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RULES
CLIENT-LAWYER RELATIONSHIP

Rule 1.7 Conflict of Interest: Current Clients

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(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

COMMENT

General Principles

[1] Loyalty and independent judgment are essential elements in the lawyer's relationship to a client. Concurrent conflicts of interest can arise from the lawyer's responsibilities to another client, a former client or a third person or from the lawyer's own interests. For specific Rules regarding certain concurrent conflicts of interest, see Rule 1.8. For former client conflicts of interest, see Rule 1.9. For conflicts of interest involving prospective clients, see Rule 1.18. For definitions of "informed consent" and "confirmed in writing," see Rule 1.0(e) and (b).

[2] Resolution of a conflict of interest problem under this Rule requires the lawyer to: 1) clearly identify the client or clients; 2) determine whether a conflict of interest exists; 3) decide whether the representation may be undertaken despite the existence of a conflict, i.e., whether the conflict is consentable; and 4) if so, consult with the clients affected under paragraph (a) and obtain their informed consent, confirmed in writing. The clients affected under paragraph (a) include both of the clients referred to in paragraph (a)(1) and the one or more clients whose representation might be materially limited under paragraph (a)(2).

[3] A conflict of interest may exist before representation is undertaken, in which event the representation must be declined, unless the lawyer obtains the informed consent of each client under the conditions of paragraph (b). To determine whether a conflict of interest exists, a lawyer should adopt reasonable procedures, appropriate for the size and type of firm and practice, to determine in both litigation and non-litigation matters the persons and issues involved. See also Comment to Rule 5.1. Ignorance caused by a failure to institute such procedures will not excuse a lawyer's violation of this Rule. As to whether a client-lawyer relationship exists or, having once been established, is continuing, see Comment to Rule 1.3 and Scope.

[4] If a conflict arises after representation has been undertaken, the lawyer ordinarily must withdraw from the representation, unless the lawyer has obtained the informed consent of the client under the conditions of paragraph (b). See Rule 1.16. Where more than one client is involved, whether the lawyer may continue to represent any of the clients is

determined both by the lawyer's ability to comply with duties owed to the former client and by the lawyer's ability to represent adequately the remaining client or clients, given the lawyer's duties to the former client. See Rule 1.9. See also Comments [5] and [29].

[5] Unforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation, might create conflicts in the midst of a representation, as when a company sued by the lawyer on behalf of one client is bought by another client represented by the lawyer in an unrelated matter. Depending on the circumstances, the lawyer may have the option to withdraw from one of the representations in order to avoid the conflict. The lawyer must seek court approval where necessary and take steps to minimize harm to the clients. See Rule 1.16. The lawyer must continue to protect the confidences of the client from whose representation the lawyer has withdrawn. See Rule 1.9(c).

Identifying Conflicts of Interest: Directly Adverse

[6] Loyalty to a current client prohibits undertaking representation directly adverse to that client without that client's informed consent. Thus, absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated. The client as to whom the representation is directly adverse is likely to feel betrayed, and the resulting damage to the client-lawyer relationship is likely to impair the lawyer's ability to represent the client effectively. In addition, the client on whose behalf the adverse representation is undertaken reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client, i.e., that the representation may be materially limited by the lawyer's interest in retaining the current client. Similarly, a directly adverse conflict may arise when a lawyer is required to cross-examine a client who appears as a witness in a lawsuit involving another client, as when the testimony will be damaging to the client who is represented in the lawsuit. On the other hand, simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients.

[7] Directly adverse conflicts can also arise in transactional matters. For example, if a lawyer is asked to represent the seller of a business in negotiations with a buyer represented by the lawyer, not in the same transaction but in another, unrelated matter, the lawyer could not undertake the representation without the informed consent of each client.

Identifying Conflicts of Interest: Material Limitation

[8] Even where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests. For example, a lawyer asked to represent several individuals seeking to form a joint venture is likely to be materially limited in the lawyer's ability to recommend or advocate all possible positions that each might take because of the lawyer's duty of loyalty to the others. The conflict in effect forecloses alternatives that would otherwise be available to the client. The mere possibility of subsequent harm does not itself require disclosure and consent. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

Lawyer's Responsibilities to Former Clients and Other Third Persons

[9] In addition to conflicts with other current clients, a lawyer's duties of loyalty and independence may be materially limited by responsibilities to former clients under Rule 1.9 or by the lawyer's responsibilities to other persons, such as fiduciary duties arising from a lawyer's service as a trustee, executor or corporate director.

Personal Interest Conflicts

[10] The lawyer's own interests should not be permitted to have an adverse effect on representation of a client. For example, 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. Similarly, when a lawyer has discussions concerning possible employment with an opponent of the lawyer's client, or with a law firm representing the opponent, such discussions could materially limit the lawyer's representation of the client. In addition, a lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed financial interest. See Rule 1.8 for specific Rules pertaining to a number of personal interest conflicts, including business transactions with clients. See also Rule 1.10 (personal interest conflicts under **Rule 1**.7 ordinarily are not imputed to other lawyers in a law firm).

[11] When lawyers representing different clients in the same matter or in substantially related matters are closely related by blood or marriage, there may be a significant risk that client confidences will be revealed and that the lawyer's family

relationship will interfere with both loyalty and independent professional judgment. As a result, each client is entitled to know of the existence and implications of the relationship between the lawyers before the lawyer agrees to undertake the representation. Thus, a lawyer related to another lawyer, e.g., as parent, child, sibling or spouse, ordinarily may not represent a client in a matter where that lawyer is representing another party, unless each client gives informed consent. The disqualification arising from a close family relationship is personal and ordinarily is not imputed to members of firms with whom the lawyers are associated. See Rule 1.10.

[12] A lawyer is prohibited from engaging in sexual relationships with a client unless the sexual relationship predates the formation of the client-lawyer relationship. See Rule 1.8(j).

Interest of Person Paying for a Lawyer's Service

[13] A lawyer may be paid from a source other than the client, including a co-client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty or independent judgment to the client. See Rule 1.8(f). If acceptance of the payment from any other source presents a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in accommodating the person paying the lawyer's fee or by the lawyer's responsibilities to a payer who is also a co-client, then the lawyer must comply with the requirements of paragraph (b) before accepting the representation, including determining whether the conflict is consentable and, if so, that the client has adequate information about the material risks of the representation.

Prohibited Representations

[14] Ordinarily, clients may consent to representation notwithstanding a conflict. However, as indicated in paragraph (b), some conflicts are nonconsentable, meaning that the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent. When the lawyer is representing more than one client, the question of consentability must be resolved as to each client.

[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. Thus, under paragraph (b)(1), representation is prohibited if in the circumstances the lawyer cannot reasonably conclude that the lawyer will be able to provide competent and diligent representation. See Rule 1.1 (competence) and Rule 1.3 (diligence).

[16] Paragraph (b)(2) describes conflicts that are nonconsentable because the representation is prohibited by applicable law. For example, in some states substantive law provides that the same lawyer may not represent more than one defendant in a capital case, even with the consent of the clients, and under federal criminal statutes certain representations by a former government lawyer are prohibited, despite the informed consent of the former client. In addition, decisional law in some states limits the ability of a governmental client, such as a municipality, to consent to a conflict of interest.

[17] Paragraph (b)(3) describes conflicts that are nonconsentable because of the institutional interest in vigorous development of each client's position when the clients are aligned directly against each other in the same litigation or other proceeding before a tribunal. Whether clients are aligned directly against each other within the meaning of this paragraph requires examination of the context of the proceeding. Although this paragraph does not preclude a lawyer's multiple representation of adverse parties to a mediation (because mediation is not a proceeding before a "tribunal" under Rule 1.0(m)), such representation may be precluded by paragraph (b)(1).

Informed Consent

[18] Informed consent requires that each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client. See Rule 1.0(e) (informed consent). The information required depends on the nature of the conflict and the nature of the risks involved. When representation of multiple clients in a single matter is undertaken, the information must include the implications of the common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege and the advantages and risks involved. See Comments [30] and [31] (effect of common representation on confidentiality).

[19] Under some circumstances it may be impossible to make the disclosure necessary to obtain consent. For example, when the lawyer represents different clients in related matters and one of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision, the lawyer cannot properly ask the latter to consent. In some cases the alternative to common representation can be that each party may have to obtain separate representation with the possibility of incurring additional costs. These costs, along with the benefits of securing separate representation, are factors that may be considered by the affected client in determining whether common representation is in the client's interests.

Consent Confirmed in Writing

[20] Paragraph (b) requires the lawyer to obtain the informed consent of the client, confirmed in writing. Such a writing

may consist of a document executed by the client or one that the lawyer promptly records and transmits to the client following an oral consent. See Rule 1.0(b). See also Rule 1.0(n) (writing includes electronic transmission). If it is not feasible to obtain or transmit the writing at the time the client gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter. See Rule 1.0(b). The requirement of a writing does not supplant the need in most cases for the lawyer to talk with the client, to explain the risks and advantages, if any, of representation burdened with a conflict of interest, as well as reasonably available alternatives, and to afford the client a reasonable opportunity to consider the risks and alternatives and to raise questions and concerns. Rather, the writing is required in order to impress upon clients the seriousness of the decision the client is being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing.

Revoking Consent

[21] A client who has given consent to a conflict may revoke the consent and, like any other client, may terminate the lawyer's representation at any time. Whether revoking consent to the client's own representation precludes the lawyer from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of the other clients and whether material detriment to the other clients or the lawyer would result.

Consent to Future Conflict

[22] Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).

Conflicts in Litigation

[23] Paragraph (b)(3) prohibits representation of opposing parties in the same litigation, regardless of the clients' consent. On the other hand, simultaneous representation of parties whose interests in litigation may conflict, such as coplaintiffs or codefendants, is governed by paragraph (a)(2). A conflict may exist by reason of substantial discrepancy in the parties' testimony, incompatibility in positions in relation to an opposing party or the fact that there are substantially different possibilities of settlement of the claims or liabilities in question. Such conflicts can arise in criminal cases as well as civil. The potential for conflict of interest in representing multiple defendants in a criminal case is so grave that ordinarily a lawyer should decline to represent more than one codefendant. On the other hand, common representation of persons having similar interests in civil litigation is proper if the requirements of paragraph (b) are met.

[24] Ordinarily a lawyer may take inconsistent legal positions in different tribunals at different times on behalf of different clients. The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest. A conflict of interest exists, however, if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another client in a different case; for example, when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client. Factors relevant in determining whether the clients need to be advised of the risk include: where the cases are pending, whether the issue is substantive or procedural, the temporal relationship between the matters, the significance of the issue to the immediate and long-term interests of the clients involved and the clients' reasonable expectations in retaining the lawyer. If there is significant risk of material limitation, then absent informed consent of the affected clients, the lawyer must refuse one of the representations or withdraw from one or both matters.

[25] When a lawyer represents or seeks to represent a class of plaintiffs or defendants in a class-action lawsuit, unnamed members of the class are ordinarily not considered to be clients of the lawyer for purposes of applying paragraph (a)(1) of this Rule. Thus, the lawyer does not typically need to get the consent of such a person before representing a client suing the person in an unrelated matter. Similarly, a lawyer seeking to represent an opponent in a class action does not typically need the consent of an unnamed member of the class whom the lawyer represents in an unrelated matter.

Nonlitigation Conflicts

[26] Conflicts of interest under paragraphs (a)(1) and (a)(2) arise in contexts other than litigation. For a discussion of directly adverse conflicts in transactional matters, see Comment [7]. Relevant factors in determining whether there is significant potential for material limitation include the duration and intimacy of the lawyer's relationship with the client or clients involved, the functions being performed by the lawyer, the likelihood that disagreements will arise and the likely prejudice to the client from the conflict. The question is often one of proximity and degree. See Comment [8].

[27] For example, conflict questions may arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such as husband and wife, and, depending upon the circumstances, a conflict of interest may be present. In 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. In order to comply with conflict of interest rules, the lawyer should make clear the lawyer's relationship to the parties involved.

[28] Whether a conflict is consentable depends on the circumstances. For example, a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest even though there is some difference in interest among them. Thus, a lawyer may seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest or arranging a property distribution in settlement of an estate. The lawyer seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party might have to obtain separate representation, with the possibility of incurring additional cost, complication or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them.

Special Considerations in Common Representation

[29] In considering whether to represent multiple clients in the same matter, a lawyer should be mindful that if the common representation fails because the potentially adverse interests cannot be reconciled, the result can be additional cost, embarrassment and recrimination. Ordinarily, the lawyer will be forced to withdraw from representing all of the clients if the common representation fails. In some situations, the risk of failure is so great that multiple representation is plainly impossible. For example, a lawyer cannot undertake common representation of clients where contentious litigation or negotiations between them are imminent or contemplated. Moreover, because the lawyer is required to be impartial between commonly represented clients, representation of multiple clients is improper when it is unlikely that impartiality can be maintained. Generally, if the relationship between the parties has already assumed antagonism, the possibility that the clients' interests can be adequately served by common representation is not very good. Other relevant factors are whether the lawyer subsequently will represent both parties on a continuing basis and whether the situation involves creating or terminating a relationship between the parties.

[30] 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. Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.

[31] As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the 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. See Rule 1.4. The lawyer should, at the outset of the common representation and as part of the process of obtaining each client's informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other. In limited circumstances, it may be appropriate for the lawyer to proceed with the representation when the clients have agreed, after being properly informed, that the lawyer will keep certain information confidential. For example, the lawyer may reasonably conclude that failure to disclose one client's trade secrets to another client will not adversely affect representation involving a joint venture between the clients and agree to keep that information confidential with the informed consent of both clients.

[32] When seeking to establish or adjust a relationship between clients, the lawyer should make clear that the lawyer's role is not that of partisanship normally expected in other circumstances and, thus, that the clients may be required to assume greater responsibility for decisions than when each client is separately represented. Any limitations on the scope of the representation made necessary as a result of the common representation should be fully explained to the clients at the outset of the representation. See Rule 1.2(c).

[33] Subject to the above limitations, each client in the common representation has the right to loyal and diligent representation and the protection of Rule 1.9 concerning the obligations to a former client. The client also has the right to discharge the lawyer as stated in Rule 1.16.

Organizational Clients

[34] A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as a parent or subsidiary. See Rule 1.13(a). Thus, the lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.

[35] A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer's resignation from the board and the possibility of the corporation's obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as a director or should cease to act as the corporation's lawyer when conflicts of interest arise. The lawyer should advise the other members of the board that in some circumstances matters discussed at board meetings while the lawyer is present in the capacity of director might not be protected by the attorney-client privilege and that conflict of interest considerations might require the lawyer's recusal as a director or might require the lawyer and the lawyer's firm to decline representation of the corporation in a matter.

ANNOTATION

2002 AMENDMENTS

Rule 1.7(a) as amended in 2002 sets forth the basic prohibition against representation involving conflicting interests ("concurrent conflicts"). The amended rule identifies two types of concurrent conflicts: direct-adversity conflicts (**Rule 1.7**(a)(1)), and material-limitation conflicts (**Rule 1.7**(a)(2)).

Rule 1.7(b) then sets forth a single standard of consentability and informed consent governing direct-adversity and material-limitation conflicts alike. Until the 2002 amendment, the rule used different formulas for each type of conflict: a representation directly adverse to another client was permissible with both clients' consent if the lawyer reasonably believed the relationship with the existing client would not be adversely affected, and a representation that may have been materially limited by the lawyer's interests or responsibilities to others was permissible with client consent if the lawyer reasonably believed the representation would not be adversely affected. The reporter to the Ethics 2000 Commission noted that "[l]awyers frequently [[became] confused" applying this distinction. See American Bar Association, A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2005, at 165 (2006).

The test in amended **Rule 1.7**(a)(2) (significant risk that the representation will be materially limited) is a rewording of the test in former **Rule 1.7**(b) (representation may be materially limited); the change is "not substantive," according to the reporter's notes, "but rather reflects how current paragraph (b) is presently interpreted by courts and ethics committees." American Bar Association, A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2005, at 165 (2006).

Subsection (b) adds a requirement that informed consent always be confirmed in writing.

The comment was amended in 2002 to address some recurring fact settings and to encompass concerns formerly addressed by Model Rule 2.2 (Intermediary). (Rule 2.2 was deleted in 2002 because it incorrectly suggested that intermediation was something other than an instance of common representation. American Bar Association, A Legislative History: The Development of the ABA Model Rules of Professional Conduct, 1982-2005, at 171 (2006).) Much of the former Rule 2.2 survives in Rule 1.7's Comments [26] through [28] (nonlitigation conflicts) and Comments [29] through [33] (special considerations in common representation). See generally William Freivogel, A Short History of Conflicts of Interest. The Future?, 20 Prof. Law., no. 2, at 3 (2010); Charles W. Wolfram, Ethics 2000 and Conflicts of Interest: The More Things Change …, 70 Tenn. L. Rev. 27 (Fall 2002).

STANDING TO SEEK DISQUALIFICATION

The general rule is that only a former or current client has standing to bring a motion to disqualify counsel on the basis of a conflict of interest. In re Yarn Processing Patent Validity Litig., 530 F.2d 83 (5th Cir. 1976) (often cited in standing cases);

Great Lakes Constr., Inc. v. Burman, 114 Cal. Rptr. 3d 301 (Ct. App. 2010); Cunningham ex rel. Rogers v. Anderson, 887 N.Y.S.2d 712 (App. Div. 2009).

A nonclient may seek disqualification only if there is an "ethical breach [[that] so infects the litigation … that it impacts the moving party's interest in a just and lawful determination of her claims." Colyer v. Smith, 50 F. Supp. 2d 966 (C.D. Cal. 1999); see Jamieson v. Slater, No. CV 06-1524-PHX-SMM, 2006 WL 3421788 (D. Ariz. Nov. 27, 2006) (plaintiff had standing to move to disqualify opposing counsel, who was himself a co-defendant and whose actions while representing his co-defendants were subject of plaintiff's suit; notwithstanding co-defendants' waiver of conflict, lawyer's interest in justifying what he did while representing them would "undoubtedly cloud" his ability to examine their alternatives); Doe v. Lee, 178 F. Supp. 2d 1239 (M.D. Ala. 2001) (plaintiff suing psychologist for disclosing her confidential records lacked standing to seek disqualification of defense counsel on grounds that counsel would have to cross-examine his own wife, who was potential material witness); Bernocchi v. Forcucci, 614 S.E.2d 775 (Ga. 2005) (nonclient movant must show "violation of the rules which is sufficiently severe to call in question the fair and efficient administration of justice"). See generally Ivy Johnson, Standing to Raise a Conflict of Interest, 23 N. Ill. U. L. Rev. 1 (Fall 2002); Douglas R. Richmond, The Rude Question of Standing in Attorney Disqualification Disputes, 25 Am. J. Trial Advoc. 17 (Summer 2001).

Subsection (a): Conflict Identification

RULE 1.7(A)(1): DIRECTLY ADVERSE INTERESTS

• Representing Opposing Parties in Same Lawsuit

Representation of opposing persons in the same lawsuit is prohibited by **Rule 1**.7(a)(1). This type of conflict is not waivable. Model **Rule 1**.7(b)(3); see, e.g., Ex parte Osbon, 888 So. 2d 1236 (Ala. 2004) (in divorce proceeding, husband's lawyer subpoenaed wife's records from mental health agency; lawyer's partner responded on behalf of agency); Vinson v. Vinson, 588 S.E.2d 392 (Va. Ct. App. 2003) (representing both husband and wife in divorce proceeding was ""gross conflict of interest"); cf. Fremont Indem. Co. v. Fremont Gen. Corp., 49 Cal. Rptr. 3d 82 (Ct. App. 2006) (when lawyer's two clients adverse in proceeding in which lawyer not involved, lawyer's duty of loyalty not implicated and disqualification not justified); D.C. Ethics Op. 326 (2004) (lawyer may refer prospective client to another lawyer even though prospective client adverse to current client of lawyer in same matter).

• Representing Someone in Unrelated Suit against Existing Client

Rule 1.7(a)(1) prohibits a lawyer from representing anyone directly adverse to a current client, even if the matters are unrelated. See Harrison v. Fisons Corp., 819 F. Supp. 1039 (M.D. Fla. 1993) (even though law firm represented bank only as guardian of estate, firm could not be adverse to bank on unrelated matters; no distinction between fiduciary and individual capacity); Morse v. Clark, 890 So. 2d 496 (Fla. Dist. Ct. App. 2004) (law firm that represented trustee of decedent's living trust in probate proceedings disqualified because assignee of intestate heirs already its client on unrelated matters; interest in upholding validity of living trust was directly adverse to heirs' interests in maximizing size of estate); State ex rel. Neb. State Bar Ass'n v. Frank, 631 N.W.2d 485 (Neb. 2001) (lawyer may not represent client in workers' compensation claim against employer's insurer whom lawyer already represents in unrelated litigation); Ill. Ethics Op. 04-01 (2004) (lawyer cannot represent real estate buyer if one of lawyer's clients is trying to collect debt owed by seller); Pa. Ethics Op. 00-67 (2000) (solicitor for political subdivision may not represent discharged subordinates of separately elected official whom they are suing for wrongful discharge; political subdivision is nominal defendant in employment suit); S.C. Ethics Op. 05-14 (2005) (without consent, lawyer may not represent mortgagor in foreclosure proceeding if mortgagee is client in other foreclosure proceedings); see also ABA Formal Ethics Op. 92-367 (1992) (generally, lawyer may not undertake representation that will require cross-examination of another client as adverse witness). See generally Edwin S. Gault, Jr., Note, Simultaneous Representation of Adverse Interests: Suing One Client on Behalf of Another, 15 Miss. C. L. Rev. 189 (Fall 1994); Thomas D. Morgan, Suing a Current Client, 9 Geo. J. Legal Ethics 1157 (Summer 1996) (proposition that "a lawyer may never take a position directly adverse to a current client" is not the rule, nor should it be); Brian J. Redding, Suing a Current Client: A Response to Professor Morgan, 10 Geo. J. Legal Ethics 487 (Spring 1997); Norman W. Spaulding, Reinterpreting Professional Identity, 74 U. Colo. L. Rev. 1 (Winter 2003); Gregory Zimmer, Suing a Current Client: Responsibility and Respectability in the Conduct of the Legal Profession, 11 Geo. J. Legal Ethics 371 (Winter 1998).

When a lawyer is employed by a government entity, analysis of conflicts depends upon identifying precisely which government entity is the client. See, e.g., Brown & Williamson Tobacco Corp. v. Pataki, 152 F. Supp. 2d 276 (S.D.N.Y. 2001) (law firm that represented state agencies not disqualified from representing tobacco company in its suit challenging state statute); ABA Formal Ethics Op. 97-405 (1997) (lawyer not barred by **Rule 1**.7 from simultaneously performing legal

services for government entity and private clients against another government entity in same jurisdiction, as long as two entities not considered same client); Ill. Ethics Op. 01-07 (2002) (two lawyers in same firm may continue to represent two different governmental units that function under separate boards and are not currently adverse on any issues).

• Disqualification Not Inevitable

A violation of **Rule 1.7**(a) does not always result in disqualification, particularly if the firm has implemented a screen and the complaining party cannot show it was harmed. See, e.g., Hempstead Video, Inc. v. Vill. of Valley Stream, 409 F.3d 127 (2d Cir. 2005); Bayshore Ford Truck Sales, Inc. v. Ford Motor Co., 380 F.3d 1331 (11th Cir. 2004); Wyeth v. Abbott Labs., 692 F. Supp. 2d 453 (D.N.J. 2010) (court approved same screen as that in Boston Scientific Corp. v. Johnson & Johnson Inc., 647 F. Supp. 2d 369 (D. Del. 2009), case involving same parties and patents as Wyeth).

• "Hot-Potato" Rule

A law firm trying to take on a matter that presents a conflict under **Rule 1.7** may not simply drop a client to be free to take on a more attractive one. Violation of the so-called "hot-potato" rule normally results in disqualification. See, e.g., Flying J. Inc. v. TA Operating Corp., No. 1:06-CV-30TC, 2008 WL 648545 (D. Utah Mar. 10, 2008) (collecting cases); El Camino Res., Ltd. v. Huntington Nat'l Bank, 623 F. Supp. 2d 863 (W.D. Mich. 2007).
Courts are more forgiving if the conflict was unforeseeable and arose through no fault of the law firm--as, for example, when a conflict is created by a corporate merger or acquisition. See Model **Rule 1.7**, cmt. [5] (lawyer may have option to withdraw from one of two representations when conflict created by "[u]nforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation"). This is sometimes referred to as the "thrust-upon" exception to the "hot-potato" rule. See, e.g., Carlyle Towers Condo. Ass'n, Inc. v. Crossland Sav., FSB, 944 F. Supp. 341 (D.N.J. 1996) (conflict created by defendant's merger with parent corporation of subsidiary for which plaintiff's law firm had done transactional work did not require disqualification; firm had promptly withdrawn from representation of subsidiary); see also D.C. Ethics Op. 356 (2010) (when second client creates unforeseeable conflict, such as by submitting bid competing with that of first client, lawyer need not withdraw from representing first client even though her obligation of confidentiality to it precludes her from asking for second client's informed consent).

• Simultaneously Representing Clients Involved in Different Suits over Related Matters

Simultaneous representation of clients involved in different lawsuits can give rise to a conflict if the suits involve related matters. See In re Big Mac Marine, Inc., 326 B.R. 150 (B.A.P. 8th Cir. 2005) (lawyer barred from representing debtor in bankruptcy case; lawyer already representing debtor's owners in another bankruptcy proceeding, in which they might assert claims against debtor that lawyer would have to evaluate); Rembrandt Techs., LP v. Comcast Corp., No. 2:05CV443, 2007 WL 470631 (E.D. Tex. Feb. 8, 2007) (disqualifying law firm from simultaneously prosecuting patent infringement case for one client and representing potential infringer on other matters); Andrew Corp. v. Beverly Mfg. Co., 415 F. Supp. 2d 919 (N.D. Ill. 2006) (without consent, law firm may not render noninfringement opinion for one client if patent belongs to another client); In re Cole, 738 N.E.2d 1035 (Ind. 2000) (lawyer cannot represent defendant in delinquency case while serving as deputy prosecutor); In re Houston, 985 P.2d 752 (N.M. 1999) (lawyer could not reasonably believe he could adequately represent husband and wife in divorce and also represent husband on charges of criminal sexual contact with couple's daughter and battery of wife); Mo. Ethics Op. 20010010 (2001) (lawyer retained by mother of minor child to represent child in personal injury case may not represent mother's husband, who is not child's father, in divorce action unless both spouses agree after full disclosure); Va. Ethics Op. 1774 (2003) (without consent, law firm may not render noninfringement opinion for one client if patent belongs to another client). See generally Charles W. Wolfram, Competitor and Other "Finite-Pie" Conflicts, 36 Hofstra L. Rev. 539 (Winter 2007).

• Direct Adversity in Nonlitigation Context

Comment [7] points out that direct adversity "can also arise in transactional matters." See, e.g., Iowa Supreme Court Bd. of Prof'l Ethics & Conduct v. Wagner, 599 N.W.2d 721 (Iowa 1999) (may not represent both buyer and seller in residential real estate transaction). However, outside the litigation context the lawyer is far more likely to encounter material-limitation conflicts under **Rule 1.7**(a)(2), discussed below, than direct-adversity conflicts under **Rule 1.7**(a)(1).

RULE 1.7(A)(2): MATERIAL-LIMITATION CONFLICTS

Rule 1.7(a)(2) focuses not on direct adversity of interests, but on the extent to which a representation is likely to be limited because of interests jeopardizing the lawyer's exercise of independent professional judgment.

• Responsibilities to Other Clients

Multiple representation that does not involve direct adversity of interests under **Rule 1**.7(a)(1) can still pose a conflict under **Rule 1**.7(a)(2) if responsibilities to one client could materially limit the representation of another. See, e.g., In re Shay, 756 A.2d 465 (D.C. 2000) (conflict materially limited lawyer's representation of couple in estate planning when lawyer knew at time wills drafted that husband, unbeknownst to wife, was actually married to another person); Idaho State Bar v. Frazier, 28 P.3d 363 (Idaho 2001) (no violation of **Rule 1.7** when lawyer representing both trust and beneficiary's estate bills trust fees and costs to beneficiary's estate, because no evidence that interests of estates not aligned or representation of estates affected); In re Twohey, 727 N.E.2d 1028 (Ill. 2000) (lawyer advised client to invest money in another client's company); In re Toups, 773 So. 2d 709 (La. 2000) (assistant district attorney representing husband in divorce case should have withdrawn after client's wife filed criminal complaint against husband); In re Bullis, 723 N.W.2d 667 (N.D. 2006) (lawyer for computer software company also represented company's landlord, its chief financial officer, an investor, a creditor, and corporation that bought company; construing "adversely affect" test rather than "materially limit" test); In re Marshall, 157 P.3d 859 (Wash. 2007) (lawyer represented multiple plaintiffs in discrimination case without adequately explaining possible conflicts or obtaining waivers); N.Y. City Ethics Op. 2001-2 (2001) (detailed analysis of multiple representation in transactional matters); S.C. Ethics Op. 00-17 (2000) (lawyer may represent multiple parties at real estate closings if lawyer complies with requirements of **Rule 1**.7); see also D.C. Ethics Op. 301 (2000) (law firm representing 3,000 special education students seeking benefits from government may also represent class member in personal injury action against same defendant; possibility of conflict "remote").

In litigation, multiple representation of co-parties in civil matters is permitted if there is no "substantial discrepancy" among positions, testimony, or settlement prospects. Model **Rule 1**.7, cmt. [23]; see, e.g., Patterson v. Balsamico, 440 F.3d 104 (2d Cir. 2006) (although defense of any 42 U.S.C. § 1983 action against municipality and its officers/employees presents potential joint-representation conflict, employee's motion for new trial properly denied; his defense consistent with that of municipality, and counsel never argued that employee acted outside scope of his employment); Miller v. Alagna, 138 F. Supp. 2d 1252 (C.D. Cal. 2000) (city's lawyers defending city and police officers in civil rights suit knew of potential conflicting defenses at outset but did not obtain informed consent; officers fired them after city fired officers; officers then moved successfully to disqualify them from continuing to represent city); J & J Snack Foods Corp. v. Kaffrissen, No. CIV A 98-5743, 2000 WL 562736 (E.D. Pa. May 9, 2000) (during settlement of wrongful death case, corporation first intervened to recoup what it spent on decedent's medical care and then sued beneficiaries and their counsel for it; when counsel represented himself and continued to represent beneficiaries as his co-defendants, court--concerned that one beneficiary did not understand she had potential malpractice action against him--disqualified him from representing any beneficiaries); In re Adoption of Baby Girl T, 21 P.3d 581 (Kan. Ct. App. 2001) (lawyer may represent both adoptive and birth parents with fully informed consent of all); Pa. Ethics Op. 00-78B (2000) (lawyer may represent child as well as child's onlooker sibling in personal injury case arising out of dog bite; child and sibling not making competing claims against limited settlement fund). See generally Debra Lyn Bassett, Three's a Crowd: A Proposal to Abolish Joint Representation, 32 Rutgers L.J. 387 (Winter 2001); R. David Donoghue, Conflicts of Interest: Concurrent Representation, 11 Geo. J. Legal Ethics 319 (Winter 1998); Ze'ev Eiger & Brandy Rutan, Note, Conflicts of Interest: Attorneys Representing Parties with Adverse Interests in the Same Commercial Transaction, 14 Geo. J. Legal Ethics 945 (Summer 2001); Carrie Menkel-Meadow, Ethics and the Settlement of Mass Torts: When the Rules Meet the Road, 80 Cornell L. Rev. 1159 (May 1995); Geoffrey P. Miller, Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard, 2003 U. Chi. Legal F. 581 (2003); Dina Mishra, Note, When the Interests of Municipalities and Their Officials Diverge: Municipal Dual Representation and Conflicts of Interest in § 1983 Litigation, 119 Yale L.J. 86 (Oct. 2009); Jack B. Weinstein, Ethical Dilemmas in Mass Tort Litigation, 88 Nw. U. L. Rev. 469 (Winter 1994); William E. Wright, Jr., Ethical Considerations in Representing Multiple Parties in Litigation, 79 Tulane L. Rev. 1523 (June 2005).

