convey the import of the term, including the famous phrasing in *Meinhard v. Salmon*:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[212]

Most frequently, the central point of the fiduciary concept has been explained as acting solely in the beneficiaries' interest. In a recent ERISA case, the Supreme Court stated the duty as an actual guarantee of beneficiaries' interests:

> Thus, the common law (understood as including what were once the distinct rules of equity) charges fiduciaries with a *duty of loyalty to guarantee beneficiaries' interests*: 'The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty . . . . It is the duty of a trustee *to administer the trust solely in the interest of the beneficiaries*.' 2A A. Scott & W. Fratcher, Trusts § 170, 311 (4th ed. 1987) (hereinafter Scott); see also G. Bogert & G. Bogert, Law of Trusts and Trustees § 543 (rev. 2d ed. 1980) ("Perhaps the most fundamental duty of a trustee is that he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary and must exclude all selfish interest and all consideration of the interests of third persons").[213]

The general principle for the agent's duty of loyalty is that unless otherwise agreed, an agent must act "solely for the benefit of the principal" in all matters

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[212] 164 N.E. 545, 546 (N.Y. 1928).

[213] Pegram v. Hendrich, 530 U.S. 211, 244 (2000); *see In re* Marble, No. 07-50099-RLJ-11, 2007 Bankr. LEXIS 1743, at *12–13 (Bankr. N.D. Tex. May 25, 2007) (citing *Pegram*, 530 U.S. at 224) (emphasis added) (adopting reasoning of *Pegram* as an explanation of fiduciary duties of DIP counsel).

connected with his agency.[214] The concept may be fleshed out with a historical perspective.

*A. The Historical Context of Fiduciary Duties*

The somewhat nebulous nature of fiduciary duties stems from its long history. One commentator placed its "obscure genesis in the English courts of equity."[215] Another has traced the concept back to Roman inheritance law, adapted by medieval clerics into "utilitas ecclesiae" which was the forbear of the "use and the trust" that in turn led to agency, partnership and corporate law.[216] That author's article on the history of fiduciary duties also sets forth the impact of German influences from Salic law and other philosophical and legal traditions, including the biblical concept of humans as stewards of God's and others' property. She shows how "'trust'" came to have the meaning ascribed to it today and "'quasi-trust'" and "'fiduciary'" describe situations "within the broader ambit of breach of confidence or trust, but not technically a trust."[217] Professor Jack Williams has traced the genesis of corporate fiduciary principles to admiralty law.[218]

The number of relationships categorized as fiduciary has expanded over time to include not only principal-agent and attorney-client but also partner-partner, officer and director-shareholder, union leader-union members, investment broker-customer, lender bank-borrower.[219] The types of relationships considered fiduciary are expanding with changing perceptions of power and increasing specialization.[220]

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[214] *See* RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

[215] *See* Andrew D. Shaffer, *Corporate Fiduciary - Insolvent: The Fiduciary Relationship Your Corporate Law Professor (Should Have) Warned You About*, 8 AM. BANKR. INST. L. REV. 479, 483 (2000) (explaining "one of the principal reasons for . . . perplexity" is attributed to concept's evolution which originated in English courts of equity as early as 18th century).

[216] *See* Mary Szto, *Limited Liability Company Morality: Fiduciary Duties in Historical Context*, 23 QUINNIPIAC L. REV. 61, 86–112 (2004) (explaining "the genealogy of fiduciary duties can be traced" back thousands of years and how fiduciary duties have been impacted by Roman law).

[217] Szto, *supra* note 216, at 97; *see also* L.S. Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 71–72 (1962) (pointing out term "fiduciary . . . was adopted to describe" relationships similar to trust-trustee, but "which fell short of the now strictly-defined trust"); Shaffer, *supra* note 215, at 481, 483 ("Courts eventually recognized that certain relationships were similar to trusts, but did not meet the specific requirements for trust establishment. These 'almost-a-trust' relationships came to be known as fiduciary relationships.").

[218] *See* Williams, *supra* note 68; *see also* Thorman v. Am. Seafoods Co., 421 F.3d 1090, 1096–98 (9th Cir. 2005) (noting limited fiduciary duties owed by ship owners to seamen).

[219] *See* Evan J. Criddle, *Fiduciary Foundations of Administrative Law*, 54 UCLA L. REV. 117, 125 (2006) (noting continued expansion of fiduciary rhetoric to "legal obligations of parents, educators, physicians, psychiatrists, clergymen" and others); *see also* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 425, 432–34 (1993) ("The many agency relations that fall under the 'fiduciary banner' are so diverse that a single rule could not cover all without wreaking havoc."); Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 802 (1983) (opining society based on fiduciary relations is emerging).

[220] *See* Robert Flannigan, *The Fiduciary Obligation*, 9 OXFORD J. LEGAL. STUD. 285, 285 (1989) (noting increasing interest in and use of fiduciary obligations throughout England); *see also* Frankel, *supra* note 219, at 803–04; DeLarme R. Landes, Comment, *Economic Efficiency and the Corporate Opportunity Doctrine:*

*B. The Central Principles of Fiduciary Duties*

There are three core aspects to fiduciary duties: a duty of loyalty, a duty of care, and a duty of impartiality in the event of multiple beneficiaries.[221] A central feature of fiduciary relationships is that the fiduciary acts as a substitute for the entrusting beneficiary.[222] This may be a voluntary transfer of authority based on expertise or it may be a matter of status, *e.g*. an incompetent or minor. The fiduciary is vested with power to act to facilitate performance of functions for the beneficiary.[223] The fiduciary holds discretionary control over significant aspects of the beneficiary's life or assets.[224] Fiduciary law focuses on preventing abuse of that power through preventing conflicts of interest, incentives, controls, and monitoring and regulation.[225]

1. The Duty of Loyalty

The central principles of the duty of loyalty concern aspects of placing the interest of the beneficiary first: avoiding self-dealing and conflicts of interest. Notably, the duty of loyalty includes the duty not to disclose confidential

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*In Defense of a Contextual Disclosure Rule*, 74 TEMP. L. REV. 837, 866 (2001) (discussing utility of fiduciary system in terms of specialization and "resource-pooling benefits").

[221] *See* Brook Valley VII, Joint Venture v. Schropp (*In re* Brook Valley VII, Joint Venture), 496 F.3d 892, 900 (8th Cir. 2007) ("The fiduciary obligation consists of two duties: the duty of care and duty of loyalty."); *In re* Microwave Prods. of Am., 102 B.R. 666, 672 (Bankr. W.D. Tenn. 1989) (noting DIP's has fiduciary duties, such as duty to avoid conflicts, duty to avoid self-dealing, and the duty to avoid "negligent behavior"); John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1122 (2004) (recognizing core fiduciary duties of loyalty, impartiality, and prudence of conduct).

[222] *See* Criddle, *supra* note 219, at 126 ("The starting point for all fiduciary relations is substitution."); *see also* Frankel, *supra* note 219, at 808; Susanna M. Kim, *The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute*, 60 WASH. & LEE L. REV. 111, 153 (2003) (stating fiduciary is "type of substitute for the entrustor").

[223] *See* Frankel, *supra* note 219, at 809 (recognizing fiduciary is delegated power from entrustor to act effectively); *see also* Joseph M. Healey, Jr. & Kara L. Dowling, *Controlling Conflicts of Interest in the Doctor-Patient Relationship: Lessons from* Moore v. Regents of the University of California, 42 MERCER L. REV. 989, 1000 (1991) (stating fiduciary is vested with power for "well-being of the entrustor"); Tuttle, *supra* note 178, at 897 (stating fiduciary takes "power and responsibility over a portion of the beneficiary's life").

[224] *See* Roy Ryden Anderson & Walter W. Steele, Jr., *Fiduciary Duty, Tort and Contract: A Primer on the Legal Malpractice Puzzle*, 47 S.M.U. L. REV. 235, 240 (1993) (opining discretionary control is one of main elements of fiduciary obligation); *see also* Kenneth B. Davis, Jr., *Judicial Review of Fiduciary Decision Making – Some Theoretical Perspectives*, 80 NW. U. L. REV. 1, 4 (1985) (recognizing problem with fiduciaries is combination of fiduciary's control over significant portions of principal's assets or affairs and imperfect alignment of principal's and fiduciary's interests); Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209, 1215 (1995) ("[F]iduciaries cannot perform their services without receiving power over the entrustors, their property, or their interests.").

[225] *See* Anderson & Steele, *supra* note 224, at 243 (noting unique aspect of fiduciary law is it regulates only fiduciary); *see also* Frankel, *supra* note 219, at 811 (discussing categories of protections); Tuttle, *supra* note 178, at 898 (noting despite fiduciary's broad discretion, her acts must be for beneficiary's welfare, "not the fiduciary's own self-interest").

information.[226] As summarized by one commentator: "Fiduciary duties include acting with utmost fairness to clients, making full disclosure, avoiding representation that conflicts with that of the client, and preserving confidences of the client."[227]

Importantly, the duty of loyalty is breached only when the fiduciary obtains an *improper* personal benefit; there is no requirement that even a trustee lack any personal benefit.[228] The guardian cannot embezzle from the ward's assets, but he can be paid from the trust estate to care for the ward's assets. Similarly, corporate directors owe undivided and unqualified loyalty to the corporation which they serve. In the context of operating a business, however, courts have recognized that in some circumstances, fiduciary management entails taking action in which the decision-makers have personal interests and conflicts.[229] Corporate directors are not purely disinterested trustees for a single beneficiary. The duty of loyalty can still be met in such circumstances through full disclosure and approval or ratification of the decision by disinterested persons. A common example of this rule is the approval of corporate transactions with a board member by a vote of other disinterested board members.[230] The corporate codes of most states protect conflict of interest transactions from being voided if: (1) they are fair, or (2) they are approved by a "disinterested" majority of the directors, or (3) they are ratified by the shareholders.[231] Thus, even when directors fail to disclose and approve their self-

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[226] *See In re* Mortgage & Realty Trust, 195 B.R. 740, 750 (Bankr. C.D. Cal. 1996) (defining fiduciary duty of protecting confidential information); *see also* RESTATEMENT (SECOND) OF AGENCY § 395 (1958) (stating agent has duty of confidentiality); Szto, *supra* note 216, at 100–01 (discussing specific duties encompassed in agent's general duty of loyalty).

[227] *See* Anderson & Steele, *supra* note 224, at 241 (discussing obligations existing in fiduciary relationship).

[228] *See In re* Microwave Prods. of Am., Inc., 102 B.R. 666, 671–72 (Bankr. W.D. Tenn. 1989) (noting debtor is subject to fiduciary obligations prohibiting self-dealing); *see also* 7 COLLIER ON BANKRUPTCY, ¶ 1107.02[4] at 1107-16 (Alan N. Resnick et al. eds., 15th ed. rev. 2006) (compiling instances where managers of debtors in possession breach duty of loyalty); Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 EMORY BANKR. DEV. J. 1, 35 (1989) (indicating duty of loyalty and good faith forbids use of position and control to further private interest).

[229] *See In re Microwave Prods.*, 102 B.R. at 672 (noting fiduciary relationship may exist between various entities that may create degree of conflict); *see also* Nimmer & Feinberg, *supra* note 228, at 32–33 (highlighting managers are decision-makers and must accommodate and balance interests among groups); Szto, *supra* note 216, at 112 (stating directors are presumed to meet standard of care when making decisions because of business judgment rule).

[230] *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.02(a)(2)(B) (1994) (indicating circumstances where duty of fair dealing is fulfilled); *see also, e.g.*, Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 900 (Del. Ch. 1999) (stating only votes by disinterested stockholders are eligible for ratification of transaction). *Cf.* Brook Valley VII, Joint Venture v. Schropp (*In re* Brook Valley VII, Joint Venture), 496 F.3d 892, 901 (8th Cir. 2007) (noting fiduciary must prove transaction was fair when challenged for breach of duty of loyalty).

[231] *See* 3 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 915.10 (perm. ed. rev. vol. 2002) (discussing effects of state statutory provisions on transactions or contracts between interested direction and corporation); *see also, e.g.*, Hicks v. Midwest Transit, Inc., 500 F.3d 647, 651 (7th Cir. 2007) (applying Illinois law and requiring proof of fairness);

interested transactions, they still have an opportunity to either ratify them by a shareholder vote or demonstrate their fairness.[232]

2. The Duty of Care

The duty of care requires that the fiduciary act with the care and skill that is standard in that locality for the fiduciary's work and level of skill.[233] A trustee's duty of care has been defined as using "such care and skill as a man of ordinary prudence would exercise in dealing with his own property."[234] In a corporate context of management fiduciary duties, the duty of care for corporate directors is substantially the same. They are to act "in a reasonably prudent manner, in the interest of the company," after obtaining adequate information and in good faith.[235]

The standard of liability for both types of fiduciaries is thus one of negligence.[236] Actions and judgments of corporate fiduciaries are protected by the application of the business judgment rule, however, while ordinary trustees and

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Resolution Trust Corp. v. Dean, 854 F. Supp 626, 644 (D. Ariz. 1994) (stating Arizona law provides transaction or contract between corporation and director is not automatically void or voidable).

[232] For example, Delaware's code protects conflict of interest transactions if (1) a majority of the disinterested directors authorize the transaction, (2) the shareholders approve the transaction, or (3) the transaction is fair. DEL. CODE ANN. tit. 8, § 144 (2001); *see also Harbor Fin. Partners*, 751 A.2d at 901 (arguing shareholder approval of transaction indicates transaction is fair); 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.02(a) (1994) (indicating circumstances of transaction fulfilling duty of fair dealing).

[233] *See* RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958) (stating agent has duty to act with standard of care and skill to principal); Szto, *supra* note 216, at 101 (discussing agent's duty of care owed to principal); *see also* United States v. Aldrich (*In re* Rigden), 795 F.2d 727, 730 (9th Cir. 1986) ("A bankruptcy or reorganization trustee has a duty to exercise that measure of care and diligence that an ordinary prudent person would exercise under similar circumstances.").

[234] *See* RESTATEMENT (SECOND) OF TRUSTS § 174 (1959); *see also In re* Unisys Corp. Retiree Med. Benefit "ERISA" Litig., 242 F.3d 497, 509 (3d Cir. 2001) (discussing legal requirement that fiduciaries exercise care and skill of ordinary prudent man); Dardovitch v. Haltzman, 190 F.3d 125, 150 (3d Cir. 1999) (discussing trustee's duty of care).

[235] *See* MODEL BUS. CORP. ACT § 8.30(a) (2008) (stating director shall perform duties "in good faith coupled with conduct reasonably believed to be in the best interests of corporation"); *see also* Daniel B. Bogart, *Liability of Directors of Chapter 11 Debtors in Possession: "Don't Look Back – Something May Be Gaining On You*," 68 AM. BANKR. L.J. 155, 168 (1994); Howard L. Nations, Mark L. Duke & Gary R. Black, Jr., *Legal Implications of the Millennium Bug: The Multiple Roles of Lawyers in Coping with the Fallout from the Trillion-Dollar Computer Glitch*, 18 REV. LITIG. 417, 446–47 (1999) (stating duty of care requires director to perform duties in good faith, with care, skill, and corporation's best interests in mind).

[236] *See, e.g.*, Sw. Media, Inc. v. Rau, 708 F.2d 419, 425 (9th Cir. 1983) (finding trustee not negligent in selling assets of debtor free and clear of liens); Ford Motor Credit Co. v. Weaver, 680 F.2d 251, 461 (6th Cir. 1982) (explaining "reasonable trustee rule" standard for evaluating trustee behavior); Julien P. Benjamin Equip. Co. v. Sapp, 641 F.2d 182, 183–84 (4th Cir. 1981) (noting trustee merely made nonactionable mistake in judgment by deciding to continue debtor's business and in accepting lease of equipment as made by debtor). *Compare* Bogart, *supra* note 235, at 187 (discussing whether trustees were negligent) *with* John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 148 (1993) (discussing common law trustee standard is more stringent than corporate fiduciary standard). *But see* David P. Primack, Note, *Confusion and Solution: Chapter 11 Bankruptcy Trustee's Standard of Care for Personal Liability*, 43 WM. & MARY L. REV. 1297, 1318 (2001–2002) (explaining differing standards of care when judging personal liability of fiduciaries).

bankruptcy trustees receive the protection of judicial immunity from lawsuits.[237] The burden of proving a corporate director's judgment was unreasonable or irrational or that a trustee's action was objectively unreasonable is held by the plaintiff in a duty of care case.[238]

It is not uncommon for questioned actions to involve both the duty of care and the duty of loyalty.[239] The corporate business judgment rule does not apply to alleged breaches of the duty of loyalty.[240] The burden to prove an action is fair and appropriate under the circumstances is borne by the interested director in a duty of loyalty case.[241] However, an interested director can bear his burden through approval by a majority of disinterested board members.[242] Similarly, a trustee

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[237] *See* Bogart, *supra* note 235, at 169, 202. Bogart sharply criticizes the doctrine of derived judicial immunity with standards of care that trustees owe to their beneficiaries, noting that whether a trustee was negligent — that is, acted in an "objectively unreasonable manner" — is the crucial issue. *Id*.

[238] *See id.* at 174 (discussing business judgment rule places burden of proof on party objecting to directors actions); *see also* Wendi J. Powell, *Corporate Governance and Fiduciary Duty: The "Mickey Mouse Rule"* or *Legal Consistency, Protection of Shareholder Expectations, and Balanced Director Autonomy*, 14 GEO. MASON L. REV. 799, 806–07 (2007) (stating plaintiff must establish corporate directors judgment was not reasonable); Randolph Stuart Sergent, *The Corporate Director's Duty of Care in Maryland: Section 2-405.1 and the Business Judgment Rule*, 44 HOWARD L.J. 191, 231 (2001) (stating plaintiff should always have burden of proving violation of duty of care).

[239] *See* Bogart, *supra* note 235, at 174 n.87 ("Many transactions that eventually result in litigation concerning the directors' fiduciary duties involve both duty of care and duty of loyalty violations. The core of the allegation is that directors' decisions were in some sense negligent. However, if the plaintiffs' attorneys were to leave the allegation in this simple form, the business judgment rule would likely insulate directors from liability. By also arguing that the director has a conflict of interest or was otherwise 'interested,' business judgment rule protection is eliminated. Without protection of the rule, there is no presumption that the decisions are reasonable and that the requisite duty of care is met. In addition, directors have the burden of proving that the transaction is fair to the corporation and thereby meet the directors' duty of loyalty."); *see also* Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 57 FORDHAM L. REV. 375, 383 (1988) ("[T]he business judgment rule may shield from judicial scrutiny business decisions or errors in judgment by directors. Yet the rule never shields from scrutiny transactions or decisions about which colorable claims of self-dealing have been made."). *See generally* Gaines v. Haughton, 645 F.2d 761, 778 (9th Cir. 1981) (discussing directors' broad discretion in making business judgments).

[240] *See, e.g.*, *In re* Fleming Packaging Corp., 351 B.R. 626, 634 (Bankr. C.D. Ill. 2006) (stating business judgment rule does not protect against breaches of duty of loyalty); T. Richard Giovannelli, Note, *Revisiting* Revlon*: The Rumors of its Demise Have Been Greatly Exaggerated*, 37 WM. & MARY L. REV. 1513, 1527 (1996) (discussing business judgment rule does not apply when plaintiffs allege directors have breached duty of loyalty).

[241] *See* Bogart, *supra* note 235, at 178 (noting directors must show their judgment was "reasonably related to a corporate end"); *see also* Clark W. Furlow, *Reflections on the Revlon Doctrine*, 11 U. PA. J. BUS. L. 519, 543 (2009) (discussing burden shifts from plaintiff to defendant in duty of loyalty cases); Charles W. Murdock, *Corporate Governance—The Role of Special Litigation Committees*, 68 WASH. L. REV. 79, 85 (1993) (stating in duty of loyalty cases, burden is on defendant to justify actions).

[242] *See* Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) ("[S]ection 144 [of the Delaware Code] allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule."); *see also* PRINCIPLES OF CORPORATE GOVERNANCE § 5.02(a)(2)(B) (1994) (explaining director can meet burden by getting advance approval of disinterested directors); Branson, *supra* note 239, at 385 (noting duty of loyalty statutes provide that "[a] conflict of interest transaction may be approved upon *either* full disclosure and a disinterested director vote *or* fairness."). These exculpatory statutes come in two primary forms. Some of these statutes entirely exculpate directors from causes of action based on duty of loyalty violations if the director follows a prescribed disclosure procedure. Other statutes are less generous.

bears the burden of proof when self-dealing, conflict or other breach of the duty of loyalty is alleged. [243]

Corporate fiduciaries have a heightened duty of care when there is a corporate control contest. First, when management acts to protect a corporation from takeover, it must affirmatively show: "(1) it had reasonable grounds for believing a danger to corporate policy existed; and (2) its defensive response was proportional to the threat posed."[244] Once it is clear that the company will be sold, management

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If the director follows the disclosure procedure, and the transaction is approved by a majority of disinterested directors, the burden of proving that the transaction at issue is unfair shifts to the party complaining of it. *See* Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 155, 173 (Del. Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006) (finding plaintiff failed to demonstrate unfairness where transaction was approved by disinterested and independent directors and not consummated for improper purpose); *see also* Nebenzahl v. Miller, No. 13206, 1996 Del. Ch. LEXIS 113, at *11–12 (Del. Ch. Aug. 26, 1996) (stating director's satisfaction of section 144 places burden on plaintiff to plead facts asserting unfairness of transaction); Branson, *supra* note 239, at 386 (discussing burden-shifting "effect of corporate compliance with" exculpatory statutes). However, even where the statute falls into the category of a provision that actually exculpates the director, courts are reluctant to give full force to the statute. *See Benihana*, 891 A.2d at 185 (rejecting defendants' argument that transaction was "beyond reach of entire fairness" because requirements of section 144(a) were satisfied and emphasizing that compliance with section 144(a) only means conflict of interest alone will not invalidate challenged transaction); *see also* Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987) (noting court's refusal to interpret section 144 as "either completely preemptive of the common law duty of director fidelity or as constituting a grant of broad immunity"); Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976) (rejecting literal reading of exculpation statute and requiring transaction to be fair to corporation despite all elements of the exculpation provision having been met). As Branson states regarding *Fliegler*, "[a]lthough the court ultimately found that the transaction's terms were fair, *Fliegler's* message was clear: the duty of loyalty cannot be circumvented merely by use of intracorporate conflict of interest procedures." Branson, *supra* note 239, at 387.