• Duties to Former Clients and Prospective Clients

Conflicts arising out of duties to former clients are discussed in the Annotation to Model Rule 1.9. Conflicts arising out of the duty to protect information received from a prospective client are discussed in the Annotation to Model Rule 1.18.

• Positional Conflicts

Positional or issue conflicts arise when a lawyer's successful advocacy of a client's legal position in one case could be detrimental to the interests of a different client in another case. See Williams v. State, 805 A.2d 880 (Del. 2002) (lawyer who argued in one pending capital appeal that trial court was required to give great weight to jury's recommendation against death penalty permitted under **Rule 1**.7(b) to withdraw from second capital appeal in which he would be arguing that trial court gave too much weight to jury's recommendation favoring death penalty); ABA Formal Ethics Op. 93-377 (1993) (law firm may not concurrently represent clients whose matters would require firm to argue directly contrary positions in same jurisdiction unless neither case likely to lead to precedent harmful to other and each client gives informed consent). See generally Helen A. Anderson, Legal Doubletalk and the Concern with Positional Conflicts: A

"Foolish Consistency"?, 111 Penn St. L. Rev. 1 (Summer 2006); John S. Dzienkowski, Positional Conflicts of Interest, 71 Tex. L. Rev. 457 (Feb. 1993); Douglas R. Richmond, Choosing Sides: Issue or Positional Conflicts of Interest, 51 Fla. L. Rev. 383 (July 1999).

• Corporate-Family Conflicts

The majority rule is that there is no per se prohibition against undertaking a representation that is adverse to an affiliate of a corporate client. See Certain Underwriters at Lloyd's v. Argonaut Ins. Co., 264 F. Supp. 2d 914 (N.D. Cal. 2003); see also Pa. Ethics Op. 01-62 (2001) (representation of multiple franchisees of franchisor in connection with advice on leases poses no apparent **Rule 1**.7 conflict).

In some cases, however, the relationship between the parent and subsidiary is too close to permit the firm to proceed. See, e.g., GSI Commerce Solutions, Inc. v. BabyCenter, L.L.C., 618 F.3d 204 (2d Cir. 2010) (both entities used same law department and shared personnel and facilities). See generally William Freivogel, Selected Ethics Issues in Litigation Practice, 72 Tulane L. Rev. 637, 645-48 (Dec. 1997); Darian Ibrahim, Solving the Everyday Problem of Client Identity in the Context of Closely Held Businesses, 56 Ala. L. Rev. 181 (Fall 2004); Michael Sacksteder, Formal Opinion 95-390 of the ABA's Ethics Committee: Corporate Clients, Conflicts of Interest, and Keeping the Lid on Pandora's Box, 91 Nw. U. L. Rev. 741 (Winter 1997); John Steele, Corporate Affiliate Conflicts: A Reasonable Expectations Test, 29 W. St. U. L. Rev. 283 (Spring 2002); Charles W. Wolfram, Corporate-Family Conflicts, 2 J. Inst. for Study Legal Ethics 295 (1999).

See the Annotation to Model Rule 1.13(g) for discussion of conflicts presented by simultaneous representation of an organization and one or more of its constituents.

• Simultaneous Representation of Co-Parties in Criminal Cases

Much of the law involving conflicts of interests in criminal cases interprets the Sixth Amendment right to effective assistance of counsel. Key decisions from the Supreme Court include Mickens v. Taylor, 535 U.S. 162 (2002) (when trial court fails to address potential conflict of interest about which it reasonably should have known, defendant must establish that conflict adversely affected his lawyer's performance); Wheat v. United States, 486 U.S. 153 (1988) (district court has discretion to disqualify defense counsel even if defendant waives conflict); and Glasser v. United States, 315 U.S. 60 (1942) (federal courts may not force defendant to accept appointment of counsel who is representing another defendant in same proceeding). (Glasser was extended to state court proceedings in Holloway v. Arkansas, 435 U.S. 475 (1978).) See generally Jeffrey Scott Glassman, Note, Mickens v. Taylor: The Court's New Don't-Ask, Don't-Tell Policy for Attorneys Faced with a Conflict of Interest, 18 St. John's J. Legal Comment. 919 (Summer 2004); Mark W. Shiner, Conflicts of Interest Challenges Post Mickens v. Taylor: Redefining the Defendant's Burden in Concurrent, Successive, and Personal Interest Conflicts, 60 Wash. & Lee L. Rev. 965 (Summer 2003).

• Lawyer's Own Financial and Professional Interests

A lawyer's financial interests may conflict with a client's interests. See In re Evans, 902 A.2d 56 (D.C. 2006) (when lawyer whose title company was insuring real estate in loan transaction learned that actual owner was unprobated estate of borrower's deceased mother-in-law, lawyer initiated probate proceeding on borrower's behalf to transfer title to her but did not explain his own financial interest in facilitating closing); ABA Formal Ethics Op. 04-432 (2004) (advancing bail on behalf of accused client may pose conflict if amount of bail is "material" to lawyer); ABA Formal Ethics Op. 02-427 (2002) (discussing propriety of lawyer taking security interest in client's property to guarantee payment of fees). See generally John S. Dzienkowski & Robert J. Peroni, The Decline in Lawyer Independence: Lawyer Equity Investments in Clients, 81 Tex. L. Rev. 405 (Dec. 2002).

For discussion of the propriety of acquiring an ownership interest in a client, see the Annotation to Model Rule 1.8(a). For discussion of the conflict presented by simultaneous negotiation of settlement and attorneys' fees, see the Annotation to Model Rule 1.5.

Professional interests that are not purely financial can also materially limit a representation. See Jamieson v. Slater, No. CV 06-1524-PHX-SMM, 2006 WL 3421788 (D. Ariz. Nov. 27, 2006) ("[The lawyer's] position as both a co-defendant and counsel to the remaining defendants is so egregiously untenable that … any informed written consent to the concurrent conflicts of interest identified here would be ineffective."); In re Allsep, 541 S.E.2d 245 (S.C. 2001) (lawyer who represented client in foreclosure proceedings against real estate owners failed to advise client that real estate owners' lawyer concurrently represented him in ongoing matter); ABA Formal Ethics Op. 08-453 (2008) (discussion of role of "ethics counsel" within law firm and duties to clients versus duties to law firm); ABA Formal Ethics Op. 97-406 (1997) (not necessarily improper for two lawyers to represent adverse interests at same time that one lawyer represents the other; each lawyer must evaluate whether relationship could materially limit representation of third-party client, but disclosure of their relationship is "prudent"); ABA Formal Ethics Op. 94-384 (1994) (lawyer usually need not withdraw from representation just because opponent files grievance against him or her, but if lawyer's interest in avoiding discipline could materially limit representation, lawyer first must reasonably conclude representation will not be adversely affected and

then must seek client's consent); Conn. Ethics Op. 00-8 (2000) (no material-limitation conflict when lawyer drafts will and serves as both executor of and lawyer for estate, or when lawyer drafts will and subsequent trust agreement under which lawyer serves as co-trustee); Pa. Ethics Op. 02-1 (2002) (lawyer who represents asylum applicant in case pending with immigration court and employs applicant as translator may have conflict of interest if representation of applicant is materially limited by lawyer's own interests as applicant's employer; material limitation may result if applicant's employment terminated); cf. Sands v. Menard, Inc., 787 N.W.2d 384 (Wis. 2010) (order of reinstatement in general counsel's wrongful-termination suit violated public policy; parties' "mutual animosity and distrust" created personal-interest conflict under **Rule 1**.7(a)(2)).

When a lawyer for a corporation serves on the corporation's board of directors, the two sets of duties may come into conflict. See generally ABA Formal Ethics Op. 98-410 (1998) (suggesting ways to minimize risk of violating ethics rules); Susanna M. Kim, Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation, 68 Tenn. L. Rev. 179 (Winter 2001); Bethany Smith, Note, Sitting on vs. Not Sitting on Your Client's Board of Directors, 15 Geo. J. Legal Ethics 597 (Spring 2002); Patrick W. Straub, Note, ABA Task Force Misses the Mark: Attorneys Should Not Be Discouraged from Serving on Their Corporate Clients' Board of Directors, 25 Del. J. Corp. L. 261 (2000); Stephen M. Zaloom, Status of the Lawyer-Director: Avoiding Ethical Misconduct, 8 U. Miami Bus. L. Rev. 229 (Spring 2000); Am. Bar Ass'n Section of Litig., The Lawyer-Director: Implications for Independence: Report on the Task Force on the Independent Lawyer (1998).

• Lawyer's Family Ties and Personal Relationships

Family ties and personal relationships can create a material-limitation conflict. See, e.g., Petrovic v. Amoco Oil Co., 200 F.3d 1140 (8th Cir. 1999) (law firm representing plaintiff class disqualified because two class representatives were close relatives--husband and sister-in-law--of partner in firm; clear danger their interests would conflict with class's interests when making decisions that could affect law firm's fees); In re Driscoll, 856 N.E.2d 840 (Mass. 2006) (lawyer for bank lending money to his secretary notarized secretary's husband's signature on loan documents without witnessing signature; had she been a stranger, lawyer would have sought verification from husband); Haley v. Boles, 824 S.W.2d 796 (Tex. App. 1992) (lawyer excused from handling indigent criminal defense case because one firm partner was spouse of prosecutor assigned to case); Ariz. Ethics Op. 2001-12 (2001) (when assistant public defender is in romantic relationship with law enforcement officer who regularly investigates and arrests office's clientele, informed client consent required to defend any client in whose case officer is involved; if officer also expected to testify, conflict ordinarily nonconsentable); N.Y. State Ethics Op. 738 (2001) (improper for lawyer to refer real estate client to title abstract company in which lawyer's spouse has ownership interest for other than purely ministerial work; intimate relationship and economic interests of husband and wife inseparable). See generally Stephen W. Simpson, From Lawyer-Spouse to Lawyer-Partner: Conflicts of Interest in the 21st Century, 19 Geo. J. Legal Ethics 405 (Spring 2006).

• Sex with Clients

A sexual relationship with a client that arises during the course of the representation can interfere with the lawyer's ability to exercise independent professional judgment on the client's behalf. The 2002 amendments to the Model Rules identify sex with clients as a specific instance of a material-limitation conflict. See Model Rule 1.8(j); see also Model **Rule 1**.7, cmt. [12].

Even in the absence of the specific prohibition, however, courts have had no trouble applying **Rule 1**.7 or its Model Code predecessor to lawyer-client sexual relationships. See, e.g., Horaist v. Doctor's Hosp. of Opelousas, 255 F.3d 261 (5th Cir. 2001); In re Ryland, 985 So. 2d 71 (La. 2008); Attorney Grievance Comm'n v. Hall, 969 A.2d 953 (Md. Ct. Spec. App. 2009); cf. In re Anonymous, 699 S.E.2d 693 (S.C. 2010) (sex with client's wife is "per se violation of **Rule 1**.7"). See generally Phillip R. Bower & Tanya E. Stern, Conflict of Interest?: The Absolute Ban on Lawyer-Client Sexual Relationships Is Not Absolutely Necessary, 16 Geo. J. Legal Ethics 535 (Summer 2003); Linda Fitts Mischler, Personal Morals Masquerading as Professional Ethics: Regulations Banning Sex between Domestic Relations Attorneys and Their Clients, 23 Harv. Women's L.J. 1 (Spring 2000).

• Responsibilities to Others

Responsibilities attendant upon other kinds of relationships, in addition to personal relationships and lawyer-client relationships, can also create material-limitation conflicts under **Rule 1**.7(a)(2). See Berry v. Saline Mem'l Hosp., 907 S.W.2d 736 (Ark. 1995) (lawyer who had served on hospital's board of governors may not represent patient seeking hospital records under state's freedom of information act for use in patient's action against hospital's insurer; as former board member, lawyer had fiduciary duty not to act to hospital's detriment); Conn. Ethics Op. 00-17 (2000) (lawyer who is town councilman may not represent plaintiff in personal injury action against employee of town and town itself; representation would be materially limited by lawyer's duties to town); D.C. Ethics Op. 337 (2007) (lawyer's responsibilities to person employing her as expert witness may materially limit her ability to represent someone adverse to

him in related matter); Ill. Ethics Op. 00-01 (2000) (conflict of interest exists between lawyer's representation of one client and other similar clients if lawyer complies with client's accountant's request to sign confidentiality agreement that would prohibit lawyer from revealing ideas accountant developed to reduce client's tax obligations). Compare United States v. Daniels, 163 F. Supp. 2d 1288 (D. Kan. 2001) (motion to disqualify denied; even though lawyer defending physician in fraud case was being paid by physician's malpractice insurer and was representing physician and insurer in malpractice actions brought by fraud victims, physician was also being defended by two independent criminal defense lawyers and had knowingly waived conflict), with State v. Culbreath, 30 S.W.3d 309 (Tenn. 2000) (district attorney and his staff disqualified from prosecuting indecency case because of district attorney's use of private lawyer who received substantial compensation from special interest group opposed to activities of sexually oriented businesses). See generally Nancy J. Moore, Ethical Issues in Third-Party Payment: Beyond the Insurance Defense Paradigm, 16 Rev. Litig. 585 (Summer 1997).

Payment of a client's fees by a third person, including an insurance company, is discussed in the Annotations to Model Rules 1.8(f) and 5.4(c).

Subsection (b): Client Consent

INFORMED CONSENT

If a lawyer reasonably believes that no client will be adversely affected, and if the representation is not prohibited by law and does not involve one client asserting a claim against another, the lawyer may represent conflicting interests if each affected client gives informed consent, confirmed in writing. Rule 1.0(e) defines "informed consent" to mean that the lawyer has ""communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." See, e.g., Centra, Inc. v. Estrin, 538 F.3d 402 (6th Cir. 2008) (client's "vague and general" knowledge of firm's prior work "not an adequate foundation for informed consent"); Anderson v. Nassau County Dep't of Corr., 376 F. Supp. 2d 294 (E.D.N.Y. 2005) (granting employer-defendants' motion to disqualify plaintiff's counsel, whose firm concurrently represented different employee in similar Title VII action in which plaintiff was fellow defendant; irrelevant that firm already disqualified in that action; employee's offer to withdraw her claims against plaintiff to cure conflict "can only be viewed to support the … possible diminution in the vigor of representation that the Second Circuit has sought to prevent in granting motions to disqualify counsel"); Discotrade Ltd. v. Wyeth-Ayerst Int'l, Inc., 200 F. Supp. 2d 355 (S.D.N.Y. 2002) (disqualification granted; "it is clear from the documentary record that [[counsel] knew it had not secured an effective waiver before filing this lawsuit"); Image Technical Servs., Inc. v. Eastman Kodak Co., 820 F. Supp. 1212 (N.D. Cal. 1993) (no exception for international law firms with multinational clients; duty to obtain fully informed consent applies "no matter how difficult the communication hurdles"); In re Evans, 902 A.2d 56 (D.C. 2006) (rejecting lawyer's argument that pursuant to "company policy" of his title company, lawyer's associate responsible for informing client of lawyer's interest in company; lawyer's admission that he had not personally ensured client gave informed consent established violation of **Rule 1.7**); Iowa Supreme Court Attorney Disciplinary Bd. v. Clauss, 711 N.W.2d 1 (Iowa 2006) (lawyer for creditor also undertook to represent debtor in seeking to lift injunction against her business operations; warning client that lawyer represents both sides is not enough to validate waiver); In re Wyllie, 19 P.3d 338 (Or. 2001) (lawyer for three co-defendants hired by father of one to give second opinion about feasibility of pleas to lesser charges not excused from disclosing likely conflict of interest among co-defendants simply because co-defendants already represented by appointed trial lawyer); Fullmer v. State Farm Ins. Co., 514 N.W.2d 861 (S.D. 1994) (defendant must be advised by independent counsel and informed that her proposed new counsel served as witness for co-defendant in earlier trial before her consent to representation deemed valid); In re Guardianship of Lillian P., 617 N.W.2d 849 (Wis. Ct. App.) (waiver requires lawyer to disclose nature of all conflicts or potential conflicts relating to lawyer's representation of client's interests, and how they could affect lawyer's exercise of independent professional judgment for client; client must understand risks involved in not choosing other representation), review denied, 619 N.W.2d 93 (Wis. 2000). See generally Peter R. Jarvis & Bradley F. Tellam, When Waiver Should Not Be Good Enough: An Analysis of Current Client Conflicts Law, 33 Willamette L. Rev. 145 (1997); Fred C. Zacharias, Waiving Conflicts of Interest, 108 Yale L.J. 407 (Nov. 1998).

• Written Confirmation

Rule 1.7(b)(4) requires a lawyer to obtain written confirmation of a client's informed consent to the lawyer's conflict of interest. This requirement was imposed by the 2002 amendments to the Model Rules. See Model **Rule 1.7**, cmt. [20]; see also Model Rule 1.0(b).

• Government-Entity Consent

Jurisdictions differ about whether a government entity may waive its counsel's conflict of interest. Some jurisdictions adhere to a per se government-cannot-consent rule, relying upon the public interest and reasoning that a government

lawyer may use--or suggest an ability to use--his or her position to secure consent improperly or to gain an improper advantage for a private client. See, e.g., State ex rel. Morgan Stanley & Co. v. MacQueen, 416 S.E.2d 55 (W. Va. 1992) (government inherently incapable of consenting to its law firm's concurrent representation of government employees who, though not named as parties, are indirectly accused of acting contrary to government's interest); N.J. Ethics Op. 697 (2005) (although court recently adopted Model Rules, it specifically chose to retain per se rule, "essentially a protective remnant of the appearance-of-impropriety rule"); Tenn. Ethics Op. 2002-F-146 (2002) (government cannot consent to public prosecutor's representation of criminal defendants within same judicial district).

Other jurisdictions, however, have come to reject this rationale. See, e.g., Ill. Ethics Op. 95-5 (1995); Iowa Ethics Op. 06-03 (2006); Md. Ethics Op. 99-28 (1999) (modifying prior opinions); N.Y. State Ethics Op. 629 (1992) (modifying prior opinions); Pa. Ethics Op. 2006-24 (2006).

• Prospective Waivers

The effectiveness of a client's prospective waiver of a conflict depends upon whether the conflict is consentable in the first place, and how clearly the waiver identifies the anticipated conflict. Compare Worldspan, L.P. v. Sabre Group Holdings, Inc., 5 F. Supp. 2d 1356 (N.D. Ga. 1998), and Celgene Corp. v. KV Pharm. Co., Civ. No. 07-4819 (SDW), 2008 WL 2937415 (D.N.J. July 29, 2008) (disqualification despite advance waivers), with Visa U.S.A., Inc. v. First Data Corp., 241 F. Supp. 2d 1100 (N.D. Cal. 2003), and Centennial Ins. Co. v. Apple Builders & Renovators, Inc., 875 N.Y.S.2d 466 (App. Div. 2009) (disqualification avoided by advance waivers). See also ABA Formal Ethics Op. 05-436 (2005) (lawyer may obtain advance waiver from client allowing lawyer to represent unidentified future clients with interests potentially adverse to existing client's interests; waiver more apt to be enforceable if client ""experienced user of legal services" or independently represented in connection with waiver); D.C. Ethics Op. 309 (2001) (lawyer may seek prospective waiver in connection with firm's current or future clients in matters not substantially related to matter firm is undertaking for client; unless client independently represented, waiver must specify types of potential adverse representations and types of adverse clients); N.Y. State Ethics Op. 829 (2009) (approving advance waivers); N.Y. City Ethics Op. 2006-1 (2006) (law firm may ask sophisticated clients to execute prospective waivers permitting it to represent multiple clients in same transactional matter, if clients' interests not starkly antagonistic and certain other requirements met; opinion includes three sample waivers). For a spirited debate on prospective waivers, see Lawrence J. Fox, All's OK between Consenting Adults: Enlightened Rule on Privacy, Obscene Rule on Ethics, 29 Hofstra L. Rev. 701 (Spring 2001); and Jonathan J. Lerner, Honoring Choice by Consenting Adults: Prospective Conflict Waivers as a Mature Solution to Ethical Gamesmanship, 29 Hofstra L. Rev. 971 (Spring 2001). See generally Alice E. Brown, Note, Advance Waivers of Conflicts of Interest: Are the ABA Formal Ethics Opinions Advanced Enough Themselves?, 19 Geo. J. Legal Ethics 567 (Summer 2006); Nathan M. Crystal, Enforceability of General Advance Waivers of Conflicts of Interest, 38 St. Mary's L.J. 859 (2007); Michael J. DiLernia, Advance Waivers of Conflicts of Interest in Large Law Firm Practice, 22 Geo. J. Legal Ethics 97 (Winter 2009); Angela R. Elbert & Sarah G. Malia, Playing Both Sides? Navigating the Murky Waters of Advance Conflict Waivers, 19 Prof. Law., no. 1, at 14 (2008); Lauren Nicole Morgan, Note, Finding Their Niche: Advance Conflicts Waivers Facilitate Industry-Based Lawyering, 21 Geo. J. Legal Ethics 963 (Summer 2008).

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RULES
CLIENT-LAWYER RELATIONSHIP

Rule 1.9 Duties to Former Clients

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(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

COMMENT

[1] After termination of a client-lawyer relationship, a lawyer has certain continuing duties with respect to confidentiality and conflicts of interest and thus may not represent another client except in conformity with this Rule. Under this Rule, for example, a lawyer could not properly seek to rescind on behalf of a new client a contract drafted on behalf of the former client. So also a lawyer who has prosecuted an accused person could not properly represent the accused in a subsequent civil action against the government concerning the same transaction. Nor could a lawyer who has represented multiple clients in a matter represent one of the clients against the others in the same or a substantially related matter after a dispute arose among the clients in that matter, unless all affected clients give informed consent. See Comment [9]. Current and former government lawyers must comply with this Rule to the extent required by Rule 1.11.

[2] The scope of a "matter" for purposes of this Rule depends on the facts of a particular situation or transaction. The lawyer's involvement in a matter can also be a question of degree. When a lawyer has been directly involved in a specific transaction, subsequent representation of other clients with materially adverse interests in that transaction clearly is prohibited. On the other hand, a lawyer who recurrently handled a type of problem for a former client is not precluded from later representing another client in a factually distinct problem of that type even though the subsequent representation involves a position adverse to the prior client. Similar considerations can apply to the reassignment of military lawyers between defense and prosecution functions within the same military jurisdictions. The underlying question is whether the lawyer was so involved in the matter that the subsequent representation can be justly regarded as a changing of sides in the matter in question.

[3] Matters are "substantially related" for purposes of this Rule if they involve the same transaction or legal dispute or if there otherwise is a substantial risk that confidential factual information as would normally have been obtained in the prior

representation would materially advance the client's position in the subsequent matter. For example, a lawyer who has represented a businessperson and learned extensive private financial information about that person may not then represent that person's spouse in seeking a divorce. Similarly, a lawyer who has previously represented a client in securing environmental permits to build a shopping center would be precluded from representing neighbors seeking to oppose rezoning of the property on the basis of environmental considerations; however, the lawyer would not be precluded, on the grounds of substantial relationship, from defending a tenant of the completed shopping center in resisting eviction for nonpayment of rent. Information that has been disclosed to the public or to other parties adverse to the former client ordinarily will not be disqualifying. Information acquired in a prior representation may have been rendered obsolete by the passage of time, a circumstance that may be relevant in determining whether two representations are substantially related. In the case of an organizational client, general knowledge of the client's policies and practices ordinarily will not preclude a subsequent representation; on the other hand, knowledge of specific facts gained in a prior representation that are relevant to the matter in question ordinarily will preclude such a representation. A former client is not required to reveal the confidential information learned by the lawyer in order to establish a substantial risk that the lawyer has confidential information to use in the subsequent matter. A conclusion about the possession of such information may be based on the nature of the services the lawyer provided the former client and information that would in ordinary practice be learned by a lawyer providing such services.

Lawyers Moving Between Firms

[4] When lawyers have been associated within a firm but then end their association, the question of whether a lawyer should undertake representation is more complicated. There are several competing considerations. First, the client previously represented by the former firm must be reasonably assured that the principle of loyalty to the client is not compromised. Second, the rule should not be so broadly cast as to preclude other persons from having reasonable choice of legal counsel. Third, the rule should not unreasonably hamper lawyers from forming new associations and taking on new clients after having left a previous association. In this connection, it should be recognized that today many lawyers practice in firms, that many lawyers to some degree limit their practice to one field or another, and that many move from one association to another several times in their careers. If the concept of imputation were applied with unqualified rigor, the result would be radical curtailment of the opportunity of lawyers to move from one practice setting to another and of the opportunity of clients to change counsel.

[5] Paragraph (b) operates to disqualify the lawyer only when the lawyer involved has actual knowledge of information protected by Rules 1.6 and 1.9(c). Thus, if a lawyer while with one firm acquired no knowledge or information relating to a particular client of the firm, and that lawyer later joined another firm, neither the lawyer individually nor the second firm is disqualified from representing another client in the same or a related matter even though the interests of the two clients conflict. See Rule 1.10(b) for the restrictions on a firm once a lawyer has terminated association with the firm.

[6] Application of paragraph (b) depends on a situation's particular facts, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together. A lawyer may have general access to files of all clients of a law firm and may regularly participate in discussions of their affairs; it should be inferred that such a lawyer in fact is privy to all information about all the firm's clients. In contrast, another lawyer may have access to the files of only a limited number of clients and participate in discussions of the affairs of no other clients; in the absence of information to the contrary, it should be inferred that such a lawyer in fact is privy to information about the clients actually served but not those of other clients. In such an inquiry, the burden of proof should rest upon the firm whose disqualification is sought.

[7] Independent of the question of disqualification of a firm, a lawyer changing professional association has a continuing duty to preserve confidentiality of information about a client formerly represented. See Rules 1.6 and 1.9(c).

[8] Paragraph (c) provides that information acquired by the lawyer in the course of representing a client may not subsequently be used or revealed by the lawyer to the disadvantage of the client. However, the fact that a lawyer has once served a client does not preclude the lawyer from using generally known information about that client when later representing another client.

[9] The provisions of this Rule are for the protection of former clients and can be waived if the client gives informed consent, which consent must be confirmed in writing under paragraphs (a) and (b). See Rule 1.0(e). With regard to the effectiveness of an advance waiver, see Comment [22] to Rule 1.7. With regard to disqualification of a firm with which a lawyer is or was formerly associated, see Rule 1.10.

ANNOTATION

OVERVIEW OF RULE 1.9

Rule 1.9 addresses the lawyer's duties regarding confidentiality and conflicts of interest after the lawyer-client relationship has ended.

Rule 1.9(a) prohibits a lawyer from representing anyone with interests materially adverse to those of a former client whom the lawyer represented in either the same or a substantially related matter.

Rule 1.9(b) deals with lawyers changing firms, and is more permissive. It prohibits subsequent adverse representation only if during the previous employment the lawyer actually and personally acquired confidential information about the former client that would be material to the subsequent representation. Model Rule 1.9, cmt. [5].

Rule 1.9(c) governs the use and disclosure of protected information and applies even when the lawyer's firm or former firm, rather than the individual lawyer, represented the former client. These duties are also discussed in the Annotations to Model Rules 1.6 and 1.10.

When the lawyer's obligations to a former client create a significant risk of materially limiting the lawyer's representation of a subsequent client, the lawyer may not proceed except with the informed consent of both, confirmed in writing. Accord Restatement (Third) of the Law Governing Lawyers § 132 (2000) (lawyer who represented client in one matter may not thereafter represent materially adverse client in same or substantially related matter unless each of them consents). For discussion see the Annotation to Model Rule 1.7.

The obligations of former and current government lawyers to their former clients are addressed in Rule 1.11. See the Annotation to Model Rule 1.11.

Subsection (a): When Proposed Representation Would Be Disloyal to Former Client

Rule 1.9(a) provides that unless the former client gives informed consent, confirmed in writing, the lawyer may not represent anyone with materially adverse interests in the same or a substantially related matter.

Courts evaluating whether a lawyer is permitted to undertake the subsequent representation consider four criteria: (1) whether there was a lawyer-client relationship in the first place--that is, whether the lawyer actually represented the client and, if so, whether the relationship is over, (2) whether the subsequent representation involves the same or a substantially related matter, (3) if the matters are either the same or substantially related, whether the interests of the subsequent client are materially adverse to those of the former client, and (4) whether the former client consented or, in the disqualification context, waived objection to the new representation.

WAS THERE A LAWYER-CLIENT RELATIONSHIP?

Application of Rule 1.9 begins with a determination of whether the lawyer and the putative former client ever actually formed a lawyer-client relationship. The relationship need not have been explicit but may be implied from the circumstances. See, e.g., City of Waukegan v. Martinovich, No. 03 C 3984, 2005 WL 3465567 (N.D. Ill. Dec. 16, 2005) (disqualifying defendant's lawyer in environmental cleanup action because plaintiff employed her in remediation project; nature of her work belied argument she had been nonlegal ""consultant"); Stratagene v. Invitrogen Corp., 225 F. Supp. 2d 608 (D. Md. 2002) (former associate's "discrete and limited" administrative work on plaintiff's patent application sufficed to create lawyer-client relationship disqualifying her from representing defendant whom plaintiff was suing for infringement of related patent). But see In re Estate of Klehm, 842 N.E.2d 1177 (Ill. App. Ct. 2006) (prior representation by executor's law firm of sons as beneficiaries of father's estate did not disqualify firm from representing executor of mother's estate in citation proceeding against sons; firm represented sons in their roles as beneficiaries only); In re James, 679 S.E.2d 702 (W. Va. 2009) (lawyer who agreed to represent defendant in drunk-driving accident after meeting with both defendant's and victim's parents did not form attorney-client relationship with victim's parents; Rule 1.9(a) not applicable). The lawyer need not intend to form an attorney-client relationship. See Restatement (Third) of the Law Governing Lawyers § 14 (2000) (lawyer-client relationship can arise when putative client reasonably relies upon lawyer to provide legal services). See generally Susan R. Martyn, Accidental Clients, 33 Hofstra L. Rev. 913 (Spring 2005); Ingrid A. Minott, Note, The Attorney-Client Relationship: Exploring the Unintended Consequences of Inadvertent Formation, 86 U. Det. Mercy L. Rev. 269 (Winter 2009).

• Organizational Clients

When the lawyer has represented an organization, rather than an individual, it is not always clear who enjoys former-client status for purposes of Rule 1.9. Confusion typically arises in three situations: (1) corporate affiliates, (2) organizations and their individual constituents, and (3) mergers and asset sales.

Corporate Affiliates

Most authorities agree that when a lawyer represents a corporation or other organizational client, the lawyer is not automatically prohibited from subsequent representation adverse to a parent, subsidiary, or sister corporation. See ABA Formal Ethics Op. 95-390 (1995); Restatement (Third) of the Law Governing Lawyers § 121 cmt. d (2000). Courts will typically evaluate the extent to which the entities' operations and interests overlap. See, e.g., Discotrade Ltd. v. Wyeth-Ayerst Int'l Inc., 200 F. Supp. 2d 355 (S.D.N.Y. 2002); Colorpix Sys. of Am. v. Broan Mfg. Co. Inc., 131 F. Supp. 2d 331 (D. Conn. 2001). But see Carlyle Towers Condo. Ass'n, Inc. v. Crossland Sav., FSB, 944 F. Supp. 341 (D.N.J. 1996) ("for conflict purposes, representation of a subsidiary corporation is equivalent to representation of its parent, and vice versa"). Because the primary concern about representation adverse to a former client is the risk that confidential information of the former client will be used to its disadvantage, courts are likely to disqualify a lawyer who had access to confidential information of the corporate affiliate during the representation. See, e.g., Avocent Redmond Corp. v. Rose Elecs., 491 F. Supp. 2d 1000 (W.D. Wash. 2007) (disqualifying lawyer from patent infringement representation adverse to sister company of entity lawyer represented in merger with parent corporation, as well as post-merger intellectual property matters; court construed legal services agreement to cover merged entity, as well as all its affiliates, in part because law firm gained confidential information regarding companies' view of aspects of their intellectual property); Huston v. Imperial Credit Commercial Mortgage Inv. Corp., 179 F. Supp. 2d 1157 (C.D. Cal. 2001) (although technically lawyer had been employed by issuer's parent corporation in connection with initial public offering, lawyer would not be permitted to represent plaintiffs suing issuer about offering when lawyer received confidential information as result of his active involvement in offering); In re Dalco, 186 S.W.3d 660 (Tex. App. 2006) (disqualification of defense lawyer unwarranted merely because debt collection agency for whom lawyer worked was affiliated with subsidiary of plaintiff; lawyer never represented plaintiff or affiliated subsidiary and no evidence lawyer likely acquired relevant confidential information about plaintiff). See generally William Andy Jones, When Are the Corporation's Partners Also a Client? 24 J. Legal Prof. 453 (2000); Charles W. Wolfram, Corporate Family Conflicts, 2 J. Inst. for Study Legal Ethics 295 (1999). Also see the Annotation to Model Rule 1.13.

Organizations and Their Individual Constituents

In addition, an implied lawyer-client relationship with an individual officer or employee may arise as a result of the lawyer's course of dealings with that individual during the representation of the organization. See, e.g., Advanced Mfg. Techs., Inc. v. Motorola, Inc., No. CIV99-01219PHXMHMLOA, 2002 WL 1446953 (D. Ariz. July 2, 2002) (implied lawyer-client relationship between nonparty retired employee of defendant corporation and corporation's lawyer was created when lawyer prepared retired employee for deposition, attended deposition, and remained silent when employee identified lawyer as his representative; when retired employee's interests became adverse to corporation's, court granted protective order preventing corporation's lawyer from deposing him); Home Care Indus., Inc. v. Murray, 154 F. Supp. 2d 861 (D.N.J. 2001) (implied lawyer-client relationship; dealings between lawyer and corporate constituent had been close, lawyer received confidential information from constituent, and constituent reasonably believed lawyer was representing him personally). But see McKinney v. McMeans, 147 F. Supp. 2d 898 (W.D. Tenn. 2001) (corporation's lawyer not disqualified from representing one of two sole shareholders in suit against other; corporation paid lawyer's fee, lawyer had little contact with defendant shareholder, and no evidence lawyer received confidences from shareholder).

The issue also arises in the reverse context, when an entity claims client status based upon the lawyer's representation of an individual constituent. See, e.g., Analytica, Inc. v. NPD Research Inc., 708 F.2d 1263 (7th Cir. 1983) (firm represented both corporate employee and corporation in transaction where corporation transferred stock to employee as additional compensation and acquired corporation's confidential information); Vt. Ethics Op. 2009-04 (2009) (law firm previously represented principal of defendant corporation but never represented corporation itself).

Mergers and Transfers of Assets

In corporate mergers, asset transfers, and other changes in corporate structure, whether the lawyer-client relationship transfers along with the ownership of the corporation depends upon the nature of the transaction. See, e.g., Goodrich v. Goodrich, 960 A.2d 1275 (N.H. 2008) (lawyer-client relationship of closely held corporation survived transfer of father's 100 percent ownership of corporate shares to his two sons; although corporation stopped providing certain services, there was "overwhelming continuity" between old and new corporation); Tekni-Plex, Inc. v. Meyner & Landis, 651 N.Y.S.2d 954 (1996) (lawyer who long represented selling company and its sole shareholder could not then represent shareholder in dispute with acquiring company for breach of warranty in connection with sale; lawyer-client relationship passed to

acquiring company).

• Insurance Defense Representation

Client-identity issues often underlie the conflicts that arise in insurance defense representation. Compare Nev. Yellow Cab v. Eighth Judicial Dist. Court, 152 P.3d 737 (Nev. 2007) (law firm disqualified from representing insured in bad-faith action against insurer; prior lawyer-client relationship with insurer during law firm's representation of insured was established because "[i]n the absence of a conflict, counsel represents both the insured and the insurer"), and Brennan v. Independence Blue Cross, 949 F. Supp. 305 (E.D. Pa. 1996) (lawyer-client relationship with insurer arose for purposes of **Rule 1.9** when lawyer protected insurer's subrogation claim concerning insured during lawyer's representation of insured in medical malpractice action), with Emons Indus., Inc. v. Liberty Mut. Ins. Co., 747 F. Supp. 1079 (S.D.N.Y. 1990) (insurer not client of insured's counsel in prior product liability cases against insured), and Marten Transp. Ltd. v. Hartford Specialty Co., 533 N.W.2d 452 (Wis. 1995) (workers' compensation insurer not client of law firm representing insured even though firm filed appearances for insurer and represented to third parties that it was counsel for both insured and insurer; insurer functioning primarily as claims administrator, making both insurer and law firm co-agents of insured). See also Restatement (Third) of the Law Governing Lawyers § 134 cmt. f (2000) (lawyer designated to represent insured does not automatically represent insurer; whether lawyer-client relationship exists is determined under general rules governing formation of relationship). See generally Aviva Abramovsky, The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship, 27 Cardozo L. Rev. 193 (Oct. 2005). For further discussion, see the Annotations to Model Rules 1.7(a) and 1.8(f).

• Joint Defense Agreements

Courts will sometimes disqualify a lawyer who has received confidential information under circumstances that create an implied professional or fiduciary relationship with the person seeking disqualification. This situation commonly arises as a result of a lawyer's participation in joint defense arrangements. If, as a result of such an arrangement, the lawyer learns confidential information about the nonclient, the nonclient may be able to obtain disqualification based upon a finding that the lawyer owes it a fiduciary duty not to use the information against it. ABA Formal Ethics Op. 95-395 (1995) (disqualifying fiduciary obligation "almost surely" exists in joint defense consortium that entailed sharing of confidential information); see In re Gabapentin Patent Litig., 407 F. Supp. 2d 607 (D.N.J. 2005) (joint defense agreement created implied lawyer-client relationship between counsel for one defendant and other signatories; counsel's new firm therefore needed each signatory's consent before it could represent plaintiff in same matter); City of Kalamazoo v. Mich. Disposal Serv., 151 F. Supp. 2d 913 (W.D. Mich. 2001) (lawyer-client relationship between one co-defendant and counsel for another co-defendant in environmental litigation was created by joint defense agreement; counsel disqualified from representing plaintiffs in subsequent environmental suit naming first co-defendant); Meza v. H. Muehlstein & Co., 98 Cal. Rptr. 3d 422 (Ct. App. 2009) (disqualifying law firm representing plaintiff in toxic tort action because, before joining law firm, associate represented one of the fifteen defendants; although that defendant dismissed, remaining defendants shared confidential information with lawyer pursuant to common-interest doctrine); Nat'l Med. Enters. v. Godbey, 924 S.W.2d 123 (Tex. 1996) (lawyer who promised in joint defense agreement to maintain confidentiality of information received from corporation while representing company's ex-employees disqualified, along with lawyer's entire firm, from subsequently representing parties adverse to corporation); D.C. Bar Ethics Op. 349 (2009) (lawyer not prohibited by **Rule 1.9** from undertaking representation adverse to member of former client's joint defense group; however, lawyer "may have acquired contractual and fiduciary obligations to nonclient group member that will preclude him from representing an adverse party in a substantially related matter").

• "Accommodation Clients"

Rule 1.9 accords with the majority of courts in refusing to recognize the concept of an "accommodation client"--someone the lawyer briefly represents as a favor to another client or another lawyer, but who does not thereafter ""count" as a former client. See, e.g., Exterior Sys., Inc. v. Noble Composites, Inc., 175 F. Supp. 2d 1112 (N.D. Ind. 2001) (rejecting accommodation-client doctrine and collecting cases); Universal City Studios, Inc. v. Reimerdes, 98 F. Supp. 2d 449 (S.D.N.Y. 2000) (rejecting law firm's argument that it was representing particular company only as accommodation to parent corporation, which was its long-standing client, and denying firm permission to withdraw in order to sue company in unrelated matter); cf. Streit v. Covington & Crowe, 98 Cal. Rptr. 2d 193 (Ct. App. 2000) (firm whose only connection to plaintiff's case was that it covered hearing on motion "as a professional courtesy" to her counsel could nevertheless be

sued for legal malpractice; no matter how perfunctory the involvement, no such thing as "limited-liability representation"). See generally Susan R. Martyn, Accidental Clients, 33 Hofstra L. Rev. 913 (Spring 2005); Douglas R. Richmond, Accommodation Clients, 35 Akron L. Rev. 59 (2001).

• Prospective Clients

Under **Rule 1.9**(a), when a lawyer-client relationship is formed, the lawyer is disqualified from representation adverse to the former client in a same or substantially related matter. The rule does not require a showing that the lawyer received significant confidential information. When a person consults with a lawyer but never forms a lawyer-client relationship, the person is a "prospective client" whose confidential information is entitled to protection, but the lawyer is disqualified from subsequent adverse representation only "if the lawyer received information from the prospective client that could be significantly harmful to that person in the matter." Model Rule 1.18(c); see, e.g., Cargould v. Manning, No. 09AP-194, 2009 WL 3674669 (Ohio Ct. App. Nov. 5, 2009) (denying husband's request to disqualify lawyer representing wife on basis of husband's previous consultation with lawyer to discuss divorce case; although husband was prospective client under Rule 1.18, he was not former client under **Rule 1.9**, and therefore more stringent test of Rule 1.18 applied). Also see the Annotation to Model Rule 1.18.

• Short-Term Limited Legal Services under Rule 6.5

When a lawyer participating in a qualified legal services program renders short-term assistance to program beneficiaries, Rule 6.5(a)(1) provides that a lawyer-client relationship is indeed established. However, it further provides that the lawyer will be subject to **Rule 1.9**(a) only if the lawyer actually knows that the representation involves a conflict of interest. For further discussion, see the Annotation to Model Rule 6.5.

• Expert Witnesses

According to ABA Formal Opinion 97-407, a lawyer testifying as an expert witness does not establish a lawyer-client relationship for **Rule 1.9** purposes. ABA Formal Ethics Op. 97-407 (1997); see Commonwealth Ins. Co. v. Stone Container Corp., 178 F. Supp. 2d 938 (N.D. Ill. 2001) (adopting reasoning of ABA Formal Opinion 97-407); see also D.C. Ethics Op. 337 (2007) (serving as expert witness does not create lawyer-client relationship with party; firm hiring lawyer-expert should explain lawyer's role to client at outset of engagement).

IS THE CLIENT A "FORMER" CLIENT?

Once a lawyer-client relationship has been found to exist, the next issue is to determine whether the relationship has ended or is ongoing. **Rule 1.9** applies only to former clients; conflicts of interest involving current clients are governed by Rules 1.7 and 1.8, which are more restrictive than **Rule 1.9**.

When a lawyer is retained for a specific matter, the representation terminates when the matter has been resolved. Model Rule 1.3, cmt. [4]; see Revise Clothing, Inc. v. Joe's Jeans Subsidiary, Inc., 687 F. Supp. 2d 381 (S.D.N.Y. 2010) (even in absence of explicit termination, attorney-client relationship found terminated because law firm contacted to represent company in particular dispute and retainer agreement stated that law firm's representation limited to particular dispute). When the lawyer's representation is not limited to a particular matter, however, it may be unclear when the representation has terminated such that the client can now be considered a former client. Whether and when such a lawyer-client relationship has ended is a question of fact. See Jones v. Rabanco, Ltd., No. CO3-3195P, 2006 WL 2237708 (W.D. Wash. Aug. 3, 2006) (evidence indicated intent that lawyer would represent client in any future issues that might arise under contract settling dispute; absent specific event indicating otherwise, three years of noncommunication between lawyer and client did not terminate attorney-client relationship); Shearing v. Allergan Inc., No. CV-S-93-866-DWH(LRL), 1994 WL 382450 (D. Nev. Apr. 5, 1994) (current-client rule applied and required disqualification even though client had not engaged firm for more than a year; firm regularly acted as client's outside counsel for thirteen years and never formally ended relationship); Hatfield v. Seville Centrifugal Bronze, 732 N.E.2d 1077 (Ohio C.P. 2000) (when lawyer provides annual advice and services to client and takes no action to notify client formally that representation has ceased, relationship continues for following year for conflicts purposes); see also Credit Index, L.L.C. v. RiskWise Int'l, L.L.C., 746 N.Y.S.2d 885 (Sup. Ct.) ("as-needed" nature of legal advice firm rendered over course of relationship with client did not release firm from duty of loyalty), aff'd, 744 N.Y.S.2d 326 (App. Div. 2002); Pa. Ethics Op. 2008-48 (2008) (company for which law firm annually performs legal services regarding stock transfers and maintains decade's worth of board minutes and company by-laws is current client even though firm has not performed any new services for two years); cf. Artromick Int'l,

Inc. v. Drustar, Inc., 134 F.R.D. 226 (S.D. Ohio 1991) (no disqualification; although lawyer's last bill disputed and remained unpaid, lawyer had not performed services for client for more than one year and client was using new lawyer); Gray v. Gray, No. E2001-COA-R3-CV, 2002 WL 31093931 (Tenn. Ct. App. Sept. 19, 2002) (no ongoing lawyer-client relationship between husband in divorce action and wife's lawyer, who prepared couple's wills ten years earlier); Pa. Ethics Op. 2001-08 (2001) (law firm that performed corporate work for company for two years and then no further work for two years may represent company's opponent in unrelated matter unless facts indicate that company reasonably believes it is still current client).

• The "Hot-Potato" Gambit

To facilitate application of **Rule 1.9** and thereby avoid the more stringent requirements of Rules 1.7 and 1.8, which apply to current clients, lawyers have been known to seek to withdraw from representing less "desirable" candidates to convert them into former clients. The attempt to drop one client to accept another--the so-called "hot-potato" gambit--has been roundly condemned. See, e.g., Snapping Shoals Elec. Membership Corp. v. RLI Ins. Corp., No. 1:05 CV 1714-GET, 2006 WL 1877078 (N.D. Ga. July 5, 2006) (despite fact that one remaining matter on which law firm represented intervenor was almost over, court found that intervenor was still a current client: "'lawyer may not evade ethical responsibilities by choosing to jettison a client whose continuing representation becomes awkward"D' (quoting Harrison v. Fisons Corp., 819 F. Supp. 1039, 1041 (M.D. Fla.1993))); Pioneer-Standard Elecs., Inc. v. Cap Gemini Am., Inc., No. 1:01CV2185, 2002 WL 553460 (N.D. Ohio Mar. 11, 2002) (refusing to recognize firm's attempt to convert existing client into former client by dropping it when asked to represent new client in suit filed by existing client; "for purposes of determining the status of an attorney-client relationship within the context of adverse representation, courts will not honor an attorney's unilateral termination of the relationship"); Santacroce v. Neff, 134 F. Supp. 2d 366 (D.N.J. 2001) (disqualifying firm from representing estate against palimony claims of testator's live-in lover, whom firm represented in business disputes; lawyer may not drop one client like "hot potato" to avoid conflict with more remunerative client; collecting cases); Universal City Studios, Inc. v. Reimerdes, 98 F. Supp. 2d 449 (S.D.N.Y. 2000) (lawyer cannot avoid disqualification due to conflict of interest merely by firing disfavored client in order to transform continuing relationship into former-client relationship).

• "Thrust-Upon" Conflicts

Courts have, however, allowed firms to withdraw from representing one client to continue (rather than begin) representing another client when an unforeseeable conflict arises through no fault of the lawyer. See, e.g., Microsoft Corp. v. Commonwealth Scientific & Indus. Research Org., Nos. 6:06 CV 549, 6:06 CV 550, 2007 WL 4376104 (E.D. Tex. Dec. 13, 2007) (permitting lawyer to withdraw because client actively concealed facts creating conflict; "[t]he "thrust upon' exception applies when unforeseeable developments cause two current clients to become directly adverse"); In re Rite Aid Corp. Sec. Litig., 139 F. Supp. 2d 649 (E.D. Pa. 2001) (hot-potato rule not applicable to disqualify firm that represented corporation and its CEO from continuing to represent corporation when CEO's position became adverse to corporation's); Ex parte AmSouth Bank, N.A., 589 So. 2d 715 (Ala. 1991) (law firm that represented bank on corporate matter and then represented corporation in shareholder's action challenging merger did not act improperly in withdrawing from representation of bank and continuing its representation of corporation when bank, as trustee, brought action against corporation for breach of fiduciary duty in connection with merger transaction involving stock held in trust; law firm had not created conflict); see also D.C. Ethics Op. 272 (1997) (if certain conditions can be met, law firm may continue to represent longtime regulatory client in adversary proceeding before administrative agency, even after different client whom it represents on unrelated matters hires separate counsel and unexpectedly initiates administrative proceeding against first client); N.Y. City Ethics Op. 2005-5 (2005) ("thrust-upon" conflicts do not implicate hot-potato rule; opinion recommends flexible approach in which "overriding factor should be the prejudice the withdrawal or continued representation will cause the parties").

ARE THE MATTERS SUBSTANTIALLY RELATED?

Once it is established that there was a lawyer-client relationship and that it has ceased, the next issue in determining whether a lawyer may undertake a representation adverse to a former client is the relationship between the two matters: if the two matters are the same or substantially related, the subsequent adverse representation is prohibited.

The substantial-relationship test grew out of caselaw on disqualification. See T.C. Theatre Corp. v. Warner Bros. Pictures, 113 F. Supp. 265 (S.D.N.Y. 1953) ("the former client need show no more than that the matters embraced within the pending suit wherein his former attorney appears on behalf of his adversary are substantially related to the matters or cause

of action wherein the attorney previously represented him").
The test protects "not only confidences but also the expectation of loyalty by a prior client." In re I Successor Corp. v. Feld Group Inc., 321 B.R. 640 (Bankr. S.D.N.Y. 2005) (collecting cases). Comment [1] accordingly makes clear that a "lawyer could not properly seek to rescind on behalf of a new client a contract drafted on behalf of the former client" and "a lawyer who has prosecuted an accused person could not properly represent the accused in a subsequent civil action against the government concerning the same transaction." See, e.g., Paul v. Judicial Watch, Inc., 571 F. Supp. 2d 17 (D.D.C. 2008) (disqualifying plaintiff's lawyer in breach-of-contract action based upon contract lawyer prepared and signed while representing defendant organization). Similarly, Comment [1] provides that a lawyer who has previously represented multiple clients in a matter may not represent one of them against another in the same or a substantially related matter after a dispute arises among them, unless all the affected current and former clients have given their informed consent. See Touchcom, Inc. v. Bereskin & Parr, 299 F. App'x 953 (Fed. Cir. 2008) (disqualifying lawyer from representing former client in dispute against former joint client; Model **Rule 1.9** broader than former Model Code provision in that it includes duty of loyalty as well as duty of confidentiality); People v. Frisco, 119 P.3d 1093 (Colo. 2005) (en banc) ("Because the use of information … is separately restricted by **Rule 1.9**(c), **Rule 1.9**(a) applies only to situations involving an inherent and substantial risk of violating an attorney's duty of loyalty to former clients."); Nationwide Assocs., Inc. v. Targee St. Internal Med. Group, P.C., 758 N.Y.S.2d 108 (App. Div. 2003) (lawyers in breach-of-contract action represented other side in substantially related mortgage foreclosure actions; conflict of interest required disqualification under state's analogue to **Rule 1.9**(a), even if no confidential information involved); Centerline Indus., Inc. v. Knize, 894 S.W.2d 874 (Tex. App. 1995) (lawyer must be disqualified even though all confidences obtained from former client disclosed in another proceeding: "if two matters are substantially related[,] it should make no difference whether the lawyer gained no confidences or whether all the confidences gained have been publicly disclosed").

• Same Transaction or Legal Dispute

According to Comment [3], two matters are by definition substantially related if they involve the same transaction or legal dispute. See, e.g., Pastor v. TransWorld Airlines, Inc., 951 F. Supp. 27 (E.D.N.Y. 1996) (disqualifying employee's counsel in discrimination case based upon her earlier representation of employer in analogous actions, including previous claim brought by same employee); Fla. Bar v. Dunagan, 731 So. 2d 1237 (Fla. 1999) (representation of husband in dissolution proceeding by lawyer who previously represented couple jointly in matters relating to their business not permissible when business was marital asset); G.D. Mathews & Sons Corp. v. MSN Corp., 763 N.E.2d 93 (Mass. App. Ct. 2002) (lawyers disqualified from representing food processing company in breach-of-contract action brought by food distributor; lawyers represented both processing company and distributor in prior litigation involving same distributorship agreement); In re Wyatt's Case, 982 A.2d 396 (N.H. 2009) (lawyer's pursuit of guardianship on behalf of conservator after lawyer terminated representation of ward violated **Rule 1.9**(a); lawyer represented ward at outset of guardianship proceedings); Falk v. Chittenden, 893 N.E.2d 116 (N.Y. 2008) (disqualifying lawyer from representing police officer in disciplinary proceeding based upon lawyer's previous representation of fellow police officer, in course of which lawyer recommended that fellow police officer initiate that disciplinary proceeding); see also City Nat'l Bank v. Adams, 117 Cal. Rptr. 2d 125 (Ct. App. 2002) (when representation involves work performed by lawyer for former client, conclusive presumption that lawyer privy to disqualifying information; collecting cases).

• Incidental Similarities

Incidental similarities between the transactions or disputes do not create a substantial relationship. See, e.g., S.D. Warren Co. v. Duff-Norton, 302 F. Supp. 2d 762 (W.D. Mich. 2004) (differences between operative facts of two products liability actions against manufacturer of rotary joint union obviated similarities in legal theories: "design and manufacturing defects alleged in the two matters are wholly dissimilar[;] mode and manner of product failure, ignition source, fire spread, and damages do not overlap [and the] physical evidence from each fire is completely different"); Ramos Laboy v. Trujillo Panisse, 213 F. Supp. 2d 54 (D.P.R. 2002) (denying defendant mayor's office motion for disqualification in 42 U.S.C. § 1983 action when plaintiff's lawyer previously defended mayor's office against another 42 U.S.C. § 1983 claim; no showing that two cases shared more specific similarities); N.Y. Marine & Gen. Ins. Co. v. Tradeline (L.L.C.), 186 F.R.D. 317 (S.D.N.Y. 1999) (law firm not disqualified from representing insured in coverage dispute regarding rain damage to cargo even though firm previously represented insurer in race discrimination and ship-hull damage litigation); Ex Parte Regions Bank, 914 So. 2d 843 (Ala. 2005) (work that counsel for indentured trustee performed for former client, although funded by bonds issued pursuant to indenture, not substantially related to trustee's action against bond underwriter for conversion); Cadle Co. v. Ginsberg, 802 A.2d 137 (Conn. App. Ct. 2002) (affirming denial of motion to disqualify

plaintiff's counsel in action on note against lawyer/grantor whose firm counsel represented in legal malpractice action; matters not substantially related, and insufficient evidence that financial information learned in malpractice action was likely to be used to defendant's disadvantage in action on note); Duvall v. Bledsoe, 617 S.E.2d 601 (Ga. Ct. App. 2005) (fact that plaintiff's counsel in medical malpractice case, while at former firm, obtained financial information about doctor while representing him in divorce and trust matters did not require disqualification; matters not substantially related); Rust v. Lawson, 714 N.E.2d 769 (Ind. Ct. App. 1999) (lawyer's prior representation of father in unrelated criminal prosecution not substantially related to later representation of guardians in proceeding to adopt father's child without his consent, nor did it amount to side-switching); Williams v. Bell, 793 So. 2d 609 (Miss. 2001) (lawyer may represent tenant in negligence action against landlord after rape on premises even though lawyer worked briefly for landlord's counsel after tenant's suit filed; work in helping landlord transfer property involved not substantially related to issues in negligence suit); Jamaica Pub. Serv. Co. Ltd. v. AIU Ins. Co., 684 N.Y.S.2d 459 (1998) (reversing disqualification; no substantial relationship between former employment as in-house counsel on professional liability insurance matters for one of large international group of insurance companies, and new firm's representation of insured in coverage dispute against insurer); R.I. Ethics Op. 2001-08 (2002) (lawyer may represent company in connection with development of real estate parcel even though company's plans for parcel are opposed by former client who owns adjoining tract and whom lawyer represented in developing it; two representations involve different subjects, unconnected except for physical proximity of parcels).

• Different Transaction or Legal Dispute

Matters that involve different transactions or disputes will be deemed substantially related if there is "substantial risk" that protected information "as would normally have been obtained" in the first representation would materially advance the new client's interests. Model **Rule 1.9**, cmt. [3]. Focusing upon the risk--as opposed to the actual fact--of disclosure spares the former client who is seeking disqualification from having to disclose the very information it is trying to protect. In re County of L.A., 223 F.3d 990 (9th Cir. 2000) ("'substantially factually related' standard is a proxy for the [[risk of] disclosure of confidential information"). As the court held in Am. Airlines v. Sheppard, Mullin, Richter & Hampton, 117 Cal. Rptr. 2d 685 (Ct. App. 2002), a breach-of-fiduciary-duty action analyzed under the former-client conflicts rule, "[i]t was not necessary for American to establish that [its former lawyer revealed] confidential information, in order to prove that [the lawyer] breached his fiduciary duty to American. He placed the noose around American's neck, without its consent, promising all the while not to kick over the chair on which it stood, blithely ignoring the sweat forming on the corporate brow…. We do not doubt that [he] believed he could maintain his client's confidence, but American simply does not have to take his word for it."

Courts consider both the factual and the legal similarities between the two matters. See, e.g., Accounting Principals v. Manpower, Inc., 599 F. Supp. 2d 1287 (N.D. Okla. 2008) (current lawsuit alleging tort claims based upon improper contact with plaintiff's employees was substantially related to prior lawsuit based upon similar allegations of improper conduct; suits involved common facts, including plaintiff's internal strategies and procedures for preventing such contact); Madukwe v. Del. State Univ., 552 F. Supp. 2d 452 (D. Del. 2008) (disqualifying plaintiffs' lawyers in employment discrimination suit against university; because lawyers previously represented defendant in employment matters for twenty-five years, likely they would have advised defendant regarding some current and former employees in similar situations); Mitchell v. Metro. Life Ins. Co., No. 01 CIV. 2112 (WHP), 2002 WL 441194 (S.D.N.Y. Mar. 21, 2002) (relationship between issues in prior and present cases must be "patently clear," "identical," or "essentially the same"); Benson v. McNutt, 657 S.E.2d 639 (Ga. Ct. App. 2008) (disqualification unwarranted because defendant failed to demonstrate that lawyer's familiarity with defendant's assets was relevant to current litigation in which estate administrators were suing defendant for misappropriating estate funds); Franzoni v. Hart Schaffner & Marx, 726 N.E.2d 719 (Ill. App. Ct. 2000) (lawyer for plaintiff in employment discrimination action disqualified; as general counsel for defendant company, lawyer handled approximately five hundred employment discrimination claims for it and contributed to its employment policies); Hurley v. Hurley, 923 A.2d 908 (Me. 2007) (disqualifying husband's lawyer in divorce action; lawyer's previous representation of wife in personal injury claim gave him access to confidential medical and financial information that could be used to favor husband in determining parental rights and evaluating wife's income potential); Jacob North Printing v. Mosley, 779 N.W.2d 596 (Neb. 2010) (reversing disqualification of plaintiff's lawyer in misappropriation of trade secrets action against defendant; lawyer's prior representation of defendant in earlier breach-of-contract action by former employer did not involve same substantive claims and did not share common facts); State ex rel. Bluestone Coal v. Mazzone, 697 S.E.2d 740 (W. Va. 2010) (court determined matters were substantially related when plaintiff's lawyer requested documents related to defense used in prior litigation before defendants filed answer raising such defense); see also In re Chonody, 49 S.W.3d 376 (Tex. App. 2000) (error to deny disqualification of wife's divorce counsel; husband must be given opportunity to present evidence that prior criminal proceedings in which

wife's lawyer represented him were so closely related to divorce case that there was genuine threat wife's lawyer would divulge or use his confidences).

The passage of time can render information obtained in a prior representation "obsolete," according to Comment [3]. See, e.g., Valdez v. Pabey, No. 2:05-CV-255, 2005 WL 3556428 (N.D. Ind. Dec. 27, 2005) (law firm that had long been city's outside counsel not disqualified from representing former employees suing new administration for wrongful termination; any relevant insight "extinguished" with transition to new administration); Wieme v. Eastman Kodak Co., Nos. 02-CV-6021L, 02-CV-5212L, 2004 WL 2271402 (W.D.N.Y. Sept. 4, 2004) (reversing disqualification; passage of time has "some bearing on whether counsel was likely to have obtained relevant confidential information"); Niemi v. Girl Scouts of Minn., 768 N.W.2d 385 (Minn. Ct. App. 2009) (reversing disqualification; lawyer's knowledge of plaintiff's professional strengths and weaknesses not relevant twenty-five years later). But see R&D Muller Ltd. v. Fontaine's Auction Gallery, 906 N.E.2d 356 (Mass. App. Ct. 2009) (although substantial period of time elapsed since law firm represented defendant, firm's knowledge of defendant's corporate practices was confidential information directly relevant to issue of piercing corporate veil due to failure to observe corporate formalities).

Comment [3] notes that general knowledge of an organizational client's policies and practices--what one scholar has called "playbook" information-- does not in itself require disqualification. See Charles W. Wolfram, Former Client Conflicts, 10 Geo. J. Legal Ethics 677 (Summer 1997); see also Nichols Agency, Inc. v. Enchanted Child Care, Inc., 537 F. Supp. 2d 774 (D. Md. 2008) (when determining whether conflict of interest exists on basis that former client of opposing counsel divulged its litigation strategy to opposing counsel, claim of generalized strategy regarding litigation or settlement not sufficient to disqualify opposing counsel); Niemi v. Girl Scouts of Minn., 768 N.W.2d 385 (Minn. Ct. App. 2009) (lawyer's knowledge of plaintiff's general approach to litigation does not constitute "confidential factual information"; disqualification based upon such knowledge would effectively prohibit lawyers from ever representing adversary of former client); State ex rel. Ogden Newspapers, Inc. v. Wilkes, 566 S.E.2d 560 (W. Va. 2002) (possession of general corporate information not basis for disqualifying lawyers from handling employment discrimination suit against company they represented in employment matters ten years earlier while working as associates of another firm); cf. OneBeacon Am. Ins. Co. v. Safeco Ins. Co., No. C-1-07-358, 2008 WL 4059836 (S.D. Ohio Aug. 28, 2008) (disqualifying former lawyer for plaintiff insurance company on ground that lawyer's information concerning plaintiff's interpretation of policies involved in current coverage case exceeded mere ""playbook" information); Superguide Corp. v. DirectTV Enters., 141 F. Supp. 2d 616 (W.D.N.C. 2001) (patent licensee's former lead counsel disqualified from representing licensor in dispute regarding scope of license; lawyer had extensive knowledge of licensee's litigation strategy and of parties' course of conduct under license agreement), mandamus denied, 18 F. App'x 810 (Fed. Cir. 2001).

ARE CLIENTS' INTERESTS MATERIALLY ADVERSE?