[243] *See In re* Estate of Miller, 778 N.E. 2d 262, 267 (Ill. App. Ct. 2002) ("If a petitioner shows that a fiduciary relationship exists, any transaction between parties in which the agent profits is typically presumed to be fraudulent and the agent has the burden of proving by clear and convincing evidence that the transaction was fair and equitable."); *see also* NC Illinois Trust Co. v. First Illini Bancorp, Inc., 752 N.E. 2d 1167, 1175 (Ill. App. Ct. 2001) (placing burden on trustee to prove by clear and convincing evidence trustee did not breach duty of loyalty); RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. a (1992) (requiring trustee to demonstrate transaction was based on full disclosure and was otherwise fair to beneficiary). The equivalent result is reached in a bankruptcy trustee context under a judicial immunity analysis, because "immunity" is destroyed when the trustee commits intentional wrongs. *See* Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1979) ("[A] trustee in bankruptcy is not to be held personally liable unless he acts willfully and deliberately in violation of his fiduciary duties."); *In re* San Juan Hotel Corp., 71 B.R. 413, 427 (D. P.R. 1987) (involving "milking" of estate for benefit of trustee); *In re* Tucker Freight Lines, Inc., 62 B.R. 213, 217 (Bankr. W.D. Mich. 1986); RESTATEMENT (THIRD) OF TRUSTS § 206 cmt. a (1992) ("If the trustee commits a breach of his duty of loyalty he is chargeable with any loss or depreciation in value of the trust property resulting from the breach of duty, or any profit made by him through the breach of duty, or any profit which would have accrued to the trust estate if there had been no breach of duty."); Bogart, *supra* note 235, at 207, nn.288–89 (citing *In re* Center Teleproductions, Inc., 112 B.R. 567, 576 (Bankr. S.D.N.Y. 1990)).

[244] *See* Gilbert v. El Paso Co., 575 A.2d 1131, 1146 (Del. 1990) (finding directors' determination that bid was threat to company and shareholders, based on professional opinions, was reasonable and "[t]heir prompt adoption of defensive measures in an attempt to meet this imminent threat was hardly improvident"); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (requiring directors to demonstrate reasonable basis for believing stockholder endangered corporate strategy and effectiveness and show defensive measure was appropriately tailored to thwart perceived threat); 3A FLETCHER, *supra* note 231, at § 1041.40 (setting forth heightened standard for establishing applicability of business judgment rule in control contest scenarios).

has a duty to maximize shareholders' value by auctioning the company to the highest bidder.[245]

3. The Duty of Impartiality

When one is a fiduciary for multiple beneficiaries, it is difficult to juggle the duty of loyalty to all of them; their interests often conflict. Courts have addressed this quandary through imposing a duty of impartiality on the fiduciary.[246] Determining how to comply with a duty of impartiality itself may be difficult, however. In a trust context, the trust instrument may be used to provide guidance on how to meet this duty in the context of a particular trust. A basic tenet of trust law is that the trust document may alter or explain the common law fiduciary obligations of the trustee.[247] It may enable a trustee to determine the extent to which he should invest trust assets in income-producing assets for a surviving spouse versus investing in long-term growth assets for contingent beneficiary children, for example.

Corporate fiduciaries do not have a duty of impartiality because their fiduciary duty is only to the corporation itself and not to the individual shareholders.[248]

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[245] *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242–43 (Del. 2009) (clarifying *Revlon* does not mandate manner in which board must secure best price for shareholders, but rather requires directors to vigorously participate in transaction and verify best possible price for shareholders is attained); *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 182 (Del. 1986) (finding once company's collapse was inevitable, "directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company"); 3 FLETCHER, *supra* note 231, at § 1041.50 (discussing rule requiring auctioning of company "to maximize the company's value at a sale for the shareholders' benefit" when company's sale or demise is certain).

[246] *See* Morse v. Stanley, 732 F.2d 1139, 1145 (2d Cir. 1984) (stating "trustee must deal even-handedly among" beneficiaries of trust); *see also* Snyder v. Pa. Dept. of Public Welfare, 598 A.2d 1283, 1287 (Pa. 1991) (finding trustee's duty to deal impartially with two sibling beneficiaries prevented trustee from using trust principal to pay one sibling's medical expenses because other sibling's interest would be irreparably harmed); RESTATEMENT (THIRD) OF TRUSTS § 183 (1992) ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

[247] *See* RESTATEMENT (THIRD) OF TRUSTS § 183, cmt. a (1992) ("By the terms of the trust the trustee may have discretion to favor one or more beneficiaries over others. The court will not control the exercise of such discretion, except to prevent the trustee from abusing it."); *see also* RESTATEMENT (THIRD) OF TRUSTS § 227, cmt. a (1992) ("In the absence of a contrary statutory provision, a trustee may generally invest in such properties and in such manner as expressly or impliedly authorized by the terms of the trust. Assuming no contrary trust provision, however, the rule of this section describes the nature of the investment authority and duties normally to be implied."); RESTATEMENT (THIRD) OF TRUSTS § 78, cmt. c(2) (1997) ("[N]o matter how broad the provisions of a trust may be in conferring power to engage in self-dealing or other transactions involving a conflict of fiduciary and personal interests, a trustee violates the duty of loyalty to the beneficiaries by acting in bad faith or unfairly.").

[248] *See* FDIC v. Wheat, 970 F.2d 124, 130 (5th Cir. 1992) ("[D]irector's personal liability lies only to the entity he or she represents and not to individual shareholders or creditors of the corporation."); *see also* Danielewicz v. Arnold, 769 A.2d 274, 285 (Md. App. Ct. 2001) (explaining general principle that fiduciary duty imposed on corporate directors by law is to "the corporation and all of its stockholders, but they are not trustees for the individual stockholders" (quoting Waller v. Waller, 49 A.2d 449, 454 (Md. App. Ct. 1946))); 3 FLETCHER, *supra* note 231, at § 848 (noting director is liable for breach of fiduciary duty to corporation, rather than to individual shareholders, because director's duty is "to act solely in the interest of the corporation").

Directors of a corporation must administer the corporate affairs for the good and benefit of all the shareholders, so their duty is to serve shareholders collectively instead of individually.[249] Directors can treat shareholders selectively if one shareholder poses a threat to the corporate enterprise.[250] In limited circumstances, the directors of a corporation have the ability to neutralize a threat by either paying the threatening shareholder "greenmail" or excluding the threatening shareholder from a benefit given to other shareholders.[251] However, corporate fiduciaries stand in a sufficiently confidential relationship with shareholders to impose a duty of complete candor to the shareholders. They are required to disclose all germane or material information related to both corporate transactions and matters of corporate governance.[252]

### *C. Application of Fiduciary Principles to a DIP and Committee*

The core principles of the duty of fiduciary duties can be readily applied to DIPs and Committees when the following are taken into account: (1) the mechanism of disclosure and ratification and (2) use of the Bankruptcy Code as the equivalent of a trust instrument providing parameters for appropriate action and balancing of self-interest. As shown by the cases discussed in section II.A, C supra,

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[249] *See* Am. General Ins. Co. v. Equitable General Corp., 493 F. Supp. 721, 741 (E.D. Va. 1980) (recognizing common law duty owed to company's shareholders by its directors as duty attaching only to transactions between officers and directors of company and shareholders collectively, rather than fiduciary duty owed to each individual shareholder); *see also Unocal*, 493 A.2d at 955 (noting "basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders"); 3 FLETCHER, *supra* note 231, at § 848 ("[T]he directors of a corporation, in the performance of their duties as trustees of the corporation's business and property, must administer the corporate affairs for the good and benefit of all the shareholders.").

[250] *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989) (indicating shareholder's rights may be limited by board when faced with threat to "deliberately conceived corporate plan"); *see also Unocal*, 493 A.2d at 958 ("[I]n the face of the destructive threat . . . the board had a supervening duty to protect the corporate enterprise, which includes other shareholders, from threatened harm."); Jan Jensen, *Discrimination Against Shareholders in Opposing a Hostile Takeover*, 59 S. CAL. L. REV. 1319, 1335 (1985–1986) (proposing selective treatment of "raider-shareholder" may be permissible where there is "inadequate and coercive tender offer and the threat of greenmail").

[251] *See Unocal*, 493 A.2d at 957 (reasoning exclusion of raiding shareholder from benefit given to other shareholders was valid given nature of threat posed to corporation); *see also* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (suggesting board may pay greenmail "if the actions of the board were motivated by a sincere belief that the buying out of the dissident stockholder was necessary to maintain what the board believed to be proper business practices"). *But see* Nicholas L. Georgakopoulos, *Corporate Defense Law for Dispersed Ownership*, 30 HOFSTRA L. REV. 11, 30–31 (2001–2002) (arguing payment of greenmail to threatening shareholders "contradicts the classic principle of corporate law that assets go to the shareholders proportionately").

[252] *See* Lacos Land Co. v. Arden Group, Inc., 517 A.2d 271, 279 (Del. Ch. 1986) (noting board is required "to disclose fully and fairly pertinent information within the board's control" when it seeks shareholder action); *see also* 3 FLETCHER, *supra* note 231, at § 837.70 ("A board's duty of complete candor to its shareholders to disclose all germane or material information applies to matters of corporate governance as well as to corporate transactions."); Eric J. Wittenberg, *Underwater Stock Options: What's a Board of Directors to Do?*, 38 AM. U. L. REV. 75, 91 (1988–1989) (identifying failure to disclose material information to shareholders can result in setting aside of otherwise validly ratified transactions).

DIPs and Committees owe a duty of loyalty, a duty of care and a duty of impartiality to their constituencies. As in other fiduciary contexts, the DIP bears the burden of proving a transaction challenged as breaching the duty of loyalty was in fact fair and reasonable, while the duty of care requires the DIP to make good faith decisions that can be attributed to a rational business purpose, decisions that are not second-guessed if made in good faith.[253]

Despite owing these fiduciary duties, neither the DIP nor Committee members are required to be disinterested.[254] Numerous decisions made by DIP management and by Committee members impact their personal interests as well as the interests of creditors. When determining whether a DIP or Committee member has improperly elevated personal interests over beneficiaries' interests, the Bankruptcy Code and Rules may be considered the equivalent of the trust instrument, setting forth parameters that displace implied fiduciary duties.[255] Chapter 11 contemplates negotiation among the parties to determine how property and future earnings will be allocated. It specifies an order of priorities for creditor distributions, and provides standards for forcing plan provisions on creditors that do not accept a reorganization plan.[256] In this sense, the Bankruptcy Code provides a substitute for the duty of impartiality.[257]

Exercising rights within the provisions and intent of the Bankruptcy Code and Rules would not be an improper taking of personal benefit that breaches fiduciary duties.[258] The DIP is permitted to participate actively in plan negotiations and use

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[253] *See* Brook Valley VII, Joint Venture v. Schropp (*In re* Brook Valley VII, Joint Venture), 496 F.3d 892, 900–01 (8th Cir. 2007) (finding DIPs breached their duty of loyalty since they failed to prove transaction involving purchase of bankruptcy estate property was fair and reasonable); *see also* Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461–62 (6th Cir. 1982) (observing DIP standard of liability is negligence or willful and deliberate violation of fiduciary duties to creditors, like bankruptcy trustee); *In re* Integrated Resources, Inc., 147 B.R. 650, 656 (S.D.N.Y. 1992) (noting business judgment rule allows for presumption that decisions by corporate directors were made in good faith and for best interests of company).

[254] *See* Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997) (indicating debtor in possession, by definition, is not disinterested).

[255] *See* Bogart, *supra* note 235, at 245 ("[T]he replacement of the traditional duty of impartiality with a process of negotiation is consonant with both trust law and the Bankruptcy Code.").

[256] *See* 11 U.S.C. § 726 (2006) (outlining priorities for creditor distribution of property of bankruptcy estate); Bland v. Farmworker Creditors, 308 B.R. 109, 112 (S.D. Ga. 2003) (noting repayment prioritization set forth in Bankruptcy Code is settled upon confirmation of chapter 11 reorganization plan); *In re* BMW Group I, Ltd., 168 B.R. 731, 749 (Bankr. W.D. Okla. 1994) (acknowledging reorganization plan can be forced upon objecting creditor when majority of class it belongs to accepts plan).

[257] *See* Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 515 (7th Cir. 1991) (holding DIP's fiduciary duty to creditors met by good faith compliance with Code and Rule provisions); *see also* Bogart, *supra* note 235 at 201–02 (noting impartiality not problem in bankruptcy cases because Code states trustee must enlarge debtor estate, requiring e.g. collection of preferences from some creditors and benefiting others by virtue of such Code compliance).

[258] *See* Casco N. Bank, N.A. v. DN Assocs. (*In re* DN Assocs.), F.3d 512, 516 (1st Cir. 1993) (noting DIP did not breach fiduciary duties because DIP pursued plans preserving interests of equity while paying creditors); *see also* Bogart, *supra* note 235, at 214–15 (noting DIP may carry out statutory duties "without necessarily violating fiduciary obligations"); Stephen H. 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*, ALI-ABA Williamsburg Conference on Bankruptcy (Oct. 17-19, 1988) *available at* WL C371 ALI-ABA 1, 7 ("[A] key distinction in the duty-of-loyalty concept must be

its leverage without violating fiduciary obligations.[259] This is especially the case when parties in interest are both actively and openly negotiating while litigating as adversaries before the court.[260] Cases addressing Committee misconduct likewise evaluate whether the Committee member acted within the scope of Committee rights and duties under the Bankruptcy Code, or *ultra vires* its authority.[261]

In the sale context, including a debtor's sale of estate assets to an insider, courts generally follow the Seventh Circuit's *Schipper* opinion in holding that the rights of the debtor and duties of the DIP are balanced and met by complying with Bankruptcy Code and Rule procedures.[262] The courts thus define the DIP's fiduciary duties by the statutory framework that empowers the DIP to act and specifies the procedures under which it must act. In *Schipper*, the Seventh Circuit refused to apply to the 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.[263] Rather, the court held that by meeting the standards of the Bankruptcy Code and Rules, the DIP adequately complies with its fiduciary obligations to creditors in an asset sale context.[264]

If bankruptcy rules, orders and procedures for asset sales are not met, especially including notice rules, the DIP may be sanctioned for breach of fiduciary duties to injured creditors.[265]

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insisted upon at the outset: *improper personal conflicts of interest of the trustee* must, on the one hand, be clearly separated from *conflicts of interest among beneficiaries* on the other hand. The duty of loyalty, on the one hand, prohibits such personal conflicts; on the other hand fiduciary duty requires that conflicts of interest as between beneficiaries be properly resolved.").

[259] *See In re* Water's Edge Ltd. P'ship, 251 B.R. 1, 7 (Bankr. D. Mass. 2000) (stating Bankruptcy Code imposes no fiduciary obligations on DIP in plan negotiation process); *see also* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 459–60 (D. Utah 1998) (noting DIP may negotiate with creditors without violating fiduciary duties); Bogart, *supra* note 235, at 240–41 (noting trustee cannot have improper personal interest); Case, *supra* note 258, at 7 ("The duty of loyalty, on the one hand, prohibits such personal conflicts; on the other hand fiduciary duty requires that conflicts of interest as between beneficiaries be properly resolved.").

[260] *See* Bogart, *supra* note 235, at 244 (noting Code allows DIP to propose plan resulting from negotiations). *But see* Thomas G. Kelch, *The Phantom Fiduciary in Chapter 11: The Debtor in Possession in Chapter 11*, 38 WAYNE L. REV. 1323, 1350–54 (1992) (arguing inherent conflicts in chapter 11 cases create problems meeting impartiality duty).

[261] *See, e.g.*, Luedke v. Delta Air Lines, Inc., 159 B.R. 385, 392 (Bankr. S.D.N.Y. 1993) (analyzing immunity for creditor committee conduct "beyond the scope of the authority conferred upon it by the statute or the court"); *In re* Mesta Machine Co., 67 B.R. 151, 159 (Bankr. W.D. Pa. 1986) (noting Committee modifying plan to benefit Committee member had fiduciary duty to notify constituent individual class members). *See generally* 11 U.S.C. § 1103 (2006) (outlining Creditor Committee powers and duties).

[262] *See* Peterson v. Scott (*In re* Scott), 172 F.3d 959, 967–68 (7th Cir. 1999) (reaffirming DIP fiduciary duty can be met through compliance with Bankruptcy Code); *see also* Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 516 (7th Cir. 1991) (holding DIP complied with Code provisions and declining to apply a "common-law trustee standard of duty" to DIP).

[263] *See Schipper*, 933 F.2d at 516 ("This court is unwilling . . . to apply the common-law trustee standard of duty.").

[264] *See id.* at 516 (holding DIP not liable because of compliance with Code).

[265] *See, e.g.*, Nw. Nat'l Bank of St. Paul v. Halux, Inc. (*In re* Halux, Inc.), 665 F.2d 213, 216 (8th Cir. 1981) (finding breach of duty to lessor whose equipment was sold without notice); Tenn-Fla Partners v. First Union Nat'l Bank of Fla., 229 B.R. 720, 734 (W.D. Tenn. 1999) (holding sale under plan at price insufficient to pay creditors fully, re-sale post-confirmation at higher price benefiting only equity; serious interest of second buyer

The Bankruptcy Code and Rules do not require that Committee members submit themselves to the same degree of scrutiny and restrictions as a debtor or DIP. Courts have repeatedly recognized that Committee members are not expected to subordinate their self interest as creditors with claims against the estate and as businesses with primary concerns and responsibilities to their own "bottom lines."[266] Mere status as a Committee member does not subject that member to a corporate fiduciary's obligations to disclose all transactions with the debtor, obtain the consent of disinterested Committee members, and demonstrate that the proposed action is not detrimental to the debtor.[267] However, when a Committee member acts in its Committee capacity, and uses opportunities and confidential information obtained as a Committee member to further his self-interest, courts do apply such requirements of disclosure and ratification by other Committee members (and in some instances also the court), and evidence of fairness and "turning square corners."[268]

*D. DIP and Committee Standard of Care - Gross Negligence.*

An early Supreme Court case addressing the standard of care for a bankruptcy trustee is *Mosser v. Darrow*.[269] In *Mosser,* a trustee authorized his employees to

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hidden during case); *In re* Simon Transp. Servs., Inc., 292 B.R. 207, 217–18 (Bankr. D. Utah 2003) (demonstrating inadequate notice of assets being sold; mentioned but with no reference to substantial value); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 846 (Bankr. C.D. Cal. 1991) (finding failure to disclose sale was to insider); *In re* Vallejo, 77 B.R. 365, 367 (Bankr. D. P.R. 1987) (condemning sales without court approval); *In re* Frankel, 77 B.R. 401, 403–04 (Bankr. W.D.N.Y. 1987) (exemplifying sale of secured inventory on credit without required secured creditor approval).

[266] *See, e.g.*, Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561, 572 (W.D. Pa. 2005) (finding while Committee members cannot act solely in self interest, it does not always result in breach of fiduciary duty); *In re* Rickel & Assoc., Inc., 272 B.R. 74, 100–01(Bankr. S.D.N.Y. 2002) (explaining Committee member can still further own interests, such as by participating in bidding for assets); *In re* El Paso Refinery, L.P., 196 B.R. 58, 74–75 (Bankr. W.D. Tex. 1996) (discussing Committee members' responsibility to deal fairly with other creditors while protecting own right "to look out for own interests").

[267] *See, e.*g., *Walsh*, 327 B.R. at 573 (explaining fiduciary duty created for Committee members, but not to the level of a corporate director or officer); *In re Rickel*, 272 B.R. at 100 (indicating Committee members' fiduciary duty as "hybrids who serve more than one master"); *In re El Paso Refinery*, 196 B.R. at 74 (stating Committee members do not need to disclose every business choice made); Herbert P. Minkel, Jr. & Cynthia A. Baker, *Claims and Control in Chapter 11 Cases: A Call for Neutrality*, 13 CARDOZO L. REV. 35, 64–68 (1991) (discussing Committee members' fiduciary duties as "fuzzy" and limits to those duties that allow members to act in self interest).