Rule 1.9 prohibits the subsequent representation only if the interests of the new client are "materially adverse" to those of the former client. See, e.g., FMC Techs., Inc. v. Edwards, 420 F. Supp. 2d 1153 (W.D. Wash. 2006) (disqualifying defendant's law firm based upon previous representation of witness for plaintiff who had been co-defendant in essentially same controversy; although witness not party to current lawsuit, law firm would be cross-examining its former client on exactly same issues involved in prior representation); Colorpix Sys. of Am. v. Broan Mfg. Co., 131 F. Supp. 2d 331 (D. Conn. 2001) (disqualifying law firm from representing insurer suing company whose parent and sister company it defended in prior subrogation action brought on same theory; any judgment against manufacturer would affect parent's bottom line; parent's general counsel supervised manufacturer's defense, and manufacturer and parent also shared one legal department, officers, and defense strategy); In re Jones & McClain, LLP, 271 B.R. 473 (Bankr. W.D. Pa. 2001) (representation of law firm partner who filed involuntary bankruptcy petition against firm was adverse to former-client firm partner who might have to pay law firm's debts); Sec. Investor Prot. Corp. v. R.D. Kushnir & Co., 246 B.R. 582 (Bankr. N.D. Ill. 2000) (interests of bankrupt securities brokerage firm and its principal adverse because trustee had potential causes of action against principal for failure to supervise broker-employee); McPhearson v. Michaels Co., 117 Cal. Rptr. 2d 489 (Ct. App. 2002) (lawyer permitted to represent plaintiff in employment dispute notwithstanding prior representation of another employee who entered confidential settlement agreement with employer and was expected to be fact witness in present case; interests of former and present clients not adverse); Simpson Performance Prods., Inc. v. Horn, P.C., 92 P.3d 283 (Wyo. 2004) (lawyer represented manufacturer of safety equipment in investigating possible suit against National Association of Stock Car Auto Racing, and then represented individual who recently resigned as manufacturer's CEO in his own suit against NASCAR arising out of same incident; no adversity of interests within meaning of **Rule 1.9**); ABA Formal Ethics Op. 99-415 (1999) (only direct adversity of interests meets **Rule 1.9** threshold of "material adversity").

DID FORMER CLIENT CONSENT?

Under both subsection (a) and subsection (b) of **Rule 1.9**, a lawyer who would otherwise be disqualified may nevertheless undertake the representation if the "former client gives informed consent, confirmed in writing." For a definition and explanation of "informed consent," see Rule 1.0(e) and Comments [[6] and [7] to Model Rule 1.0.
Unlike Rule 1.7, **Rule 1.9** contains no restriction on the ability of a former client to consent to a subsequent conflict. Indeed, Comment [9] to **Rule 1.9** suggests that informed consent, confirmed in writing, will always be effective, stating that "[t]he provisions of this Rule are for the protection of former clients and can be waived if the client gives informed consent." See Gates Rubber Co. v. Bando Chem. Indus. Ltd., 855 F. Supp. 330 (D. Colo. 1994) (citing with approval Comment [9]). In the criminal context, however, see Wheat v. United States, 486 U.S. 153 (1988) (potential for conflict of interest supersedes criminal defendant's Sixth Amendment right to choose own counsel).

• Consent versus Waiver

Lawyers often use the terms "consent" and "waiver" interchangeably, but the terms are not the same, particularly when applied in the different contexts of discipline and disqualification. For purposes of discipline, the lawyer is required to seek the former client's permission to take on a new representation; notice to the former client and lack of objection are clearly insufficient. See Fla. Bar v. Dunagan, 731 So. 2d 1237 (Fla. 1999) (wife's failure to object affirmatively to representation could not be construed as consent after consultation as required by earlier version of **Rule 1.9**). For purposes of disqualification, however, a court may permit representation adverse to a former client to proceed if the former client unfairly delays in raising an objection, suggesting that it is using the disqualification motion to secure a tactical advantage. See, e.g., Rohm & Haas Co. v. Am. Cyanamid Co., 187 F. Supp. 2d 221 (D.N.J. 2001) (factors relevant to determination of waiver are length of delay in bringing motion to disqualify, when movant learned of conflict, whether movant represented by counsel during delay, why delay occurred, and whether disqualification would result in prejudice to nonmoving party; collecting cases).

• Advance Consent

Client consent to conflicts arising in the future is typically used to permit lawyers to represent one current client in a matter directly adverse to another current client in a matter that is unrelated to the firm's representation of the other client. See the Annotation to Model Rule 1.7. Such advance consents (or advance waivers) may also be used to permit a lawyer to represent a new or an existing client in a matter that will be adverse to a former client in a substantially related matter. See Elliott v. McFarland Unified Sch. Dist., 165 Cal. App. 3d 562 (Ct. App. 1985) (interpreting "joint powers agreement" to permit counsel for joint clients to continue representing one client after conflict arose and other client sought independent counsel); D.C. Ethics Op. 309 (2001) (advance waivers permitted under certain circumstances under Rules 1.7 and 1.9). See generally Richard W. Painter, Advance Waiver of Conflicts, 13 Geo. J. Legal Ethics 289 (Winter 2000) (discussing benefits of agreement at outset of representation to reduce uncertainties about subsequent application of either Rule 1.7 or **Rule 1.9**, including identifying client and defining what will or will not constitute ""substantially related" matter or "materially adverse" interest for purposes of **Rule 1.9**).

STANDING TO DISQUALIFY

The majority view is that only the former client has standing to move for disqualification, unless an "unethical change of sides [is] manifest and glaring" or an ethical violation is "open and obvious." In re Yarn Processing Patent Validity Litig., 530 F.2d 83 (5th Cir. 1976); see FMC Techs., Inc. v. Edwards, 420 F. Supp. 2d 1153 (W.D. Wash. 2006) (permitting plaintiffs to raise former-client conflict of nonparty who was their key witness; conflict affected "'just and lawful determination' of the plaintiffs' claims"). The minority view is that a nonclient litigant may bring the motion to disqualify, relying upon the "court's well recognized power to control the conduct of the attorneys practicing before it." Colyer v. Smith, 50 F. Supp. 2d 966 (C.D. Cal. 1999) (describing majority and minority views).

Subsection (b): When Lawyer's Former Firm, Rather Than Lawyer Personally, Represented Client in Substantially Related Matter

When the lawyer's former firm, rather than the lawyer personally, represented someone whose interests are materially adverse to those of the prospective client, the lawyer will be disqualified only if he or she actually and individually acquired protected information that would be material to the new matter. See In re ProEducation Int'l, 587 F.3d 296 (5th

Cir. 2009) (disqualification unwarranted as result of alleged conflict arising from former firm's representation of another creditor in case; lawyer never personally represented, or gained any actual knowledge of, other creditor during employment with former firm); Hermann v. GutterGuard Inc., 199 F. App'x 745 (11th Cir. 2006) (disqualifying partner assigned to monitor team meetings of firm lawyers representing clients in employment matters; partner attended meeting in which confidential information of former client discussed); Edward v. 360° Commc'ns, 189 F.R.D. 433 (D. Nev. 1999) (no disqualification of plaintiff's lawyer despite prior employment by opponent's law firm; lawyer not directly involved in case while working with firm, and affidavits by lawyer and firm members rebutted presumption that lawyer privy to confidential information about case); Dieter v. Regents of Univ. of Cal., 963 F. Supp. 908 (E.D. Cal. 1997) (lawyers who previously worked for law firm that represented adverse party not disqualified; lawyers not personally involved in representation, had no knowledge of matter, and did not work out of office that handled adverse party's account); Adams v. Aerojet-Gen. Corp., 104 Cal. Rptr. 2d 116 (Ct. App. 2001) (firm-switching lawyer not automatically disqualified on basis of imputed knowledge from case involving client of former firm; focus upon whether lawyer's responsibilities and interactions with colleagues at prior firm made it likely he obtained confidential information relating to current case); Green v. Toledo Hosp., 764 N.E.2d 979 (Ohio 2002) (refusing to disqualify lawyer even though nonlawyer employee worked for opponent's lawyer; presumption that employee disclosed confidential information adequately rebutted); see also Hempstead Video, Inc. v. Vill. of Valley Stream, 409 F.3d 127 (2d Cir. 2005) (noting and joining "strong trend" toward allowing presumption of confidence-sharing within firm to be rebutted); Or. Ethics Op. 2005-120 (2005) (acquisition of material confidential information can arise from informal exchanges within firm even if lawyer did no work on client's matters); Pa. Ethics Op. 2006-052 (2006) (lawyer may represent prospective plaintiff in civil lawsuit despite his former law firm's prior representation of prospective defendant; even if matters substantially related, lawyer will not be disqualified unless he acquired information about defendant that is material to current lawsuit). See generally Eli Wald, Lawyer Mobility and Legal Ethics: Resolving the Tension Between Confidentiality Requirements and Contemporary Lawyers' Career Paths, 31 J. Legal Prof. 199 (2007).

Subsection (c): Using or Disclosing Information Related to Representation of Former Client

Rule 1.9(c) regulates the use and disclosure of confidential information. Subsection (c) applies whether or not a subsequent representation is involved, and it applies even if the lawyer's former firm--rather than the individual lawyer--represented the former client.

USING INFORMATION

Rule 1.9(c)(1) prohibits a lawyer from using information about a former client except in ways that would be permitted were the relationship still in effect. In re Wilder, 764 N.E.2d 617 (Ind. 2002) (suspending lawyer for representing unmarried couple in organizing business and subsequently representing one of them in unwinding business when their personal relationship deteriorated; lawyer used documents about other partner that he acquired while representing couple); In re Lane's Case, 889 A.2d 3 (N.H. 2005) (discipline unwarranted because lawyer's disclosure of accounting prepared by former client-executor not used to disadvantage of former client, but rather to his advantage); In re Gadbois, 786 A.2d 393 (Vt. 2001) (evidence did not support board's conclusion that lawyer representing present client against former client used client secrets for personal advantage, when only evidence offered was his expressed position that his presence as "known" character would help settle divorce case in which he was representing wife against husband whom he had represented in prior divorce thirteen years earlier).

The sole exception is for information that has become generally known. The fact that information is in the public record does not necessarily mean that the information is generally known within the meaning of **Rule 1.9**(c). See Pallon v. Roggio, Nos. 04-3625 (JAP), 06-1068 (FLW), 2006 WL 2466854 (D.N.J. Aug. 24, 2006) (information must be within basic understanding and knowledge of public; discovery materials widely available to public through Internet or other sources are not "generally known" within meaning of rule); Steel v. Gen. Motors Corp., 912 F. Supp. 724 (D.N.J. 1995) (defendant company's litigation techniques and trial strategies and content of form pleadings, though widely known to lawyers involved in similar cases against company, are not generally known information); see also In re Anonymous, 932 N.E.2d 671 (Ind. 2010) (no evidence that information relating to husband's accusations against former client, or even divorce filing, was generally known). But see State v. Mancilla, No. A06-581, 2007 WL 2034241 (Minn. Ct. App. July 17, 2007) (lawyer's cross-examination of former client regarding prior convictions would not have violated **Rule 1.9**(c) because "prior convictions were matters of public record and, therefore, fall within the generally-known-information exception").

DISCLOSING INFORMATION

Rule 1.9(c)(2) prohibits any disclosure (as opposed to use) of former-client information that would not be permitted in connection with a current client, regardless of whether the information has become generally known. See In re Harman, 628 N.W.2d 351 (Wis. 2001) (lawyer disciplined for disclosing former client's medical records to prosecutor; irrelevant that records made public when filed in former client's medical malpractice action). For a discussion of the duty of confidentiality, see the Annotation to Model Rule 1.6.

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386 Fed.Appx. 145
This case was not selected for publication in the Federal Reporter.
Not for Publication in West's Federal Reporter See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also Third Circuit LAR, App. I, IOP 5.7. (Find CTA3 App. I, IOP 5.7)
United States Court of Appeals,
Third Circuit.

In Re: JADE MANAGEMENT SERVICES d/b/a Crown Mountain Water Services, Appellant.

No. 09-2800. | Submitted Pursuant to Third CircuitLAR 34.1(a) May 4, 2010. | Filed: July 9, 2010.

Synopsis

Background: Attorney that corporate Chapter 11 debtor had been allowed to employ by earlier order of court filed application for award of fees, and purchaser of debtor's assets objected on ground that attorney was suffering from a disqualifying "conflict of interest" and should never have been employed as counsel to debtor or, in alternative, on ground that amount of fees requested was unreasonable. The Bankruptcy Court of the Virgin Islands overruled objection and awarded fees, and purchaser appealed. The District Court, Virgin Islands, Curtis V. Gomez, J., 2009 WL 1421276, affirmed. Purchaser again appealed.

Holdings: The Court of Appeals, Chagares, Circuit Judge, held that:

[1] bankruptcy court did not abuse its discretion in determining that there was only a remote possibility that potential conflict of interest, arising out of attorney's simultaneous representation of corporate Chapter 11 debtor and its sole shareholder in their separate bankruptcy cases, would ever ripen into actual conflict, and in approving attorney's employment as counsel to corporate debtor;

[2] court did not abuse its discretion in awarding compensation to Chapter 11 debtor's attorney for time that she spent in protecting debtor from personal injury claim for which debtor had liability insurance; and

[3] court did not abuse its discretion in awarding compensation to Chapter 11 debtor's attorney for time that she spent in curing deficiencies in official corporate paperwork submitted to government.

Affirmed.

West Headnotes (3)

[1] **Attorney and Client**
Bankruptcy

Bankruptcy court did not abuse its discretion in determining that there was only a remote possibility that potential conflict of interest, arising out of attorney's simultaneous representation of corporate Chapter 11 debtor and its sole shareholder in their separate bankruptcy cases, would ever ripen into actual conflict, and in approving attorney's employment as counsel to corporate debtor, despite belated objection by party challenging attorney's right to be compensated that this dual representation affected attorney's "disinterestedness," especially since shareholder had personally guaranteed corporate debtor's secured debts; value of corporation's encumbered assets far outpaced value of secured claims that shareholder had guaranteed, such that it appeared substantially certain from the outset that all secured claims would be paid in full, and that shareholder would never be called upon to honor her guarantee. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[2] **Bankruptcy**
Duplicative services; co-counsel

Bankruptcy court did not abuse its discretion in awarding compensation to Chapter 11 debtor's attorney for time that she spent in protecting debtor from personal injury claim for which debtor had liability insurance, upon theory that

attorney's work was duplicative of that of counsel to liability insurer, given letter from insurer to debtor advising it that policy limit was $100,000, and that debtor might wish to retain counsel to protect against verdict in excess of that amount, and given that settlement amount ultimately negotiated by attorney exceeded this amount. 11 U.S.C.A. § 330(a).

Cases that cite this headnote

[3] **Bankruptcy**
Benefit to estate

Bankruptcy court did not abuse its discretion in awarding compensation to Chapter 11 debtor's attorney for time that she spent in curing deficiencies in official corporate paperwork submitted to government; it would be strange to hold that such work did not, in some sense, benefit corporate debtor. 11 U.S.C.A. § 330(a).

Cases that cite this headnote

***146** On Appeal from the District Court of the Virgin Islands, No. 3-05-cv-00148, District Judge: Honorable Curtis V. Gomez.

Attorneys and Law Firms

Benjamin A. Currence, Esq., St. Thomas, VI, Grant Y. Lee, Esq., Patrick M. Ouimet, Esq., Sarles & Ouimet, Chicago, IL, for Appellant.

Carol A. Rich, Esq., Dudley, Clark & Chan, St. Thomas, VI, for Defendant-Appellee.

Before: SMITH, CHAGARES, and JORDAN, Circuit Judges.

OPINION

CHAGARES, Circuit Judge.

We review in this bankruptcy action an award of attorney's fees to Nancy D'Anna, Esq., who for a time represented the appellant, Jade Management Services ("Jade"), as debtor's counsel. We will affirm.

I.

We write solely for the parties' benefit and, accordingly, give only a brief recitation of the facts. Jade owned certain real estate in the Virgin Islands while a sister corporation, Crown Mountain Water, Inc. ("CMW"), operated a business selling potable water extracted from wells located on Jade's property. In 1995, the two entities merged, retaining Jade's corporate name. On September 11, 2002, Jade filed a petition for bankruptcy protection under Chapter 11 of the Bankruptcy Code. The next day, Jeannie Benjamin, Jade's sole shareholder and its president and chief executive officer, filed an individual petition for bankruptcy protection under Chapter 13 of the Bankruptcy Code. D'Anna executed these two petitions as counsel representing both Jade and Benjamin.

On January 14, 2003, the Bankruptcy Court approved Jade's unchallenged application to employ D'Anna as debtor's counsel in its Chapter 11 case. Joint Appendix ("JA") 177. On August 15, 2003, Jade filed a proposed plan of reorganization, under which its assets would be sold and the proceeds applied to satisfy, in full, all secured claims and tax liens. Satisfaction of the unsecured claims, however, would be uncertain under the proposed plan.[1] JA 182-84. Although Benjamin had personally guaranteed some or all of Jade's secured ***147** debts, as a result of the proposed plan, she was never called upon to satisfy her guarantees, nor did she ever file a claim against Jade. The Bankruptcy Court confirmed the plan on July 8, 2004, and the asset sale was scheduled for February 15, 2005. JA 45, 204.

Four days before the sale was set to occur, Benjamin executed a stock purchase agreement with another entity, Ursula and The Eleven Thousand Virgins, LLC ("Ursula").[2] JA 48-62. The same day, Ursula filed an emergency motion in the Bankruptcy Court to stay the sale of Jade's assets in the Chapter 11 case. JA 45-47. Ursula represented that it had the immediate financial ability and intent to satisfy not only the secured claims and tax liens, but 100% of allowed unsecured claims as well. Upon the Bankruptcy Court's approval in Benjamin's Chapter 13 case, Ursula assumed control of Jade on February 15, 2005. On May 16, 2005, it filed a proposed amended plan of reorganization consistent with its stated intentions. JA 102-11. The Bankruptcy Court

confirmed the proposed amended plan on October 5, 2005. JA 282-85.

In the interim, D'Anna filed an application for fees and expenses, in which she sought a total outstanding sum of $70,251.36 for legal services performed between September 9, 2002 and May 10, 2005. JA 68-101. On July 15, 2005, Ursula filed an objection to the fee application, asserting (1) that D'Anna had been improperly employed because she was not a disinterested person, and (2) that the fee request was unreasonable.

On September 8, 2005, the Bankruptcy Court held a hearing regarding the application for fees and expenses, after which it entered an order overruling Ursula's objections and approving the fee request. JA 243. Ursula appealed to the District Court of the Virgin Islands, which affirmed the award. JA 3-28. Ursula now appeals to our Court.[3]

II.

A.

[1] Ursula argues first that D'Anna was ineligible for employment under 11 U.S.C. § 327(a), and is therefore ineligible to receive compensation for her services. Specifically, Ursula argues that D'Anna was not a "disinterested person" (as § 327(a) requires) because she simultaneously represented Jade in its Chapter 11 case and Benjamin in her Chapter 13 case, and because Benjamin had personally guaranteed Jade's secured debts. Consequently, Ursula contends, D'Anna operated under an actual conflict of interest-here, a material risk that she would elevate Benjamin's personal interests over those of Jade's secured creditors. Accordingly, Ursula argues that D'Anna was improperly employed from the outset, ***148** thereby eliminating the Bankruptcy Court's discretion to award her fees.[4]

Section 327 permits a debtor-in-possession (here, Jade) to employ attorneys "that do not hold or represent an interest adverse to the estate, and that are disinterested persons[.]" 11 U.S.C. § 327(a). The Bankruptcy Code defines a "disinterested person" as a person who:

> (A) is not a creditor, an equity security holder, or an insider; (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and (C) does not have an interest materially adverse to the interest of the estate or of *any class of creditors* or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14) (emphasis added). Paragraphs (A) and (B) are inapplicable here; the question is whether D'Anna's concurrent representation of Benjamin and Jade in their respective bankruptcy cases caused D'Anna to have an interest that was materially adverse to, or created an actual conflict of interest with, Jade's secured creditors.

Under our precedents, "[§] 327(a) presents a *per se* bar to the appointment of a[n attorney] with an actual conflict, [but] gives the [Bankruptcy C]ourt wide discretion in deciding whether to approve the appointment of a[n attorney] with a potential conflict." *In re Marvel Entm't Group, Inc.,* 140 F.3d 463, 477 (3d Cir.1998); *see also In re Pillowtex, Inc.,* 304 F.3d 246, 251-52 (3d Cir.2002); *In re First Jersey Sec., Inc.,* 180 F.3d 504, 509 (3d Cir.1999) ("[Section] 327(a) mandates disqualification when there is an actual conflict of interest, allows for it when there is a potential conflict, and precludes it based solely on an appearance of conflict."); *In re BH & P, Inc.,* 949 F.2d 1300, 1316-17 (3d Cir.1991).

Distinguishing between potential and actual conflicts is a flexible enterprise, and necessarily is one that is governed by the factual niceties of each particular case. Generally, however, "a conflict is actual, and hence *per se* disqualifying, if it is likely that a professional will be placed in a position permitting [her] to favor one interest over an impermissibly conflicting interest." *Pillowtex,* 304 F.3d at 251 (citation omitted). Nevertheless, as we explained in *BH & P,* "denomination of a conflict as 'potential' or 'actual' and the decision concerning whether to disqualify a professional based upon that determination in situations not yet rising to the level of an actual conflict are matters committed to the bankruptcy court's sound exercise of discretion." 949 F.2d at 1316-17. *See also In re Martin,* 817 F.2d 175, 182-83 (1st Cir.1987) ("The bankruptcy judge is on the front line, in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails.... [E]ach situation must be judged prospectively on its own merits.... [H]orrible imaginings alone cannot be allowed to carry the day. Not every

conceivable conflict must result in sending counsel away to lick his wounds.").

***149** We are convinced that the Bankruptcy Court did not abuse its discretion here. Under the particular factual circumstances of this case, there existed at most a potential conflict of interest inherent in D'Anna's concurrent representation of the debtor-in-possession and its sole shareholder who had guaranteed the debtor's secured debt. "Simultaneous representation of a debtor corporation and the controlling shareholders, although not a disqualifying conflict *per se,* becomes a basis to disqualify counsel when adverse interests either exist *or are likely* to develop." *In re Plaza Hotel Corp.,* 111 B.R. 882, 890 (Bankr.E.D.Cal.1990) (emphasis added; citations omitted); *see also TWI Int'l, Inc. v. Vanguard Oil & Serv. Co.,* 162 B.R. 672, 675 (S.D.N.Y.1994) ("[A]n attorney that represents a corporation in bankruptcy and its principal is not *per se* interested.") (citation omitted); *In re Hurst Lincoln Mercury, Inc.,* 80 B.R. 894, 895 (Bankr.S.D.Ohio 1987) ("It is fundamental that simultaneous representation of a corporation and its sole stockholder is not in and of itself improper.") (citation omitted).

In this case, the value of Jade's encumbered assets far outpaced the value of the secured claims that Benjamin had guaranteed. *Compare* JA 41, 192-93 (appraised value of Jade's business approximately $1.2 million) *with* JA 39 (secured claims totaling $422,170). From the outset, it appeared substantially certain that all secured claims would be satisfied in full, thereby diminishing or eliminating outright any potential tension between Benjamin and the secured creditors. And while it is not dispositive, we note that that likelihood ultimately came to fruition, for Benjamin filed no claims against the estate. Though a "court should generally disapprove employment of a professional with a potential conflict," there exists an exception to that general rule "where the possibility that the potential conflict will become actual is remote [.]" *BH & P,* 949 F.2d at 1316. We find no abuse of discretion in the Bankruptcy Court's determination that such a remote possibility existed here.

Ursula's reliance on *Plaza Hotel* undermines, rather than supports, its position. *See* Appellant Reply Br. at 6. There, the court explained that an "actual conflict generally exists where ... owners-guarantors *are being sued* on their guarantees of the debtor corporation's debt." *Plaza Hotel,* 111 B.R. at 890 (emphasis added). But as we have said, that is not the case here, where there appeared to be no significant risk that Benjamin would ever be called upon to satisfy her guarantees. Our cases make clear that we eschew bright-line rules in the determination whether a given arrangement constitutes an actual or potential conflict of interest.

Our conclusion is further bolstered by the fact that Ursula did not so much as hint that it objected to D'Anna's dual representation until after the stock purchase agreement had been approved, after it had taken control of Jade, after it had submitted an amended proposed plan of reorganization, and after D'Anna had completed her representation. *Cf. In re Kliegl Bros. Universal Elec. Stage Lighting Co.,* 189 B.R. 874, 877 (Bankr.E.D.N.Y.1995) (emphasizing importance of objecting to professional's employment under § 327(a) at earliest practicable time). Indeed, at the hearing, the Bankruptcy Court characterized Ursula's challenge to the fee application as little more than a *post hoc* attempt to decrease the purchase price for which it had bargained: "[I]t seems to me ... that pursuant to the [stock purchase agreement], you've got to pay the administrative expenses, and now [you] don't like the administrative expenses." JA 229. We do ***150** not disagree with this assessment.[5]

Ursula's challenge places heavy reliance on D'Anna's failure to provide a complete statement pursuant to Federal Rule of Bankruptcy Procedure 2014. That rule effectuates § 327(a)'s disinterestedness requirement, and mandates that a debtor's application to employ the professional "be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." Fed. R. Bankr. P. 2014(a). In this case, D'Anna's verified statement represented only that she had "no prior relationship or connection with any creditor which would be adverse to the interest of the debtor," omitting her connection to Benjamin, who clearly was a party in interest. JA 148. Seizing on the omission, Ursula argues that this is clear evidence of D'Anna's actual conflict of interest.

We are not persuaded. Under the rule, "[a]ll facts that *may* be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate must be disclosed." *In re Hathaway Ranch P'ship,* 116 B.R. 208, 219 (C.D.Cal.1990) (emphasis in original; citations omitted). "The duty is one of complete disclosure of all facts, and, if the duty is neglected, even innocently, the offender should stand no better than if the duty to disclose had been correctly performed." *Plaza Hotel,* 111 B.R. at 883. But again, from the outset, D'Anna's dual representation of Jade and Benjamin was known to all concerned. The matters were assigned to the

same Bankruptcy Judge (Judge Cosetti), who regularly heard both matters together, establishing that he was well aware of D'Anna's connection to Benjamin. Indeed, Judge Fitzerald (to whom the cases were assigned after Judge Cosetti's retirement) recognized this fact explicitly: "I don't agree that [D'Anna's employment] was in error. Judge Cosetti clearly was aware of the facts in the case ... at the beginning[,] when the appointment was approved[.]" JA 228. Consequently, as a result of her employment, D'Anna stood in no better position than she would have had she provided a more comprehensive Rule 2014 affidavit. *Cf. Plaza Hotel,* 111 B.R. at 883. At bottom, the record makes clear that the Bankruptcy Court was "[a]rmed with knowledge of all the relevant facts." *Martin,* 817 F.2d at 182.[6]

We find no cause to disturb the Bankruptcy Court's order authorizing D'Anna's employment. Accordingly, we conclude that the court did not err in finding her eligible for compensation.[7]

***151 B.**

[2] Ursula next argues that the Bankruptcy Court erred by awarding D'Anna the full amount of fees for which she applied because they were unreasonable. A court may award an attorney employed under § 327 "reasonable compensation for actual, necessary services rendered" or expenses incurred, but may not award compensation for "unnecessary duplication of services," or "services that were not ... reasonably likely to benefit the debtor's estate[ ] or necessary to the administration of the case." 11 U.S.C. § 330(a)(1), (4). In addressing the fee request, the Bankruptcy Court was required to consider the following factors: (1) the time spent performing the services; (2) the rates charged; (3) whether the services were necessary to the administration of, or beneficial toward the completion of, the case; (4) whether the services were performed within a reasonable amount of time commensurate with the complexity or importance of the task(s) completed; (5) whether the attorney demonstrated skill and experience in the bankruptcy field; and (6) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases. 11 U.S.C. § 330(a)(3). We review for abuse of discretion, *see In re Engel,* 124 F.3d 567, 571 (3d Cir.1997) (citation omitted), and we find none.

Ursula argues that D'Anna's work on the Whyte personal injury matter, *see supra* note 1, was duplicative of work performed by counsel for Jade's liability insurance carrier. Ursula paraphrases a letter from the insurance carrier to Jade, in which Ursula claims that the carrier advised Jade that it "need not expend any costs for its defense." Appellant Br. at 46. But the letter supports, rather than undermines, D'Anna's claim that her work on the Whyte matter was reasonable and necessary. The letter advised Jade that its policy limit was $100,000, and that Jade would not be covered to the extent a verdict was returned in excess of that amount. JA 156. Accordingly, the insurance carrier specifically suggested that Jade "may wish to retain the services of another counsel to protect [its] interests[ ] against a verdict in excess of policy limits." *Id.* The letter only advised that Jade had no *obligation* to "assume any legal expenses" *if* it did not "wish to engage personal counsel." *Id.* That Jade opted to use D'Anna's additional services, consistent with the insurance carrier's suggestion, does not render the services duplicative. And, in fact, the settlement amount turned out to be greater than the $100,000 policy limit. JA 107, 211-12. Given these circumstances, it was plainly not an abuse of discretion to award D'Anna fees for work performed on the Whyte matter.

[3] Ursula also challenges D'Anna's work in addressing certain technical defects in the 1995 merger between Jade and CMW. Specifically, several annual reports and corporate franchise taxes that the companies were required to file and pay apparently never were, and thus the Virgin Islands Government never formally processed the merger. Accordingly, ***152** D'Anna spent time addressing these defects in contemplation of the sale of the business to Ursula. JA 36 n. 1; 162 n. 1; 235-36. Ursula now argues that D'Anna's efforts to complete the merger caused it to assume the liability potentially accompanying the Whyte claim. Consequently, Ursula says, D'Anna's services were actually harmful, rather than beneficial, to the estate. D'Anna argues, conversely, that execution of the stock purchase agreement was contingent on Jade providing to Ursula a certificate of its good standing, which she says included proof of bona fide title to CMW's assets.

We need not parse the terms of the stock purchase agreement to resolve the issue. Irrespective of Jade's contractual obligations, it would be strange indeed to hold that curing deficiencies in official corporate paperwork submitted to the Government does not in some sense benefit the corporation. And we do not so hold.

The remainder of Ursula's challenge to the fee request amounts to little more than trifling objections to D'Anna's fee calculation. Upon review, we find these objections (which, we note, Ursula failed to specify to the Bankruptcy Court, JA 231) to be without merit. We

decline to disturb the Bankruptcy Court's considered judgment. *See In re Busy Beaver Bldg. Ctrs., Inc.,* 19 F.3d 833, 845 (3d Cir.1994) ("Because its time is precious, the reviewing court need only correct reasonably discernible abuses, not pin down to the nearest dollar the precise fee to which the professional is ideally entitled.") (footnote omitted).

III.

For the foregoing reasons, we will affirm the order of the District Court.

Parallel Citations

2010 WL 2712139 (C.A.3 (Virgin Islands))

Footnotes

1 One of the unsecured claims was based on a pending personal injury suit that had been brought against CMW by Alvin and Eleanor Whyte, in which the Whytes sought damages of approximately $1.6 million. JA 164. Jade contested the claim, asserting that the suit was without legal basis. JA 40. The suit ultimately settled for approximately $170,000. JA 107; 211-12.

2 The stock purchase agreement was subject to the Bankruptcy Court's approval in Benjamin's Chapter 13 case, which the court did indeed approve. Solely for sake of clarity, we refer hereafter to "Jade" as the entity operating before Ursula assumed control, and we refer to the entity now challenging the fee award as "Ursula." We do so fully cognizant that the title of the reorganized debtor (and appellant here) remains "Jade Management Services."

3 The Bankruptcy Court had jurisdiction under 28 U.S.C. § 157. The District Court had intermediate appellate jurisdiction under 28 U.S.C. § 158(a). We exercise appellate jurisdiction under 28 U.S.C. § 158(d). We review the District Court's order *de novo,* and we apply the same standards that it was required to apply when reviewing the underlying decision by the Bankruptcy Court. *In re Visual Indus., Inc.,* 57 F.3d 321, 324 (3d Cir.1995).

4 We review the Bankruptcy Court's decision to approve Jade's application to employ D'Anna for abuse of discretion. *See In re Pillowtex, Inc.,* 304 F.3d 246, 250 (3d Cir.2002). "An abuse of discretion exists where the [Bankruptcy C]ourt's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law or an improper application of law to fact." *In re Marvel Entm't Group, Inc.,* 140 F.3d 463, 470 (3d Cir.1998) (quotations and citation omitted).

5 We note further that, at the hearing regarding the fee request, the United States Trustee stated on the record that it too "ha[d] reviewed the application and ... ha[d] no objection to the award of compensation requested." JA 237.

6 Ursula also argues that the Bankruptcy Court should have rejected D'Anna's fee request because she fraudulently omitted her connection to Benjamin on her Rule 2014 affidavit. For similar reasons, we reject this argument as well. Again, because the record plainly reveals Judge Cosetti's awareness of D'Anna's dual representation, there is no reason to believe that he would have rejected Jade's application to employ her even if a complete Rule 2014 statement had been filed. Moreover, aside from the omission in the Rule 2014 affidavit, Ursula has proffered no evidence intimating that D'Anna in any way attempted to defraud the court. While we certainly do not condone D'Anna's substandard affidavit, we cannot fault the Bankruptcy Court for failing to reject it as fraudulent.

7 Given our resolution, we have no occasion to decide whether a bankruptcy court retains discretion under § 328-which authorizes a court to award compensation where a professional becomes disinterested during his or her employment-to award compensation to a professional who is improperly employed under § 327(a). *Compare In re Crivello,* 134 F.3d 831, 836-39 (7th Cir.1998) (holding that bankruptcy court has discretion to award fees under § 328 despite professional's improper employment under § 327(a)) *with In re Federated Dep't Stores, Inc.,* 44 F.3d 1310, 1319-20 (6th Cir.1995) (holding that bankruptcy courts are not so authorized); *cf. also U.S. Trustee v. Price Waterhouse,* 19 F.3d 138, 142 (3d Cir.1994) (stating in dicta that "we interpret [§] 328(c) to mean that if a non-'disinterested' professional person is improperly employed ... the court may deny compensation and reimbursement").

End of Document

426 F.3d 675
United States Court of Appeals,
Third Circuit.

In re: CONGOLEUM CORP., et al.
Century Indemnity Company, as Successor to CCI Insurance Company, as Successor to Insurance Company of North American; Ace American Insurance Company f/k/a Cigna Insurance Company; Ace Property & Casualty Insurance Company f/k/a Cigna Property & Casualty Insurance Company, Appellants
v.
Congoleum Corporation; Congoleum Sales, Inc.; Congoleum Fiscal, Inc.
No. 04–3609. | Argued July 15, 2005. | Filed Oct. 13, 2005. | As Amended Oct. 20, 2005.

Synopsis
Background: Debtor-asbestos products manufacturer filed application to retain law firm as "special insurance counsel" in prepackaged Chapter 11 reorganization. Liability insurers objected. The United States Bankruptcy Court for the District of New Jersey granted the application, and insurers appealed. The District Court, Stanley R. Chesler, J., affirmed, and insurers appealed.

Holdings: The Court of Appeals, Weis, Circuit Judge, held that:

[1] the insurers and their attorneys had standing to bring the appeal, even under the more restrictive standard applied to bankruptcy proceedings;

[2] firm, which represented debtor prepetition in negotiating settlement arrangements with asbestos injury claimants represented by attorneys who were co-counsel with firm in insurance matters for those same claimants, had an actual, concurrent conflict of interest;

[3] firm did not receive effective waivers from the claimants it represented and, therefore, acted in violation of the New Jersey Rules of Professional Conduct; and

[4] given the actual conflict of interest and firm's lack of disinterestedness, retention of firm was contrary to the section of the Bankruptcy Code governing the employment of professional persons.

Reversed and remanded.

West Headnotes (23)

[1] **Bankruptcy**
Conclusions of law; de novo review
Bankruptcy
Findings of Fact

In reviewing a bankruptcy court's decision, the Court of Appeals, twice removed from the primary tribunal, reviews both the factual and the legal determinations of the district court for error.

Cases that cite this headnote

[2] **Bankruptcy**
Scope of review in general

To determine whether the district court erred in reviewing a bankruptcy court's decision, the Court of Appeals reviews the bankruptcy court's findings by the standards the district court should have employed.

4 Cases that cite this headnote

[3] **Federal Civil Procedure**
In general; injury or interest
Federal Civil Procedure
Causation; redressability

Article III standing need not be financial and only need be fairly traceable to the alleged illegal action. U.S.C.A. Const. Art. 3, § 2, cl. 1.

4 Cases that cite this headnote

[4] **Bankruptcy**
Right of review and persons entitled; parties; waiver or estoppel

In the bankruptcy field, a jurisprudential rule has been adopted that limits appellate standing to persons or entities that are aggrieved by an order which diminishes their property, increases their burdens, or detrimentally affects their rights.

2 Cases that cite this headnote

[5] **Bankruptcy**
Right of review and persons entitled; parties; waiver or estoppel

Liability insurers for Chapter 11 debtor and their attorneys had standing to bring appeal from lower courts' approval of debtor's application to retain law firm as "special insurance counsel," even under the more restrictive standard for appellate standing applied to bankruptcy proceedings; retention of special insurance counsel was an important preliminary matter that would profoundly affect the determination of the validity of a proposed plan ab initio as well as the fairness of the entire bankruptcy proceeding, it was extremely important to resolve this preliminary matter now, or else it may never be addressed, counsel for insurers had a right to raise the issue of possible ethical violations under the New Jersey Rules of Professional Conduct and require adjudication by the court, and it was highly unlikely that, in this prepackaged case, any party other than insurers or their attorneys would challenge the application. 11 U.S.C.A. § 327; N.J.RPC 8.3.

6 Cases that cite this headnote

[6] **Attorney and Client**
Disqualification in general

In ruling on disqualification motions, bankruptcy courts must be cautious about infringing on the right of the debtor to retain counsel of its choice. 11 U.S.C.A. § 327.

1 Cases that cite this headnote

[7] **Federal Courts**
Counsel

State precedents as to professional responsibility should be consulted by the federal courts when such precedents are compatible with federal law and policy and do not "balkanize federal law."

2 Cases that cite this headnote

[8] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

In determining existence of conflicts of interest, bankruptcy professionals are required to examine their relationship not only based on the two-party litigation model, but also one guided by a stricter, fiduciary standard.

2 Cases that cite this headnote

[9] **Attorney and Client**
Representing Adverse Interests

Under the New Jersey Rules of Professional Conduct, a lawyer shall not represent a client if there is a "concurrent conflict of interest." N.J.RPC 1.7.

1 Cases that cite this headnote

[10] **Attorney and Client**
Representing Adverse Interests

Pursuant to the American Bar Association's

(ABA) Model Rules of Professional Conduct, absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, because a conflict that materially limits a lawyer's representation of her client, even absent direct adversity, may hinder a lawyer's ability to recommend or advocate all possible positions for her clients. ABA Rules of Prof.Conduct, Rule 1.7.

Cases that cite this headnote

[11] **Attorney and Client**
Representing Adverse Interests

Under the New Jersey Rules of Professional Conduct, a lawyer's own interests should not be permitted to have an adverse effect on, or otherwise materially limit, the representation of a client. N.J.RPC 1.7.

Cases that cite this headnote

[12] **Attorney and Client**
Representing Adverse Interests

Under the New Jersey Rules of Professional Conduct, a lawyer cannot allow a related business interest to affect his representation, for example, by referring clients to an enterprise in which the lawyer has an identified financial interest. N.J.RPC 1.7.

Cases that cite this headnote

[13] **Attorney and Client**
Persons subject to regulations
Bankruptcy
Attorneys

In addition to the standards established by professional ethics, attorneys retained in bankruptcy proceedings are also required to meet the restrictions imposed by the section of the Bankruptcy Code governing the employment of professional persons. 11 U.S.C.A. § 327.

Cases that cite this headnote

[14] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Section of the Bankruptcy Code governing the employment of professional persons applies to a debtor-in-possession as well as to a trustee. 11 U.S.C.A. § 327.

Cases that cite this headnote

[15] **Attorney and Client**
Bankruptcy
Bankruptcy
Employment of Professional Persons or Debtor's Officers

Bankruptcy Code restricts retention of lawyers and other professionals to those who do not hold or represent an interest adverse to the estate and are disinterested. 11 U.S.C.A. § 327(a).

4 Cases that cite this headnote

[16] **Attorney and Client**
Bankruptcy
Bankruptcy
Attorneys

Bankruptcy Code permits employment of an attorney for a specified special purpose, so long as the attorney does not hold or represent any interest adverse to the debtor or to the estate with respect to the matter on which he is to be employed, and the "special purpose" must be unrelated to the reorganization and must be explicitly described in the application. 11

U.S.C.A. § 327(e).

3 Cases that cite this headnote

[17] **Attorney and Client**
Bankruptcy

Law firm that Chapter 11 debtor-asbestos products manufacturer sought to retain postpetition as "special insurance counsel" had an actual, concurrent conflict of interest, under both the New Jersey Rules of Professional Conduct and the Bankruptcy Code, where firm had represented debtor prepetition in negotiating settlement arrangements with asbestos injury claimants represented by attorneys who were co-counsel with firm in insurance matters for those same claimants. 11 U.S.C.A. § 327; N.J.RPC 1.7.

1 Cases that cite this headnote

[18] **Attorney and Client**
Disclosure, waiver, or consent

Law firm that Chapter 11 debtor-asbestos products manufacturer sought to retain postpetition as "special insurance counsel," but that had an actual, concurrent conflict of interest because it had represented debtor prepetition in negotiating settlement arrangements with asbestos injury claimants represented by attorneys who were co-counsel with firm in insurance matters for those same claimants, did not receive effective waivers from the individual claimants it represented and, therefore, acted in violation of the New Jersey Rules of Professional Conduct; firm did not contact the claimants but, instead, relied on co-counsel to secure the waivers, and the record did not establish that co-counsel had authority to issue waivers on behalf of the thousands of individual claimants it represented, did not include the information, if any, that co-counsel furnished to the individuals, and did not indicate that they were given opportunity to object to firm's representation. 11 U.S.C.A. § 327; N.J.RPC 1.7.

1 Cases that cite this headnote

[19] **Attorney and Client**
Bankruptcy

Retention by Chapter 11 debtor-asbestos products manufacturer of law firm as its "special insurance counsel" was contrary to section of the Bankruptcy Code governing employment of professional persons; given expansive nature of firm's assignment, application fell under subsection allowing employment of professionals to assist generally in administration of the estate, rather than under subsection governing retention for a specified special purpose, firm had an actual, concurrent conflict of interest under the New Jersey Rules of Professional Conduct because it had represented debtor prepetition in negotiating settlement arrangements with asbestos injury claimants represented by attorneys who were co-counsel with firm in insurance matters for those same claimants, and firm's status as co-counsel and its ownership interest in third party hired by debtor to screen claims prevented firm from being completely loyal to debtor, so that it was not disinterested. 11 U.S.C.A. § 327(a, e); N.J.RPC 1.7.

4 Cases that cite this headnote

[20] **Attorney and Client**
Bankruptcy

Appearance of impropriety, standing alone, is not a sufficient ground for disqualification of an attorney under the section of the Bankruptcy Code governing the employment of professional persons. 11 U.S.C.A. § 327.

1 Cases that cite this headnote

[21] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Waivers are ordinarily not effective, under the subsection of the Bankruptcy Code allowing the employment of professionals to assist generally in the administration of the estate. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[22] **Bankruptcy**
The Plan

Bankruptcy court must apply careful scrutiny to prepetition procedures in prepackaged Chapter 11 plans. 11 U.S.C.A. § 327.

1 Cases that cite this headnote

[23] **Bankruptcy**
Power and Authority

Bankruptcy court has an obligation to prevent unnecessary expenditures in the administration of an estate.

Cases that cite this headnote

Attorneys and Law Firms

***678** Tancred V. Schiavoni (Argued), Jonathan J. Kim, O'Melveny & Myers LLP, New York, New York, Marty F. Siegal, Siegal & Napierkowski, Cherry Hill, New Jersey, Leonard P. Goldberger, White & Williams LLP, Philadelphia, PA, for Appellants Century Indemnity Company; ***679** Ace American Insurance Company; Ace Property & Casualty Insurance Company.

Kerry A. Brennan (Argued), Richard L. Epling, Pillsbury Winthrop Shaw Pittman LLP, New York, New York, Paul S. Hollander, Okin, Hollander & DeLuca, LLP, Fort Lee, NJ, for Appellees Congoleum Corporation, Congoleum Sales, Inc., Congoleum Fiscal, Inc.

Richard W. Hill (Argued), Rachel L. Diehl, Kevin J. Licciardi, McCarter & English, LLP, Newark, New Jersey, for Gilbert Heintz & Randolph, LLP.

Before: SLOVITER, MCKEE and WEIS, Circuit Judges.

OPINION

WEIS, Circuit Judge.

In this pre-packaged Chapter 11 reorganization, we hold that evidence of pre-petition conduct in this case by a law firm is relevant to a review of a debtor's application to retain the firm as special insurance counsel. We conclude that the bankruptcy judge should not have granted the application here. The firm had acted as counsel for the debtor pre-petition in negotiating settlement arrangements with asbestos injury claimants represented by attorneys who were co-counsel with the firm in insurance matters for those same claimants. We conclude that conflicts existed which precluded the firm's retention under the Rules of Professional Conduct and the Bankruptcy Code.

Facing nearly 100,000 claims for injury caused by asbestos in its products and the exhaustion of its primary liability insurance coverage, Congoleum filed a declaratory judgment in the Superior Court of New Jersey in 2001 against a number of excess carriers.[1] The complaint was filed by the law firm of Dughi, Hewit & Pallatucci, which had represented Congoleum in insurance matters for more than ten years.[2]

While that litigation continued, Congoleum[3] sought relief in the Bankruptcy Court in a Chapter 11 pre-packaged plan of reorganization designed to channel existing and future asbestos claims to a trust as authorized by 11 U.S.C. § 524(g). Approval of the plan would enable Congoleum to preserve its assets and continue in business because the trust would assume its asbestos liability. Section 524(g) of the Bankruptcy Code requires that 75% of current asbestos claimants approve a plan of reorganization before a channeling order may be issued. As a result, garnering support from a large number of claimants is crucial to the success of a plan.

A unique feature of asbestos personal injury litigation is the fact that a small group of law firms represents hundreds of thousands of plaintiffs. Another notable

aspect is that, because over time they may have been exposed to asbestos in various environments, some of the injured persons may have claims against a number of defendants.

***680** The realities of securing favorable votes from thousands of claimants to meet the 75% approval requirement forces debtors to work closely with the few attorneys who represent large numbers of injured claimants. A prepackaged plan of reorganization acceptable to the debtor must be satisfactory for the claimants as well[4] and, consequently, extensive negotiations are necessary.

I.

In this case, negotiations between the debtor and counsel for plaintiffs produced a proposal that involved the creation of a trust funded primarily by proceeds from Congoleum's insurance carriers to pay for settlements of existing, as well as future asbestos personal injury claims. Congoleum was to contribute to the trust a $2.7 million promissory note payable ten years after confirmation and ABI, Congoleum's parent corporation, was to contribute $250,000 cash and the pledge of its shares in Congoleum to secure Congoleum's promissory note. Notably, neither Congoleum nor related entities were required to contribute equity to the trust.[5]

The pre-petition activity that occurred in this case is fairly typical of that in a number of asbestos pre-packaged plans. Joseph F. Rice and Perry Weitz, two plaintiffs' lawyers,[6] negotiated a settlement of numerous asbestos claims with Congoleum's counsel, Gilbert, Heintz & Randolph, LLP ("Gilbert"). The agreement employed a matrix to "resolve and settle" the amounts the various classes of claimants would receive as damages. For example, mesothelioma victims were each allocated $100,000. In contrast, those with non-malignant injuries would receive $1,000.[7]

To qualify for compensation, a participating claimant was required to provide evidence of injury and exposure to Congoleum products. Claims of the qualified participating claimants would be secured to 75% of the matrix values and the remainder would be treated as unsecured ***681** claims. In contrast to the claims of participating claimants addressed in the settlement agreement, claims settled with a separate group of claimants pre-petition would be secured in full.

II.

The role Gilbert played in preparing the plan is challenged in this proceeding. In October 2002, Perry Weitz recommended that Congoleum retain Gilbert to assist in solving insurance coverage for Congoleum's mounting asbestos liability. Gilbert specializes in insurance coverage disputes and product liability matters. It serves in a variety of capacities related to various asbestos mass tort cases and represents defendants as well as claimant and creditor committees in various asbestos bankruptcies.

At the time he recommended the firm to Congoleum, Weitz had existing co-counsel relationships with Gilbert in other asbestos related proceedings.[8] The arrangements were that Gilbert would represent the claimants in seeking recovery from the insurers of asbestos defendants.

Gilbert described its work as co-counsel with Weitz as providing:

> "insurance-related advice to certain claimants in asbestos and other contexts. [Gilbert] represents certain asbestos-related bodily injury claimants in proceedings against a primary insurer with respect to that insurer's coverage obligations ... in pursuing coverage claims against insurers ... and in pursuing coverage from insurers of similar defendants."

Gilbert explained that it did not represent the individual claimants with respect to the establishment of their tort claims, "but only with respect to the collection of insurance monies to pay claims that may be established."

On February 6, 2003, Gilbert entered into a formal retention agreement to advise and represent Congoleum in efforts to negotiate with claimants' counsel to settle "pending asbestos-related bodily injury" claims, and arrange for the "terms of a 'pre-packaged' plan of reorganization." For these services, Gilbert was to receive a fixed fee of $2 million from Congoleum. Congoleum also paid Perry Weitz and Joseph Rice [9] $1 million each for fees and expenses they "incurred or may incur in connection with" negotiating the pre-packaged plan.

In its letter of retention, Gilbert disclosed to Congoleum its many representations in the asbestos field, including that it had been retained to represent individual tort claimants "to provide legal advice with respect to

insurance matters." Gilbert explained that its "co-counsel with respect to many of these matters is [Weitz]." Gilbert also stated that it

> ***682** "represents other clients, not listed here, that are or may be adverse to the [sic] Congoleum with respect to asbestos related claims. GHR will continue to represent these and other similarly situated clients in these capacities in the future.... In light of the Firm's representation of entities that are potentially adverse to Congoleum in other matters, GHR cannot provide any legal services to Congoleum that could impair its ability to represent fully its corporate and other clients. Congoleum agrees that GHR may continue to represent or to undertake to represent existing or new clients as described above or in other matters, even though the positions taken by other clients in those matters may be adverse to the positions taken by Congoleum in those or other matters. Congoleum will not, in [sic] the basis of GHR's representation of them, object to GHR's continuing or undertaking the representation of other clients in matters where the positions taken by such clients are adverse to those taken by Congoleum in those or other matters."

In addition to negotiating on Congoleum's behalf with claimants' counsel to structure the contemplated bankruptcy reorganization, Gilbert participated in the declaratory judgment action in New Jersey state court, although the Dughi firm is the lead trial counsel in that proceeding.

Congoleum filed its reorganization petition on December 31, 2003 and on January 23, 2004 applied for bankruptcy court approval to retain Gilbert as "special insurance counsel." The application stated that Gilbert "would be primarily responsible for strategic advice on insurance issues, including but not limited to insurance-related settlement negotiations, and the representation of the Debtors with respect to insurance issues arising in the context of the Chapter 11 Cases."

The application continued, "GHR was the primary counsel that negotiated with representatives of asbestos plaintiffs to create the structure of the Debtors' Plan. GHR also represented Congoleum in negotiating and drafting asbestos settlement agreements that liquidated numerous claims asserted against Congoleum in the tort system. The settlement of numerous asbestos claims allowed the Debtors to negotiate the Plan, which contemplates that the primary assets dedicated to pay asbestos claims will be Congoleum's right to receive insurance proceeds."

The following services "among other things" were to be provided by Gilbert:

> "(a) advising and representing the Debtors in insurance-related settlement negotiations and mediations with insurers and other parties;
>
> (b) pursuant to request of the Debtors, advising and assisting the Debtors in consultations with parties-in-interest regarding unresolved, potentially available insurance coverage;
>
> (c) advising the Debtors as to the appropriate steps necessary to assert claims against and obtain proceeds from insurers;
>
> (d) reviewing and analyzing insurance-related documents, data, applications, orders, operating reports, schedules and other materials;
>
> (e) representing the Debtors at hearings concerning insurance-related issues in the bankruptcy case;
>
> (f) advising and assisting the Debtors in preparing appropriate insurance-related legal pleadings and proposed insurance-related orders in the bankruptcy case;
>
> (g) pursuant to requests of the Debtors, advising and assisting the Debtors with respect to insurance-related issues in connection with the formulation negotiation and confirmation of a plan of reorganization;
>
> ***683** (h) pursuant to requests of the Debtors, assisting and advising the Debtors generally with respect to insurance-related issues during the Chapter 11 Cases, and such other services as may be in the best interest of the Debtors; and
>
> (i) preparing appropriate pleadings and orders, conducting discovery, and representing Congoleum in the Coverage Litigation (if the automatic stay is not maintained) or in any adversarial proceeding relating to the determination of insurance rights or collection of

> insurance claims; provided, however, that the Debtors anticipate that [Dughi] will continue to act as primary litigation counsel in the Coverage Litigation and GHR's role in this regard will consist of coordinating the Coverage Litigation with insurance settlement efforts and assisting [Dughi] as required."

Certain of Congoleum's liability insurers who had not participated in the formulation of the plan objected to the application to retain Gilbert. They alleged that Gilbert was in conflict because of the duties it owed the individual claimants it represented as co-counsel with Weitz. The insurers also pointed out that the Kenesis Group, LLC ("Kenesis"), a third party owned 70% by Gilbert and hired pre-petition by Congoleum to screen claimants, had already been disqualified from being retained to review claims in *In re ACandS, Inc.,* 297 B.R. 395 (Bankr.D.Del.2003), a proceeding in which Gilbert had been involved. They argued that Gilbert's extensive relationship to Perry Weitz and Joseph Rice in other asbestos matters violated both the disinterestedness requirement of section 327(a) of the Bankruptcy Code and the Rules of Professional Conduct. Moreover, the details of the fee arrangement between Gilbert and Weitz had not been disclosed. The insurers also asked for discovery to further explore Gilbert's relationship with other parties involved in the bankruptcy.

On March 1, 2004, the bankruptcy judge heard argument on Congoleum's application to retain Gilbert. The United States Trustee appeared and stated that he did "not object to Gilbert Heintz' retention." The Trustee conceded, however, that "[t]here are certainly potential conflicts. And when it's potential under *Marvel,*[10] there's a weighing of whether it's going to become actual or not ... [a]nd we need to see what happens here."

Gilbert contended that its conduct pre-petition was not relevant to its employment as special counsel. It argued that, as to the matters listed in the application, the interests of the individuals it represented as co-counsel with Weitz were aligned with Congoleum's interests to obtain recovery from the insurers.

The bankruptcy judge granted the application to employ Gilbert, holding that the standards set in section 327(e) of the Bankruptcy Code, rather than those in section 327(a), applied and, hence, the requirement of disinterestedness of section 327(a) was not pertinent. The judge noted the difference between pre- and postpetition representation and said,

> "[w]hatever else may have gone on in the pre-petition negotiations, even if GHR was bad, bad, bad, now today, both the Debtor and GHR want to preserve and maximize the Debtor's insurance assets. I'm not making a finding about whether GHR acted improperly pre-petition.
>
> I'm just saying that its pre-petition behavior cannot carry the day on a post-petition retention application for different services."

In addition to the challenge to Gilbert's retention, the insurers also contested Congoleum's ***684** employment of Kenesis Group, LLP as consultants and claim processors. Gilbert owned a 70% interest in Kenesis. Congoleum had paid $1,678,000 for Kenesis' work screening asbestos claimants.[11] Congoleum's application described Kenesis' work pre-petition, indicating that it would continue to review claims it had previously processed and determined to be deficient to determine whether the defects had been cured. In addition, the application indicated that Kenesis would perform consulting services for Congoleum's law firms, including Gilbert and Dughi.

On April 5, 2004, about one month after granting Gilbert's application, the Bankruptcy Court heard argument on the Kenesis application. In response to the objections from Congoleum's insurers and the United States Trustee, the Court denied the application. The bankruptcy judge based her denial on the "concern that Kenesis [was] not disinterested due to its relationship with [Gilbert]." The judge noted that Kenesis had been involved in "negotiating the Claimant Agreement [pre-petition] and that forms the backbone of the reorganization plan. So the Court finds that they were and continue to be involved in negotiating the plan."

The bankruptcy judge further expressed concern that Kenesis might have a conflict of interest with the debtor because the payment it received for pre-petition services might be a preference. Moreover, the court shared "the U.S. Trustee's concern that Kenesis is not disinterested due to its relationship with GHR. The prospect that GHR would be reviewing the work product of an entity with such a strong overlap of identity is still more reason that Kenesis does not meet the standards of 327."

The insurers appealed the ruling on Gilbert's retention. The District Court concluded that the bankruptcy judge was correct in her rulings on the alignment of interests and the application of section 327(e). The district judge commented that because the insurance companies were the primary source of funds to pay claimants, the carriers "have every interest in making it, to put it bluntly, difficult to confirm this bankruptcy, and that motivation is not lost on the Court."

In their appeal to this Court, the insurers raise several

issues including: (1) whether the District Court erred in affirming the Bankruptcy Court's determination that retaining Gilbert violated neither the Bankruptcy Code nor the Rules of Professional Conduct; (2) whether the District Court erred by affirming that section 327(e) of the Bankruptcy Code applied rather than section 327(a); (3) whether the District Court erred in not reversing the Bankruptcy Court's findings of fact and conclusions of law where the Bankruptcy Court neither conducted an evidentiary hearing nor allowed discovery; (4) whether the District Court erred by failing to consider Gilbert's economic and other ties to lawyers representing asbestos claimants who are adverse to Congoleum; and (5) whether the District Court erred by affirming the Bankruptcy Court's denial of the insurers' Motion for Judicial Notice.

Congoleum questions whether the insurers have standing to challenge the retention of special insurance counsel.

III.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). The District Court had jurisdiction pursuant to ***685** 28 U.S.C. §§ 157 and 1334. We have before us a final order which we review under 28 U.S.C. § 1291. *In re United Artists Theatre Co. v. Walton,* 315 F.3d 217 (3d Cir.2003); *In re: Pillowtex,* 304 F.3d 246 (3d Cir.2002).

[1] [2] Because we are a court of appeals, "twice removed from the primary tribunal, we review both the factual and the legal determinations of the district court for error." *In re BH & P, Inc.,* 949 F.2d 1300, 1305 (3d Cir.1991)(quoting *Universal Minerals, Inc. v. C.A. Hughes & Co.,* 669 F.2d 98, 101–02 (3d Cir.1981)). In order to determine whether the District Court erred, we review the bankruptcy court's findings by the standards the District Court should have employed. *Id.* at 1306.

IV.

At the outset we must consider Congoleum's contention that the insurers lack standing to bring this appeal. Congoleum argues that the insurers are not creditors of the debtor, are not persons aggrieved by the retention order, and under the more restricted bankruptcy standards, lack appellate standing. In support of its position, Congoleum cites *Travelers Insurance Company v. H.K. Porter Company, Inc.,* 45 F.3d 737 (3d Cir.1995) and *In re: Dykes,* 10 F.3d 184 (3d Cir.1993).

[3] [4] Article III standing need not be financial and only need be fairly traceable to the alleged illegal action. *See Miller v. Nissan Motor Acceptance Corp.,* 362 F.3d 209, 221 (3d Cir.2004) (listing the elements of Article III standing). In the bankruptcy field, however, we have adopted a jurisprudential rule that limits appellate standing to persons or entities that are aggrieved by an order which diminishes their property, increases their burdens, or detrimentally affects their rights. *Travelers,* 45 F.3d at 742.

We cited the standing distinction in *In re: Combustion Engineering, Inc.,* 391 F.3d 190 (3d Cir.2005). We recognized the acute need to limit appeals in bankruptcy cases which often involve a myriad of parties indirectly affected by every bankruptcy court order. *Combustion Engineering* involved a pre-packaged Chapter 11 plan similar to the one before us. We concluded that some of the insurers had appellate standing but only with respect to the limited group of issues that affected them. *Id.* at 217–18.

[5] Here, the insurers are entitled to standing even under the more restrictive standard applied to bankruptcy proceedings. The retention of special insurance counsel is an important preliminary matter that will profoundly affect the determination of the validity of a proposed plan *ab initio.* It is an issue based on procedural due process concerns that implicate the integrity of the bankruptcy court proceeding as a whole. The retention of Gilbert as special insurance counsel will affect the resolution of issues that may directly affect the rights of insurers and fairness to the asbestos claimants.

Combustion Engineering and *Dykes,* on the other hand, were appeals from final orders confirming plans of reorganization. In *Travelers,* the objections were directed at an order reinstating certain claims. In the present case, the appeal is from an order which will affect the fairness of the entire bankruptcy proceeding, including the determination of issues such as those for which we granted insurer standing to challenge a final order in *Combustion Engineering.*

Further, it is extremely important to resolve this preliminary matter now; otherwise, it may never be addressed.

In re: Marvel Entertainment Group, 140 F.3d 463 (3d Cir.1998), presented a challenge to our jurisdiction in an appeal ***686** from an order refusing the trustee's request to retain a certain law firm. We treated the bankruptcy judge's order as final, pointing out that if we did not take

jurisdiction at that point, no "meaningful review" of the denial of the appointment could ever take place. *Id.* at 470.

We observed that once a plan has proceeded to confirmation, orders involving retention of professionals are unlikely to get the attention they deserve. Once a bankruptcy reorganization has been completed, it would be unlikely that the proceedings would commence again from the beginning to correct preliminary issues. *Id.; see also In re: Amatex Corp.,* 755 F.2d 1034, 1040 (3d Cir.1985) (noting that "waiting until a final plan is approved may well cause several years of hearings and negotiations to be wasted"); *In re: G–I Holdings,* 385 F.3d 313 (3d Cir.2004) (reviewing an order appointing a trustee prior to plan confirmation). Addressing the challenges to Gilbert's retention at this stage comports with our discussion of the unlikelihood of review late in a bankruptcy in *Marvel* as well as the concern for fairness and due process throughout complex bankruptcy proceedings such as this one.

In addition, counsel for the insurers has a responsibility, if not a duty, to alert the Court to ethical conflicts. Rules governing professional conduct are often viewed as even more necessary and applicable in bankruptcy cases than in other contexts. *See* 1 Collier on Bankruptcy (15th ed.) ¶ 8.01[1] ("Thus the importance of adherence to the ethical rules, as well as disclosure, initial and continuing, cannot be overemphasized.").

[6] There are, of course, concerns about the tactical use of disqualification motions to harass opposing counsel. *See Richardson–Merrell, Inc. v. Koller,* 472 U.S. 424, 436, 105 S.Ct. 2757, 86 L.Ed.2d 340 (1985) (disqualification of counsel in a civil, not a bankruptcy appointment). Similarly, courts must be cautious about infringing on the right of the debtor to retain counsel of its choice. Nevertheless, the obligation to ensure that professional ethics are followed has led courts to rule that counsel has standing to raise and challenge unethical procedures on the part of opposing lawyers. *See Kevlik v. Goldstein,* 724 F.2d 844, 848 (1st Cir.1984) (citing cases from the Courts of Appeals for the Fourth and Fifth Circuits authorizing attorneys to report ethical concerns to the court).