[268] In *El Paso Refinery*, the Committee member did not learn of a potential transaction because of his membership on the Committee, and pursued the business opportunity without taking advantage of his Committee membership. 196 B.R. at 74–75. In *Walsh*, the court held that if the Committee member had given notice to the Committee and debtor and obtained court approval, his pursuit of a business opportunity it discovered as a Committee member would not have breached his fiduciary duty. *See* 327 B.R. at 573–76. In *Rickel*, a cause of action against a Committee member was stated, and a complaint not dismissed, when a constituent creditor alleged the member used his position on the Committee to obtain information about a transaction and gain an edge in negotiations, and further misrepresented transaction facts to the Committee, misusing Committee status to advance his personal interest to the detriment of other creditors. *See* 272 B.R. at 100–01.

[269] 341 U.S. 267 (1951).

trade on securities related to the trust.[270] Because his authorization was a willful and deliberate breach of his fiduciary duty, the trustee was held personally liable even though he did not personally profit.[271] The court explained that "Equity tolerates in bankruptcy trustees no interest adverse to the trust . . . . These strict prohibitions would serve little purpose if the trustee were free to authorize others to do what he is forbidden."[272]

The *Mosser* court, however, did not rule whether a trustee can be held personally liable for negligence: "We see no room for the operation of the principles of negligence in a case in which conduct has been knowingly authorized."[273] But the court, in dicta did give some guidance on what the standard should be. It indicated that courts are "quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment."[274] The court further explained that personal liability can be avoided by seeking instructions from the court.[275]

While *Mosser* provided some guidance for later courts, a circuit split developed over the proper standard for bankruptcy trustees. The Tenth Circuit, and the courts that followed its decision, held that a trustee in bankruptcy should not be held personally liable unless he acts willfully and deliberately in violation of his fiduciary duties.[276] The Ninth Circuit went to the opposite extreme, imposing liability for mere negligence.[277] More recently, however, the Fifth Circuit followed a Massachusetts bankruptcy court decision that took an intermediate position, gross negligence.[278] Imposing a gross negligence standard is consistent with the Final Report of the National Bankruptcy Review Commission and seeks to avoid dissuading capable people from becoming trustees while still encouraging responsible estate management.[279] The gross negligence standard is also the most

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[270] *See id.* at 269.

[271] *See id*. at 273–74 (stating personal liability is best sanction for acting against court authority).

[272] *See id.* at 271.

[273] *See id.* at 272.

[274] *See id.* at 274.

[275] *See id.*

[276] *See In re* Chicago Pacific Corp., 773 F.2d 909, 915 (7th Cir. 1985) (using holding in *Sherr* as rule of law); *see also* Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461–62 (6th Cir. 1982) (agreeing with holding in *Sherr*, that trustee in bankruptcy will be held personally liable for willful and deliberate acts); Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1977) (holding trustee in bankruptcy will be held personally liable only if he acts "willfully and deliberately").

[277] *See In re* Gorski, 766 F.2d 723, 727 (2d Cir. 1985) (acknowledging liability may come from not only intentional action, but also negligent breach of fiduciary duty); *see also* Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983) (claiming while trustee is not liable for mistakes in judgment where discretion is allowed, he is liable for intentional and "negligent violations of duties imposed upon him by law").

[278] *Compare* Dodson v. Huff (*In re* Smyth), 207 F.3d 758, 762 (5th Cir. 2000) (citing *In re* J.F.D. Enters., Inc., 223 B.R. 610 (Bankr. D. Mass. 1998), *aff'd*, 236 B.R. 112 (Bankr. D. Mass. 1999)) (establishing personal liability for trustees only when there is gross negligence because it strikes proper balance between trustees task and interest of creditors), *with Sherr*, 552 F.2d at 1375 (finding personal liability only for willful and deliberate acts), *and In re Cochise*, 703 F.2d at 1357 (holding liability for not only intentional acts but also negligent violations).

[279] The commission recommended the adoption of a gross negligence standard for chapter 7, 12, and 13 trustees, and tying a chapter 11 trustee to the standard of care applicable to officers and directors of a

consistent approach to the *dicta* in *Mosser* since it protects trustees from the liability for mere negligence, but still requires responsible action.[280]

The gross negligence standard also has some similarities to a corporate board's duty to make informed decisions in a corporate control context, which is analogous to a chapter 11 reorganization case.[281] A seminal Delaware case, *Smith v. Van Gorkom*,[282] applied this duty in holding directors personally liable for approving a merger without sufficiently informing themselves of the facts surrounding the merger.[283] Thus, while the business judgment rule generally applies to the substance of directors' decisions, they must meet procedural duties to diligently and reasonably inform themselves of all relevant facts before approving a transaction to gain that protection.[284]

Committee members do 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.[285]

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corporation in the state in which the chapter 11 case is pending. *See In re Smyth*, 207 F.3d at 761–62 (citing NAT'L BANKR. REVIEW COMM'N FINAL REPORT § 3.3.2 at 860–61).

[280] *See Mosser*, 341 U.S. at 274 ("Courts are quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment. But a trusteeship is serious business and is not to be undertaken lightly or so discharged."); *see also* United States v. Schilling (*In re* Big Rivers Electric Corp.), 355 F.3d 415, 437 (6th Cir. 2004) (assessing $1 million sanction to trustee after considering disloyalty is "'not to be undertaken lightly or so discharged'" (quoting *Mosser*, 341 U.S. at 274)); Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 515 (7th Cir. 1991) (finding trustee did not breach his fiduciary duty because trustee's actions were made in good faith).

[281] *See* GEORGE G. BOGERT ET AL., LAW OF TRUSTS AND TRUSTEES § 543 (2d ed., rev. vol. 1280); *see also* Richard M. Cieri, Lyle G. Ganske & Heather Lennox, *Breaking Up Is Hard to Do: Avoiding the Solvency-Related Pitfalls in Spinoff Transactions*, 54 BUS. LAW. 533, 538 (1999) ("The duty of care requires that directors act in an informed and considered manner, meaning that, prior to making a business decision, the directors must have informed themselves of 'all material information reasonably available to them' and, '[h]aving become so informed, they must then act with requisite care in the discharge of their duties.'"); Ely R. Levy, Note, *Corporate Courtship Gone Sour: Applying a Bankruptcy Approach to Termination Fee Provisions in Merger and Acquisition Agreements*, 30 HOFSTRA L. REV. 1361, 1373 (2002) (stating board of directors' conduct examined under gross negligence standard when deciding if board acted in informed, deliberate manner in approving agreements prior to submitting them to shareholders).

[282] 488 A.2d 858, 893 (Del. 1985).

[283] *Van Gorkom*, 488 A.2d at 873 ("In the specific context of a proposed merger of domestic corporations, a director has a duty . . . to act in an informed and deliberate manner in determining whether to approve an agreement of merger."); *see* Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 275 (2d Cir. 1986) (stating directors violated duty of care by approving lock-up stock option after only a three -hour late night meeting, in which directors at no time inquired about financial advisor whether he had calculated fair price range for options); *see also* 3 FLETCHER, *supra* note 231, at § 1041.60 ("[I]t is imperative that the board make an 'informed' judgment.").

[284] *See* Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 66 (Del. 1989) ("We look for evidence as to whether a board has acted in a deliberate and knowledgeable way in identifying and exploring alternatives."); *see also Van Gorkom*, 488 A.2d at 873 (stating director has duty to act in informed, deliberate manner when approving merger agreement).

[285] *See, e.g.*, *In re* PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000) (stating Committee's release in plan, excepting liability for willful misconduct or gross negligence, reflects Committee's limited immunity and no change in liability standard); *In re* Dow Corning Corp., 255 B.R. 445, 485 (E.D. Mich. 2000) ("To overcome this immunity, the party alleging breach of fiduciary duty must prove that the committee engaged in willful misconduct or 'ultra vires' activity."); *In re* Granite Partners, L.P., 210 B.R. 508, 516–17 (Bankr. S.D.N.Y. 1997) (holding immunity where no willful misconduct or activities *ultra vires* to Committee activities); *In re*

Committee members enjoy a qualified immunity, like a trustee, to the extent that they act within the scope of their duties under bankruptcy law.[286] If the Committee acts outside the scope of its authority under the Bankruptcy Code, or acts recklessly or with gross negligence in carrying out assumed tasks, Committee members may be liable.[287] The remedy for a Committee member's breach of fiduciary duty is generally disqualification from continued service.[288] However, damages may also be awarded.[289]

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L.F. Rothschild Holdings, Inc., 163 B.R. 45, 49 (S.D.N.Y. 1994) ("Nevertheless, 'any such immunity must be limited to actions taken within the scope of the committee's authority as conferred by statute or the court and may not extend to 'willful misconduct' of the committee or its members.'" (quoting Luedke v. Delta Air Lines, Inc., 159 B.R. 385, 392–93 (S.D.N.Y. 1993))); *In re* General Homes Corp. and FGMC, Inc., 181 B.R. 870, 880–82 (Bankr. S.D. Tex. 1994) (noting limited immunity of Committee did not extend to filing adversary complaint without court authority in violation of stay; attorney and Committee members jointly and severally liable); *Luedke*, 159 B.R. at 392–94 (indicating complaint against Committee and its members by former debtor employees stated cause of action; Committee allegedly usurped DIP role in sale negotiations and manipulated reorganization; Committee allegedly assumed duty to all parties in reorganization case by becoming joint sponsor and joint plan proponent); *In re* Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 722 (Bankr. S.D.N.Y. 1992) *aff'd,* 140 B.R. 347 (S.D.N.Y. 1992) (stating plan could release Committee members from any liability connecting with reorganization except claims arising from willful misconduct); *In re* Tucker Freight Lines, Inc., 62 B.R. 213, 215 (Bankr. W.D. Mich. 1986) (noting debtor's sole shareholder sued Committee, alleging letter urging vote against DIP plan included false and misleading statements). *See generally In re* Rickel & Assoc., Inc., 272 B.R. 74 (Bankr. S.D.N.Y. 2002) (finding cause of action stated for Committee member's use of inside information); REA Holdings Corp., 8 B.R. 75 (Bankr. S.D.N.Y. 1980) (finding actionable breach of fiduciary duty as Committee member diverted business from debtor to member).

[286] *See, e.g.*, *In re PWS Holding Corp.*, 228 F.3d at 246 ("11 U.S.C. § 1103(c), has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members."); *In re* Granite Partners, L.P., 210 B.R. 508, 516 (Bankr. S.D.N.Y. 1997) ("[C]ommittee members enjoy qualified immunity for the actions they take within the scope of the authority conferred upon them by statute or the court."); Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R. 438, 514 (S.D.N.Y. 1994) (indicating Committee members enjoy qualified immunity extending to conduct within scope of Committee's authority); *In re Tucker Freight Lines, Inc.*, 62 B.R. at 217 ("A trustee has immunity only if his actions are within the scope of the authority conferred upon him by statute or the court."); Weissman v. Hassett, 47 B.R. 462, 466 (S.D.N.Y. 1985) ("[T]rustee's position will not immunize him from suit for torts committed in conducting the business affairs of bankrupt company.").

[287] *See In re Tucker Freight Lines, Inc.*, 62 B.R. at 217 (indicating if Committee urged rejection of plan for reasons they knew, or should have known but for recklessness, to be false, would violate fiduciary duty and deprive Committee members of their limited immunity under 11 U.S.C. § 1103(c)(3)); *see also* Pension Benefit Guar. Corp. v. Pincus, 42 B.R. 960, 964 (E.D. Pa. 1984) (directing trial with expert evidence on whether Committee counsel was negligent to Committee constituent in excluding it from distribution of funds without notice).

[288] *See In re* Venturelink Holdings, Inc., 299 B.R. 420, 423 (Bankr. N.D. Texas 2003) ("This court has held that a conflict of interest that amounts to a breach of that fiduciary duty constitutes the type of conflict that would mandate removal of the creditor from the committee."); *In re* Fas Mart Convenience Stores, Inc., 265 B.R. 427, 432 (Bankr. E.D. Va. 2001) ("Moreover, if a party is unwilling or unable, due to overwhelming conflicts of interest or any other reason, to exercise and honor its fiduciary obligations, it should not be allowed to serve on the committee, and the trustee should take steps to remove that member."); *In re* Pierce, 237 B.R. 748 (Bankr. E.D. Cal. 1999) (noting if member is unable or unwilling to exercise fiduciary duties, U.S. Trustee should remove him from Committee; disagreement over strategy or objections not per se a conflict mandating removal); *In re* Swolsky, 55 B.R. 144, 146 (Bankr. N.D. Ohio 1985) (finding Committee member should be removed because of conflict of interest).

[289] *See* Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561, 577 (W.D. Pa. 2005) (holding trustee was entitled to money damages for Committee member's breach of fiduciary duty); *Luedke*, 159 B.R. at 392–94 (S.D.N.Y. 1993) (determining airline's allegations against Creditors Committee's "willful

*E. Application of Fiduciary Principles to DIP and Committee Counsel*

> As Justice Frankfurter stated: "But to say that a man is a fiduciary only begins analysis . . . . To whom is he a fiduciary? What obligations does he owe as a fiduciary?"[290]

An attorney for the DIP or Committee, like the DIP and Committee members, cannot engage in improper self-dealing or have unacceptable conflicts of interest. Like the DIP and Committee clients, counsel has personal interests and conflicts, including most notably the interest in being compensated for work performed, and receiving that compensation on an administrative expense basis ahead of other creditors.[291] This personal interest comes to the fore frequently when DIP or Committee counsel seeks a retainer for representation, or negotiates a carve-out to DIP loans for professional fees.[292] The balancing of personal interests in compensation over client interests may be critical when the ability to confirm a plan turns on sufficiency of funds to pay administrative claims for professional fees in full.[293] Even there, where the conflict between the interests of the attorneys and the creditors and other stakeholders is most stark, courts have recognized that the lawyer need not subordinate her personal interest.[294] The critical point is to disclose

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misconduct" was sufficient to lift committee's qualified immunity from suit); *In re General Homes Corp.*, 181 B.R. at 882 (sanctioning official Unsecured Creditors Committee for willfully violating automatic stay by filing complaint without bankruptcy court's approval); *In re* Mesta Machine Co., 67 B.R. 151, 166 (Bankr. W.D. Pa. 1986) (finding Committee members and counsel jointly and severally liable to repay bankruptcy estate funds for breach of fiduciary duty based on improper compensation received).

[290] SEC v. Chenery Corp., 318 U.S. 80, 85–86 (1943).

[291] *See In re* Martin, 817 F.2d 175, 180 (1st Cir. 1987) (acknowledging any attorney retained for DIP "becomes a creditor of the estate just as soon as any compensable time is spent on account"); *see also In re* Roamer Linen Supply, Inc., 30 B.R. 932, 934 (Bankr. S.D.N.Y. 1983) (considering debtor's arguments to compensate attorneys in chapter 11 case by subordinating creditors and tax agencies, but ultimately holding attorneys were not entitled to super-creditor status).

[292] *See In re* Qmect, Inc., 359 B.R. 270, 271 (Bankr. N.D. Cal. 2007) (acknowledging objections filed by attorneys with administrative claims, including Committee attorney, who protested proposed compromise between debtor and trustee to settle chapter 7 case); *see also In re* ABC Auto. Prod. Corp., 210 B.R. 437, 443 (Bankr. E.D. Pa. 1997) (recognizing attorney's interests are divergent from unsecured creditors where attorneys are incentivized to maximize fees by increasing services performed for Committee); *In re* Am. Res. Mgmt. Corp., 51 B.R. 713, 717–18 (Bankr. D. Utah 1985) (recognizing Committee counsel's argument of having administrative fees paid in full from creditor's collateral).

[293] *See* 11 U.S.C. § 1129(a)(9)(A) (2006) (stating debtor must pay administrative fees included in 11 U.S.C. § 507(a)(2) in order to have plan confirmed); *see also In re* Capitol Hill Group, 313 B.R. 344, 347 (D. D.C. 2004) (recognizing problem when debtor, in process of confirming plan, asked counsel to accept less than full amount agreed to, despite previously agreeing to pay entire amount); *In re* Dale's Serv., Inc., No. 07-01255-JDP, 2008 Bankr. LEXIS 1652, at *10 (Bankr. D. Idaho May 27, 2008) (acknowledging attorney may object to confirmation of plan that did compensate attorney for services).

[294] *See In re* Roberts, 75 B.R. 402, 404, 413 (D. Utah 1987) (noting although law firm failed to disclose potential conflict of interest when filing bankruptcy petitions, "need for attorney discipline is outweighed by equities of this case"); *see also In re* Metro. Envtl., Inc., 293 B.R. 871, 883 (Bankr. N.D. Ohio 2003) (suggesting conflict of interest of counsel serving two masters does not automatically preclude counsel from representing debtor-corporation, but rather creates "significant potential" counsel will be unable to represent debtor); *In re* Creative Rest. Mgmt., Inc., 139 B.R. 902, 909 (Bankr. W.D. Mo. 1992) (analyzing whether

the conflicts fully so that all parties in interest are informed, and let the disinterested court make a decision on the proposed action.

The fiduciary mechanisms of disclosure, court ratification, and use of the Bankruptcy Code as the equivalent of a trust instrument, thus apply readily to DIP and Committee counsel's personal conflict of interest issues, without focusing on whether duties run to the DIP or Committee, the court or the estate. These concepts can also be applied to conflicts based upon representation of other clients in the bankruptcy case in addition to the DIP client for DIP counsel and the Committee client for Committee counsel. Thus, representing the DIP and a creditor unrelated to the DIP are easily identifiable as conflict-based breaches of fiduciary duties as well as violations of professional responsibility rules. The fundamental principle that one cannot serve two masters with conflicting interests is straightforward, and rises above any need to denote the harmed party as the estate in addition to the DIP and creditor clients. Similarly, in a Committee context, simultaneously representing a non-Committee constituent with adverse interests is a clear conflict of interest.[295]

The harder cases arise where DIP counsel's representation of the Debtor/DIP is considered to improperly advance the interests of DIP insiders, or Committee counsel advises Committee members doing ongoing business with the DIP about their administrative expense claim issues. To a certain extent, the concepts of disclosure and court ratification and application of Bankruptcy Code provisions as a standard for appropriate actions helps connect fiduciary principles to DIP and Committee counsel. Those standards work when the lawyer's beneficiary is his client, the Debtor/DIP or Committee. For example, when all parties in interest understand that DIP counsel is openly negotiating with adverse counsel for the Committee and secured creditors, *e.g*. by seeking a smaller "new value" plan contribution by equity owners, and doing so within the boundaries of the Bankruptcy Code and subject to court approval of the result as fair and not overreaching, the lawyer is representing the Debtor aspects of the DIP client and successfully avoids any conflict between the interest of the DIP as fiduciary DIP and the same client as Debtor. When deals benefiting DIP insiders are hidden from adverse parties in interest and the court, and fall outside the parameters of the Bankruptcy Code and Rules, DIP counsel may well be charged with having taken on representation of an additional party in interest adverse to the DIP, a conflict of interest. The lawyer is then perceived as serving two masters, the insider and the fiduciary entity, which would be the same case outside of bankruptcy if the lawyer secretly advised the corporate president to embezzle instead of to openly arrange for

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law firm should represent chapter 11 debtor by determining whether the Bankruptcy Code makes a law firm ineligible after having already determined it has conflict of interest).

[295] *See* Locks v. U.S. Tr., 157 B.R. 89, 92 (W.D. Pa. 1993) (holding counsel for a Committee member lacked standing to advocate for another client's position contrary to interests of Committee and its constituency; lawyer for Committee member had fiduciary duty to Committee constituency); *see also In re* Johns-Manville Corp., 26 B.R. 919, 925 (Bankr. S.D.N.Y. 1983) (holding Committee representative would breach fiduciary duty by representing "a competing class of creditors;" therefore, attorneys were not disinterested persons as required by section 327 of the Bankruptcy Code).

a legitimate stock option from the corporate client, approved by disinterested board members.

The most difficult cases are on the fine lines where an overstep by the self-interested client decision-maker results in a violation of the DIP's or Committee's fiduciary duties. The client is entitled to advice and the lawyer is entitled and obligated to give advice on how far the client can go without crossing legal boundaries. Further, when the client has engaged counsel for a workout transaction or a bankruptcy case, the client is entitled to receive and the lawyer is obligated to give proactive advice on compliance with statutory and fiduciary obligations.[296] As noted in this article, numerous courts have assumed this duty is a fiduciary one, owed not to the client person or entity but to the estate, which is problematic.

The mechanisms of disclosure, court ratification and Bankruptcy Code parameters are insufficient to enable counsel's compliance with fiduciary law if the lawyer's beneficiary is considered the body of all creditors or, for DIP counsel, shareholders and other stakeholders as well as creditors. The principal reason for the disconnect is that an attorney may not make decisions for a client; counsel advises the client, but the client is the decision-maker and the lawyer only speaks as the client's agent with very limited discretionary authority to act contrary to the client's instructions.[297]

A fundamental threshold for a relationship to be denoted as "fiduciary" is that the beneficiary surrenders authority over certain actions to the fiduciary. In the attorney-client context, the client allows the lawyer not only to prepare but also to execute documents and argue positions on the client's behalf. The counterpart for this delegation of authority and a critical component of the beneficiary's consent to that agency relationship and protection from abuse is the beneficiary's right to control the agent's actions.[298] As stated in the Restatement (Second) of Agency, a "fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."[299] Professional conduct rules regulate the client's authorization for an attorney to act and the client's control of the hired attorney.

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[296] *See* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 464 (D. Utah 1998) (DIP counsel must exercise independent judgment in advising DIP client of its fiduciary duties to the estate and not favor the interests of management to the exclusion of creditors); *see also In re* Count Liberty, LLC, 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) (recognizing "debtor in possession's attorney must be proactive" and ready to provide advice even without being requested in order to ensure DIP carries out its fiduciary responsibilities properly); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (highlighting how attorney for DIP has duty to remind DIP of debtor's duties under the Bankruptcy Code as a fiduciary of the estate); *In re* Consupak, Inc., 87 B.R. 529, 549 (Bankr. N.D. Ill. 1988) (stressing where trustee's attorney has obligations to estate and to court, lawyer must be more active in advising his client of preventative and corrective measures available).

[297] MODEL RULES OF PROF'L CONDUCT R. 1.2, 1.4 (2009); *see also infra* Part VII.A.

[298] *See* Criddle, *supra* note 219, at 129 (remarking on agency fiduciary relationship entrustor's right to supervise fiduciary performance); *see also* Christine L. Eid, Comment, *Lawyer Liability for Aiding and Abetting Squeeze-Outs*, 34 WM. MITCHELL L. REV. 1177, 1190 (2008) (noting degree of control existing in agency fiduciary relations gives entrustor great power over fiduciary).

[299] RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958).

## VII. PROFESSIONAL RESPONSIBILITY CONSEQUENCES OF FIDUCIARY DUTIES TO PARTIES IN ADDITION TO THE DIP OR COMMITTEE, INCLUDING AS COUNSEL FOR THE "ESTATE."

### *A. Client Decision-Maker Issues*

A lawyer may not act except at the direction of a client.[300] DIP counsel cannot file a motion or plan he believes is in the best interest of the estate when the DIP is incompetent.[301] Committee counsel must take direction from Committee members and present their actual views, not what Committee counsel believes their position should be.[302] When counsel believes a filing the client requests would violate the attorney's duties to the court he cannot file it, but neither can he file an alternative substantive document; he can only seek to withdraw.[303] If DIP counsel's client is considered the bankruptcy "estate," who provides the direction to the lawyer? Property interests cannot direct counsel. If the estate consists of all the disparate parties in interest in a bankruptcy case with their conflicting views and goals, the group cannot direct counsel either, practically or theoretically.

The creditors and parties in interest other than the DIP do not deputize DIP counsel to speak on their behalf in court filings or otherwise. They do not surrender control over their strategy to DIP counsel. Rather, their own counsel may and often do appear individually as well as collectively through Committee counsel. The DIP, through DIP counsel, moves for authority to sell assets, reject contracts, approve settlements, approve financing, and approve a plan. The DIP's motions do not bind other parties in interest until approved by the court after the other parties have an opportunity to be heard in opposition through their own counsel. It is indeed questionable whether creditors believe DIP counsel reposes in them a relationship of attorney-client trust and confidence, especially when they have separate counsel.[304]

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[300] MODEL RULES OF PROF'L CONDUCT R. 1.2, 1.4, 1.14, 3.3 (2009)

[301] *See 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 no business making decisions that are the responsibility of the fiduciary."); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.14 (2009).

[302] *See In re* ABC Auto. Prods. Corp., 210 B.R. 437, 443 (Bankr. E.D. Pa. 1997) ("[T]he bankruptcy process is compromised when its attorney does not present the actual views of his clients but rather what he believes they should be.").

[303] *See In re* The Phoenix Group Corp., 305 B.R. 447, 452 (Bankr. N.D. Tex. 2003) (remarking counsel as fiduciary cannot be penalized for failing to act in accordance with client's instructions if to do so would require the attorney "to act illegally, unethically or contrary to fiduciary responsibilities"); *see also In re Rivers*, 167 B.R. at 300 (explaining it is attorney duty to advise court and U.S. Trustee client DIP is incompetent and allow trustee to be appointed); MODEL RULES OF PROF'L CONDUCT R. 1.16 (2009) (stating attorney must withdraw from client relationship if will violate rules of professional conduct).

[304] *See* Official Unsecured Creditors' Comm. v. Michaels (*In re* Marin Motor Oil, Inc.), 689 F.2d 445, 451–53 (3d Cir. 1982) (explaining rights of parties in interest to intervene in bankruptcy proceedings); *see also In re* D. H. Sharrer & Son, Inc., 44 B.R. 976, 978–79 (Bankr. M.D. Pa. 1984) (observing creditor's absolute right to appear and be heard in bankruptcy proceeding); *see also* Margaret L. Howell & Vicki Joyce Hyche, Comment, *Creditors' Committees' Right to be Heard in Chapter Eleven Reorganization Actions*, 37

The imposition of a fiduciary duty is particularly problematic because of the duty of loyalty to act "solely for the benefit of the principal" when there are numerous parties in interest in a bankruptcy case.[305] While a duty of impartiality helps, when a contract rejection decision is to be made, or a choice is offered to sell a company division or borrow money to expand it and try to make the division viable, some parties in interest will benefit and some will suffer. To which "beneficiary" is counsel to be more loyal?

To hold any lawyer responsible as a fiduciary for actions that only another party and its counsel have the right to take is not only unfair but theoretically flawed. It imposes fiduciary duties without the concomitant right to communicate within an attorney-client privilege and to counsel that party before taking action the party expressly directs. It leaves the attorney guessing as to what numerous aligned and adverse parties might want, and obliged to take action without express direction by any of them and without prior privileged consultation with them. If counsel does not have the right to speak for a party, to frame his words to achieve a client-directed goal after client counseling, and does not have the right bind that party by his actions as its agent, he should not be held liable for a breach of fiduciary duty.

If the estate is considered an entity, acting through its trustee or DIP management, the individuals comprising the management team could direct Debtor/DIP counsel. Here, the obligation to counsel the DIP client has been re-focused by some courts into an obligation by DIP counsel to creditors to police the DIP, and ensure the DIP is meeting its own fiduciary obligations of loyalty, care and impartiality.[306] The DIP individual or entity client does not disappear, however. Under this analysis, ethical problems arise because (1) counsel represents two clients, the estate speaking through the DIP and the Debtor/DIP, (2) counsel must contend with issues of disclosure of confidential information as a matter of attorney-client privilege and professional responsibility rules, and (3) if the lawyer believes the "estate's management team" is not serving the estate's best interest, but the real Debtor/DIP client's decisions do not cross the high threshold for attorney withdrawal rights under applicable professional conduct rules, the lawyer is not

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MERCER L. REV. 1067, 1067 (1986) (remarking on creditors ability to be heard on all aspects of bankruptcy cases).

[305] *See* Martin J. Bienenstock, *Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. CIN. L. REV. 543, 543, n.2 (1992) (discussing management's conflict of interest in chapter 11 filings); *see also* Roache, *supra* note 236, at 144–45 (noting DIP owes fiduciary obligation to all parties who have interest in estate); Jay Lawrence Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287, 287 (1993) (stating there are "unavoidable conflicts that are inherent in the representation of DIPs").

[306] *See, e.g.*, *In re Rivers*, 167 B.R. at 301 (noting DIP's attorney's dual roles as DIP's counselor and officer of the court); *In re* Harp, 166 B.R. 740, 748 (Bankr. N.D. Ala. 1993) ("[D]ebtor's attorney must . . . provide guidance for management of the debtor." (quoting *In re* Whitney Place Partners, 147 B.R. 619, 620–21 (N.D. Ga. 1992))); *In re* Sky Valley, 135 B.R. 925, 937–38 (Bankr. N.D. Ga. 1992) (stating DIP's attorney has duties to supervise sale of property and advise professionals of responsibilities); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (requiring attorney to have "*active* concern for the interests of the estate, and its beneficiaries, the unsecured creditors"). *But see In re* Dieringer, 132 B.R. 34, 36 (Bankr. N.D. Cal. 1991) (holding DIP's attorney had no fiduciary duty to supervise DIP).

only stymied but at risk of liability to non-clients, and experiences personal conflicts from desires to avoid such risks.

*B. Multiple Client Conflicts*

If DIP counsel is treated as counsel for the estate, in effect the estate is considered as an entity for Model Rule 1.13 analysis, with DIP personnel as expendable management for that entity.[307] The existing client, the Debtor/DIP, still remains, and receives advice from and directs counsel through the same individuals. The two are not fully congruent, because the Debtor/DIP is not obliged to investigate or report on its own actions, and is entitled to bargain openly for the interests of equity holders.[308]

A lawyer may only represent multiple clients with conflicting interests, whether actual and direct or potential and indirect, after he obtains the informed consent of each client.[309] Assuming the court's approval of DIP counsel's employment after reviewing Rule 2014 and 2016 disclosures and hearing from adverse parties constitutes such informed consent on the part of the estate, the Model Rules nonetheless prohibit a lawyer from undertaking "common representation of clients where contentious litigation or negotiations between them are imminent or contemplated."[310] Further, professional responsibility rules require that a lawyer be impartial between commonly represented clients, [so that] representation of multiple clients is improper when it is unlikely that impartiality can be maintained.[311] Litigation and negotiation between the Debtor/DIP and its creditors,

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[307] *See* Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (holding counsel's duties are to estate in bankruptcy); *see also In re* Delta Petroleum (P.R.), Ltd., 193 B.R. 99, 111 (D. P.R. 1996) (citing MODEL RULES OF PROF'L CONDUCT R. 1.13(a) (1983)) (holding bankruptcy attorney as counsel for estate, not trustee); *In re Rivers*, 167 B.R. at 301 ("When the interests of the [debtor] conflict with those of the [estate], it is the estate and the court to which the attorney owes his highest allegiance.").

[308] *See* 11 U.S.C. § 1107(a) (2006) ("[A] debtor in possession shall . . . perform all the function and duties, except the [investigative] duties . . . of a trustee."); *see also* 11 U.S.C. § 704(a)(7) (2006) (giving trustee duty of giving information to interested parties); Sandy Ridge Oil Co. v. Centerre Bank Nat'l Ass'n (*In re* Sandy Ridge Oil Co.), 807 F.2d 1332, 1334 (7th Cir. 1986) (stating 11 U.S.C. § 1107(a) does not give DIP investigatory duties).

[309] *See* Visa U.S.A., Inc. v. First Data Corp., 241 F. Supp. 2d 1100, 1105 (N.D. Cal. 2003) (noting attorney for adverse clients may continue representing both with full disclosure and written consent); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(4) (2009) (requiring written, informed consent for attorney to represent conflicted clients); RESTATEMENT (THIRD) OF LAW GOVERNING LAW § 122(1) (2000) (providing attorney representing conflicted clients may continue representation with informed consent from each client).

[310] *See* CenTra, Inc. v. Estrin, 538 F.3d 402, 413 (6th Cir. 2008) ("[A] lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other." (quoting MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [28] (2009))); *see also In re* Jaeger, 213 B.R. 578, 587 (Bankr. C.D. Cal. 1997) (stating attorney representing adverse clients can be disqualified if adverse to clients' interests); MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [29] (2009).

[311] *See* Maiden v. Bunnell, 35 F.3d 477, 481 n.4 (9th Cir. 1994) ("[E]thic[s] rules prohibit any conflicts which could diminish or dilute a lawyer's loyalty and zeal in representing a client." (quoting JOHN WESLEY HALL, PROFESSIONAL RESPONSIBILITY OF THE CRIMINAL LAWYER 401 (1987))); *see also* United States v.

executory contract holders and other parties in interest is the essence of a chapter 11 case. And, impartiality is the opposite of what courts deeming DIP counsel as counsel for the estate have mandated; they have enjoined DIP counsel to put the interest of the estate, a conglomeration of conflicting parties, ahead of the Debtor/DIP client.

As explained by the court in *Hansen, Jones & Leta*, the DIP's job is to manage inherent conflicts, running its business and deciding what assets to sell and what contracts to reject and what claims to avoid, differentiating among classes of beneficiaries, making decisions which benefit some claimants over others, and balancing the interests of equity and management with those of the creditors and equity, a conflict-ridden fiduciary position.[312] The Bankruptcy Code countenances this conflict for the DIP, but it is unacceptable for lawyers under professional conduct rules.

Client conflicts of interest under a theory of an estate client managed by the DIP is most obvious in the context of an individual chapter 11 case.[313] The individual chapter 11 estate's interest is best served by maximizing the property held by the estate for use in the case; the individual is best served by exempting property from the estate and using income for living expenses. DIP counsel can advise the Debtor/DIP to comply with the strictures of the Bankruptcy Code, with full disclosures and exemptions and property use only within the limits of the law. But the lawyer cannot zealously represent the interests of both sides on these issues.

### *C. Disclosure of Confidential Information*

Attorneys have an ethical obligation to maintain their clients' rights to protect from disclosure communications within the scope of the attorney-client privilege.[314]

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Moscony, 927 F.2d 742, 749 n.8 (3d Cir. 1991) (citing 204 PA. CODE § 81.4, R. 1.16(a)(1) (1990)) (noting attorney must withdraw if representation of conflicted parties results in violation of Rules of Professional Conduct); MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [29] (2009).

[312] *See* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 458–59 (D. Utah 1998) (explaining DIP's conflict between duties to creditors and equity owners); *see also* Bienenstock, *supra* note 305, at 543 n.2 (observing DIP's fiduciary duties conflicted between creditors and shareholders); Nimmer & Feinberg, *supra* note 228, at 31–32 (arguing DIP owes conflicting obligations to creditors and equity owners).

[313] *See* C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47, 71 (1997) (describing in individual chapter 11 cases pre-debtor's counsel's role in pre-bankruptcy planning as "clearly at odds" with the Estate Counsel's fiduciary duty to the Estate); *see also* Jack F. Williams & Jacob L. Todres, *Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11*, 13 AM. BANKR. INST. L. REV. 701, 706 (2005) (discussing role of individual debtor, as DIP, as fiduciary to estate); Alexander Wu, Note, *Motivating Disclosure by a Debtor in Bankruptcy: The Bankruptcy Code, Intellectual Property, and Fiduciary Duties*, 26 YALE J. ON REG. 481, 498 (2009) (noting DIP not owing fiduciary duty to creditors before bankruptcy while having interest adverse to trust in bankruptcy).

[314] *See* Yvette Joy Liebesman, *The Potential Effects of* United States v. Councilman *on the Confidentiality of Attorney-Client E-mail Communications*, 18 GEO. J. LEGAL ETHICS 893, 904 (2004–2005) (stating under Model Rule 1.6 "attorney must make reasonable effort to maintain confidentiality of attorney-client protected communications"); *see also* William Alan Nelson II, *Attorney Liability Under the Foreign Corrupt*

When an attorney represents multiple clients, the existence of individual privileges for each client, immune from disclosure to the others, is questionable.[315] Even if treated like a joint defense or common interest privilege, 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.[316] This issue arises in bankruptcy cases when a single lawyer represents both parent and subsidiary and the subsidiary's bankruptcy trustee is able to obtain documents and testimony on matters where both entities collectively consulted counsel about their common interest from the lawyer for both, unimpeded by claims of privilege once the two entities are adverse.[317] Courts deeming counsel for the Debtor/DIP to be counsel for the estate as well do not address the privilege consequences for the Debtor/DIP.

In addition to the attorney-client privilege, lawyers have ethical obligations to hold their clients' confidences inviolate from disclosure. This is particularly problematic when a lawyer represents multiple clients. As explained in a comment to Model Rule 1.7,

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*Practices Act: Legal and Ethical Challenges and Solutions*, 39 U. MEM. L. REV. 255, 270 (2008–2009) (discussing confidentiality of information under by Model Rule 1.6 for communications between client and attorney); MODEL RULES OF PROF'L CONDUCT R. 1.6 (2009) (providing guidelines for attorney disclosure and non-disclosure of information related to representation of client).

[315] *See* MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [30] (2009) ("A particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality and the attorney-client privilege. With regard to the attorney-client privilege, the prevailing rule is that, as between commonly represented clients, the privilege does not attach."). *Compare In re* Teleglobe Commc'ns Corp., 493 F.3d 345, 362–66 (3d Cir. 2007) (analyzing extensively co-client privilege and common interest privilege), *and In re* Benun, 339 B.R. 115, 127–28 (Bankr. D. N.J. 2006) (applying common interest doctrine to attorney for two parties), *with In re* Indiantown Realty Partners Ltd. P'ship, 270 B.R. 532, 538–39 (Bankr. S.D. Fla. 2001) (discussing common interest doctrine and joint defense doctrine for attorney with three parties), *and* Sec. Investor Prot. Corp.v. R.D. Kushnir & Co., 246 B.R. 582, 588–89 (Bankr. N.D. Ill. 2000) (examining joint defense argument by attorney fighting motion to disqualify him).

[316] *See In re Teleglobe*, 493 F.3d at 354 (involving corporate parent subsidiary context); *see also In re* Ducane Gas Grills, Inc., 320 B.R. 312, 323 (Bankr. D.S.C. 2004) (preventing party from asserting common interest doctrine to preclude disclosure of information shared with co-party to business agreement); Sec. Investor Prot. Corp. v. Stratton Oakmont, Inc., 213 B.R. 433, 439 (Bankr. S.D.N.Y. 1997) (concluding joint defense privilege is waived when previous members to joint defense agreement become adversaries in subsequent litigation); *In re* Mich. Boiler and Eng'g Co., 87 B.R. 465, 471 (Bankr. E.D. Mich. 1988) (holding joint defense privilege did not bar discovery of communications between parties with common interest when those parties later became adverse); *In re* Blier Cedar Co., Inc., 10 B.R. 993, 1002 (Bankr. D. Me. 1981) ("Although communications among two or more clients with their mutual attorney are privileged, the privilege is dissolved in a subsequent adversarial contest among the clients.").

[317] *See In re* Tri-River Trading, LLC, 329 B.R. 252, 268 (B.A.P. 8th Cir. 2005) (concluding attorney who represented member and LLC could testify in subsequent controversy between same parties); *see also In re* Brownsville Gen. Hosp., Inc., 380 B.R. 385, 391 (Bankr. W.D. Pa. 2008) (holding no privilege for corporate entities over corporate reorganization documents in subsequent litigation between same parties); *In re* Mirant Corp., 326 B.R. 646, 652 (Bankr. N.D. Tex. 2005) (holding no privilege for parent in discovery request from adverse subsidiary); *In re Indiantown*, 270 B.R. at 539 (concluding no privilege for general partner in adversary proceedings with its limited partnership); *Stratton*, 213 B.R. at 439 (holding joint defense principal is waived between corporation and former principal in adversary proceeding).

> As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one asks lawyer not to disclose to the other client information relevant to the common representation. This is so because the lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interests and the right to expect that the lawyer will use that information to that client's benefit.[318]

Courts stating that DIP counsel as counsel for the estate has an obligation to disclose Debtor/DIP breaches of fiduciary duty to the estate client or estate beneficiaries have not addressed privilege and confidentiality issues in the broader context of communications throughout the case. That is a substantial and legitimate concern of DIP counsel and the Debtor/DIP client that is inherent in the notion of DIP counsel as counsel for the estate as well as the Debtor/DIP.

Even if DIP counsel is not considered counsel for the estate, but only to have fiduciary duties to estate beneficiaries as non-clients, the lawyer is faced with confidentiality problems. Under the Model Rules, "[a] lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules."[319] The Model Rules provide for limited exceptions to the prohibition on disclosure: (1) client consent and disclosures impliedly authorized to carry out the representation; (2) disclosures to prevent the client from committing a criminal act the lawyer reasonably believes is likely to result in death or substantial bodily harm; (3) the client's intent to commit a crime and the information necessary to prevent the crime; (4) information the lawyer reasonably believes necessary to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to another's financial interests or property, or to mitigate or rectify such substantial injury, in furtherance of which the client has used or is using the lawyer's services; (5) disclosures to establish the lawyer's claim or defense when his conduct is questioned or to secure legal advice about compliance with the rules, and (6) to comply with other law or a final court order directing the lawyer to disclose such information.[320]

When knowing and fraudulent, concealment of estate assets, false oaths or accounts, giving or attempting to obtain any advantage, withholding of information

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[318] MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [31] (2009).

[319] *Id.* AT R. 1.8(b).