We raised, but did not decide, whether a "motion to disqualify must be brought by a former client" in *In re: Corn Derivatives Antitrust Litigation,* 748 F.2d 157, 161 (3d Cir.1984). However, we noted, "one of the inherent powers of any federal court is the admission and discipline of attorneys practicing before it." *Id.* at 160.

The District Court in *Schiffli Embroidery Workers' Pension Fund v. Ryan, Beck & Co.,* 1994 WL 62124 (D.N.J.1994), cited then Rule 8.1 of the New Jersey Rules of Professional Conduct, which required lawyers to report violations of the Rules of Professional Conduct. Based on that duty, the court found that a lawyer had standing to present a motion to disqualify its opposing counsel.

Rule 8.3 of the New Jersey Rules of Professional Conduct is the current version of the rule addressed in *Schiffli;* it provides that 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." *See also O'Connor v. Jones,* 946 F.2d 1395, 1399 (8th Cir.1991) ("In cases where counsel is in violation of professional ethics, the court may act on motion of an aggrieved party or may act *sua sponte* to ***687** disqualify."); *International Electronics Corp. v. Flanzer,* 527 F.2d 1288, 1295 (2d Cir.1975) (considering the issue of attorney conflict despite failure of parties to raise the point).

We need not decide whether the insurers' counsel had a duty to disclose Gilbert's conduct in this case. It is enough that the insurers' counsel had the right to raise the issue under the Rules of Professional Conduct and require adjudication by the court. Concluding otherwise would suggest that we do not support the long-standing role of lawyers practicing before federal courts in monitoring and reporting ethical violations.

We note also, as a practical matter, that in circumstances such as those present here, it is highly unlikely that any of the parties other than the insurers or their attorneys would challenge the application for retention of Gilbert. Congoleum, Gilbert, Perry Weitz and Joseph Rice worked together to negotiate the terms of the pre-packaged plan and all were deeply committed in having it approved. Moreover, we are aware that the standard set out in *Travelers* is a jurisprudential and not a strict statutory requirement for standing. We are persuaded that, in the circumstances here, the insurers and their attorneys have standing to present this appeal.

V.

Having concluded that standing has been established, we turn to the Rules of Professional Conduct and the standards set by the Bankruptcy Code.

A.

The District Court's local rules provide that the rules of American Bar Association, as revised by the New Jersey Supreme Court, apply to attorneys practicing before the court "subject to such modifications as may be required or permitted by federal statute, regulation, court rule or decision of law." Local Rule 103.1 (D.N.J.). In the absence of a "definitive state court decision interpreting the rules as promulgated by the [New Jersey] Supreme Court, the federal court will proceed to reach its own conclusions as to the appropriate application of the rules of professional conduct." *United States v. Balter,* 91 F.3d 427, 435 (3d Cir.1996) (quoting New Jersey District Court Local Rules).

In *International Business Machines Corp. v. Levin,* 579 F.2d 271, 279 n. 2 (3d Cir.1978), we noted that the "conduct of practitioners before the federal courts must be governed by the rules of those courts rather than those of the state courts." However, in *United States v. Miller,* 624 F.2d 1198 (3d Cir.1980), we approved the district court's reliance on an opinion of the Supreme Court of New Jersey in applying the local rules on professional conduct. We observed that incorporation of state law in this field serves to avoid "detriment to the public's confidence in the integrity of the bar that might result from courts in the same state enforcing different ethical norms." *Id.* at 1200.

[7] [8] State precedents as to professional responsibility should be consulted when they are compatible with federal law and policy and do not "balkanize federal law." *Grievance Comm. for Southern District of New York v. Simels,* 48 F.3d 640, 645 (2d Cir.1995); *see also Resolution Trust Corp. v. Bright,* 6 F.3d 336, 341 (5th Cir.1993). Bankruptcy professionals are required to examine their relationship not only based on the two-party litigation model, but also one guided by "a stricter, fiduciary standard." 1 Collier on Bankruptcy (15th ed.) ¶ 8.01[1].

[9] Rule 1.7 of the New Jersey Rules of Professional Conduct, like Rule 1.7 of the ABA's Model Rules of Professional Conduct, provides that, a lawyer shall not represent a client if there is a "concurrent ***688** conflict of interest," a situation where either:

> (1) the representation of one client will be directly adverse to another client; or
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer.

NJ RPC 1.7(a).[12] Notwithstanding the existence of a concurrent conflict of interest, a lawyer may undertake the representation if:

> (1) each affected client gives informed consent, confirmed in writing, after full disclosure and consultation ... [w]hen the lawyer represents multiple clients in a single matter, the consultation shall include an explanation of the common representation and the advantages and risks involved;
>
> (2) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (3) the representation is not prohibited by law; and
>
> (4) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.

NJ RPC 1.7(b).

[10] Comments to the ABA version of this rule explain the policies underlying a rule against concurrent conflicts of interest. Absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, because a conflict that materially limits a lawyer's representation of her client, even absent direct adversity may hinder a lawyer's ability to "recommend or advocate all possible positions" for her clients. Annotated Model Rules of Professional Conduct 109 (5th ed.).

[11] [12] As the New Jersey rule specifies, the lawyer's own interests should not be permitted to have an adverse effect on, or otherwise materially limit, the representation of a client. A lawyer cannot allow a related business interest to affect his representation, for example, by referring clients to an enterprise in which the lawyer has an identified financial interest. *See id.*

[13] [14] [15] [16] In addition to the standards established by professional ethics, attorneys retained in bankruptcy proceedings are also required to meet the restrictions imposed by section 327 of the Bankruptcy Code.[13] Subsection (a) restricts retention of ***689** lawyers and other professionals to those who do not hold or represent an interest adverse to the estate and are disinterested. Subsection (e) permits employment of an attorney "for a specified special purpose," so long as the attorney does not hold or represent "any interest adverse to the debtor or to the estate with respect to the matter" on which he is to be employed. The "special purpose" must be unrelated to

the reorganization and must be explicitly described in the application. 3 Collier on Bankruptcy (15th ed.) ¶ 327.04[9][d].

[17] To put the matter in focus we will review Gilbert's activities in chronological order. In September 2002, when it had existing co-counsel agreements with Weitz in several asbestos matters, Gilbert represented Congoleum in settlement negotiations with Weitz to resolve the claims of two of its own clients,[14] Cook and Arseneault, whose mesothelioma claims were then in trial. Congoleum settled the cases for cash, plus a secured claim against funds that Congoleum hoped to recover from its excess insurers.[15] In November 2002, Gilbert became co-counsel with Weitz in two other asbestos bankruptcy cases.

In February 2003, Congoleum retained Gilbert for the purpose of negotiating the pre-packaged chapter 11 reorganization. The retainer called for negotiations with "key asbestos bodily injury claimants' counsel" as well as arriving at the "terms of a 'pre-packaged' plan of reorganization ... reviewing and commenting on the plan of reorganization ... [and] assisting or consulting with Congoleum and its bankruptcy counsel on a strategy for confirmation of the pre-packaged plan."

For most of 2003, Gilbert, Weitz and Rice worked on the terms of an agreement to settle Congoleum's current asbestos related injury claims. The settlement agreement they ultimately drafted provided for screening of each participating claimant by Kenesis, a process that was in effect during the pre-petition period. At the same time, Gilbert was assisting the Dughi firm in the coverage litigation in the New Jersey state court.

Weitz represented many individuals who presented claims against Congoleum and who were screened by Kenesis and who were also clients of Gilbert as co-counsel. Before the insurers' appeal reached the District Court, Gilbert produced in the New Jersey coverage action a list of claimants that it represented as co-counsel with Weitz. This list contains the names of approximately 15,000 individuals; the insurers estimated 10,000 of those individuals have claims against Congoleum. Neither Gilbert nor Congoleum have denied that there is an overlap of claimants.[16]

***690** In at least three other asbestos claimant cases, Gilbert and Weitz had agreed to charge the individuals they jointly represented a 10% contingency fee "on any and all insurance proceeds recovered ... [by the claimant] in connection with their claims against [the asbestos defendant] and its insurers." The insurers here assert that that same fee arrangement is present in cases against Congoleum. Gilbert has not denied that assertion despite demands that it disclose the details of its fee sharing arrangements with Weitz. Thus Gilbert represented Congoleum and actively participated in the claimants' settlement negotiations while simultaneously representing some of those claimants, albeit assertedly only in insurance matters.

In negotiating the settlement agreement and plan terms with Weitz and Rice pre-petition, Gilbert, as counsel for Congoleum, had a duty to limit the company's responsibility on such key features as the disease matrix, exposure to asbestos from Congoleum products, if any, and the extent of actual injury. Although the settlement agreement required the claimants to release Congoleum, Gilbert admitted in the coverage action in state court that the release was a limited one and applied only if proceeds were recovered from the insurance companies. If that attempt failed, then Congoleum would be liable to the individual claimants for the amount of the settlements, thus pitting Congoleum against the individual claimants Gilbert represents as co-counsel with Weitz.

Congoleum's interests called for a reduction in the number of claims approved that would likely be included in a settlement package presented to the insurers. The insurers cited major deficiencies in the validity of some claims approved by Kenesis. To the extent that the claims were not valid, it was Gilbert's responsibility in representing Congoleum to see that they were rejected, even though it would be adverse to Gilbert's interests if those claims were pursued individually or were excluded from a "package" offered to the insurers in settlement. This was not a potential, but an actual conflict.

[18] To legitimize the alleged conflicts, Gilbert relies on waivers both from Congoleum and clients the firm represented as co-counsel with Weitz. However, Gilbert did not contact the claimants; instead it relied upon Weitz to secure those waivers.

As discussed above, in several earlier asbestos bankruptcy proceedings, Weitz executed engagement letters for Gilbert's work as co-counsel. In those agreements, Weitz waived "all present and future conflicts of interest on behalf of" the individual clients the firms jointly represented and agreed to advise the clients of the information contained in the engagement letters including Gilbert's disclosure of its representation of tort defendants. Gilbert has not disclosed an engagement letter with Weitz for claimants in the Congoleum case, although it has not denied that one exists.

The record does not establish that Weitz had the authority to issue waivers on behalf of the thousands of individual claimants it represented. In addition, the record does not include the information, if any, that Weitz furnished to the individuals nor does it indicate whether they were given the opportunity to object to Gilbert's representation.[17]

***691** Although concurrent conflicts may be waived by clients under the New Jersey and ABA Rules of Professional Conduct, the effect of a waiver, particularly a prospective waiver, depends upon whether the clients have given truly informed consent. Given the complexities of the bankruptcy proceeding and the "many hats" worn by Gilbert throughout the pre- and post-petition process, we cannot conclude that the purported waivers Gilbert received from Weitz "on behalf of" the individual clients constituted informed, prospective consent. *See Baldasarre v. Butler,* 132 N.J. 278, 625 A.2d 458 (1993) (concluding that informed consent was not sufficient in a complex commercial real estate transaction); *In re Matter of Edward J. Dolan,* 76 N.J. 1, 384 A.2d 1076, 1082 (1978) ("[T]his Court will not tolerate consents which are less than knowing, intelligent and voluntary."); *In re Lanza,* 65 N.J. 347, 322 A.2d 445 (1974) ("concluding that attorney should have first explained ... all the facts and indicated in specific detail all of the areas of potential conflict that foreseeably might arise.").

We conclude that Gilbert did not receive effective waivers from the claimants it represented and, therefore, acted in violation of the Rules of Professional Conduct.

B.

[19] In addition to failing to review the waiver problem, the bankruptcy judge relied on an unrealistic view that the insurance interests of the claimants and Congoleum were so closely aligned and so narrowly defined that there was no actual conflict of interest. This error was the result, to a great extent, of the court's refusal to consider evidence about Gilbert's activities in negotiating and preparing the plan before its filing. Those pre-petition activities were clearly separate from seeking a recovery from insurance companies after the claims were liquidated or from attempting to negotiate settlements with the insurers.[18]

The application presented to the bankruptcy court recited that Gilbert would be "primarily responsible for strategic advice on insurance issues, including but not limited to insurance-related settlement negotiations and the representation of the Debtors with respect to insurance issues arising in the context of the chapter 11 cases." However, the application also stated that Gilbert's representation had encompassed the negotiations of the plan and pre-petition settlement of asbestos claims. The application indicated that services to be provided post-petition included "advising and assisting the debtors with respect to insurance-related issues in connection with the formulation, negotiation, and confirmation of a plan of reorganization."

Although the bankruptcy court relied on the narrow role Gilbert was to have in the reorganization process, the judge did not inquire about the broad scope of Gilbert's activities in negotiating the plan and the settlement agreement. Nor did the court question Gilbert's role post-petition, as described in Congoleum's application, in "advising and assisting [Congoleum] with respect to insurance-related issues in connection with the formulation, negotiation and confirmation of a plan of reorganization."

***692** Gilbert, in fact, continues to participate actively in formulating and revising the plan. There have been changes and amendments, at least four of them, to the text of the original plan thus far and Gilbert has been involved in that process. A fifth version of the plan is set for consideration some months hence.

In the usual situation, when counsel is retained to recover insurance proceeds, the underlying claim has been reduced to a judgment or settled for a specific amount. The retention of special counsel to act solely as appellate lawyer in such circumstances is an example of the intent of section 327(e). But here the claims have not been liquidated—the plan has not yet been approved and only that ruling will confirm the specific allocation of damages. Until that occurs, action against the insurers is premature. Gilbert has attempted to draw a sharp demarcation between its insurance advice and other tasks it undertook. Its efforts, however, might be likened to attempts at using a scalpel to carve a bowl of soup.

Gilbert's retention is far too expansive an assignment to be appropriate for an appointment under § 327(e). The application more properly falls under the ambit of § 327(a) which allows employment of professionals to assist generally in the administration of the estate. That subsection, however, prohibits appointments of individuals or entities who hold or represent an interest adverse to the estate and are not "disinterested."

[20] In *Marvel Entertainment Group,* 140 F.3d 463 (3d Cir.1998), we held that disqualification could be imposed where an actual conflict of interest was present or, within

the discretion of the court, where a potential conflict of interest existed. The presence of the appearance of impropriety standing alone is not a sufficient ground for disqualification, *id.* at 477, but there is more than that here. *See also In re: BH & P,* 949 F.2d 1300, 1313 (3d Cir.1991) ("[I]n some circumstances, the potential for conflict and the appearance of conflict may, without more, justify remov[al] ... [of a trustee]."); *In re: Martin,* 817 F.2d 175, 180–81 (1st Cir.1987) (concluding that section 327 addresses the appearance of impropriety, "irrespective of the integrity of person or firm under consideration."); 3 Collier on Bankruptcy (15th ed.) § 327.04[5][a] (noting that the appearance of impropriety may, when combined with a potential conflict, be sufficient for disqualification).

[21] Our discussion of the Rules of Professional Conduct demonstrates that Gilbert also cannot meet the Bankruptcy Code's requirement of disinterestedness contained in section 327(a). Its status as co-counsel with Weitz and its ownership interest in Kenesis represent factors which prevent Gilbert from being completely loyal to Congoleum's interests. We note also in this respect that waivers under § 327(a) are ordinarily not effective. *See In re: Granite Partners LP,* 219 B.R. 22, 34 (Bankr.S.D.N.Y.1998); Collier on Bankruptcy ¶ 328.05[3] (15th ed.).

We conclude that Gilbert's employment in this case was contrary to section 327 of the Bankruptcy Code.

[22] We do not approve of a bankruptcy court applying less than careful scrutiny to pre-petition procedures in pre-packaged plans. The parties here seek the court's *imprimatur* of a reorganization that will free the debtor of all current and future asbestos liability. The legitimacy of such a transaction is dependent on the stature of the court.[19]

***693** In a pre-packaged setting, most of the work on a plan of reorganization that would occur in a "traditional bankruptcy" happens before the debtor files its petition. For a court to approve a pre-packaged plan whose preparation was tainted with overreaching, for example, would be a perversion of the bankruptcy process.

Pre-packaged plans offer a means of expediting the bankruptcy process by doing most of the work in advance of filing. That efficiency, however, must not be obtained at the price of diminishing the integrity of the process. In this case, it was not a proper exercise of the bankruptcy court's discretion to fail to consider and appraise the conduct of the parties and counsel pre-petition.

[23] We observe also that the bankruptcy court has an obligation to prevent unnecessary expenditures in the administration of an estate. *See In re: Busy Beaver Bldg. Ctrs., Inc.,* 19 F.3d 833 (3d Cir.1994) (holding that the bankruptcy court has authority to examine counsel fees *sua sponte*). Even if it be assumed that Gilbert's representation of Congoleum post-petition was exclusively related to its forthcoming disputes with the insurers, it is not clear on this record why it was necessary to appoint an additional firm to handle insurance issues. The Dughi firm had represented Congoleum for more than ten years in insurance matters and had been actively engaged in the state court coverage action since 2001. The record fails to reveal what special competence in the insurance field Gilbert would provide in addition to that of the Dughi firm.

The flood of asbestos litigation has been a serious problem for the courts of this country because the large number of claims are not easily adaptable to traditional common law procedures. *See Amchem Products v. Windsor,* 521 U.S. 591, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997); *Combustion Engineering,* 391 F.3d at 200. Congress has provided for the use of a trust and channeling injunction as a possible solution, but it appears that the proposals for implementation of an administrative system somewhat similar to that used in black lung claims are more promising.

As this case demonstrates, leaving the procedures for allocation of resources predominantly in the hands of private, conflicting interests has led to problems of fair and equal resolution. The need for counsel with undivided loyalties is more pressing in cases of this nature than in more familiar conventional litigation. Correspondingly, the level of court supervision must be of a high order.

Many of the issues are similar to those that arise in class actions for personal injuries. *In re: Community Bank of Northern Virginia,* 418 F.3d 277 (3d Cir.2005), we commented that "in class actions, particularly settlement-only suits, the district court has a duty 'to protect the members of the class ... from lawyers for the class who may, in derogation of their professional and fiduciary obligations, place their pecuniary self-interest ahead of that of the class.' " *Id.* at 318 (quoting ***694** *Reynolds v. Beneficial Nat'l Bank,* 288 F.3d 277, 279 (7th Cir.2002)). We need make no finding that this has occurred in the case before us, but we caution that here, as in situations of settlement-only class litigation, "careful and comprehensive scrutiny is required."

We recognize that ordinarily a remand to the District and Bankruptcy courts would be in order for further findings

and appropriate action. However, here the record contains sufficient evidence that we may expedite the procedures. Therefore, we will reverse the order approving the retention of the Gilbert firm and remand to the District Court for further proceedings consistent with this Opinion.

Parallel Citations

45 Bankr.Ct.Dec. 122, Bankr. L. Rep. P 80,371

Footnotes

1 *Congoleum Corporation v. Ace American Ins. Co., et al.,* Superior Court of New Jersey, Law Division, Middlesex County, Docket No. MID–L 8908–01.

2 We take judicial notice of the state court proceedings insofar as they are relevant here. *See Furnari v. Warden, Allenwood Federal Correctional Inst.,* 218 F.3d 250, 255 (3d Cir.2000); *In re Indian Palms Assocs., Ltd.,* 61 F.3d 197, 205 (3d Cir.1995) (concluding that judicial notice can be taken of certain facts such as that a document was filed, a position taken, an admission or allegation made "as long as it is not unfair to a party to do so and does not undermine the trial court's factfinding authority.").

3 Congoleum Corporation, Congoleum Sales, Inc. and Congoleum Fiscal, Inc. filed for bankruptcy. We will refer to those entities as "Congoleum."

4 Pre-packaged bankruptcies employing a channeling injunction are not eligible for the "cram down" provision contained in 11 U.S.C. § 1129(b)(1) which allows the bankruptcy court to confirm a plan of reorganization over creditors' objections in certain circumstances.

5 11 U.S.C.A. § 524(g) provides for the bankruptcy channeling injunction and subsection (2)(B) contains the requirements for the injunction; it requires that—

(i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—

(I) is to assume the liabilities of a debtor ...;

(II) is to be funded in *whole or in part by the securities of 1 or more debtors* involved in such plan and by the obligation of such debtor or debtors to make future payments, including dividends;

(III) is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of—

(aa) each such debtor;

(bb) the parent corporation of each such debtor; or

(cc) a subsidiary of each such debtor that is also a debtor; and

(IV) is to use its assets or income to pay claims and demands; ...

11 U.S.C.A. § 524(g)(emphasis added).

6 Perry Weitz is a partner in the law firm of Weitz & Luxenberg, P.C. Joseph Rice is a partner in the law firm of Motley Rice, LLC. Those two firms represent hundreds of thousands of asbestos claimants. Weitz and Rice executed the Claimant Agreement as representatives of participating asbestos claimants.

7 The settlement amounts were assigned as follows:

(1) mesothelioma—$100,000;
(2) lung cancer—$30,000;
(3) other cancers—$10,000;
(4) Level II non-malignant disease—$3,000; and
(5) Level I—nonmalignant disease—$1,000.

8 Perry Weitz's suggestion that Congoleum contact Gilbert occurred in the midst of negotiations of claims against Congoleum by two individuals suffering from mesothelioma, Messrs. Cook and Arseneault.

9 No party has raised objections to the fees of $2 million payable to Gilbert and the $1 million each payable to Weitz and Rice. That matter is not before us and we do not rule on it at this point.

In *In re: Combustion Engineering,* 295 B.R. 459 (Bankr.D.Del.2003) (vacated on other grounds, 391 F.3d 190 (3d Cir.2004)), a pre-packaged asbestos bankruptcy case, Joseph Rice sought a $20 million fee for his pre-petition work. That fee was to be paid by a corporation affiliated with the debtor, but was disallowed by the bankruptcy judge because Rice had a conflict of interest.

In *In re Pittsburgh Corning,* 308 B.R. 716 (Bankr.W.D.Pa.2004), the bankruptcy court refused to allow a fee of $30 million to be received by Gilbert in representing the asbestos claimants' committee. The judge found Gilbert had a conflict of interest in

that pre-package asbestos proceeding.

10 *In re: Marvel Entertainment Group,* 140 F.3d 463 (3d Cir.1998).

11 Kenesis subcontracted its work to The Clearinghouse LLC, an organization owned by an individual who was on leave of absence from a position as a paralegal at Joseph Rice's law firm. Kenesis purchased The Clearing House before beginning claims review work for Congoleum.

12 Rule 1.7 of the New Jersey Rules of Professional Conduct was revised in November 2003 and the new rule became effective on January 1, 2004. The previous version of Rule 1.7 did not address situations where a lawyer's responsibilities to former clients impaired the current representation and it did not use the "significant risk language"; instead it mentioned situations where the representation of a client "may be materially limited" by a lawyer's other responsibilities. These changes do not affect our disposition of the case because Gilbert would have been acting under a concurrent conflict under either version of the rule.

13 Section 327(a) states:

> "Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title."

11 U.S.C.A. § 327(a). Section 327(e) addresses professionals employed for a "specified special purpose" and provides that

> "The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed."

11 U.S.C.A. § 327(e).
Section 327 applies to a debtor in possession as well as a trustee. *United States Trustee v. Price Waterhouse,* 19 F.3d 138 (3d Cir.1994).

14 It appears that Gilbert acted as co-counsel with Weitz for these two individuals in their claims against another bankrupt asbestos company.

15 We note a striking disparity between the combined settlement of $16 million, which included fully secured assignments of insurance proceeds Messrs. Cook and Arseneault received, and the partially unsecured $100,000 settlement that others with mesothelioma claims would receive under the settlement agreement's disease matrix.

16 In a deposition in the New Jersey coverage action, Scott Gilbert, a partner in Gilbert, was asked if any of the claimants he represented as co-counsel with Weitz in the Robert A. Keasbey case were also suing Congoleum. Scott Gilbert replied that he was unsure how many claimants overlapped and had never attempted to determine if there was an overlap. In subsequent deposition testimony he would only "assume" that Gilbert represented clients in other bankruptcies that had claims against Congoleum, including Messrs. Cook and Arseneault.

17 In a subsequent proceeding, the insurers challenged Rice & Weitz's failure to disclose any type of co-counsel, consultant or fee sharing relationships as required by Bankruptcy Rule 20019. The bankruptcy judge directed Weitz, Rice and others to comply and commented that many of the creditors "have never seen a copy of the disclosure statement and, for all the court knows, have absolutely no idea how their claim will be treated under the plan." *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Committee [Congoleum],* 321 B.R. 147 (D.N.J.2005).

18 On May 13, 2005, the state judge in the New Jersey coverage action heard oral argument on a motion to disqualify Gilbert as counsel for Congoleum in that action. The court concluded it would "reluctantly deny the insurance companies' motion to disqualify GHR as Congoleum's attorney." The judge stated that he might have reached a different result if he had received the motion to disqualify earlier in the proceedings. The court also noted, in support of its decision not to grant the motion to disqualify, that the Bankruptcy and District Courts in this proceeding had previously denied similar motions as to Gilbert's alleged conflicts of interest.

19 In *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Committee [Congoleum],* 321 B.R. 147 n. 17 (D.N.J.2005), a proceeding in the Congoleum case subsequent to this one, both courts agreed that pre-petition relationships were relevant. "The totality of the facts before the bankruptcy court suggest the opportunity for abuse of fee sharing relationships, involving attorneys in connection with the pre-petition process, to the end of conferring preferential security interests on appellant's clients."
See also S. Elizabeth Gibson, Fed. Judicial Ctr., *Judicial Management of Mass Tort Bankruptcy Cases* 122 (2005). ("A judge

presented with a prepackaged mass tort plan needs to be fully informed about the circumstances surrounding the prepetition negotiations in order to determine whether the process has been tainted by conflicts of interest or self-interested actions by the participants.").

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462 B.R. 514
United States District Court,
E.D. Pennsylvania.

In re THE HARRIS AGENCY, LLC, Debtors.
Paul J. Winterhalter, P.C., Appellant,
v.
Office of the United States Trustee, et al.,
Appellees.

Bankruptcy No. 09–10384. | Civil Action No. 11–4525. | Nov. 17, 2011.

Synopsis
Background: Law firm that had represented Chapter 11 debtor applied for allowance of fees. United States Trustee (UST) objected. The United States Bankruptcy Court for the Eastern District of Pennsylvania, 451 B.R. 378, disqualified law firm as counsel to debtor as of specified date, partially disallowed fees and expenses sought, and mandated disgorgement of fees received in excess of allowable amount. Law firm appealed.

Holdings: The District Court, Anita B. Brody, J., held that:

[1] law firm had actual conflict of interest requiring its disqualification;

[2] denying law firm reimbursement of expenses and compensation for services rendered after its disqualification was not abuse of discretion;

[3] neither res judicata nor collateral estoppel applied to bar bankruptcy court from entering second disqualification order against law firm;

[4] law of the case doctrine did not apply to bar bankruptcy court from entering second disqualification order that disqualified law firm as of earlier date than first order; and

[5] actual conflict of interest underlying disqualification provided basis for order requiring law firm's disgorgement of fees received from third parties.

Affirmed.

West Headnotes (24)

[1] **Bankruptcy**
Discretion

Bankruptcy court's decision to disqualify counsel and to order disgorgement of attorney fees is reviewed for abuse of discretion.

Cases that cite this headnote

[2] **Bankruptcy**
Discretion

Bankruptcy court's decision regarding fee awards is reviewed for an abuse of discretion.

Cases that cite this headnote

[3] **Bankruptcy**
Discretion

"Abuse of discretion" exists where court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact.

Cases that cite this headnote

[4] **Bankruptcy**
Attorneys
Bankruptcy
Necessity of Appointment or Approval

Debtor-in-possession may, with bankruptcy court approval, employ one or more attorneys to represent it and to assist it in fulfilling its duties. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[5] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Power of debtor-in-possession to employ professionals is the same as that of a trustee, and is specified by statute. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[6] **Attorney and Client**
Bankruptcy

Bankruptcy statute's two prohibitions on employment of counsel set forth two separate standards for counsel's disqualification, the first prohibiting employment of attorneys holding or representing any "interest adverse to the estate," and the second prohibiting employment of attorneys who are not disinterested. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[7] **Attorney and Client**
Bankruptcy

To be employed as debtor's counsel, professional may not have any conflict of interest with bankruptcy estate, whereas conflict of interest with creditors must be material to preclude representation. 11 U.S.C.A. §§ 101(14)(C), 327(a).

Cases that cite this headnote

[8] **Attorney and Client**
Bankruptcy

Although bankruptcy court may initially authorize debtor's employment of counsel, it must disqualify counsel upon learning of an actual conflict of interest, and it may exercise its discretion to remove counsel if there is a potential conflict of interest. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[9] **Attorney and Client**
Bankruptcy

Law firm had actual conflict of interest requiring its disqualification from representation of Chapter 11 debtor-limited liability company (LLC) as of the date on which it entered its appearance as counsel for another, related LLC which had lent money to debtor prepetition, was co-obligor with debtor on loan underlying litigation in which firm represented it, and was owned by same principals as debtor, which no longer had same interests as principals once it became debtor-in-possession. 11 U.S.C.A. § 327(a).

1 Cases that cite this headnote

[10] **Bankruptcy**
Debtor in possession, in general

Debtor-in-possession owes the same fiduciary obligation to creditors and shareholders as would trustee for debtor out-of-possession.

1 Cases that cite this headnote

[11] **Bankruptcy**
Debtor in possession, in general

Among the fiduciary obligations of a debtor-in-possession is the duty to protect and conserve property in its possession for the

benefit of creditors.

1 Cases that cite this headnote

[12] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Conflict of interest is "actual conflict of interest," and hence per se disqualifying, if it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[13] **Bankruptcy**
Conflict of interest

Denying law firm that had represented Chapter 11 debtor-in-possession reimbursement of expenses incurred and compensation for services rendered after firm's disqualification, due to actual conflict of interest, was not abuse of discretion. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[14] **Bankruptcy**
Disclosure requirements

Duty of debtor's counsel, under bankruptcy rule, to disclose any connections with debtor, creditors, and other parties in interest continues throughout attorney's representation of debtor, and requires spontaneous, timely, and complete disclosure. Fed.Rules Bankr.Proc.Rule 2014, 11 U.S.C.A.

Cases that cite this headnote

[15] **Bankruptcy**
Disclosure requirements

Law firm that represented Chapter 11 debtor-in-possession violated bankruptcy rule imposing ongoing duty on debtor's counsel to disclose any connections with debtor, creditors, and other parties in interest by failing to disclose its representation of related limited liability company (LLC) that was both creditor and co-obligor of debtor. 11 U.S.C.A. § 327(a); Fed.Rules Bankr.Proc.Rule 2014, 11 U.S.C.A.

Cases that cite this headnote

[16] **Judgment**
Nature and requisites of former recovery as bar in general
Judgment
Nature and requisites of former adjudication as ground of estoppel in general

Both res judicata and collateral estoppel only apply to re-litigation of issues or claims decided in a prior case.

Cases that cite this headnote

[17] **Judgment**
Nature and requisites of former recovery as bar in general
Judgment
Nature and requisites of former adjudication as ground of estoppel in general

Both of bankruptcy court's orders disqualifying law firm from representing Chapter 11 debtor were part of same litigation, and therefore neither res judicata nor collateral estoppel applied to bar bankruptcy court from entering second order imposing disqualification as of earlier date than prior order.

Cases that cite this headnote

Cases that cite this headnote

[18] **Courts**
Previous Decisions in Same Case as Law of the Case

Law of the case doctrine is concerned with the extent to which the law applied in decisions at various stages of the same litigation becomes the governing legal precept in later stages.