[320] *See* McClure v. Thompson**,** 323 F.3d 1233, 1247–48 (9th Cir. 2003) (finding attorney did not violate duty of confidentiality because disclosure was made to prevent crime he reasonably believed was likely to result); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.6. (2009) (stating attorneys have duty to established confidentiality between themselves and clients except under limited circumstances); Hon. Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147, 210–11 (2006) (explaining state laws and ABA professional conduct rules "except from client confidentiality any information concerning an ongoing crime or fraud").

and the like are criminal, along with knowing and fraudulent embezzlement and transfers of estate assets.[321] Such crimes do not result in death or substantial bodily harm, but if material, they may result in substantial injury to the financial interests or property of others, in which case they may be subject to disclosure if the lawyer's services have been or are being used to commit that crime or fraud. Certainly, DIP counsel cannot ignore a client's stated intent to commit a crime, let alone help to facilitate it, but may and should advise the client on how to comply with the law.[322]

Whether "other law" in the form of Bankruptcy Code or Rule disclosure requirements or common law obligations imposed on a lawyer mandate disclosure in the context of misconduct not rising to the level of one of the other privilege exceptions is problematic in many cases. The flow of estate money must be reported in public filings on a monthly basis.[323] Accurate and complete asset and other disclosures set forth in bankruptcy schedules and the statement of affairs must be completed.[324] Disclosures of insider interests in sales and transactions for use of estate assets are required.[325] Arguable failure to put the estate's best interest ahead of the Debtor's interest is another question.

When the client is an entity or organization, it makes decisions through people. Under the Model Rules:

> When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer *even if their*

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[321] *See* 18 U.S.C. §§ 152, 153, 3284 (2000) (providing list of fraudulent actions that violate Bankruptcy Code such as concealment of assets, false oaths and withholding of information); *see also* United States v. Goodstein**,** 883 F.2d 1362, 1370 (7th Cir. 1989) (finding jury could have concluded that debtor transferred property fraudulently "with intent to defeat bankruptcy laws as required to support a conviction under section 152"); United States v. Zonca**,** 97 F. Supp. 2d 1127, 1133 (M.D. Fla. 1999) (finding defendant "willfully and fraudulently concealed the property from creditors and from the United States Trustee, as charged, in violation of 18 U.S.C. § 152(1)").

[322] *See In re* St. Stephen's 350 E. 116th St., 313 B.R. 161, 171 (Bankr. S.D.N.Y. 2004) ("Instead, 'The debtor's attorney, while not a trustee, nevertheless is charged with the duty of counseling the debtor in possession to comply with its duties and obligations under the law.'" (quoting Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 25 (B.A.P. 2d. Cir. 1997))); *see also In re* Nilges, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) (explaining counsel needs to supervise client to ensure Bankruptcy Code compliance).

[323] *See* LOCAL RULES OF U.S. BANKR. N.D. CAL., § 2015-2(a) (stating monthly operating reports "are required from a trustee or debtor-in-possession" in certain circumstances); *see also* LOCAL RULES OF U.S. BANKR. N.D. W. VA., App. E ("The Debtor in Possession shall file with the Court . . . a sworn written report of the operations and financial conditions of the Debtor's estate."); LOCAL RULES OF U.S. BANKR. N.D. FLA. Form 2c ("Debtors-in-Possession and Trustees must file with the Bankruptcy Court, and serve on the United States Trustee, financial reports reflecting the activities of debtor(s) each month.").

[324] *See* 11 U.S.C. § 521(1) (2006) (stating debtor obligated to file comprehensive schedules of creditors, assets and liabilities, and "statement of the debtor's financial affairs"); *see also In re* Park, 246 B.R. 837, 842 (Bankr. E.D. Tex 2000) (stating disclosure "obligation is strict and the law requires such schedules to be as complete and accurate as possible").

[325] *See In re* Atravasada Land and Cattle Inc., 388 B.R. 255, 264 (Bankr. S.D. Tex. 2008) (finding debtor "obligated to provide adequate information to creditors accurately reflecting the assets and the transactions of the Debtor, particularity transactions with insiders of the Debtor"); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 842 (Bankr. C.D. Cal. 1991) ("Clearly then, a debtor who proposes a sale of all of its assets to an insider must fully disclose to the court and creditors the relationship between the buyer and seller.").

> *utility or prudence is doubtful*. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province…however…*when the lawyer knows that the organization is likely to be substantially injured by action of an officer or other constituent that ...is in violation of law that might be imputed to the organization*, the lawyer must proceed as is reasonably necessary in the best interest of the organization. As defined in Rule 1.0(f), knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious.[326]
>
> . . . Even in circumstances where a lawyer is not obligated by Rule 1.13 to proceed, a lawyer may bring to the attention of an organizational client, including its highest authority, matters that the lawyer reasonably believes to be of sufficient importance to warrant doing so *in the best interests of the organization*.[327]

The difference between a decision of the DIP/Debtor client balancing personal and creditor interests that is imprudent and one that violates the law may be unclear, and is generally evaluated in hindsight.[328] Using the Model Rule comment about the option to bring to an organization decisions "in the best interest of the organization" as a justification for bringing Debtor/DIP confidences to the "estate" of creditors and other adverse parties/estate beneficiaries on a DIP counsel estate entity-client theory would expose an attorney to charges of professional misconduct to her formal Debtor/DIP client.

As a general rule, if an entity's counsel discloses confidential information to shareholders, the privilege is deemed waived.[329] The same rule is likely to apply to disclosure of confidential information to bankruptcy estate parties in interest.[330] Some state courts have held that the attorney-client privilege does not protect

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[326] MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt [3] (2009) (emphasis added).

[327] *Id.* at R. 1.13 cmt. [4] (emphasis added).

[328] *See* Lawrence A. Hamermesh, *The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct*, 17 GEO. J. LEGAL ETHICS 35, 44 (2003) (noting concern among lawyers that Rule 1.13 would create liability on basis of hindsight); *see also* Tuttle, *supra* note 178, at 939 ("These exceptions, however, do not seem to apply to a disclosure of a fiduciary's breach of trust.").

[329] *See* Garner v. Wolfinbarger, 430 F.2d 1093, 1103 (5th Cir. 1970) (limiting corporate client's ability to invoke attorney-client privilege where stockholders show cause to disallow privilege); *see also* McDermott, Will & Emery v. Superior Court, 99 Cal. Rptr. 2d 622, 626 (Cal. Ct. App. 2000) (prohibiting shareholder derivative legal malpractice action because corporation's law firm cannot defend itself without waiving attorney-client privilege).

[330] *See* Official Comm. of Asbestos Claimants of G-I Holding, Inc. v. Heyman, 342 B.R. 416, 422 (S.D.N.Y. 2006) (rejecting argument that Creditors Committee was entitled to disclosures subject to debtor's attorney-client privilege); *see also In re* Commercial Fin. Servs., Inc., 247 B.R. 828, 845 (Bankr. N.D. Okla. 2000) (limiting waiver of attorney-client privilege concerning disclosures to estate's parties in interest); *In re* Am. Metrocomm Corp., 274 B.R. 641, 654 (Bankr. D. Del. 2002) (ordering formerly retained law firms to turn over documents because production was not precluded by DIP's failure to waive attorney-client privilege).

communications between the trustee and his counsel from discovery by the beneficiary when the lawyer is employed at the trust's expense.[331] Treating a DIP client as the equivalent of a trustee for purposes of fiduciary disclosure obligations to estate "beneficiaries" could thus lead to a dramatic alteration of attorney-client privilege practice in bankruptcy cases. Scholarly commentary on the consequences of imposing a duty on the Kaye Scholer firm as counsel for a financial institution to disclose misconduct to federal regulators illustrates the issues.[332]

*D. Withdrawal Difficulties*

Before a lawyer withdraws on account of disagreements over the case that rise to the level warranting such action, he is ethically obliged to remonstrate with and counsel the client.[333] The lawyer is to go "up the ladder" to the Debtor/DIP's highest decision-makers, the board of directors for a corporate debtor.[334] There is no larger, alternative "board" of creditors, executory contract holders and other parties in interest in a bankruptcy case to override the directive of the Debtor/DIP decision-makers. Neither the U.S. Trustee nor the court serves as a super-board for decision-making except where the Bankruptcy Code provides for the court to approve certain choices, *e.g.* sales outside the ordinary course of business.[335] Thus, the final decision-maker of the direct client, the Debtor/DIP, is the only one with whom DIP counsel can discuss legal strategies and withdrawal.

Court opinions stating that DIP counsel should have withdrawn from representation often say that DIP counsel may in some cases be obligated to bring the DIP's breaches of fiduciary duty or a Debtor's misrepresentations to the attention

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[331] *See* Gump v. Wells Fargo Bank, 237 Cal. Rptr. 311, 334–35 (Cal. Ct. App. 1987); *see also* Riggs Nat'l Bank v. Zimmer, 355 A.2d 709, 712 (Del. Ch. 1976); Tuttle, *supra* note 178, at 940, n.279 (citing Washington-Baltimore Newspaper Guild v. Washington Star Co., 543 F. Supp. 906, 909 (D. D.C. 1982)).

[332] *See generally* George H. Brown, *Financial Institution Lawyers as Quasi-Public Enforcers*, 7 GEO. J. LEGAL ETHICS 637, 642–43 (1994) (examining potential disclosure obligations of financial institution attorneys after Kaye Scholer action); James O. Johnston, Jr. & Daniel Scott Schecter, Symposium, *In the Matter of Kaye, Scholer, Fierman, Hays & Handler: A Symposium on Government Regulation, Lawyers' Ethics, and the Rule of Law*, 66 S. CAL. L. REV. 977, 978 (1993) (discussing "greater implications" of civil action against Kaye Scholer); Harris Weinstein, *Attorney Liability in the Savings and Loan Crisis*, 1993 U. ILL. L. REV. 53, 60–64 (1993) (providing Office of Thrift Supervision's perspective on issues in Kaye Scholer action).

[333] *See* Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997) (requiring DIP counsel to advise DIP client to follow the law); *see also In re* Saturley, 131 B.R. 509, 519 (Bankr. D. Me. 1991) (predicating withdrawal on proper client counseling regarding consequences of failure to disclose); *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 847 (Bankr. C.D. Cal. 1991) (demanding diligent inquiry before moving to be relieved as counsel); MODEL RULES OF PROF'L CONDUCT R. 1.2 cmt. [14], 1.4, 3.3 cmts. [6], [10] (2009).

[334] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) & cmt. [5] (2009).

[335] *See* 11 U.S.C. § 363(b) (2006) (requiring trustee to have court approval in order to "use, sell, or lease, other than in the ordinary course of business, property of estate"); *see also* 11 U.S.C. § 365(a) (2006) (requiring trustee to have court approval in order to "assume or reject any executory contract or unexpired lease of the debtor"); 11 U.S.C. § 503(b) (2006) (requiring court approval for allowance of administrative expenses).

of the court, usually without explaining how that should be done.[336] As noted just above, lawyers are ethically obliged to preserve their clients' privileged information and confidences. The only disclosures authorized by the Model Rules consist of giving notice of the fact of withdrawal from representation, and further state that "the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like."[337]

The cases that do address the procedure to be used to notify the court and creditors of confidential information about client misconduct state that the lawyer should withdraw in accordance with state ethics rules in a manner to instigate the U.S. Trustee to investigate.[338] The lawyer accomplishes this by preserving specific client confidences, and simply stating in the withdrawal motion that continued representation is inconsistent with applicable ethics rules or would result in a violation of those rules.[339] The motion to withdraw might also recite applicable

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[336] *See In re JLM*, 210 B.R. at 26 ("Counsel must do more [than withdraw], informing the court in some manner of derogation by the debtor in possession."); *see also In re* North Star Management, LP, 305 B.R. 312, 320 (Bankr. D. N.D. 2003) (court-approved management company must act affirmatively to investigate and halt misappropriation of funds, and report to court or U.S. Trustee), *rev'd*, 308 B.R. 906 (B.A.P. 8th Cir. 2004) (finding professional took appropriate steps but was undermined by wrongdoer); *In re* Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) (finding it is duty of DIP counsel to inform U.S. Trustee and court if DIP is incompetent); *In re* Granite Sheet Metal Works, Inc., 159 B.R. 840, 848 (Bankr. S.D. Ill. 1993) (determining it was DIP counsel's duty to bring to court's attention DIP was breaching fiduciary duties by refusing to investigate insider transfers); *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.").

[337] *See* MODEL RULES OF PROF'L CONDUCT R. 4.1 cmt. [3] (2009) ("Sometimes it may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like."); *see also id*. R. 2.1 cmt. 10 (discussing how lawyer may not assist client in conduct discovered to be criminal or fraudulent, but must instead withdraw from representation and how there may be instances where "withdrawal alone might be insufficient" and "[i]t may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like"); *id*. R. 1.16 (c) ("A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation."); *id.* R. 1.6 cmt. [7] (discussing limited exception to rule of confidentiality, permitting lawyer "to reveal information to the extent necessary to enable affected persons or appropriate authorities to prevent the client from committing a crime or fraud . . . that is reasonably certain to result in substantial injury to the financial or property interests of another and in furtherance of which the client has used or is using the lawyer's services"); *Withdrawal when a Lawyer's Services will Otherwise be Used to Perpetrate a Fraud*, 1992 A.B.A. COMM. ON ETHICS AND PROF'L RESPONSIBILITY 92-366 (discussing counsel's duty of "'noisy' withdrawal" from representation when he or she knows "services or work product are being used or are intended to be used by a client to perpetrate a fraud").

[338] *See In re* Matthews, 154 B.R. 673, 680 (Bankr. W.D. Tex. 1993) (describing attorney's duty of integrity to court system, which can be fulfilled by requesting that court relieve lawyer of representing client "in the event that the attorney learns that he or she has been misled by the client"); *see also In re Saturley*, 131 B.R. at 519 (acknowledging if attorney has serious concerns about client's candor, he may withdraw from representation and "[i]n the worst case, when the attorney is convinced a fraud has occurred, he or she had best follow appropriate provisions of the applicable code of conduct"); *In re Wilde Horse Enters., Inc.*, 136 B.R. at 847 (stressing upon suspicion of debtor dishonesty or neglect of fiduciary duty to estate, "it is the attorneys' duty to first ask *probing* questions and *demand full and reasonably corroborated responses*, and then if counsel is still unsatisfied or ethically uncomfortable, immediately bring the unresolved concerns to the Court's attention by way of a motion to be relieved as counsel of record or in some other way").

[339] *See* MODEL RULES OF PROF'L CONDUCT R. 1.16 cmt. [3] (2009) (describing how when situations arise where court requests explanation for attorney's withdrawal but attorney is bound to keep such facts confidential, "[t]he lawyer's statement that professional considerations require termination of the representation ordinarily

professional conduct rules, again illustrating the underlying reasons for withdrawal and the need for additional inquiry without directly divulging client confidences. The motion may be accompanied by a filing stating that counsel disavows or withdraws particular fraudulent documents, thereby accomplishing the "noisy withdrawal."

*E. Harsher Sanctions; Liability and Bar License Exposure*

In addition to sanctions by the bankruptcy court, lawyers charged with breaching fiduciary duties to third parties risk lawsuits by those third parties. In state courts, beneficiaries have been allowed to sue their fiduciaries for breach of duties.[340] Reported decisions so far have followed the *ICM Notes* opinion and stated that DIP counsel does not owe a duty to the plaintiff creditor and accordingly may not be liable for damages.[341] One court indicated that DIP counsel might be liable to creditors for "mishandling a bankruptcy" if the lawyer's subjective intent was "fraudulent or otherwise intentionally wrongful," a standard that invites litigation and discovery.[342] In the Committee context, a lawsuit by one or more creditors against Committee members has been held to state a cause of action when Committee counsel was allegedly responsible for an action that damaged the creditors.[343] There can be no assurance that creditors will not sue counsel held to have a fiduciary duty to them when they feel injured by a reorganization failure.

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should be accepted as sufficient"); *Withdrawal when a Lawyer's Services will Otherwise be Used to Perpetrate a Fraud*, 1992 A.B.A. COMM. ON ETHICS AND PROF'L RESPONSIBILITY 92-366 (determining although "'noisy'" withdrawal may result in disclosure of information otherwise protected as client confidence, lawyer must refrain from disclosing such confidences, however nothing "prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw, or disaffirm any opinion, document, affirmation, or the like"); Bowles, *supra* note 150, at 40–41 ("A noisy withdrawal gives you a middle ground on which to fulfill your ethical and fiduciary duties to the bankruptcy court and the bankruptcy estate without having to directly disclose a client's confidences directly to the tribunal or other parties."). *See supra* Section IV.D.

[340] *See* Kaszirer v. Kaszirer, 730 N.Y.S.2d 87, 88 (N.Y. App. Div. 2001) (finding trust beneficiary whose "interests are united with plaintiffs beneficiaries" has standing to appeal breach of fiduciary judgment which adversely affected her); *see also* Slaughter v. Swicegood, 591 S.E.2d 577, 583 (N.C. Ct. App. 2004) ("North Carolina courts have granted beneficiaries standing to sue individually for breach of fiduciary duty against current trustees who allegedly mismanaged trust funds.").

[341] *See* ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117, 123–24 (Bankr. S.D. Tex. 2002) (discussing how although DIP counsel may owe general fiduciary duties to bankruptcy estate, "this duty cannot be extended to justify the imposition of a fiduciary duty running from counsel for the debtor-in-possession directly to a particular creditor that would support a separate civil action for breach"), *aff'd without change*, 324 F.3d 768 (5th Cir. 2003); *see also In re* Count Liberty, LLC, 370 B.R. 259, 280 n.54 (Bankr. C.D. Cal. 2007) ("Fiduciary duties of a debtor in possession's counsel to the estate do not extend to any particular creditor in a chapter 11 case."); *In re* Texasoil Enters., Inc., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (acknowledging DIP counsel does not directly owe fiduciary duties to creditors).

[342] *See In re* Dieringer, 132 B.R. 34, 37 (Bankr. N.D. Cal. 1991) ("Accordingly, the court holds that a debtor's attorney is not liable to creditors for mishandling a bankruptcy except to the extent that his conduct was fraudulent or otherwise intentionally wrongful.").

[343] *In re* Pension Benefit Guar. Corp., 42 B.R. 960, 963–64 (Bankr. E.D. Pa. 1984) (acknowledging Committee counsel was responsible for omission of creditor's claim from plan distribution; court held Committee counsel owed duty of care to each Committee constituent); *see In re* Mirant Corp., 334 B.R. 787, 793–94 (Bankr. N.D. Tex. 2005) (misleading statements by Ad hoc Shareholders Committee counsel as

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.[344] The 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.[345] Judges have a comparable reporting obligation.[346] Suspension or disbarment by one court generally triggers comparable sanctions in other jurisdictions, where the facts found by the first court are taken as dispositive.[347]

Assisting a client embezzling money from a bankruptcy estate or commit another crime or fraud is a grave matter that warrants serious consequences. Lawyers may justifiably be concerned about broad language in cases of less serious situations. Public cases stating that lawyers violated fiduciary duties by not subordinating the client's directions to interests of other parties accordingly raise legitimate issues that judges and practitioners not in the lawyer's shoes may not realize or appreciate.

One problem with imposing the concept of fiduciary duties to non-clients on DIP and Committee counsel is that a number of courts have conflated the duty of

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fiduciary for class of shareholders in solicitation of plan rejections enjoined by examiner and debtor, analogizing to shareholders' derivative claim); *see also In re* D.H. Overmyer Telecasting Co., 47 B.R. 823, 824 (Bankr. N.D. Ohio 1985) (malpractice and breach of fiduciary duty claims against Committee counsel "belong to the creditors' committee or to the unsecured creditors in general").

[344] *See In re* Black, 116 B.R. 818, 821 (Bankr. W.D. Okla. 1990) (noting attorneys have ethical responsibility to inform proper authorities of professional misconduct of other lawyers); *see also In re* Himmel, 533 N.E.2d 790, 796 (Ill. 1988) (holding lawyer failed to report another lawyer's misconduct and thus warranted one year suspension); MODEL RULES OF PROF'L CONDUCT R. 8.3(a) (2009) ("A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority.").

[345] *See* Century Indem. Co. v. Congoleum Corp. (*In re* Congoleum Corp.), 426 F.3d 675, 687 (3d Cir. 2005) (permitting standing where insurers' counsel had right to bring issue under Rules of Professional Conduct); *see also In re* Fischer, 202 B.R. 341, 352 (E.D.N.Y. 1996) (finding lower court erred in denying debtor standing because court had obligation to inspect attorney-client conflict); Schiffi Embroidery Workers' Pension Fund v. Ryan, Beck & Co., No. 91-5433, 1994 WL 62124, at *2 (D.N.J. Feb. 23, 1994) (determining brokerage firm, through its lawyers, had standing based on duty to report violations under Rules of Professional Conduct).

[346] *See* MODEL CODE OF JUDICIAL CONDUCT Canon 3D(2) (2007) ("A judge who receives information indicating a substantial likelihood that a lawyer has committed a violation of the Rules of Professional Conduct should take appropriate action.").

[347] *See, e.g.*, Selling v. Radford, 243 U.S. 46, 50 (1917) (recognizing lack of authority reviewing court has for actions decided for personal and professional misconduct); *In re* Kramer, 282 F.3d 721, 724 (9th Cir. 2002) ("[A] federal court's imposition of reciprocal discipline on a member of its bar based on a state's disciplinary adjudication is proper unless an independent review of the record reveals (1) a deprivation of due process; (2) insufficient proof of misconduct; or (3) grave injustice which would result from the imposition of such discipline."); *In re* Edelstein, 214 F.3d 127, 131 (2d Cir. 2000) (acknowledging court will enforce reciprocal discipline unless one of three factors is satisfied).

care with the duty of loyalty, and ended up with a concept of "fiduciary breach" that alters the negligence standard of care in malpractice cases.[348]

*F. Risk-Averse Self-Interest Conflicts*

Lawyers are ethically precluded from representing clients when "there is a significant risk that the representation of one or more clients will be materially limited by a…personal interest of the lawyer."[349] As noted in a comment to Model Rule 1.7, "if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice."[350] If DIP counsel has an obligation to put third parties' interests ahead of own client's interests, he has the equivalent of a multi-client conflict. If DIP counsel believes he is also at risk of sanction, let alone potential liability to those third parties, on account of alleged breaches of personal fiduciary duty, his personal interest may materially limit the lawyer's responsibilities to the Debtor/DIP and cause a disqualifying conflict of interest.[351]

*G. Use of "Conflicts Counsel"*

It is not unusual for a law firm representing a DIP or a Committee to represent other parties in interest in a bankruptcy case on unrelated matters. Model Rule 1.7 provides that a lawyer shall not represent a client if (a) "the representation will be directly adverse to another client; or (b) there is a significant risk that the representation . . . will be materially limited by the lawyer's responsibilities to another client, former client or third person," unless (1) the lawyer reasonably believes the representation will not adversely affect the relationship and (2) each client consents after consultation, which shall include an explanation of the implications of common representation and the advantages and risks involved.[352]

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[348] *See In re* Food Mgmt. Group, LLC, 380 B.R. 677, 708–09 (Bankr. S.D.N.Y. 2008) (finding attorney's for DIP breached fiduciary duties by failing to assist DIP with Bankruptcy Code compliance); *see also In re* Count Liberty, LLC, 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) ("[A]n attorney for the debtor in possession has fiduciary obligations to the estate stemming from his fiduciary obligations to the debtor in possession and his responsibilities as an officer of the court."); Gregory, *supra* note 65, at 206 ("The conflation of negligence (duty of care) and intent (duty of loyalty) . . . should be condemned, because it destroys clear legal concepts and substitutes vague terminology.").

[349] MODEL RULES OF PROF'L CONDUCT R. 1.7(a)(2) (2009) (establishing lawyer conflict restrictions); *see* Salzano v. Forman, No. 09-1945, 2009 WL 2057268, at *1–5 (D.N.J. July 14, 2009) (affirming bankruptcy court determination finding disinterest where counsel retained as trustee previously represented creditors against debtor in unrelated matter); *see also In re* Johnson, No. 07-33312-KRH, 2008 WL 183342, at *1,*4,*6 (Bankr. E.D. Va. Jan. 18, 2008) (finding material conflict where lawyer delayed property foreclosure on clients by encouraging separate bankruptcy filing by underage client).

[350] MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. [10] (2009).

[351] *See id*., R. 1.7 cmt. [8] (cautioning absent direct adverseness, zealous advocacy still jeopardized by conflicting interests); *see also* Markell, *supra* note 140, at 425–26 (noting despite actual personal conflict, potential malpractice suit can inhibit effective representation which would require withdrawal).

[352] *See* MODEL RULES OF PROF'L CONDUCT R. 1.7 (2009); *see also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 128 (2000) ("Unless all affected clients consent to the representation under the

As to part (a), litigating a claim objection or avoidance action against the other client would be "directly adverse" and would be "asserting or defending a claim" in the words of the Restatement. It is more problematic whether that categorization applies to forcing contract compliance pending assumption/rejection or resisting a prompt decision on assumption/rejection or merely filing the chapter 11 petition. The determination is objective, and turns on whether such action will have a substantial impact on the other firm client, *e.g.* by staying pending litigation, or preventing contract termination or a suit that would otherwise be brought given the amount involved. In a single-asset bankruptcy case, the mere filing of a petition is undoubtedly "directly adverse" to the secured lender. In a chapter 11 of an operating business, merely filing the case is likely not directly adverse to small creditors and parties in interest. The part (b) test of determining whether there is a significant risk that representation of the DIP or Committee will be materially limited by responsibilities to another client is subjective, and focuses on the impact on counsel's decision-making - *e.g.* will it affect evaluation of whether to file preference litigation? The materiality of any limitation is also affected by how pervasive the creditor's role is in the case and how important the creditor is to the law firm.[353]

Courts have allowed DIP counsel and Committee counsel to avoid the lack of disinterestedness or existence of an adverse interest caused by the role of other firm clients in the bankruptcy case by appointing special counsel to deal with all matters adverse to the other clients.[354] If a creditor client's role is central to the case, such a carve-out of DIP representation may be infeasible.[355] The point is to preclude adversity to an existing client by having special counsel handle all matters considered directly adverse to that client.[356] The Restatement of the Law Governing

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limitations and conditions provided in section 122, a lawyer in civil litigation may not: (1) represent two or more clients in a matter if there is a substantial *risk* that the lawyer's *representation* of one client would be *materially and adversely affected* by the lawyer's duties to another client in the matter; *or* (2) represent one client to *assert or defend a claim* against or brought by another client currently represented by the lawyer, even if the matters are not related.") (emphasis added).

[353] *See, e.g.*, *In re* Git-N-Go, Inc., 321 B.R. 54, 61 (Bankr. N.D. Okla. 2004) (noting firm's longstanding creditor representation would "color and influence, and materially limit, the advice rendered *to the Debtor* for the benefit of the estate"); *In re* Kaiser Group Int'l, Inc., 272 B.R. 846, 851–52 (Bankr. D. Del. 2002) (approving debtor's counsel where attorney restricted by "screening Wall" insulating firm from interest conflict); *In re* Amdura Corp., 121 B.R. 862, 867 (Bankr. D. Colo. 1990) (barring debtor representation where client creditor was "'the hand that feeds the firm'").

[354] *See In re* Cook, 223 B.R. 782, 791–92 (B.A.P. 10th Cir. 1998) (hiring conflicts counsel during suit commencement might have provided adequate safeguard); *see also In re* Enron Corp., No. 01-16034, 2003 WL 32034346, at *11 (S.D.N.Y. May 23, 2003) (noting special conflicts counsel important to approval of DIP counsel); *In re* eToys, Inc., 331 B.R. 176, 191–92 (Bankr. D. Del. 2005) (finding DIP counsel should have promptly filed disclosure affidavit where disinterested professional could have handled creditor client matter).

[355] *See, e.g.*, *In re Git-N-Go*, 321 B.R. at 61 (barring law firm DIP representation where creditor client's relationship with debtor permeated entire case); *In re* Amdura, 139 B.R. 963, 977, 979 (Bankr. D. Colo. 1992) (prohibiting dual representation where creditor client's interest "so pervasive and important"). *But see In re* Chicago South & South Bend R.R., 101 B.R. 10, 14–15 (Bankr. N.D. Ill. 1989) (allowing major creditor representation where party waived "screening wall" objection).

[356] Even if direct adversity is avoided, the creditor client may be so important to the firm as to preclude representation under the subjective test of risking a material limitation on representation – "pulling punches"

Lawyers states that conflicts can be eliminated by an agreement limiting the scope of the lawyer's representation.[357] The Model Rules reach the same result with permissible provisions in a conflict waiver letter.[358] Thus, for example, a creditor client (on unrelated matters) and the DIP client could ethically agree that the firm would not represent the DIP on matters directly adverse to the creditor, and that objecting to the creditor client's proof of claim, or filing any adversary proceeding against it would be deemed direct adversity, while plan treatment of the claim would not be directly adverse. They could agree that negotiating terms for and seeking to assume the creditor client's contract would not be considered direct adversity, while a motion to reject that contract would be deemed directly adverse.[359]

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to avoid offending an important client. *See In re* Brokers, Inc., No. 04-53451, 2005 WL 1288835, at *2–3 (Bankr. M.D.N.C. Jan. 14, 2005) (denying debtor's application to retain as special counsel attorney and law firm representing him in a previous bankruptcy proceeding because its members had close ties both with debtor and estate which was listed as one of debtor's creditors); *see also In re Amdura*, 139 B.R. at 972–73, 978 (finding magnitude of relationship between firm and creditor so great special counsel that cannot cure); MODEL RULES OF PROF'L CONDUCT R. 1.7(a)(2) (2009) (noting existence of conflict of interest if "there is a substantial risk that the representation of one or more clients will be materially limited" by attorney's "responsibilities to another client," a third party, or "by a personal interest" of attorney); *Lawyer Examining a Client as an Adverse Witness, or Conducting Third Party Discovery of the Client*, 1992 A.B.A. COMM. ON ETHICS AND PROF'L RESPONSIBILITY 92-367 (discussing possible solutions to conflicts of interests, such as where attorney could cure conflict with prospective adverse witness by retaining another firm to conduct cross-examination).

[357] *See* RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 121 cmt. c(iii) (2000) ("Some conflicts can be eliminated by an agreement limiting the scope of the lawyer's representation."). The limitation must not render the remaining representation by the lawyer objectively inadequate. *See id*; *see also* Elonex I.P. Holdings, Ltd. v. Apple Computer, Inc., 142 F. Supp. 2d 579, 582 (D. Del. 2001) ("As a general matter, a client may expressly or impliedly waive his objection and consent to an adverse representation."); *In re* Sagan, 218 B.R. 494, 498–99 (Bankr. W.D. Mo. 1998) (noting oral consent is enough to remedy conflict of interest).

[358] *See* MODEL RULES OF PROF'L CONDUCT R. 1.7(b) (2009) (stating lawyer may represent a client if he reasonably believes that he can provide "competent and diligent representation" to each client and each client consents in writing); *see also id*., R. 1.7(b) cmt. 15 ("Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest."); RESTATEMENT OF LAW GOVERNING LAWYERS § 122 cmt. e (2000) ("A client's informed consent to a conflict can be qualified or conditional… the *client might condition consent* on particular action being taken by the lawyer or law firm… Such a partial or conditional consent can be valid even if an unconditional consent in the same situation would be invalid. For example, a *client might give informed consent to a lawyer serving only in the role of mediator between clients, but not to the lawyer representing those clients opposing each other in litigation* if mediation is unavailing.") (emphasis added).

[359] *See In re* Walnut Equip. Leasing Co., 213 B.R. 285, 287–88, 292 n.7 (Bankr. E.D. Pa. 1997) (finding Committee counsel retained with agreement it would not represent Committee in suing member/client). Any such limitations must be spelled out and disclosed to the court. *See* Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994) ("Absent the spontaneous, timely and complete disclosure required by section 327(a) and Fed. R. Bankr. P. 2014(a), court-appointed counsel proceed *at their own risk*."); *see also In re* Jore Corp., 298 B.R. 703, 725 n.24 (Bankr. D. Mont. 2003) (noting disclosures are to be "strictly construed" under the Bankruptcy Code and "failure to disclose relevant connections is an independent basis" for sanction). In the *Jore* case, DIP counsel agreed with the DIP lender, a client on unrelated matters, not to litigate against the lender, without disclosing the no-litigation carve-out from the waiver to the court. 298 B.R. at 708–09. When a dispute over ability to impose a section 506(c) surcharge arose, the lender considered that to be litigation within the scope of the waiver carve-out. *Id.* at 710.

Conflicts counsel accordingly may solve the problem of qualification for appointment as counsel under Bankruptcy Code sections 327 and 1103.[360] Direct fiduciary duties to the other firm client based upon an attorney-client relationship may be avoided, as long as the other client clearly understands that the lawyer will not represent the client's interests in connection with the bankruptcy case. However, conflicts counsel will not solve the problem of fiduciary duties deemed to exist on account of DIP counsel's or Committee counsel's relationship to the entire body of creditors. It would be anomalous at best if counsel was held to be a fiduciary for all of the Debtor's creditors except those that are firm clients on unrelated matters. If individual creditors, a class of creditors or the Committee on behalf of all creditors have standing to assert claims against DIP counsel or Committee counsel for breach of fiduciary duties to the creditor class, the existence of conflicts counsel to deal with individual creditor issues is irrelevant.

## VIII. THEORIES FOR IMPOSING A "FIDUCIARY" OVERLAY ON LAWYER DUTIES TO BENEFICIARIES OF CLIENT FIDUCIARIES

### *A. Theory of "Derivative Client"*

When a lawyer's client is a fiduciary, some courts have held that the fiduciary is merely the "primary" client and the beneficiary is the "derivative" client, "entitled to the duty of loyalty almost as if he were a client."[361] According to HAZARD & HODES, this is "a small additional semantic step, and not a large analytic one," with the result that the lawyer's obligation to avoid participating in a client's fraud "is engaged by a more sensitive trigger" and that volunteering truthful and complete information to the beneficiary must be understood to be "impliedly authorized in order to carry out the representation" under Model Rule 1.6(a).[362] Further, HAZARD & HODES concludes that if the primary client's instructions cannot be assumed to be in the derivative client's best interest, the fiduciary's lawyer has a duty to disobey instructions that would wrongfully harm the beneficiary.[363]

Notably, HAZARD & HODES cites for this proposition only cases concerning a single fiduciary and beneficiary, where the fiduciary did not operate a business, but

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[360] *See* 11 U.S.C. § 327(a) (2006) (determining trustee may employ one or more professionals persons—such as attorney or accountant—who "do not hold . . . an interest adverse to the estate" to represent trustee in carrying out his duties under title 11); *see also* 11 U.S.C. § 1103(b) (2006) (disallowing attorney or accountant who represents a Committee appointed under section 1102 of title 11 to also "represent any other entity having an adverse interest in connection with" the pending case); *In re* Muma Servs, Inc., 286 B.R. 583, 590–91 (Bankr. D. Del. 2002) (comparing section 327(a) with 1103(b) and announcing "[t]he language of section 1103(b) is not more stringent than section 327(a)").

[361] *See* 1 GEOFFREY C. HAZARD & W. WILLIAM HODES, THE LAW OF LAWYERING § 2.7 at 2-11 (3d ed. 2003); *see also* Markell, *supra* note 140, at 420 (noting hazards of theory of derivative liability to creditors).

[362] HAZARD & HODES, *supra* note 361, § 2.7 at 2-11.

[363] *See id.* § 2.7 at 2-12–2-15 (citing cases where guardian's lawyer was held to have responsibilities to see incompetent ward's interests were adequately protected).

rather managed a ward's assets.[364] In one, a lawyer for the guardian of an incompetent ward refused to withdraw from representation when fired until he could assure that the ward's interests were adequately protected.[365] The second case concerned a guardian's lawyer who was held liable to the ward for negligently failing to prevent the defalcations of his client, premised upon a finding of divided loyalty between the guardian and ward.[366] In the third case, the court took a narrow view of the derivative client doctrine in the context of multiple beneficiaries, and held that a lawyer who had given bad advice to the personal representative of an estate was not liable to the group of beneficiaries.[367]

If counsel for a fiduciary takes on all of the client's beneficiaries as indirect clients, conflicts and privileges issues abound, as discussed above. The potential for exposure to creditor derivative lawsuits, second-guessing counsel's advice, is real too.

> It is all too easy for creditors, after the fact, to allege that the corporation, properly advised and being faithful to its fiduciary duties, would have and should have considered their interests paramount. Any variation, it will be alleged, undoubtedly was due to a breach by the lawyer for which the lawyer should be liable.[368]

In the bankruptcy context, one court that referred to DIP counsel as having fiduciary duties derivative of the DIP client did so for the purpose of narrowing the attorney's duties, ruling that they did not encompass investigation of the client because the DIP is exempted from doing so under Bankruptcy Code section 1107(a).[369] Another simply utilized the term "derivative" as a justification for imposing fiduciary duties on DIP counsel.[370]

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[364] *See, e.g.*, Fickett v. Superior Court, 558 P.2d 988, 989 (Ariz. Ct. App. 1976) (acknowledging former guardian was responsible for assets of guardianship estate); Trask v. Butler, 872 P.2d 1080, 1082 (Wash. 1994) (indicating personal representative was fiduciary who handled assets of decedent's estate); *In re* Fraser, 523 P.2d 921, 927 (Wash. 1974) (determining guardian was responsible for incompetent ward's assets).

[365] *In re Fraser*, 523 P.2d at 928 (discussing how lawyers have obligations to look out for best interests of wards).

[366] *See Fickett*, 558 P.2d at 990 (declaring lawyer will be held responsible for injury to ward if it is known or foreseeable that guardian is "acting adversely to his ward's interests").

[367] *See Trask*, 872 P.2d at 1085 (acknowledging "unresolvable conflict of interest" to impose such duty).

[368] Markell, *supra* note 140, at 420.

[369] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) ("[T]he fiduciary duty of the debtor's professionals is derivative of the debtor's fiduciary duty. Since . . . a debtor in possession has no duty to investigate his own financial affairs, it follows that his professionals have no such duty either.").

[370] *See In re* Bellevue Place Assoc., 171 B.R. 615, 626 (Bankr. N.D. Ill. 1994) (relying on *In re Grabill Corp*. to suggest DIP's attorney owes his allegiance to entity because DIP's fiduciary duties and obligations "carry over" to DIP's attorney); *see also In re* Doors and More Inc., 126 B.R. 43, 45 (Bankr. E.D. Mich. 1991) (citing *In re Grabill Corp.* to indicate attorney for DIP is fiduciary for estate); *In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) ("This principle of fiduciary duties and obligations carries over to the attorneys and other professionals listed in Bankruptcy Rule 2014(a) who are retained for the debtor-in-possession.").

*B. The Trust Fund Doctrine*

Some courts and commentators have theorized that upon insolvency, an entity's assets are held informally in trust for creditors as a trust *res*, or trust fund, to be administered for the benefit of creditor beneficiaries.[371] The trust fund theory originated in an 1824 opinion of Justice Story, where he held that directors could be liable for return of a dividend received when winding up a bank's affairs without first paying all the bank's debts.[372] For the most part, the doctrine has been superseded by statutes, but has nonetheless been applied in corporate dissolution cases and some "zone of insolvency" cases.[373]

The trust fund doctrine may provide a good theoretical footing for expanding a corporation's fiduciary duties to its creditors, but it does not provide an adequate theory for imposing a fiduciary overlay on lawyer duties to beneficiaries of client fiduciaries. If an attorney's client is an insolvent corporation that is holding its assets in trust for the benefit of the creditors, the corporation clearly has a fiduciary duty to the creditors. But simply because a client has a fiduciary duty does not automatically mean that the attorney's fiduciary duty extends to the beneficiary. As previously noted, most states hold that no attorney-client relationship is imposed between the trustee's lawyer and the trust beneficiaries.[374] Thus, it requires an additional theory beyond the trust fund doctrine to extend a fiduciary duty to the fiduciary's attorney.[375]

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[371] *See In re* Strasnick 256 B.R. 330, 340 (Bankr. M.D. Fla. 2000) ("Under this theory, the fiduciaries of a corporation (officers, directors, shareholders) hold the assets of the corporation in a trust for a corporation's creditors."); *see also* TaeRa K. Franklin, *Depending Insolvency: What it is and Why it Should Prevail*, 2 N.Y.U. J. L. & BUS. 435, 457 (2006) ("[W]hen a corporate entity becomes insolvent, the corporate assets of the corporation become a trust for the creditors' benefit and directors become fiduciaries to the creditor under the trust."); Markell, *supra* note 140, at 403 (discussing trust fund doctrine).

[372] *See* Wood v. Dummer, 30 F. Cas. 435, 440 (D. Me. 1824)*; see also* Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1332–33 (2007) (analyzing theory behind Justice Story's "trust fund doctrine" and stating decision in *Wood* "had little to do with the corporate objective and more to do with roguish behavior"); Markell, *supra* note 140, at 406 (citing *Wood v. Dummer*).

[373] *See* Hunter v. Fort Worth Capital Corp., 620 S.W. 2d 547, 550 (Tex. 1981) (acknowledging trust fund doctrine has been applied to cases of corporate dissolution); *see also* Markell, *supra* note 140, at 407–09 (citing Henry I. Siegel Co. v. Holliday, 663 S.W.2d 824, 825 (Tex. 1984)); Steven L. Schwartz, *Rethinking a Corporation's Obligations to Creditors*, 17 CARDOZO L. REV. 647, 668 (1996) (recognizing some courts apply trust fund doctrine to insolvent corporations).

[374] *See supra* note 175 and accompanying text; *see also* Spinner v. Nutt 631 N.E.2d 542, 545–46 (Mass. 1994) (stressing trustee's attorney cannot be liable to trust beneficiary because it would result in conflicting loyalties that could impermissibly interfere with the attorney's task of advising the trustee); Reynolds v. Schrock, 142 P.3d 1062, 1070 (Or. 2006) (acknowledging courts in other jurisdictions limit trustee's attorney's liability, including Supreme Judicial Court in Massachusetts, which "rejected claims by trust beneficiaries that a trustee's lawyers could be liable for assisting the trustee's breach of fiduciary duty").