Cases that cite this headnote

[19] **Courts**
Other particular matters, rulings relating to

Evidence that law firm representing Chapter 11 debtor also was representing related limited liability company (LLC) in litigation concerning loan for which LLC and debtor were co-obligors, which did not become available to bankruptcy court until after it entered its first order disqualifying law firm from representing debtor as of date of that order, differed materially from evidence that formed basis of first order, which resulted from law firm's representation of yet another related entity, and drastically undermined court's decision to allow law firm to represent debtor until date of first order, and therefore law of the case doctrine did not apply to bar bankruptcy court from entering second disqualification order that disqualified law firm as of earlier date, based on its representation of LLC.

Cases that cite this headnote

[20] **Courts**
Previous Decisions in Same Case as Law of the Case

The "law of the case" doctrine directs courts to refrain from re-deciding issues that were resolved earlier in the litigation.

Cases that cite this headnote

[21] **Courts**
Previous Decisions in Same Case as Law of the Case

Rather than limit a federal court's power, the law of the case directs its exercise of discretion.

Cases that cite this headnote

[22] **Courts**
Previous Decisions in Same Case as Law of the Case

Availability of new evidence serves as one exception to the law of the case doctrine that warrants reconsideration of issue decided at earlier stage of same litigation.

Cases that cite this headnote

[23] **Courts**
Previous Decisions in Same Case as Law of the Case

To warrant reconsideration of issue decided at earlier stage of same litigation, as exception to law of the case doctrine, new evidence must materially differ from the evidence initially presented, and it must undermine support for the initial decision on the issue.

Cases that cite this headnote

[24] **Bankruptcy**
Conflict of interest

Actual conflict of interest that arose when law firm representing Chapter 11 debtor entered its

appearance as counsel for related limited liability company (LLC) in district court litigation concerning loan on which debtor and LLC were co-obligors provided basis for bankruptcy court's order requiring law firm to disgorge all fees received from third parties for services rendered after its disqualification as debtor's counsel. 11 U.S.C.A. § 329(b).

Cases that cite this headnote

Attorneys and Law Firms

***517** Paul J. Winterhalter, Philadelphia, PA, for Appellant.

The Harris Agency, LLC, Plymouth Meeting, PA, Corinne M. Samler, Paul J. Winterhalter, Paul J. Winterhalter PC, Philadelphia, PA, for The Harris Agency, LLC.

Frederic J. Baker, Office of the U.S. Trustee, Philadelphia, PA, George M. Conway, Office of the U.S. Trustee, Philadelphia, PA.

R. Todd Neilson, trustee, Los Angeles, CA, Bradford J. Sandler, Pachulski Stangziehl & Jones LLP, Wilmington, DE, for R. Todd Neilson.

MEMORANDUM

ANITA B. BRODY, District Judge.

Appellant Paul J. Winterhalter, P.C. appeals the final order of the United States Bankruptcy Court for the Eastern District of Pennsylvania disqualifying Appellant as counsel to the Debtor, The Harris Agency, LLC, as of March 10, 2009, partially disallowing fees and expenses sought by Appellant, and mandating disgorgement of fees received in excess of the allowable amount. I exercise jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a)(1). For the reasons set forth below, I will affirm the bankruptcy court's order.

I. BACKGROUND

A. History of the Debtor and Its Affiliates

The Harris Agency, LLC ("Harris" or "Debtor") is an insurance company that was formed on July 1, 2005 by Nevada Investment Partners, LLC ("NIP"). The membership interests in NIP are held by Eric K. Bossard, Randall Siko, Debra Agnew, and Fred Milbert (collectively, the "Principals"). These individuals, or most of them, have also formed the following entities that are related to the Debtor: Alliance Insurance Services, LLC ("Alliance"), Archway Insurance Services, LLC ("Archway"), and Union One Insurance Group, LLC ("Union One").[1]

In 2007, NIP negotiated a deal to purchase for Harris a book of business from Brown & Brown Insurance of Nevada, Inc. ("Brown & Brown"). NIP agreed to pay Brown & Brown $5,250,000 for the book of business, with half of the purchase price due upon signing the agreement, 25% due on January 23, 2008, and the final 25% due on July 23, 2008.

To make the first payment for the book of business, the Debtor, NIP, and Union One borrowed approximately $2.9 million on a secured basis. To make the second payment, Archway lent the Debtor and NIP approximately $1.3 million. The Debtor was unable to make the third payment to Brown & Brown because the volume of business was lower than expected.

During this time period, Alliance also lent the Debtor approximately $445,000 to help the Debtor cope with diminished cash flow and the need to maintain operating expenses. Additionally, Union One lent the Debtor approximately $180,000 for the same reason.

On December 3, 2008, Brown & Brown recorded a judgment against Harris in Nevada. This judgment precipitated Harris to file a Chapter 11 petition for bankruptcy on January 20, 2009.

518** ***B. The Appointment of Paul J. Winterhalter, P.C.

The same day that Harris filed a petition for bankruptcy, Paul J. Winterhalter, P.C. ("Winterhalter" or the "Firm") filed an Application for Employment of Counsel ("Application for Employment") pursuant to 11 U.S.C. § 327. Along with the application, a Verified Statement of Counsel in Support of Application to Employ Counsel for Debtor was submitted pursuant to Bankruptcy Rule 2014. The verified statement from Winterhalter stated that the Firm did not have "any connection with any party in interest," and that it did not "represent[ ] an interest

adverse to the Debtor herein or this Estate....” R. 9.

The bankruptcy court conditionally approved the Firm’s Application for Employment. Following this order, Winterhalter filed a Disclosure of Compensation pursuant to 11 U.S.C. § 329(a) and Bankruptcy Rule 2016(b). This disclosure revealed that the Firm had agreed to accept $50,000 for legal representation of the Debtor, and that it had already received a $23,200 retainer paid by Harris and Alliance. Furthermore, the disclosure noted that Alliance or its affiliates would be the source of future compensation.

C. The Bankruptcy Court’s First Disqualification Order

On January 7, 2010, Winterhalter filed its first interim application for compensation and reimbursement of expenses. In this application, the Firm sought payment for $113,515.75 in fees and $2,636.92 in expenses for the time period of January 20, 2009 through December 31, 2009. In response, Frederick Milbert and the United States Trustee (the “UST”) objected to the fee application because Winterhalter had failed to disclose post-petition payments from third parties. Following these objections, Winterhalter filed an amended verified statement that disclosed, for the first time, that Winterhalter had received periodic payments since the commencement of the bankruptcy case totaling $77, 893.11 from Archway and Alliance. Specifically, the Firm received $40,393.11 from Archway, and $37,500 from Alliance. In light of the amended verified statement, the UST filed a motion requesting disqualification of Winterhalter and seeking disgorgement of the Firm’s fees.

On March 10, 2010, the bankruptcy court held a hearing on the first interim fee application and the motion to disqualify. At the hearing, it was revealed, for the first time, that the Debtor owed Archway approximately $1.3 million for a pre-petition loan. Additionally, a manager of both Archway and Alliance testified that the “family of companies”—Archway, Alliance, and Union One—had agreed to pay the Firm’s legal fees for representing the Debtor. Furthermore, the manager testified that it was understood that the Debtor would repay Archway and Alliance for any payments they made to Winterhalter.

On May 10, 2010, the bankruptcy court issued an order immediately disqualifying Winterhalter from any further representation of the Debtor due to an actual conflict of interest. According to the court:

> Winterhalter’s receipt of payments from Archway created an actual conflict of interest, at least, by the time the Plan was prepared, due to the following: (1) Archway is an unsecured creditor of the Debtor; (2) Archway was a proposed contributor to the Plan and would have been a 50% owner of the reorganized Debtor; (3) Archway is owed approximately $1.3 million by the Debtor on a pre-petition loan; (4) Archway has paid some of Winterhalter’s fees; and (5) Mr. Agnew testified that Archway expected to be reimbursed by the Debtor for any payments made to the Debtor’s counsel.

***519** R. 27, p. 10–11. Despite the UST’s request, the court declined to disqualify Winterhalter from the inception of the case, and did not rule on the Firm’s first interim fee application. No one appealed this disqualification order.

D. The Bankruptcy Court’s Second Disqualification Order

On May 20, 2010, Winterhalter filed a second interim fee application seeking $62,518.50 in fees and $1,383.08 in expenses for the time period of January 1, 2010 through May 10, 2010. Following this, The UST filed objections to both the first and second interim fee applications. A primary reason the UST objected to Winterhalter’s fee requests was the discovery it made in the summer of 2010 that Winterhalter had entered its appearance as counsel for Union One in the United States District Court for the Eastern District of Pennsylvania in the matter of *Kendall State Bank, et al. v. Union One Insurance Group, LLC.* (Civil Case No. 09–494) on March 10, 2009. Winterhalter’s simultaneous representation of Union One and the Debtor troubled the UST because Union One was a co-obligor on the $2.9 million dollar loan that Harris obtained to make the first payment on the book of business, and it was also an unsecured creditor of the Debtor since it had loaned Harris approximately $180,000 prior to its filing for bankruptcy.

The court held hearings on Winterhalter’s fee applications on January 5, 2011 and February 22, 2011. It was confirmed at the hearing that the plaintiffs in the district court case were the Consortium Banks who had acquired the interest in the $2.9 million loan given to the Debtor to make the first payment on the Brown & Brown book of business. This loan had been guaranteed by the Debtor, NIP, and Union One. Because Union One was a co-guarantor of the $2.9 million loan, the Consortium

Banks brought suit against Union One, seeking payment on the loan, as well as an injunction against Union One interfering with or contacting clients of the Debtor.

The hearings and related submissions revealed that, in addition to entering an appearance as counsel for Union One in the district court litigation, Winterhalter had filed a corporate disclosure statement and two joint stipulations for an extension of time to file a responsive pleading to the complaint. Following these actions, the district court placed the case in civil suspense on June 18, 2009, the status in which the case remained until June 10, 2010, a month after the bankruptcy court first disqualified Winterhalter from representing the Debtor. In submissions to the court, Winterhalter explained that it had only done a minimal amount of work for Union One in the district court litigation. Specifically, Winterhalter stated that it had only sought one hour of compensation in its pending fee applications for time spent representing Union One. Additionally, it noted that it had only billed Union One $1,430.00 for work on the matter.

Following the hearings, the court entered a memorandum opinion and an order on June 3, 2011. In its opinion, the court concluded that Winterhalter had an actual conflict of interest as of March 10, 2009, the date it entered an appearance for Union One, a creditor and co-obligor of Harris. According to the court, "Winterhalter's representation of both Union One and the Debtor ... created an actual conflict of interest because it prevented the Firm from having—as it should—an undivided loyalty to Harris and from taking steps that would benefit the Debtor's interests." R. 46, p. 23. The court found that Winterhalter's representation of Union One "was not necessarily in the Debtor's best interest because Harris could actually have benefitted from a successful suit against Union One." R. 46, p. 23. Specifically, the ***520** court found that an injunction against Union One would have been favorable for the Debtor because it was in the Debtor's best interest to maintain its clients without interference from Union One. Additionally, the court noted that if the district court had held Union One liable for the debt as a co-obligor this may have benefitted Harris by giving it another party to negotiate with in establishing a plan besides the lenders. Because of its representation of Union One, the court found that Winterhalter's loyalties were divided between the Debtor's interests, which included the interests of all of its creditors, and the interests of the Debtor's owners. Furthermore, the court concluded that "[t]he fact that the Debtor owes Union One $180,000, combined with the two companies' competing interests over their joint debt, shows not only that Harris Agency and Union One do not have identical interests, but also that the Firm was representing an interest adverse to the Debtor's." R. 46, p. 25. The court also noted that there was "a potential conflict of interest created by the fact that Union One was a creditor of the Debtor," and that this potential conflict "was heightened by Union One's guarantee of Winterhalter's fees while it was employed by the Debtor." R. 46, p. 26.

Ultimately, the court held that Winterhalter's actual conflict of interest necessitated the Firm's disqualification as of March 10, 2009. Additionally, the court held that the Firm's March 10, 2009 disqualification was necessary because Winterhalter had failed, as required by Bankruptcy Rule 2014, to disclose its connections to and representation of Union One.

As a result of this disqualification, the court disallowed Winterhalter from recovering any fees or expenses incurred on or after March 10, 2009. The court held that the total amount allowed for fees through March 9, 2009 was $39,053.25, and the total amount allowed for expenses was $1,293.67. Because Winterhalter had already received payments totaling $77,893.11 from Archway and Alliance, the court ordered disgorgement of $37,546.19. Specifically, the Firm was to return $19,524.02 to Archway and $18,022.17 to Alliance. In addition to the monetary sanction, the court ordered every attorney at the Firm to complete six hours of Pennsylvania continuing legal education.

Although Winterhalter did not appeal the court's first order disqualifying the Firm, Winterhalter decided to appeal the court's second order disqualifying the Firm. Consequently, Winterhalter instituted the present action.

E. Summary of the Key Connections Between the Debtor's Affiliates, the Debtor, and Winterhalter

For ease of reference, the following chart lists the Debtor's affiliates and summarizes their connections to the Debtor and to Winterhalter:

Affiliate	Connections to the Debtor (Harris)	Connections to Winterhalter

Alliance	1) Controlled by several of the same individuals (the Principals) who have membership interests in NIP, the entity that owns the Debtor.	1) Agreed to pay Winterhalter's fees for representing the Debtor. Expected to be reimbursed by the Debtor for any payments made to Winterhalter on the Debtor's behalf.
	2) Lent the Debtor approximately $445,000 in a pre-petition loan to help the Debtor maintain its operations.	2) Post-petition paid Winterhalter $37,500 for representing the Debtor.
Archway	1) Owned by many of the same individuals (the Principals) who have membership interests in NIP, the entity that owns the Debtor.	1) Agreed to pay Winterhalter's fees for representing the Debtor. Expected to be reimbursed by the Debtor for any payments made to Winterhalter on the Debtor's behalf.
	2) Lent the Debtor approximately $1.3 million to make the second payment on the Brown & Brown book of business.	2) Post-petition paid Winterhalter $40,393.11 for representing the Debtor.
	3) In the initial reorganization plan, Archway was a proposed contributor to the Plan and would have been a 50% owner of the reorganized Debtor.	
Union One	1) Owned by the same individuals (the Principals) who have membership interests in NIP, the entity that owns the Debtor.	1) Agreed to pay Winterhalter's fees for representing the Debtor. Expected to be reimbursed by the Debtor for any payments made to Winterhalter on the Debtor's behalf.

2) Lent the Debtor approximately $180,000 in a pre-petition loan to help the Debtor maintain its operations.	2) Winterhalter entered its appearance as counsel to Union One on March 10, 2009 in the United States District Court for the Eastern District of Pennsylvania in the matter of Kendall State Bank, et al. v. Union One Insurance Group, LLC.
3) Along with the Debtor and NIP, Union One guaranteed the approximately $2.9 million loan that the Debtor took to make the first payment on the Brown & Brown book of business.	3) Winterhalter sought one hour of compensation from the Debtor for its representation of Union One in the district court litigation.
	4) Winterhalter billed Union One for $1,430.00 for its representation of Union One in the district court litigation.

***521 II. LEGAL STANDARD**

[1] [2] [3] The "vantage point [of the court of appeals] is identical to that of the district court" when reviewing a decision of the bankruptcy court. *In re BH & P Inc.,* 949 F.2d 1300, 1305–06 (3d Cir.1991). In conducting an appellate review of a bankruptcy court's order, the district court applies a clearly erroneous standard of review to the bankruptcy court's factual findings and a de novo standard of review to its legal conclusions. *In re Siciliano,* 13 F.3d 748, 750 (3d Cir.1994). A bankruptcy court's decision to disqualify counsel and to disgorge attorney's fees is reviewed for abuse of discretion. *Geisenberger v. DeAngelis,* No. 10–1660, 2011 WL 4458779, at *3 (M.D.Pa. Sept. 23, 2011); *see also In re Marvel Entm't Grp., Inc.,* 140 F.3d 463, 470 (3d Cir.1998); *BH & P,* 949 F.2d at 1316–17. Likewise, a bankruptcy court's decision regarding fee awards is reviewed for an abuse of discretion. *Ferrara & Hantman v. Alvarez (In re Engel),* 124 F.3d 567, 571 (3d Cir.1997). "An abuse of discretion exists where the ... court's decision rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application of law to fact." *Int'l Union, UAW v.* ***522** *Mack Trucks, Inc.,* 820 F.2d 91, 95 (3d Cir.1987).

III. DISCUSSION

Winterhalter challenges the bankruptcy court's order on several grounds. First, Winterhalter challenges the Firm's disqualification as of March 10, 2009 by arguing that the simultaneous representation of the Debtor and Union One did not create a conflict of interest. The Firm next argues that even if a conflict of interest existed based on this dual

representation, the bankruptcy court was barred by either res judicata, collateral estoppel, or the law of the case from altering the date of Winterhalter's disqualification, which was previously determined by the court to be May 10, 2010. Lastly, the Firm argues that even if its disqualification as of March 10, 2009 was proper, the court lacked the jurisdiction to mandate disgorgement of fees to entities other than the Debtor.

A. Conflict of Interest

[4] [5] [6] [7] "A debtor in possession ... may, with bankruptcy court approval, employ one or more attorneys to represent it and to assist it in fulfilling its duties." *In re Pillowtex, Inc.,* 304 F.3d 246, 250 (3d Cir.2002) (citing 11 U.S.C. § 327). "[T]he power of a debtor in possession to employ ... professionals is the same as that of a trustee. The extent of this power is specified by Section 327(a)...." *U.S. Trustee v. Price Waterhouse,* 19 F.3d 138, 141 (3d Cir.1994) (citations omitted). Section 327(a) provides that a court may approve the employment of attorneys only if they "do not hold or represent an interest adverse to the estate" and they are "disinterested persons." 11 U.S.C. § 327(a). These two prohibitions on employment set forth two separate standards for disqualification. *Pillowtex,* 304 F.3d at 252 n. 4. The first prohibits attorneys from holding or representing any "interest adverse to the estate." *Id.* The second prohibits attorneys who are not disinterested from providing representation. *Id.* As defined by the Bankruptcy Code, attorneys are disinterested if they "do[ ] not have an interest materially adverse to the interest of ... any class of creditors or equity holders...." 11 U.S.C. § 101(14)(C); *see Pillowtex,* 304 F.3d at 252 n. 4. "Thus, a professional may not have *any* conflict with the estate, while a conflict with creditors must be 'material.' " *Pillowtex,* 304 F.3d at 252 n. 4.

[8] The Court of Appeals for the Third Circuit has interpreted § 327(a) "to impose[ ] a per se disqualification ... of any attorney who has an actual conflict of interest"; to permit a court to exercise "its discretion ... [to] disqualify an attorney who has a potential conflict of interest"; and to forbid a court from "disqualify[ing] an attorney on the appearance of conflict alone." *Marvel,* 140 F.3d at 476. While the term "actual conflict of interest" has not been defined in the Code, the Court of Appeals for the Third Circuit has explained that "a conflict is actual, and hence per se disqualifying, if it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest." *Pillowtex,* 304 F.3d at 251. "Courts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists in light of the particular facts of each case." *BH & P,* 949 F.2d at 1315 (internal quotation marks omitted). Although a court may initially authorize the employment of counsel, it must disqualify counsel upon learning of an actual conflict, and it may exercise its discretion to remove counsel if there is a potential conflict. *See id.* at 1314–17.

In addition to disqualifying attorneys who have an actual or potential conflict,

> ***523** [T]he court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 ... if, at any time during such professional person's employment under section 327 ..., 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.

11 U.S.C. § 328(c).

Here, the bankruptcy court determined that Winterhalter had an actual conflict of interest when it entered its appearance as counsel for Union One in *Kendall State Bank, et al. v. Union One Insurance Group, LLC.* because its representation of Union One created an interest adverse to the bankruptcy estate. The Firm makes several flawed arguments as to why its representation of Union One was not an actual conflict. Winterhalter repeatedly states that its representation of Union One does not merit disqualification because there was no material conflict due to the Firm's limited involvement and time spent on the district court litigation. However, this argument misstates the legal standard for disqualification under § 327(a). "[W]hile a conflict with creditors must be 'material,' " "a professional may not have *any* conflict with the estate...." *Pillowtex,* 304 F.3d at 252 n. 4. Thus, Winterhalter's materiality argument is unavailing.

[9] Although Winterhalter acknowledges that the district court litigation "was unquestionably a matter directly related and integral to the Chapter 11 re-organizational process," the Firm argues that because Union One and Harris have "wholly uniform" interests there was no conflict of interest. Appellant's Br. 21. Winterhalter argues that the interests of Union One and Harris are completely uniform because they are owned by the same individuals, they are co-obligors on the $2.9 million loan,

and Union One advanced money pre-petition to Harris to help with operating deficiencies. Rather than establish that Union One and the Debtor have identical interests, these facts actually demonstrate the divergence of interests between the two entities. That Union One lent money to Harris pre-petition makes Union One a creditor of the Debtor, a relationship that § 327 recognizes has the potential to create a conflict of interest. As for their status as co-obligors on the $2.9 million loan, it is this exact reason that the bankruptcy court found Winterhalter's representation of Union One in the district court litigation to present an actual conflict of interest.

In the district court litigation, the Consortium Banks, who held the $2.9 million loan given to the Debtor, sought two things: (1) payment from Union One on the $2.9 million loan; and (2) an injunction against Union One to prevent it from interfering with or contacting Harris's clients. Winterhalter asserts that it was in the best interest of the Debtor for the Firm to represent Union One. However, this makes little sense given that a ruling in favor of the Consortium Banks may have been favorable to the Debtor because it would have provided the Debtor with another related entity to negotiate a plan with, and it would have prevented Union One from taking an asset of the Debtor's—Harris's clients.

[10] [11] Lastly, the identical ownership of Harris and Union One is best understood as one more piece of evidence that an actual conflict of interest did in fact exist. Although the interests of the principals of Union One and Harris certainly may have been aligned, i.e. in their desire to sacrifice Harris to ensure the survival of Union One, once Harris became a debtor in possession it no longer had the same interests as its Principals. This is because ***524** a debtor in possession owes "the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession." *Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 355, 105 S.Ct. 1986, 85 L.Ed.2d 372 (1985). "[A]mong the fiduciary obligations of a debtor-in-possession is the duty to protect and conserve property in its possession for the benefit of creditors." *Marvel,* 140 F.3d at 474 (internal quotation marks omitted). While it may have been in the best interest of the Principals to obtain Harris's clients and to have Harris assume sole responsibility for the loan, this agenda was not in the best interest of Harris, as the debtor in possession, because its goal was to maximize the value of its estate.

[12] [13] [14] [15] Winterhalter argues that there can be no conflict of interest because there is no proof of harm to the Debtor from the Firm's representation of Union One. However, proof of harm is not the test for the existence of a conflict. As the Court of Appeals for the Third Circuit has explained, "a conflict is actual, and hence per se disqualifying, if it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest." *Pillowtex,* 304 F.3d at 251. When Winterhalter began its representation of Union One in the district court litigation, an action directly related to the Debtor's bankruptcy case, it likely placed itself in the position of favoring the interests of the Principals of Union One and Harris over the impermissibly conflicting interests of the Debtor. The bankruptcy court exercised sound discretion when it determined that an actual conflict of interest existed at the point Winterhalter entered its appearance as counsel to Union One in the district court litigation. Therefore, it properly disqualified Winterhalter from representing the Debtor as of March 10, 2009.[2] Additionally, it was well within the bankruptcy court's discretion to deny Winterhalter reimbursement of expenses and compensation for services rendered after the Firm's disqualification.[3]

525 *B. Res Judicata, Collateral Estoppel, and the Law of the Case

[16] [17] Winterhalter argues that even if an actual conflict of interest existed when the Firm entered an appearance as counsel for Union One, the bankruptcy court's order disqualifying the Firm as of May 10, 2010 precluded the court from later disqualifying the Firm as of March 10, 2009. Winterhalter relies on collateral estoppel, res judicata, and the law of the case as the basis for asserting that the May 10, 2010 disqualification order has preclusive effect. However, both res judicata and collateral estoppel only apply to re-litigation of issues or claims decided in a prior case. *See, e.g., Duhaney v. Att'y Gen. of U.S.,* 621 F.3d 340, 347 (3d Cir.2010) ("Res judicata, also known as claim preclusion, bars a party from initiating a second suit against the same adversary based on the same 'cause of action' as the first suit."); *Delaware River Port Auth. v. Fraternal Order of Police,* 290 F.3d 567, 572 (3d Cir.2002) ("Under the doctrine of issue preclusion, a determination by a court of competent jurisdiction on an issue necessary to support its judgment is conclusive in subsequent suits based on a cause of action involving a party or one in privity.... Stated broadly, issue preclusion prevents relitigation of the same issues in a later case."). Therefore, collateral estoppel and res judicata are inapplicable because both of the bankruptcy court's disqualification orders were part of the same litigation.

[18] [19] Unlike collateral estoppel and res judicata, the law of the case doctrine "is concerned with the extent to

which the law applied in decisions at various stages of the same litigation becomes the governing legal precept in later stages." *In re Continental Airlines, Inc.,* 279 F.3d 226, 232–33 (3d Cir.2002). Thus, the law of the case doctrine is the proper framework for analyzing Winterhalter's preclusion argument.

[20] [21] [22] [23] "The law of the case doctrine directs courts to refrain from re-deciding issues that were resolved earlier in the litigation." *Pub. Interest Research Grp. of N.J., Inc. v. Magnesium Elektron, Inc.,* 123 F.3d 111, 116 (3d Cir.1997). The purpose of the doctrine is to promote finality and judicial economy. *Id.* Rather than limit a federal court's power, the law of the case directs its exercise of discretion. *Id.* There are several "extraordinary circumstances" that the Court of Appeals for the Third Circuit has identified as warranting reconsideration of an issue decided at an earlier stage in the same litigation. *Id.* One of those circumstances is the availability of new evidence. *Id.* "This exception to the law of the case doctrine makes sense because when the record contains new evidence, the question has not really been decided earlier and is posed for the first time." *Hamilton v. Leavy,* 322 F.3d 776, 787 (3d Cir.2003) (internal quotation marks omitted). However, for this to be true, the new evidence must materially differ from the evidence initially presented and it must ***526** undermine support for the initial decision on the issue. *Id.*

Winterhalter argues that, under the law of the case doctrine, the bankruptcy court's May 10, 2010 disqualification order should have precluded it from entering the March 10, 2009 disqualification order. In doing so, Winterhalter alleges that the bankruptcy court was fully aware of the Firm's representation of Union One in the district court litigation at the time it decided to disqualify the Firm as of May 10, 2010 because the bankruptcy court had authorized a stipulated agreement in May of 2009 that mentioned the Union One district court litigation. Therefore, Winterhalter posits that the law of the case should prohibit disqualification of the Firm prior to May 10, 2010 because the court was not presented with any new evidence for which to alter its earlier decision.

It is entirely disingenuous of Winterhalter to argue that the bankruptcy court was aware of the Firm's representation of Union One prior to entering its May 10, 2010 disqualification order. While the record supports that the bankruptcy court did authorize a stipulated agreement that mentions the Union One district court litigation, nowhere does that document inform the court that Winterhalter was serving as counsel for Union One in that litigation. Rather, the record clearly demonstrates that the court did not become aware of Winterhalter's simultaneous representation of the Debtor and Union One until after the UST discovered this fact in the summer of 2010.

The court's first disqualification order was based on Winterhalter's impermissible relationship with Archway; whereas, the court's second disqualification order was based on Winterhalter's impermissible relationship with Union One. The evidence of Winterhalter's representation of Union One, which did not become available to the court until after the entry of the May 10, 2010 disqualification order, materially differed from the evidence that formed the basis of the court's first disqualification order and drastically undermined the court's decision to allow Winterhalter to represent the Debtor until May 10, 2010. The newly available evidence of Winterhalter's representation of Union One is an extraordinary circumstance that warranted the bankruptcy court to reconsider its earlier disqualification order. Therefore, the bankruptcy court was not barred by the law of the case from disqualifying Winterhalter as of March 10, 2009.

C. Disgorgement

[24] Lastly, Winterhalter argues that even if the bankruptcy court properly disqualified the Firm as of March 10, 2009, the court lacked jurisdiction to order disgorgement of fees received by Winterhalter from third parties. Although Winterhalter concedes that under 11 U.S.C. § 329(b) the district court had jurisdiction to order disgorgement of unreasonable and excessive fees paid by third parties, the Firm denies that its fees were unreasonable.

Section 329(b) authorizes a bankruptcy court to order the return of attorney's fees to a third party payor "[i]f such compensation exceeds the reasonable value of any such services...." In the context of bankruptcy, the Supreme Court has explained that "[R]easonable compensation for services rendered necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act. Where a claimant, who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation." *Woods v. City Nat. Bank & Trust Co. of Chicago,* 312 U.S. 262, 268, 61 S.Ct. 493, 85 L.Ed. 820 (1941) (citations omitted) (internal ***527** quotation marks omitted). "Although *Woods* was decided under Chapter X of the Bankruptcy Act, many courts still rely on its applicable standard for disallowance and disgorgement of fees in cases involving conflicts of interest by debtors' counsel." *In re McGregory,* 340 B.R. 915, 922 (8th Cir. BAP 2006). In harmony with the Supreme Court's opinion in *Woods,*

several courts have held that a court has discretion under § 329 to order disgorgement of fees when a conflict of interest exists because of its relevancy in determining whether an attorney's fees are unreasonable or excessive. *See In re Wiredyne, Inc.,* 3 F.3d 1125, 1128 (7th Cir.1993) (explaining that, under § 329, "[t]he existence of a conflict of interest is certainly a relevant factor in this analysis and is a justifiable reason to reduce or require disgorgement of attorneys' fees"); *McGregory,* 340 B.R. at 922 ("[U]nder § 329 ... conflicts of interest by a debtor's attorney can, standing alone, justify denial of all fees."); *In re Smith–Canfield,* No. 08–61630–fra13, 2011 WL 1883833, at *8 (Bankr.D.Or. May 17, 2011) (holding that "[i]n making its § 329 determination the court may consider whether the attorney had a conflict of interest when providing services," and ordering an attorney, pursuant to § 329, to disgorge fees because of the existence of a conflict of interest); *In re Vann,* 136 B.R. 863, 871 (Bankr.D.Colo. Feb. 5, 1992) (recognizing that "conflicts of interest, standing alone, could justify the denial of all fees," and holding that the bankruptcy court did not abuse its discretion in ordering disgorgement, pursuant to § 329, because of a law firm's conflict of interest).

Here, the bankruptcy court ordered Winterhalter to return all fees that it incurred after the Firm was disqualified on March 10, 2009. The reason for the court's disqualification of Winterhalter was the existence of an actual conflict of interest that developed when the Firm entered its appearance as counsel for Union One in the district court litigation. Thus, the court did not lack jurisdiction to order Winterhalter to return fees received from third parties because this conflict alone provided the court with a sufficient basis under § 329 to order disgorgement.

IV. CONCLUSION

For the reasons stated above, I will affirm the bankruptcy court's order entered on June 3, 2011.

Parallel Citations

Bankr. L. Rep. P 82,109

Footnotes

1 The same individuals own Union One and NIP, the entity which wholly owns the Debtor.

2 While I find that Winterhalter's representation of Union One in the district court litigation was an actual conflict of interest, I note that even if I were to conclude that this representation only created a potential conflict, it would still have been within the district court's discretion to disqualify the Firm. Additionally, I note that the bankruptcy court also found that even if the firm had not entered an appearance in the district court litigation, its representation of Union One created a potential conflict of interest based on Union One's status as a creditor and its guarantee to pay the fees owed to Winterhalter for the Firm's representation of the Debtor.