[375] Markell explored ways in which a lawyer representing a fiduciary could face liability from actions brought by the beneficiary. First, he looked at ways lawyers could face direct liability including aiding and abetting a breach of fiduciary duty, mishandling of fiduciary funds, or viewing the beneficiary as a client. However, only viewing the beneficiary as a client would impose a fiduciary duty on the lawyer, while the other two theories are simply actions in fraud. As for the idea that the beneficiaries are the lawyer's client, Markell said, "[it] has an air of the absurd about it." Markell also looked at the possibility that beneficiaries

*C. Counsel for the Estate (or the Fiduciary as Officeholder)*

Several courts and commentators have referred to DIP counsel as counsel for the "estate" instead of counsel for the Debtor/DIP as noted at the beginning of this article.[376] Those who analyze the point recognize that it turns on the nature of the bankruptcy estate. Is it a collection of property interests, or a legal person in which such property interests vest?[377]

The "property interests" argument cites several Bankruptcy Code provisions.[378] In *Bildisco*, the Supreme Court rejected the "separate entity" theory, and held that the DIP is the same entity as the pre-petition debtor, but empowered in a new manner.[379] The property of the debtor remains vested in the debtor, which assumes

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may have standing to bring a derivative action against a lawyer for a breach of fiduciary duty against the corporation. While this may have important practical implications, a derivative suit still only contemplates that the lawyer has a fiduciary duty to the corporation, not the beneficiaries. *See* Davis v. Woolf, 147 F.2d 629, 633–34 (4th Cir. 1945) (suggesting trust fund doctrine leads to results incompatible with rule of extending fiduciary duty to fiduciary's attorney); *see also* Chem-Age Indus., Inc., v. Glover 652 N.W.2d 756, 767, 773 (S.D. 2002) (discussing aiding and abetting breach of fiduciary duty and viewing beneficiary as client); Markell, *supra* note 140, at 414–21.

[376] *See* Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) ("Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually."); *see also* Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am. (*In re* JLM, Inc.), 210 B.R. 19, 26 (B.A.P. 2d Cir. 1997) (providing DIP counsel must serve best interest of estate and citing to *In re Perez*); *In re* Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992) (stating DIP counsel "is not merely a mouthpiece for his client" because DIP counsel "has a duty to oversee the disposition of assets of the estate to assure that the rights of debtor's creditors are protected"); Steinway v. Bolden, 460 N.E.2d 306, 307–08 (Mich. App. 1990) (under state statute authorizing probate fiduciary attorney to "employ counsel to perform necessary legal services in behalf of the estate," attorney's true client is probate estate rather than individual fiduciary).

[377] *See* United States *ex rel*. ASCS v. Gerth, 991 F.2d 1428, 1436 (8th. Cir. 1993) (examining possible effects treating estate as new entity as opposed to collection of property interests would have on mutuality and post-petition requirements); *see also* Hansen, Jones & Leta v. Segal, P.C., 220 B.R. 434, 451 (D. Utah 1998) (explaining under "new person view" estate is considered its own entity which DIP acts on behalf of, while under the "property view" estate is not separate entity but set of property interests which remain vested in DIP); Stephen McJohn, *Person or Property? On the Legal Nature of the Bankruptcy Estate*, 10 BANKR. DEV. J. 465, 523 (1994) (concluding "new person" view is disruptive, complicated, and distorts rights and obligations of debtor, creditors, shareholders and contracting parties).

[378] *See* 11 U.S.C. § 101(41) (2006) ("The term 'person' includes individual, partnership, and corporation."); *see also* 11 U.S.C. § 109(a) (2006) (stating that only a person or municipality can be a debtor under Bankruptcy Code); 11 U.S.C. § 323 (2006) (naming trustee as "representative of estate" in bankruptcy proceedings); 11 U.S.C. § 541(a) (2006) ("[E]state is comprised of all the following property." ); 11 U.S.C. § 1101(1) (2006) ("'[D]ebtor in possession' means debtor."); *Hansen, Jones & Leta P.C.*, 220 B.R. at 453, 453 n.26–27 (citing 11 U.S.C. §§ 101(13), 101(41), 541, 1101(1) in support of property theory). *Cf.* UNIF. PROBATE CODE § 1-201(11) (1990) (defining "estate" as property). The DIP is accordingly the debtor, in possession of its pre-bankruptcy property but accorded new rights and bound by new duties. 11 U.S.C. § 101(41). Debtors are all legal entities and not simply collections of property, since only a "person" or municipality can file a bankruptcy case, not a probate or trust estate. 11 U.S.C. § 109(a). While the trustee is the "representative of the estate" in 11 U.S.C. § 323, an executor of a probate estate bears the same title. UNIF. PROBATE CODE § 1-201(11).

[379] *See* Nat'l Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) ("[I]t is sensible to view the debtor-in-possession as the same 'entity' which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing."); *see also Hansen, Jones & Leta P.C.*, 220 B.R. at 452–53 (rejecting "new person view" for lack of legal support and suffering from same failings as "new entity" view

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 such as setoff rights, and the Internal Revenue Code. Recent Supreme Court cases on sovereign immunity repeatedly describe the "estate" as property to be collected and distributed to creditors, the "*res*" that is the basis for *in rem* jurisdiction, and not an amorphous compilation of creditors and other parties in interest.[380] In *CFTC v. Weintraub*, the Court quoted Bankruptcy Code Section 323 for the point that "all corporate property passes to an estate represented by the trustee," but otherwise referred to the estate as consisting of property, and said the trustee operated the debtor's business and held the debtor corporation's attorney-client privilege, not the estate's business or estate's attorney-client privilege.[381]

An alternative conceptualization of counsel for the estate is a variant on Justice Brandeis' "lawyer for the situation."[382] The ethical unacceptability of such representation was argued in the contentious hearings over Brandeis' appointment to the Supreme Court, and it is by no means authorized by today's Model Rules.[383] Besides, bankruptcy is a hybrid of transactional work and litigation, and no commentator has proposed that a single lawyer could represent multiple parties with adverse interests in court proceedings.

The estate as a corporate entity speaking through management, the DIP's officers, is the closest to a logically supportable theory to support DIP counsel's fiduciary duties. An estate consisting of diverse parties in interest certainly cannot make decisions or direct a lawyer to pursue a particular alternative course of action, any more than an estate consisting of property interests could do so. Some courts have analogized counsel's responsibility not to take action contrary to the interests of a corporate client when directed by management to do so as equivalent to not

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rejected in *Bildisco*); *In re* Allen, 135 B.R. 856, 868 (N.D. Iowa 1992) ("[T]he language of *Bildisco* is unambiguous and intended to put a stop to the rather artificial and fictitious distinctions between the debtor-in-possession and the debtor.").

[380] *See* Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 369 (2006) ("Bankruptcy jurisdiction, as understood today and at the time of the framing, is principally *in rem* jurisdiction…premised on the debtor and his estate and not on the creditors.") (citing Tenn. Student Assistance Corp. v. Hood, 541 U.S. 440, 447 (2004) ("The discharge of a debt by a bankruptcy court is . . . an *in rem* proceeding.")); *see also* United States v. Whiting Pools, Inc., 462 U.S. 198, 207–08 (1983) (emphasizing debtor's right to turnover of property of estate in possession of secured creditors).

[381] 471 U.S. 343, 352–53 (1985).

[382] *See The Nomination of Louis D. Brandeis to be an Associate Justice of the Supreme Court of the United States: Hearing Before the Subcomm. of the S. Comm. on the Judiciary*, 64th Cong. 287 (1916) (recounting Brandeis stating he was "counsel for the situation," and not any particular party to justify advising trustee while concurrently representing creditor in same bankruptcy proceeding). *Cf.* Bowles & Rapoport, *supra* note 313, at 94 (proposing estate's counsel owes fiduciary duty to estate and not to any "constituent" of estate as long as estate is understood to mean single entity with multitude of interests); Anthony T. Kronman, *The Fault in Legal Ethics*, 100 DICK. L. REV. 489, 498 (1996) (analogizing "lawyer for situation" theory to "republican legal ethics" in which lawyers strive to actively improve rules of law to better serve community as whole as opposed to promoting interests of single client).

[383] *See* MODEL RULES OF PROF'L CONDUCT R. 17.1(a) (2009) ("[A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest."). *But see* MODEL RULES OF PROF'L CONDUCT R. 17.1(b) (2009) (listing four exceptions in which lawyer may represent client regardless of existence of concurrent conflict of interest).

taking action contrary to the interests of the estate despite direction by DIP management.[384]

There are several problems with that analysis. It extracts one component of a fiduciary lawyer-client relationship while other components are unsupported and contradictory. It does not solve the problem of simultaneously representing the "estate" and the "DIP/Debtor" entity. If the "entity" is the estate that somehow speaks and directs counsel through the DIP's management and board, that same management and board speak and direct counsel on behalf of another real entity, the corporate or partnership or individual DIP/Debtor. The two are not always in accord, resulting in conflicts that the lawyer is legally and professionally obligated to avoid.

Treating the estate as the client also does not solve and exacerbates the problem of lawyer confidentiality and communications. If the "estate" is the client, the lawyer would be obligated to share confidences and to give advice to that multi-faceted client. Even if communication of advice is given to the broadly-constituted estate only through DIP management, considering the estate constituents as the equivalent of corporate shareholders opens the door to piercing the attorney-client privilege in a quasi-shareholder derivative suit, and subjects the lawyer to malpractice claims by a variety of parties adverse to his real client. To the extent the Committee represents the unsecured creditor body and so does DIP counsel, what happens when their views conflict—are they precluded from adversary litigation and obliged to share confidences because they are in effect co-counsel for the same client?[385]

Furthermore, a lawyer's right to take his client management-decision-maker's direction "up the ladder" to the entity's board and right to refuse to follow the client's direction is narrow. The Ninth Circuit in *Perez* said that if the lawyer for a bankruptcy estate has "material doubts about whether a proposed course action in fact serves the estate's interest," he must persuade his client to take a different path

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[384] *See In re* Sky Valley, Inc., 135 B.R. 925, 938–39 (Bankr. N.D. Ga. 1992) ("The unique circumstances which surround insolvency and the filing of a Chapter 11 case place the attorney for the debtor in possession in the unusual position of sometimes owing a higher duty to the estate and the bankruptcy court than to his client . . . . The attorney for a debtor in possession is not merely a mouthpiece for his client."); *see also* Bowles & Rapoport, *supra* note 313, at 94–95 (explaining "the DIP is the inchoate embodiment of the Estate, in much the same way that corporate management is the inchoate embodiment of the fictional corporation . . . [so that] Estate Counsel can apply ethics rules relating to the 'organization as client' to deal with recalcitrant or downright dishonest management . . . [by] argu[ing] that the attorney-client privilege runs to the Estate and not to [the DIP's] managers"); Nickles, *supra* note 35, at 403 ("[T]he debtor's lawyer is obligated to go well beyond refusing to side with management in the event of conflict. The lawyer must, in essence, supervise management to ensure that management does not obstruct the debtor's performance of its fiduciary duties.").

[385] *See* Bowles & Rapoport, *supra* note 313, at 86 (discussing practical problem accompanies theoretical problem: "The Estate wants to reorganize, but for whose benefit? The managers? The shareholders? The creditors? Depending on which case or article you read, you get different answers. Moreover, the interests of the Estate's constituents will vary during the case, making the determination of appropriate interests a moving target") (citations omitted).

or resign.[386] Unless the proposed course of action meets the threshold of conduct for a violation of counsel's professional conduct obligations, however, DIP counsel ethically cannot resign and is required to comply with the client's wishes, or he will be breaching his ethical duties to his client and risk bar sanctions. There is no super-board of creditors that DIP counsel can approach with client confidences about questionable decisions.

Finally, the theory is an incomprehensible legal fiction in the context of an individual chapter 11 DIP.[387] The individual chapter 11 estate's interest is best served by maximizing the property held by the estate for use in the case; the individual is best served by exempting property from the estate and using income for living expenses.

A variation on the theory of counsel for the estate is that when representing a fiduciary, "the attorney actually represents the fiduciary in his office, because the office defines the scope of the fiduciary's legitimate action."[388] The lawyer considers the "whole purpose" of the fiduciary relationship such as a guardianship rather than the fiduciary's subjective desires.[389] The whole purpose is found in applicable substantive law and the trust instrument, both of which limit and guide the fiduciary's exercise of discretion. To act against the purposes of that fiduciary relationship is to act unfaithfully. The fiduciary's judgments about the beneficiaries' best interests is presumed valid until and unless the fiduciary pursues interests that conflict with "the whole purpose of the trust."[390] "If the fiduciary departs from the duties of the office, the attorney remains bound by the broad parameters of the trust

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[386] *See* Everett v. Perez, (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) ("While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate's interests, he must seek to persuade his client to take a different course or, failing that, resign.").

[387] *See* Bowles & Rapoport, *supra* note 313, at 71 ("Even though it's fairly easy, at least in theory, to understand that the president of a corporation or the managing partner of a partnership is not your client when you are representing the business entity itself, it stretches the bounds of legal fiction to comprehend the difference between the *Bankruptcy Estate* of an individual (your client) and the *individual himself* (not your client).").

[388] *See* Tuttle, *supra* note 178, at 921.

[389] *See id.* at 926 ("[T]he officeholder approach recognizes an objective measure of the client's best interests that transcends the fiduciary's particular, stated interests. In other words, the lawyer can know the fiduciary's interests apart from the fiduciary's expressions of them. 'The whole purpose of the guardianship,' rather than subjective desires, defines the fiduciary's 'interests.'").

[390] *Id.* at 926 ("The fiduciary's judgments about the beneficiary's best interests bear a presumption of validity, but only until the fiduciary pursues interests that conflict with 'the whole purpose of the trust.'"); *see* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 449 (D. Utah 1998) (discussing importance of determining who the client is in trust relationship because "[i]t is the beginning and end of a tautology which ultimately determines the nature and scope of the duty owed, and whether the duty has been breached"); *see also* Eid, *supra* note 298, at 1188–89 ("Historically, the presence of fiduciary duties was strongest in the contexts of trusts where a high degree of confidence in the trustee was necessary for the protection and well-being of the beneficiary.").

relationship and by the purposes of the fiduciary office, and not by the erroneous and illegal determination of the fiduciary."[391]

This "officeholder" theory differs from the entity theory of fiduciary representation in that the sole client is the fiduciary, and is the only one in contractual privity entitled to sue the attorney for malpractice.[392] The fiduciary's lawyer is still subject to liability to third parties for participating in a breach of trust as long as she has notice of the breach and actively assists or encourages the fiduciary in committing the breach. If the breach is fraudulent or dishonest, the attorney may be liable even if she does not benefit personally from the breach of fiduciary duty. This theory is helpful in the context of representing a trustee, but still fails to meet the theoretical and practical problems of representing an entity that is Debtor and also DIP, with rights and interests that conflict with creditors and may legitimately be advanced within the parameters of the Bankruptcy Code. The "whole purpose" of the Debtor/DIP encompasses running the Debtor's business, determining how to restructure the enterprise and its finances, and proposing a plan that balances all constituencies' conflicting rights, including those of equityholders.

*D. Duties Imposed on Officers of the Court*

Some courts have held that DIP counsel and Committee counsel have fiduciary duties because of their roles as officers of the court.[393] While counsel undoubtedly have duties of honor and candor and truthfulness to courts, however, that does not make them fiduciaries to other parties in litigation before the court. Every lawyer is obliged by Rule 9011 not to file unsupported pleadings or pursue frivolous litigation. These duties to the court apply in every case, yet in most if not virtually all cases, counsel for one party is not a fiduciary for the adverse party.

Courts applying an officer of the court standard on DIP counsel have sanctioned lawyers for their own misrepresentations about their conflicts and unauthorized fee collection. They have also chastised lawyers as officers of the court for not disclosing criminal behavior by the DIP client, such as concealing of estate

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[391] Tuttle, *supra* note 178, at 926 (discussing purpose of officeholder approach is to limit client's discretion in matters where client is fiduciary to third parties and requires attorney representing client to rely on objective measure of third parties' interests and not on subjective interests of client).

[392] *Id.* at 927 (indicating officeholder approach recognizes traditional view of privity of contract in malpractice actions); s*ee* Trask v. Butler, 872 P.2d 1080, 1085 (Wash. 1994) (considering public policy factors and determining attorney for personal representative of estate did not owe duty to beneficiaries of estate because it placed unnecessary burden on attorney); *see also* John F. Sutton, Jr., *The Lawyer's Fiduciary Liabilities to Third Parties*, 37 S. TEX. L. REV. 1033, 1039 (1996) (rationalizing lawyer of estate should owe no duty to estate beneficiaries because beneficiaries' interests conflict with client's interests).

[393] *See* Vining v. Ward (*In re* Ward), 894 F.2d 771, 776 (5th Cir. 1990) (indicating law firms representing bankrupt may have professional and ethical duty to notify court of bankrupt's concealment of outstanding asset if it has actual knowledge of such); *see also In re* Consupak, Inc., 87 B.R. 529, 548 (Bankr. N.D. Ill. 1988) (stating attorneys are officers of court and are held to fiduciary standards when requesting compensation from estate).

assets.[394] Such concealment or embezzlement is a crime or fraud, however. When a lawyer knows that his client has committed that kind of misconduct and the client has failed or refused to redress the wrongdoing, the lawyer is obligated under professional conduct rules governing her as an officer of the court to act.[395] Compliance with professional conduct rules prohibits disclosure of client confidences in less egregious situations.

*E. Duties Imposed to Increase Controls on Fiduciary Clients*

Some courts appear to apply the term "fiduciary" to DIP counsel simply for the purpose of underscoring counsel's obligation to represent debtors in compliance with the Bankruptcy Code and Rules, and to comply themselves with requirements of disinterestedness, non-adversity to the estate, and reasonableness of fees for services that benefit the estate.[396] One bankruptcy court explained that because creditors' interests are affected by any action that affects the dividend they receive in the bankruptcy case, "the obligations of a debtor, and professionals employed by the debtor, especially the debtor's attorney, are necessarily fiduciary."[397] The actual misconduct being sanctioned in that case and others was non-compliance with the Bankruptcy Code and Rules and failure to counsel the client appropriately on such compliance. The "fiduciary" terminology was added for its strong moral tone of fidelity and trustworthiness, and to increase lawyer vigilance and sensitivity.

The term "fiduciary" is not just a synonym for careful attention to the impact of client decisions, however. It is a word with a considerable history and significance that imports legal obligations to third parties, liability that third parties can enforce, and a host of professional and practical problems noted in this article. "Fiduciary"

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[394] *See* Brown v. Gerdes, 321 U.S. 178, 182 (1944) (articulating fiduciary standards apply to all individuals seeking reimbursement from estate for services); *see also In re Ward*, 894 F.2d at 775–76 (indicating attorney for DIP had professional duty to supply accurate information to court regarding existing assets but finding him not liable because he did not possess actual knowledge asset existed); *In re* Count Liberty, L.L.C., 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) (issuing civil contempt sanctions to DIP's attorney for not appropriately counseling DIP when DIP transferred money out of account against court orders and finding DIP's attorney did not fulfill fiduciary duty to carry out responsibilities of estate).

[395] *See* FDIC v. Wise, 758 F. Supp. 1414, 1419 (D. Colo. 1991) (articulating DIP's attorney should not be passive observer and remain silent when client makes illegal decision); *see also In re* Sky Valley, 135 B.R. 925, 933 (Bankr. N.D. Ga. 1992) (penalizing DIP's attorney for failing to disclose DIP's auction to court and failing to disclose DIP used money for improvements without court approval); *In re* Wilde Horse Enters., 136 B.R. 830, 840, 846 (Bankr. C.D. Cal. 1991) (denying fees to attorney for improper conduct as officer of court for not reporting illegal sale of DIP's property and for improperly certifying application); MODEL RULES OF PROF'L CONDUCT R. 1.16, 3.3, 1.6 cmt. [18] (2009).

[396] *See* 11 U.S.C. § 327(e) (2006) (mandating attorney of debtor cannot hold adverse interest to estate and must act in its best interest); *see also In re* Gay, 390 B.R. 562, 569–70, 574 (Bankr. D. Md. 2008) (imposing civil penalties on DIP's attorney for failing to disclose payment for services rendered because attorney managing bankruptcy estate had fiduciary obligation to all parties with interests in estate).

[397] *See In re Sky Valley*, 135 B.R. at 933. The court sanctioned DIP counsel for obtaining court approval of a broker's employment without disclosing the broker's connections and lack of disinterestedness, failing to disclose the role of an insider secretly being compensated through the broker's employment, and failing to instruct the broker on disposition of sale proceeds. *Id.* at 936.

is not simply a turn of phrase to be indiscriminately added to an opinion for its *in terrrorem* effect. Attorneys taking direction from interested insider management are not substitutes for the trustees Congress deliberately did not require, and ethically cannot be so.[398]

## IX. THIRD PARTY LIABILITY CONSEQUENCES OF ADDITIONAL LAWYER FIDUCIARY DUTIES

As a general rule, attorneys do not owe a duty of care to non-clients, especially opposing parties in litigation.[399] They not only have no duty to disclose confidential information to non-clients, but are forbidden from doing so over the client's objections.[400] The existence of fiduciary status changes that exposure.

Bankruptcy courts discussing DIP counsel as a fiduciary for the estate have stated that DIP counsel is nonetheless not liable to individual creditors.[401] However,

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[398] *See In re* Brennan, 187 B.R. 135, 151 (Bankr. D.N.J. 1995) ("The ultimate conflict of interest problem in chapter 11 cases is the tension between the concept of a debtor in possession as fiduciary and the reality that the debtor usually seeks to further its own interest at the expense of its creditors. The objections based on alleged conflicts of professionals in such situations often reflect confusion about the real problem, which 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."); *see also In re* SIDCO, Inc., 162, B.R. 299, 300 (Bankr. E.D. Cal. 1993), *aff'd*. 173 B.R. 194 (E.D. Cal. 1994) (noting 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"); *In re* Best Western Heritage Inn P'ship, 70 B.R. 736, 740 (Bankr. E.D. Tenn. 1987) ("[D]ifficult 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."). *But see* Parker v. Frazier (*In re* Freedom Solar Ctrs.), 776 F.2d 14, 18 (1st Cir. 1985) (agreeing separate counsel for debtor and debtor's insiders purchasing estate assets from trustee required for same reasons noted in *Al Gelato*); *In re* BH & P, Inc., 103 B.R. 556, 572 (Bankr. D.N.J. 1989) ("[P]resumptively 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); *In re* Al Gelato Cont'l Desserts, Inc., 99 B.R. 404, 409 (Bankr. N.D. Ill. 1989) (stating separate attorney for DIP corporation "would focus more clearly on the interests" of corporation than would attorney who also represents the corporate shareholder's competing interests, even though both reported to same decision maker).

[399] *See* Wilbourn v. Mostek Corp., 537 F. Supp 302, 305 (D. Colo. 1982) (stating during performance of fiduciary duties to client, attorney is only liable to third parties if actions are "fraudulent or malicious"); *see also* Bates v. Law Firm of Dysart, Taylor, Penner, Lay & Lewandowski, 844 S.W.2d 1, 5 (Mo. Ct. App. 1992) ("While it is desirable that litigation attorneys exercise every consideration to avoid causing needless pain to opposing parties, the law recognizes no legal duty to exercise care for the interests of opposing parties."); William L. Siegel, *Attorney Liability: Is This the New Twilight Zone?*, 27 U. MEM. L. REV. 13, 16 (1996) ("Courts in virtually every jurisdiction recognize that an attorney does not owe a duty to exercise care for the benefit of opposing parties or non-clients.").

[400] *See* MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2009) ("A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent."); *see also* Siegel, *supra* note 399, at 17; Tuttle, *supra* note 178, at 938 ("The lawyer's duty of loyalty to the client demands . . . that the lawyer not reveal the client's confidential information without consent.").

[401] *See In re* Count Liberty, L.L.C., 370 B.R. 259, 280 n.54 (Bankr. C.D. Cal. 2007) ("The fiduciary duties of a debtor in possession's counsel to the estate do not extend to any particular creditor in a chapter 11 case."); *see also In re* Texasoil Enters., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (opining although

at least one court has suggested that DIP counsel might be liable to creditors for mishandling a bankruptcy if evidence of a fraudulent or intentionally wrongful intent is established.[402] Suits against Committee counsel by constituent creditors have been allowed for malpractice or breach of fiduciary duty in their actions as Committee counsel.[403] Already, wholly apart from whether DIP counsel has fiduciary duties to the "estate" and creditor body, DIP counsel is exposed to potential lawsuits by non-clients on grounds of conspiracy to breach or aiding and abetting the breach of a client's fiduciary duty if the lawyer knowingly assists client officers and directors to evade fiduciary duties.[404] A lawyer may also be liable for handling funds of a fiduciary contrary to the interest of the beneficiary.[405]

Outside of bankruptcy, a lawyer who knowingly participates in her client's breach of fiduciary duties may be liable for resulting harm to the beneficiary.[406]

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debtor's attorney may not have direct duty to creditors, attorney must make sure debtor properly maintains estate).

[402] *See* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 461 (Bankr. D. Utah 1998) (suggesting if DIP counsel acted fraudulently or criminally toward creditors, liability for such would be expected more so than liability for general breach of fiduciary duty to creditors); *see also In re* Dieringer, 132 B.R. 34, 37 (Bankr. N.D. Cal. 1991) (explaining DIP counsel served as disbursing agent under confirmed plan; continued to assure creditors they would eventually be paid while allowing debtors to make withdrawals and incur liabilities; lawyer held liable to creditors for misrepresentations for damages suffered by his forbearance from action).

[403] *See* Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein P.C., 42 B.R. 960, 963 (E.D. Pa. 1984) (finding fiduciary duty to exist, court allowed lawsuit based on breach of duty to go to jury); *see also In re* Mirant Corp., 334 B.R. 787, 793–94 (Bankr. N.D. Tex. 2005) (remarking assumption of role as Committee counsel to "ad hoc" shareholder group creates fiduciary duty, and as fiduciaries, "are answerable to the court for their conduct"); *In re* Overmyer Telecasting Co., 47 B.R. 823, 824 (Bankr. N.D. Ohio 1985) ("The malpractice and breach of fiduciary duty claims belong to the creditors' committee or to the unsecured creditors in general."); *In re* Baldwin-United Corp., 38 B.R. 802, 805 (Bankr. S.D. Ohio 1984) (holding fiduciary relationship between Committee counsel and those represented requires disclosure when requested and lack thereof is actionable).

[404] *See* Morales v. Field, 160 Cal. Rptr. 239, 243 (Cal. Ct. App. 1979) (acknowledging lawyer for fiduciary is clearly liable to beneficiary for active participation in breach of trust; divided authorities on whether also liable for negligence, turning on existence of duty to beneficiaries); *see also* Badger Cab Co. v. Soule, 492 N.W.2d 375, 381 (Wis. Ct. App. 1992) ("[A]ttorney may not use the license to practice law as a shield to protect himself/herself from the consequences of participating in an unlawful or illegal conspiracy."); Markell, *supra* note 140, at 414 (citing Whitfield v. Lindemann, 853 F.2d 1298, 1302 (5th Cir. 1988), *cert. denied*; Klepak v. Dole, 490 U.S. 1089 (1989) (holding lawyer liable to pension plan for aiding trustee in breach of duties).

[405] *See* Karris v. Water Tower Trust & Savings Bank, 389 N.E.2d 1359, 1370 (Ill. App. Ct. 1979) (holding had lawyer breached fiduciary duty to corporation, shareholder could sue lawyer through derivative action); *see also* Markell, *supra* note 140, at 415–16 (citing Willner's Fuel Distrib., Inc. v. Noreen, 882 P.2d 399, 405 (Alaska 1994)) (stating lawyer disbursed entity's trust funds to client to evade creditor levy, and thereby breached fiduciary duties to entity allowing creditors to sue on behalf of corporation as beneficiaries of fiduciary duty owed by entity). *But see In re* Dieringer, 132 B.R. 34, 36 (Bankr. N.D. Cal. 1991) (holding no breach of fiduciary duty because lawyer had fiduciary duty to bankruptcy estate, not to plaintiffs because plaintiffs were not beneficiaries of trust).

[406] *See* Whitney v. Citibank, N.A., 782 F.2d 1106, 1115 (2d Cir. 1986); Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476, 485–86 (Ky. 1991); RESTATEMENT (SECOND) OF TORTS § 874 cmt. c (1979); RESTATEMENT (SECOND) OF TRUSTS § 326 (1959); Siegel, *supra* note 399, at 20–21 ("It is well established that the attorney has immunity from liability to third parties only so long as the attorney pursues his client's interests in good faith and does not act in a malicious, fraudulent, or tortuous manner which perverts or

Some courts have held in trust contexts that "knowingly" includes notice from the circumstances, *i.e.* not ignoring "red flags".[407] Mere knowledge of such a breach is generally not enough for liability without active involvement, however.[408] "Participation" in the breach entails substantial assistance or encouragement, *e.g*. by receiving and disbursing funds, knowing the fiduciary intends to use the money illegally,[409] or by court filings to conceal the breach.[410] Indeed, some commentators have written about the tremendous increase in the number of lawsuits brought against attorneys by non-clients for aiding and abetting their clients' breach of fiduciary duty or conspiring with the clients to breach such duties.[411]

Thus, existing precedent exposes DIP counsel to liability when she does more than simply advise her client, and actually handles and distributes client funds, intentionally files reports and other documents to conceal fraud, or assists in documenting or otherwise facilitating an intentionally fraudulent transfer or other fraud. Holding DIP counsel to be a fiduciary for the estate—consisting of creditor interests and not just property—opens the door to additional litigation exposure. If DIP counsel is also considered an agent for the DIP client as principal, she faces exposure for the results of some DIP conduct under agency principles.[412] If DIP counsel is held to have her own fiduciary-beneficiary relationship to the "estate" on any theory, counsel may have an affirmative duty to disclose fiduciary breaches that is an actionable duty to and enforceable by beneficiaries.[413] In an attorney-client context, imposing such a duty to non-clients leads to attorney conflicts of interest.[414]

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frustrates the administration of justice." (citing Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App. 1985))).

[407] *See* Wyle v. R.J. Reynolds Indus. Inc., 709 F.2d 585, 590 (9th Cir. 1983) (deliberate ignorance of client's practices is equivalent of actual knowledge); *see also* Katerina P. Lewinbuk, *Let's Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client's Breach of Fiduciary Duty*, 40 ARIZ. ST. L.J. 135, 152–53 (2008); Tuttle, *supra* note 178, at 944 (citing *Whitney*, 782 F.2d at 1116).

[408] *See* Newburger, Loeb & Co., v. Gross, 563 F.2d 1057, 1074, 1080 (2d Cir. 1977) (lawyer found liable for inducing and participating in his clients' breach of fiduciary duty by affirmatively permitting transfer of funds to take place); *see also* Albright v. Burns, 503 A.2d 386 388–91 (N.J. Super. Ct. App. Div. 1986) (finding lawyer "participation" when lawyer received funds from trust and disbursed funds to fiduciary, knowing fiduciary intended to use them illegally); Tuttle, *supra* note 178, at 945 ("[E]ven if the lawyer has notice of the breach, she only assumes liability if she 'participates' in the breach.").

[409] *See* Tuttle, *supra* note 178, at 945 (citing RESTATEMENT (SECOND) OF TORTS, §§ 874, 876 (1979); RESTATEMENT (SECOND) OF TRUSTS § 326 (1959)).

[410] *See id.* (citing Pierce v. Lyman, 3 Cal. Rptr. 2d 236, 243 (Cal. Ct. App. 1991)).

[411] *See generally* Lewinbuk, *supra* note 407.

[412] "Under the law of agency, the duty of an agent of the principal . . . to a third person . . . is a function of the duty of the principal . . . to that person." Hazard, *Triangular Lawyer Relationships*, *supra* note 117, at 28 (citing RESTATEMENT (SECOND) OF AGENCY § 344 (2009)) ("An agent is subject to liability, as he would be for his own personal conduct, for the consequences of another's conduct which results from his directions if, with knowledge of the circumstances, he intends the conduct, or its consequences, except where the agent or the one acting has a privilege or immunity not available to the other.")

[413] *See* Bay Colony Ltd. v. Trendmaker, Inc., 121 F.3d 998, 1004 (5th Cir. 1997) (stating there must be fiduciary or confidential relationship for duty to disclose to exist under Texas law); *see also* Solares v. Solares, 232 S.W.3d 873, 881 (Tex. App. 2007) (affirmative duty to disclose exists when there is confidential or fiduciary relationship); Siegel, *supra* note 399, at 23 (citing Tempo Tamers, Inc. v. Crow-Houston Four, Ltd., 715 S.W.2d 658, 669 (Tex. App. 1986), *writ ref'd n.r.e*) ("An affirmative duty to speak

The cases may not be simple. DIPs, like fiduciaries who are partners and corporate officers, constantly deal with a mixture of personal interests and obligations to beneficiaries where "the fiduciary's line between acceptable and prohibited conduct is less distinct than in the trust or guardianship context."[415] In the *Perez* case, the Ninth Circuit wrote that pursuing reorganization plans paying all creditors in full constituted a breach of fiduciary duty owed to a creditor that damaged the creditor by running up its costs through bankruptcy reorganization delays.[416] Creditors often charge that they are wrongfully forced to incur such costs, and the line between appropriate advocacy for a DIP/Debtor and breach of fiduciary duty is thin indeed when a plan like the one in *Perez* is considered a breach. In a regulatory context similar to bankruptcy, the Kaye Schoeler law firm paid $41 million to settle a claim that the firm breached a duty to disclose client financial information to the regulator as the holder of all residual interests in the thrift client, the equivalent of unsecured creditors in most bankruptcy cases.[417]

Commentators on cases imposing negligence liability on attorneys to their non-clients have pointed out increasing numbers of cases where lawyer malpractice liability was founded on tort or fiduciary law instead of on the presence of an attorney-client contract.[418] Courts have found malpractice liability to non-clients

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arises where there is a relationship of trust and confidence between the parties, and one of the parties has superior knowledge or information not within the fair and reasonable reach of the other party.").

[414] *See* Hopper v. Frank, 16 F.3d 92, 95 (5th Cir. 1994) (explaining attorney represented partnership, not general partner); *see also* Multilist Serv. of Cape Girardeau, Mo., Inc. v. Wilson, 14 S.W.3d 110, 115 (Mo. App. 2000) (holding attorney has no duty to individual members of corporation and indicating conflicting interest if hold otherwise); Siegel, *supra* note 399, at 23–24 (citing Rose v. Summers, Compton Wells & Hamburg, P.C., 887 S.W.2d 683, 686–87 (Mo. Ct. App. 1994)) (noting attorney for limited partnership did not have duty to limited partners; imposition of such an affirmative duty would amount to an impossible burden and, perhaps, result in conflicts of interest).

[415] *See* Tuttle, *supra* note 178, at 949 (citing Skarbrevik v. Cohen, England & Whitfield, 282 Cal. Rptr. 627 (Cal. Ct. App. 1991)) (indicating lawyer's difficult task when representing fiduciary); *see also* Jeffrey N. Pennell, *Representations Involving Fiduciary Entities: Who Is the Client?*, 62 FORDHAM L. REV. 1319, 1322, 1334 (1994) (giving examples of various views of defining fiduciary entity while examining problem of identifying real client when lawyer's nominal client is a fiduciary).

[416] *See* Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1215, 1218–19 (9th Cir. 1994) ("Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually. Counsel has an independent responsibility to determining whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor.").

[417] W. Frank Newton, *A Lawyer's Duty to the Legal System and to a Client: Drawing the Line*, 35 S. TEX. L. REV. 701, 704–06 (1994) (discussing Kaye Scholer's settlement with Office of Thrift Supervision (OTS) and its impact on legal ethics in context of regulatory practice). *See generally* Markell, *supra* note 140 (demonstrating conflicts, risks and potential liabilities for attorneys who represent insolvent corporations); *see also* Steve McConnico & Robyn Bigelow, *Summary of Recent Developments in Texas Legal Malpractice Law*, 33 ST. MARY'S L.J. 607, 643–44 (2002) (discussing third parties suits settled by against lawyers based on alleging conspiracy and fraud).

[418] *See* Nancy J. Moore, *Expanding Duties of Attorneys to "Non-Clients:" Reconceptualizing the Attorney-Client Relationship in Entity Representation and Other Inherently Ambiguous Situations*, 45 S.C. L. REV. 659, 670–73, 682–84 (1994) (examining attorneys' duties to non-clients). *Cf.* Emily Couric, *The Tangled Web: When Ethical Misconduct Becomes Legal Liability*, 79 A.B.A.J. 64, 64 (April 1993) (discussing rapid increase in third-party legal malpractice suits); Joan Teshima, Annotation, *Attorney's Liability to One Other than Immediate Client for Negligence in Connection with Legal Duties*, 61 A.L.R. 4th 615, 625 (1988) (indicating increase in number of cases which find third-party liability against lawyers for non-clients).

who were confused about the existence of an attorney-client relationship in ambiguous circumstances, and thought counsel owed duties to them.[419] One commentator suggested that "an appropriate tort-based test for determining the formation of an attorney-client relationship in legal malpractice cases would focus on the reasonable expectations of the would-be client."[420] "In a strict sense, the test in the entity representation cases would be whether individual constituents reasonably believed that the entity lawyer was representing them as well as the entity, regardless of the lawyer's intent or belief, under circumstances in which such reliance was reasonably foreseeable."[421] Opinions in bankruptcy cases stating that DIP counsel is counsel for the estate, which consists not merely of property but also of the concerns of multiple parties in interest, fosters such non-client expectations of attorney duties to them, and accordingly malpractice liability to them.

As bankruptcy judge Bruce Markell once noted, the trend of more and more lawsuits for alleged breaches of fiduciary duties and conflicts of interest is problematic enough at the client level, where the client can file bankruptcy and resolve such issues in that forum. That is generally not an option for the lawyers representing insolvent clients, and when the conflicts and liability exposure spill over to those lawyers, the stakes are much higher and can even result in loss of the license to practice law.[422]

## X. ALTERNATIVE GROUND FOR THE SAME RESULTS

As pointed out in *Hansen, Jones & Leta*, instead of imposing an undefined fiduciary duty to the estate and its beneficiaries on DIP counsel, which has broad and undefined ramifications that bankruptcy courts probably do not intend, courts can reach the same results by finding a breach of counsel's fiduciary duty to the client DIP, violations of Bankruptcy Rule 9011, Bankruptcy Code sections 327 or 329, or failure to provide services which benefit the estate under Code section 330, or breaches of professional conduct codes or rules.[423]

The actual actions courts have directed in cases stating that DIP counsel has fiduciary duties to the estate and creditors are in fact consistent with professional

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[419] *See* Westinghouse Electric Corp. v. Kerr-McGee Corp., 580 F.2d 1311, 1320 (7th Cir. 1978) (qualifying client's belief as determinative of relationship between attorney and client regarding client's expectations of legal representation); *see also* E.F. Hutton & Co. v. Brown, 305 F. Supp. 371, 389 (S.D. Tex. 1969) (remarking client's "reasonable understanding" of relationship between client and attorney was governing factor in determining dismissal); Moore, *supra* note 418 at 681–87 (discussing difficulty in determining existence of relationship and duty between attorney and client or non-client in disqualification cases).

[420] Moore, *supra* note 418, at 687.

[421] *Id.*

[422] *See In re* Crayton, 192 B.R. 970 (B.A.P. 9th Cir. 1996) (discussing disbarment authority); *see also* Markell, *supra* note 140, at 424, 428 (providing attorneys face multifaceted liability issues of professional risk in context of insolvent corporations).

[423] *See* Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 461–67 (Bankr. D. Utah 1998) (suggesting caution is required when extending blanket fiduciary duty of counsel for DIP to beneficiaries of estate in determining breach, but Bankruptcy Code violations can be used to reach same result).

conduct rules, and reflect duties owed by counsel to the DIP client fiduciary and to the court.[424] Thus, the *Count Liberty* and *Food Management* opinions acknowledge 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.[425] 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.[426]

Lawyer-to-client duties and lawyer-to-court duties are well known, fleshed out in a wealth of opinions and commentaries, and worthy of reinforcement. However, expanding these obligations with duties to the amorphous bankruptcy "estate" are problematic at best, especially when the term "fiduciary" is added. "Fiduciary" means considerably more than vigilant concern; duties to an "estate" place DIP and Committee counsel in a professionally untenable position; and advocates, commentators, and judges would be well-served by exercising care and caution when using such terminology.

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[424] *See* Lange v. Schropp (*In re* Brook Valley VII, Joint Venture), 496 F.3d 892, 900–01(8th Cir. 2007) (enumerating general fiduciary duties of care and loyalty owed to estate by DIP and DIP's controllers); Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Charles N. Wooten, Ltd. (*In re* Evangeline Ref. Co.), 890 F.2d 1312, 1323 (5th Cir. 1989) (observing supervisors of bankruptcy process are considered court officers and are required to have "high standards of fiduciary conduct"); Pierson v. Creel (*In re* Consol. Bancshares, Inc.), 785 F.2d 1249, 1256 n.7 (5th Cir. 1986) (noting to ensure no conflict of interest exists, attorneys are required to be disinterested parties and are considered fiduciaries and court officers).

[425] *See In re* Food Mgmt. Group, LLC, 380 B.R. 677, 708 (Bankr. S.D.N.Y. 2008) (rationalizing debtor's counsel, though not trustee, must still advise debtor to act in accordance with law regarding its duties as DIP); *In re* Count Liberty, LLC, 370 B.R. 259, 281–82 (Bankr. C.D. Ca. 2007) (affirming counsel's duty to advise DIP accordingly to ensure successful discharge of responsibilities in bankruptcy proceeding).

[426] *See* Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) (reasoning counsel for DIP is counsel for estate and takes instruction from client, but counsel must use his judgment to determine if it is best for estate); *see also In re Count Liberty, LLC*, 370 B.R. at 281–82 (asserting counsel for DIP has affirmative duty as fiduciary to debtor and estate to provide "proactive" advice to client during bankruptcy process and to ensure that steps taken are in accordance with Bankruptcy Code and Rules); *In re* St. Stephen's 350 E. 116th St., 313 B.R. 161, 171 (Bankr. S.D.N.Y. 2004) (arguing counsel for DIP cannot ignore matters having adverse legal and practical consequences for estate and creditors); *In re* Sky Valley, Inc., 135 B.R. 925, 939 (Bankr. N.D. Ga. 1992) (stating DIP counsel responsible to oversee disposition of estate assets, as non-lawyers cannot be expected to know Code requirements).