3 In addition to finding that Winterhalter's actual conflict of interest necessitated disqualification and denial of compensation, the bankruptcy court also held that the Firm's failure to comply with Bankruptcy Rule 2014 also provided grounds to disqualify and sanction Winterhalter. Attorneys who seek approval by the court to represent a debtor, pursuant to § 327(a), must file an application for employment that complies with the disclosure requirements of Rule 2014. Rule 2014(a) requires that "[t]he application shall state ... to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest," and "shall be accompanied by a verified statement ... setting forth the person's connections with the debtor, creditors, [and] any other party in interest...." The duty to disclose under Rule 2014 continues throughout an attorney's representation of the debtor, and requires "spontaneous, timely, and complete disclosure...." *Rome v. Braunstein,* 19 F.3d 54, 59 (1st Cir.1994). Several Courts have stated that failure to disclose is a sufficient ground to deny compensation, and some have also stated that it merits disqualification. *See, e.g., Kravit, Gass & Weber, S.C. v. Michel (In re Crivello),* 134 F.3d 831, 836 (7th Cir.1998) ("[F]ailure to disclose is sufficient grounds to revoke an employment order and deny compensation."); *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park–Helena Corp.),* 63 F.3d 877, 882 (9th Cir.1995) ("Even a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees."); *Rome,* 19 F.3d at 60 (finding that a failure to disclose provided sufficient ground to deny compensation). Here, Winterhalter violated Rule 2014 when it failed to disclose its representation of Union One. Winterhalter does not appeal the bankruptcy court's decision that it failed to comply with Rule 2014. While this lack of disclosure may independently provide a sufficient ground for the bankruptcy court's decision to disqualify Winterhalter and deny compensation, when considered in combination with Winterhalter's actual conflict of interest, it becomes abundantly clear that the bankruptcy court did not commit an abuse of discretion.

In re The Harris Agency, LLC, 462 B.R. 514 (2011)

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United States Bankruptcy Court, D. Massachusetts, Eastern Division.

In re CHARLES STREET AFRICAN METHODIST EPISCOPAL CHURCH OF BOSTON, Debtor.

No. 12–12292–FJB. | Signed May 9, 2014.

MEMORANDUM OF DECISION ON BIDDING PROCEDURES, BREAK–UP FEE, TIMING OF SALE, AND CONFLICTS

FRANK J. BAILEY, United States Bankruptcy Judge.

***1** The debtor and debtor-in-possession, Charles Street African Methodist Episcopal Church of Boston ("CSAME"), has moved for authority to sell two contiguous parcels, known as the Storefronts and the RRC Property[1] (collectively, the "Assets"), in a private sale and, before a final hearing on the sale, to approve bidding procedures and a break-up fee and to prohibit OneUnited Bank ("OneUnited"), which holds mortgages on the properties in question, from credit bidding at the sale. The motion is before the Court on the bidding procedures/break-up fee/credit bid portion of the sale motion. Three parties have objected. Horizons for Homeless Children, Inc. ("Horizons"), a prospective purchaser who is not the stalking-horse but wishes it were, objects to the break-up fee. OneUnited and the United States Trustee object on the basis that the property has not been adequately marketed, that the sale process is tainted by an appearance of impropriety that needs to be addressed, and that CSAME has not met its burden of demonstrating cause to preclude credit bidding. This memorandum addresses the bidding procedures, break-up fee, timing of sale, and conflict issues; the court will address credit bidding separately.

a. Break–Up Fee

The relevant facts are not in dispute. Horizon is interested in purchasing the properties and conducted its due diligence over a period of months without any reliance on the efforts of the entity whom CSAME selected as its stalking-horse bidder, Action for Boston Community Development, Inc., "ABCD"). In order to get one of these entities to make a binding offer and to maximize the stalking-horse bid, CSAME gave both Horizons, which had previously offered $1.6 million, and ABCD, which had previously offered $1.75 million, a chance to make a bid (subject to later counteroffers), in exchange for which the high bidder would serve as the stalking horse bidder and receive a commitment from CSAME to pay a break-up fee of $50,000. ABCD made the higher bid, for $2,000,000, and thereby became the stalking horse bidder in the present sale motion.

Horizons now says that it is willing to match ABCD's offer and, having come to the process independently of any effort by ABCD, should not be disadvantaged in it by a break-up fee. It also argues that the break-up fee in this instance did not serve to create competitive bidding: Horizons was in fact the first bidder. CSAME responds that the promise of a $50,000 break-up fee was instrumental in obtaining an offer that is both binding and $250,000 richer than the highest earlier bid. OneUnited, which is by far the single most interested creditor, has not objected to the break-up fee; nor has the United States Trustee or any creditor.

The Court will overrule Horizon's objection to the break-up fee on two grounds. First, Horizons offers no basis for standing to object. It has no contractual right to be free of the disadvantage posed by the break-up fee. And, whatever the consequences of the break-up fee for the estate, Horizons is not a creditor and therefore lacks standing to argue that the break-up fee is contrary to the estate's interests. Second, as a bidding incentive, the break-up fee is a defensible exercise of the debtor's business judgment. It is true that the break-up fee did not in this instance serve to bring the initial offeror to the table. At best, it may have incentivized both ABCD and Horizons to maximize their proposed stalking-horse bids. Given that the bids made by both ABCD and New Horizons in their competition for stalking horse status were, in a real sense, only interim offers, subject to a later final round of bidding, it is not clear that the break-up fee generated any benefit at all that would not be realized in the final round. More importantly, however, it is also not clear that the break-up fee will *not* improve the final outcome, both by its effects to date and by its effect on the final round of bidding. In short, I do not have the evidence and confidence necessary to disturb the debtor's business judgment on the subject. Especially where OneUnited has not objected to the break-up fee—one of precious few moves by CSAME of which that is true-I am loathe to disturb it. Accordingly, the Court will approve

the break-up fee.

b. Timing of Sale

***2** CSAME initially sought to complete the sale process by the end of May, 2014. OneUnited and the U.S. Trustee objected to the timeline as too abbreviated to allow sufficient marketing of the Assets, which both contend has thus far been inadequate; both maintain that the deadline of May 30, which is built into the CSAME's stalking horse agreement with ABCD at the latter's insistence, is artificial and not driven by any real need. OneUnited also argues that CSAME should be compelled to investigate, by test marketing, the value that might be obtained for the Assets if they were sold together with a contiguous third parcel, the "Church Building," so called because it is occupied by the church building itself, CSAME's central and most important asset; OneUnited reasons that the Church Building may have to be sold eventually, and the three parcels may be more valuable as a group than they would be separately.

CSAME responded by moving to obtain a broker and obtaining the consent of ABCD to extend the deadline for closing the sale by a month, to the end of June. No further extension is required, CSAME maintains, because at least two parties are interested in purchasing the Assets, and a delay beyond the end of June risks losing one or both of them; and with the loss of even one, the estate would lose a prospect for competitive bidding that it might not enjoy again in any reasonable time. The two existing bidders confirm, credibly, that their interest is time-sensitive. The objecting parties, on the other hand, offer no alternative timeline that comes close to meeting the needs of the present bidders. CSAME also opposes any suggestion that it should research the value of a sale involving the Church Building

For the following reasons, I will approve CSAME's proposal to complete the sale by June 30. First, at present there exist both interest in the Assets and a prospect for competitive bidding. There is no assurance that these conditions will be achieved again in the reasonably near future.

Second, the stalking horse bid is itself within the range of values for the Assets that the Court found in its findings and rulings on confirmation of CSAME's then-pending plan in October 2013. To be sure, those values were based in significant part on values that were stipulated to only for purposes of that confirmation process, but the findings were not based exclusively on the stipulated values. OneUnited contends that values in Boston have increased in the intervening months, but even if this is generally true, it remains wholly speculative to contend that *these particular properties* have increased in value, and it is quite possible—again on the basis of findings made at confirmation—that at least one of these properties is decreasing in value. OneUnited can offer nothing at this juncture to say that the proffered value—which remains subject to a further round of bidding—is inadequate or cause for concern. Although it has urged CSAME to sell these assets, and opposed confirmation of the debtor's first plan because the plan involved retention of these properties, it can offer nothing but belief and speculation that the properties should fetch more than they are likely to in this process—a number it cannot know.

***3** Third, there has been little active marketing to date, but the Assets have enjoyed the benefit of free publicity from press coverage of this bankruptcy case, which brought both ABCD and Horizons to the table. Some further marketing is warranted, and CSAME has agreed to this by agreeing to hire a broker and to extend the sale deadline by a month; but it is likely that the kinds of purchasers whom OneUnited would hope to reach have already noted the availability of these Assets—or would have had they been interested.

Fourth, as OneUnited argued strenuously in the confirmation process and in support of its second motion to dismiss, CSAME and its estate can ill afford the continuing cost of insuring and retaining the Assets. It's high time these Assets were sold.

Fifth, the Court will not compel CSAME to test market the Assets in combination with the Church Building. OneUnited is free to investigate and offer evidence on the subject as cause, in the final analysis, to disallow the sale[2]; I make no ruling on the merits of this defense. In any event, the debtor is free to propose its strategy for reorganization. The Court's role is limited to approving or disapproving, not imposing alternatives. It is certainly not CSAME's obligation in the first instance to delay its sale in order to explore an option that is inconsistent with its purposes in the case, which understandably includes retention of its home and place of worship.

c. Conflict of Interest

In connection with the sale motion, CSAME's counsel in this case, the firm of Ropes & Gray LLP ("R & G"), disclosed certain significant connections it has to the bidders, both ABCD and Horizons (the "Potential Buyers"):

- R & G represents ABCD in ongoing matters unrelated to CSAME and this chapter 11 case; and R

& G also regularly participates as a major donor at certain functions that benefit ABCD. ABCD has agreed to waive any conflict involved in the firm's representation of CSAME in this case with respect to ABCD.

• R & G represents, or has in the last five years represented, certain members of the boards of directors of both Potential Buyers and entities affiliated with certain members of the boards of directors of both Potential Buyers.

• A partner at R & G is a former chairman of ABCD's board of directors, and ABCD's current corporate clerk and a member of ABCD's board of directors. He will not represent the Debtor in this chapter 11 case; and the firm will establish an ethical wall to keep CSAME's information in its files confidential from the partner.

• A partner at R & G is an honorary board member of Horizons. She will not represent CSAME in this chapter 11 case; and the firm will establish an ethical wall to keep CSAME's information in its files confidential from the partner.

R & G maintains, and no one disputes, that these connections to the Potential Buyers had nothing to do with bringing them to this transaction; and no one has alleged that R & G has acted in bad faith or otherwise not in compliance with the Bankruptcy Code. Nonetheless, in order to avoid the appearance and possibility of impropriety, OneUnited urges the following steps—or one or more of them—as necessary to neutralize potential conflicts of interest for the benefit of the estate: an order requiring CSAME to retain special counsel to represent it in conjunction with the sale prohibiting R & G from advising CSAME about the sale; retention of an independent broker or investment banker to market the assets; or expansion of the duties of the already—appointed examiner to include oversight and decisionmaking duties regarding the sale. The U.S. Trustee asks that R & G be required to make fuller disclosure of its connections to the bidders—especially whether in the aggregate these clients represent more than 1 percent of total firm revenues—and, if necessary, withdraw from the sale transaction.

***4** I address these measures in no particular order. The U.S. Trustee's request for further disclosure was warranted when made but, in view of thorough vetting of these issues at the hearing, at which all the relevant parties were represented, no further disclosure is necessary. The request to bring in a broker has been accepted by CSAME, which has already applied to employ one; an investment banker would surely be overkill in a case of this magnitude. The request to expand the examiner's duties is denied insofar as it essentially seeks to vest the examiner with a limited subset of the responsibilities of a trustee. As OneUnited and CSAME earlier agreed, the appointment of a trustee or its equivalent would be inappropriate in this case. It is also unnecessary, where the matter in issue is a simple sale of two parcels for which there is ample oversight by an active secured creditor and the U.S. Trustee. In a perfect world, the hiring of special conflicts counsel to handle the sale as a discreet matter would be appealing, but it is not practical here. R & G is handling this case *pro bono;* the estate cannot afford to hire additional counsel.[3] Also, advice on the sale is not easily separable from advice on CSAME's reorganization as a whole, and the history is long and complexities numerous. Conflicts counsel would face a steep learning curve for a relatively simple issue. The dance of coordination and separation between two sets of counsel would be difficult, the choreography more trouble than this issue is worth. R & G is not representing either bidder in this case and is establishing ethical walls to prevent its connections from influencing this process. Lastly, the "appearance" of impropriety is considerably muted by that fact that Ropes has connections not to a single bidder but to *two competing* bidders, which, if these connections had any influence on the process at all—I find they have not and trust they will not—would be inconsistent with the interests of either bidder but consistent with the maximization of value and the interests of CSAME, the estate, and OneUnited. I see no need for further correctives than those R & G has already undertaken.

d. Other Bidding Procedures

CSAME also seeks approval of a host of other bidding procedures to which no objection has been asserted. The Court takes no issue with these and now approves them. The Court reserves only the credit bidding issue and will address it in a separate memorandum.

e. Conclusion

On or before Monday, May 12, 2014, CSAME shall submit a proposed Bidding Procedures Order consistent with the above rulings, reserving only the credit bidding issue.

Footnotes

1 For consistency, I refer to the properties as they are described in the court's Memorandum of Decision on Confirmation of CSAME's Seventh Modified First Amended Plan of Reorganization [doc. # 667]. The RRC Property includes a parking lot that is part of the sale. The parking lot in question is located on Warren Avenue; it is *not* the parcel identified in the earlier Memorandum of Decision as the "Parking Lot," which is located on Elm Hill Avenue.

2 There has been plenty of time for this to date, but the possibility of selling of three properties as a unit was not even broached as a valuation concern in the confirmation process.

3 Generally, while cost does not merit consideration when evaluating a professional conflict, it is one factor that bears on the totality of the circumstances.

End of Document

464 B.R. 594
United States Bankruptcy Court,
S.D. New York.

In re MF GLOBAL INC., Debtor.

No. 11–2790 (MG) SIPA. | Dec. 27, 2011.

Synopsis

Background: Trustee appointed pursuant to Securities Investor Protection Act (SIPA) for broker-dealer's liquidation applied for order regarding his and his counsel's disinterestedness in connection with objections raised pro se by two of broker-dealer's customers.

[Holding:] The Bankruptcy Court, Martin Glenn, J., held that trustee and his counsel satisfied SIPA's disinterestedness requirements.

Application granted.

West Headnotes (13)

[1] **Securities Regulation**
In general; collection of assets

Bankruptcy Code provision allowing trustee to retain professionals who are disinterested persons does not apply in liquidation under Securities Investor Protection Act (SIPA). 11 U.S.C.A. § 327(a); Securities Investor Protection Act of 1970, § 1 et seq., 15 U.S.C.A. § 78aaa et seq.

Cases that cite this headnote

[2] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Adverse interest to estate potentially precluding person from being "disinterested" under Bankruptcy Code includes any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by Code and bankruptcy rules. 11 U.S.C.A. § 101(14).

Cases that cite this headnote

[3] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Test under Bankruptcy Code for the presence of adverse interests potentially precluding person from being "disinterested" is not retrospective; courts only examine present interests when determining whether a party has an adverse interest. 11 U.S.C.A. § 101(14).

1 Cases that cite this headnote

[4] **Securities Regulation**
Appointment of trustee

In determining whether trustee appointed pursuant to Securities Investor Protection Act (SIPA) or trustee's counsel meet statutory "disinterestedness" requirements, even the appearance of impropriety may merit disqualification. Securities Investor Protection Act of 1970, § 5(b)(6), 15 U.S.C.A. § 78eee(b)(6).

Cases that cite this headnote

[5] **Securities Regulation**
Appointment of trustee

Although procedures contained in provisions of Bankruptcy Code and bankruptcy rules governing disclosure by professionals retained under Code, and requiring disclosure of all

connections with debtor, creditors, any other party in interest, and their respective attorneys and accountants, do not apply to selection of trustee and counsel under Securities Investor Protection Act (SIPA), court's determination of "disinterestedness" of SIPA trustee and counsel requires full disclosure of relevant connections between trustee, trustee's counsel, and other parties in interest. 11 U.S.C.A. §§ 327, 1103, 1114; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.; Securities Investor Protection Act of 1970, § 5(b)(6), 15 U.S.C.A. § 78eee(b)(6).

Cases that cite this headnote

[6] **Securities Regulation**
Appointment of trustee

Paucity of information available to Securities Investor Protection Corporation (SIPC) at the time counsel for trustee is selected under Securities Investor Protection Act (SIPA) does not relieve bankruptcy court of its statutory duty to evaluate disinterestedness of SIPA trustee and counsel. Securities Investor Protection Act of 1970, § 5(b)(3, 6), 15 U.S.C.A. § 78eee(b)(3, 6).

1 Cases that cite this headnote

[7] **Securities Regulation**
Appointment of trustee

Lack of candidness in disclosing potential problems for independent court review before appointment of trustee and counsel pursuant to Securities Investor Protection Act (SIPA) in itself presents appearance of impropriety under SIPA's disinterestedness requirements. Securities Investor Protection Act of 1970, § 5(b)(6), 15 U.S.C.A. § 78eee(b)(6).

1 Cases that cite this headnote

[8] **Securities Regulation**
Appointment of trustee

Disinterestedness required under Securities Investor Protection Act (SIPA) is determined at the time SIPA trustee and trustee's counsel are appointed. Securities Investor Protection Act of 1970, § 5(b)(6), 15 U.S.C.A. § 78eee(b)(6).

1 Cases that cite this headnote

[9] **Securities Regulation**
Appointment of trustee

Although disinterestedness standards of Securities Investor Protection Act (SIPA) and Bankruptcy Code require a materially adverse interest for trustee or trustee's professionals to be disqualified, trustee and trustee's professionals may not usurp court's function in determining whether disinterestedness standards are satisfied by choosing, ipse dixit, which connections impact disinterestedness and which do not. 11 U.S.C.A. §§ 101(14), 327; Securities Investor Protection Act of 1970, § 5(b)(6), 15 U.S.C.A. § 78eee(b)(6).

Cases that cite this headnote

[10] **Securities Regulation**
Appointment of trustee

Trustee appointed under Securities Investor Protection Act (SIPA) and his counsel, which was law firm in which trustee was partner, satisfied SIPA's disinterestedness requirements where disclosures established that outside bank for broker-dealer and its parent company was no longer client of counsel, and that past representation bore no relationship to broker-dealer, and even though potential for conflicts remained, particularly as to broker-dealer's auditor and financial institutions that were counsel's current clients and could possibly be defendants in avoidance actions, risk was too attenuated to require trustee or counsel to step aside or appointment of conflicts counsel or co-trustee, and Securities Investor Protection

Corporation (SIPC), trustee, and counsel had ongoing obligation to disclose additional connections or conflicts of which they became aware. Securities Investor Protection Act of 1970, § 5(b)(3, 6), 15 U.S.C.A. § 78eee(b)(3, 6); N.Y.Rules of Prof.Conduct, Rules 1.7, 1.9(a); Restatement (Third) of Law Governing Lawyers §§ 121, 128.

Cases that cite this headnote

[11] **Trusts**
Collection of Outstanding Property

Ordinarily, a trustee must take reasonable steps to enforce all claims held in trust.

Cases that cite this headnote

[12] **Attorney and Client**
Partners and associates
Attorney and Client
Disqualification proceedings; standing

Generally, attorney's conflicts of interest are ordinarily imputed to his firm based on the presumption that associated attorneys share client confidences.

Cases that cite this headnote

[13] **Attorney and Client**
Disqualification proceedings; standing

There is a presumption that if one attorney has a conflict of interest, then attorney's entire firm has such a conflict, but this presumption may be rebutted if a screen is in place or the conflicted attorney is only partially associated with the firm, such as through "of counsel" status.

Cases that cite this headnote

Attorneys and Law Firms

***596** Hughes Hubbard & Reed LLP, By: Anson Frelinghuysen, Esq., James B. Kobak, Esq., Christopher K. Kiplok, Esq., Jeffrey S. Margolin, Esq., New York, NY, for James W. Giddens, Trustee for the SIPA Liquidation of MF Global Inc.

Robert Martin, Saddle River, NJ, pro se.

Mitch Fine, Emeryville, CA, pro se.

MEMORANDUM OPINION AND ORDER GRANTING TRUSTEE'S APPLICATION FOR ENTRY OF AN ORDER REGARDING DISINTERESTEDNESS OF THE TRUSTEE AND COUNSEL TO THE TRUSTEE

MARTIN GLENN, Bankruptcy Judge.

James W. Giddens ("*Giddens* " or the "*Trustee* "), the liquidation trustee of MF Global Inc. ("*MFGI* "), filed an *Application for Entry of an Order Regarding the Disinterestedness of the Trustee and Counsel to the Trustee* (the "*Application* "). (ECF Doc. # 45.) For the reasons explained below, the Court grants the Application, finding the Trustee and his counsel—the law firm in which he is a partner, Hughes Hubbard & Reed LLC ("*HHR* ")—to be "disinterested" pursuant to the Securities Investor Protection Act of 1970 ("*SIPA* "), as amended, 15 U.S.C. §§ 78eee(b)(3) & 78eee(b)(6)(A) (2006).

BACKGROUND

On October 31, 2011, the Honorable Paul A. Engelmayer of the United States District Court for the Southern District of New York entered an Order Commencing Liquidation of MF Global Inc. pursuant to the provisions of SIPA, 15 U.S.C. §§ 78aaa–78*lll*. *See Sec. Investor Protection Corp. v. MF Global Inc.,* No. 11–CIV–7750, 2011 WL 5142184 (S.D.N.Y. Oct. 31, 2011). That Order (i) appointed Giddens as Trustee for the liquidation of the

business of MFGI pursuant to section 78eee(b)(3) of SIPA, (ii) appointed HHR as counsel to the Trustee pursuant to section 78eee(b)(3) of SIPA, and (iii) removed the case to the bankruptcy court as required by section 78eee(b)(4) of SIPA. *Id.* at 1.[1] ***597** Neither the Trustee nor the Securities Investor Protection Corporation ("*SIPC* ") filed pleadings pertaining to the disinterestedness of the Trustee or his counsel before the district court.

Two *pro* se customers of MFGI (the "*Objectors* ") filed objections in this Court, challenging the disinterestedness of Giddens and HHR, initially based on information contained on HHR's web site stating that HHR represented JP Morgan Chase Bank, N.A. and its affiliates ("*JPMC* ") in other matters, and in a later-filed objection, additionally based on HHR's representation of Pricewaterhouse Coopers LLP ("*PwC* "). (ECF Doc. 202, 414 & 653.)

The disinterestedness of the Trustee and HHR are important requirements under SIPA and the Bankruptcy Code, as well as under applicable rules of professional responsibility. As explained below, the nature and timing of SIPA liquidation proceedings, as well as the lack of access to pertinent information when such proceedings commence, may make it difficult at the outset of the case for a SIPA trustee and counsel to identify and disclose all potential connections that may give rise to disabling conflicts that can defeat the necessary findings of disinterestedness. That is certainly true in a case of this magnitude and complexity. HHR's initial disclosures in support of the Application (ECF Doc. # 45, Ex. A & B), and HHR's supplemental disclosure required by the Court (ECF Doc. # 509), lacked sufficient information for the Court to resolve the important issues raised by the objections. HHR's third disclosure statement (ECF Doc. # 732), however, has remedied those shortcomings. Based upon the record before the Court, the Court concludes that the Trustee and HHR are disinterested within the meaning of SIPA and the Bankruptcy Code, at least insofar as the parties and issues appear in this case at the present time. As SIPC, the Trustee, and HHR have recognized, in the event that additional issues, parties, or potential claims arise that raise conflict issues for the Trustee or HHR, SIPC may need to select conflicts counsel or a co-trustee to handle those specific matters.

Since this SIPA liquidation proceeding began, the Court has approved three transfers of customer property, totaling in excess of $4.2 billion, intended to return as much customer property as possible, as soon as possible, to as many former MFGI customers as possible. (ECF Doc. 14, 316, 717 & 718.) The Trustee has reported an apparent shortfall of customer property that, while still subject to uncertainty, is currently estimated at $1.2 billion. Once completed, the three transfers approved by the Court are intended to return approximately 72% of each customer's property that should have been, but apparently was not, maintained in segregated accounts with MFGI. Efforts by the Trustee and others to locate and recover missing property continue unabated. The Court has also approved the claims procedures, designed to determine the amounts and priorities of customers' claims and, hopefully, to approve further distributions of funds to customers. (ECF Doc. # 423.)

The Trustee has acknowledged that he may need to bring legal action to recover missing funds or seek recovery of damages. The Objectors focus on the Trustee's ability to bring such actions, arguing that disabling conflicts prevent him from ***598** doing so, particularly as to JPMC and PwC. JPMC was the one of the principal outside banks for MFGI and its parent company, MF Global Holdings Ltd. ("*MFGHL* "); PwC has been the outside auditor for the MF Global entities. While no allegations of wrongdoing have been made against JPMC and PwC, numerous news stories and some Congressional testimony have raised questions about transfers of funds or property from MFGHL or MFGI to JPMC in the days before the company's collapse.[2] The Trustee's counsel has said the Trustee will examine the transactions.[3] Questions have not been raised at this point about PwC, but the conduct of auditors is frequently a subject for inquiry. The Objectors challenge Giddens' and HHR's ability to be adverse to JPMC or PwC.

Because HHR has represented JPMC and PwC, the Objectors argue that the Trustee and his counsel are not "disinterested" as defined by the section § 78eee(b)(6) of SIPA. Therefore, the Objectors assert, the Trustee and HHR are prohibited from serving as Trustee and counsel under SIPA and the Bankruptcy Code.

The Court held oral argument regarding the Application on November 22, 2011, after which the Court ordered the Trustee and his counsel to provide supplemental disclosure to the Court, specifically addressing the issues raised in the objections. On November 29, 2011, the Trustee filed a *Supplemental Declaration of James B. Kobak, Jr. Regarding Disinterestedness* ("*Supplemental Declaration* "). (ECF Doc. # 509.) One of the Objectors filed a response to the Supplemental Declaration. (ECF Doc. # 653.) On December 7, 2011, after finding both attempts at disclosure by the Trustee and his counsel "sparse," the Court ordered the Trustee, his counsel, and, to the extent necessary, SIPC, to make further disclosures to the Court, specifically addressing questions of law and

fact pertaining to the Trustee's and HHR's current and former representation of clients who are also creditors of MFGI. (ECF Doc. # 660.) On December 12, 2011, the Trustee and his counsel filed a corrected *Statement in Further Support of Disinterestedness and In Response to Court Order Dated December 7, 2011* ("*Third Disclosure Statement* "), (ECF Doc. # 732), with an accompanying *Declaration of James Kobak, Jr.* ("*Third Kobak Declaration* ") (ECF Doc. # 728). SIPC also filed a *Memorandum of the Securities Investor Protection Corporation in Response to the Court's Order Directing Trustee To File Further Disclosures Regarding Disinterestedness* (the "*SIPC Memorandum* "). (ECF Doc. # 721).

DISCUSSION

In a liquidation of a broker-dealer under SIPA, SIPA operates in conjunction with the Bankruptcy Code and the Federal ***599** Rules of Bankruptcy Procedure. *See* 15 U.S.C. § 78fff(b) ("[T]o the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3 and 5 of subchapters I and II of chapter 7 of title 11."). The Application asks the Court to enter an order finding the Trustee and his counsel "disinterested" within the meaning of section 78eee(b)(6) of SIPA, as the statute specifies that "no person may be appointed to serve as trustee or attorney for the trustee [in a liquidation under SIPA] if such person is not disinterested." *See id.* § 78eee(b)(3).

A. Disinterestedness Standard

Under SIPA, a person is not disinterested if

> (i) such person is a creditor (including a customer), stockholder, or partner of the debtor;
>
> (ii) such person is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the filing date was the underwriter of any securities of the debtor;
>
> (iii) such person is, or was within two years prior to the filing date, a director, partner, officer, or employee of the debtor or such an underwriter, or an attorney for the debtor or such an underwriter; or
>
> (iv) it appears that such person has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such an underwriter, or for any other reason, an interest materially adverse to the interests of any class of creditors (including customers) or stockholders,
>
> except that SIPC shall in all cases be deemed disinterested, and an employee of SIPC shall be deemed disinterested if such employee would, except for his association with SIPC, meet the standards set forth in this subparagraph.

Id. § 78eee(b)(6)(A).

SIPA does not define "disinterested"; however, the legislative history of SIPA clearly indicates congressional intent for courts to apply the same meaning as the same term is given in the Bankruptcy Code. *See* H.R. REP. No. 91–1613, at 20 (1970), *reprinted in* 1970 U.S.C.C.A.N. 5254, 5274 ("[T]he court would be authorized to appoint as trustee for liquidation of the [broker-dealer], such persons as SIPC would specify. However, such persons would have to be 'disinterested persons' within the meaning of section 158 of the Bankruptcy Act.").[4]

The Bankruptcy Code defines "disinterested person" as a person that

> ***600** (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14).

[1] [2] [3] That definition of "disinterested person" under section 101(14) "overlaps with the adverse interest requirement of section 327(a), creating a single test for courts to employ when examining conflicts of interest." *In re Project Orange Assocs., LLC,* 431 B.R. 363, 370 (Bankr.S.D.N.Y.2010) (citing section 101(14)(C)); *see also In re Granite Partners, L.P.,* 219 B.R. 22, 23 (Bankr.S.D.N.Y.1998).[5] Although undefined by the Bankruptcy Code, courts have defined "adverse interest" as

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate

or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

Bank Brussels Lambert v. Coan (In re AroChem Corp.), 176 F.3d 610, 623 (2d Cir.1999) (quoting *In re Roberts,* 46 B.R. 815, 827 (Bankr.D.Utah 1985), *aff'd in part and rev'd in part on other grounds,* 75 B.R. 402 (D.Utah 1987)); *see also Kravit, Gass & Weber, S.C. v. Michel (In re Crivello),* 134 F.3d 831, 835–36 (7th Cir.1998). "More generally, it includes any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules." *In re Granite Partners, L.P.,* 219 B.R. at 33 (internal quotations and citations omitted). Although courts have distinguished between actual and potential conflicts, "a more recent trend elides the distinction and focuses on the concerns of divided loyalties and affected judgments." *Id.* Importantly, however, "[t]he test [for the presence of adverse interests] is not retrospective; courts only examine present interests when determining whether a party has an adverse interest." *In re Project Orange Assocs., LLC,* 431 B.R. at 370.[6]

[4] In construing the disinterestedness standard, bankruptcy courts have held ***601** trustees and their retained professionals to a rigorous standard. *See, e.g., In re Allegheny Int'l, Inc.,* 117 B.R. 171, 178–79 (W.D.Pa.1990); *In re Realty Assocs. Sec. Corp.,* 56 F.Supp. 1007, 1007 (D.C.N.Y.1944) ("The trustee must be divested of any scintilla of personal interest which might be reflected in his decision concerning estate matters."). Likewise, in SIPA liquidations, "courts take a strict view of the disinterestedness standard under SIPA." *Intercontinental Enters., Inc. v. Keller (In re Blinder, Robinson & Co.),* 131 B.R. 872, 878 (D.Colo.1991). Because of the "orient[ation] toward the protection of the customer of the broker or dealer" particular to SIPA liquidations, *see SEC v. Schreiber Bosse & Co.,* 368 F.Supp. 24, 27 (N.D.Ohio 1973),[7] "it is not sufficient that the trustee and his counsel actually be disinterested; the appearance of disinterestedness must also be avoided...." *In re Perry, Adams & Lewis Sec., Inc.,* 5 B.R. 63, 64 (Bankr.W.D.Mo.1980). Indeed, "[i]t becomes the duty of the trustee and of his attorneys not only to be impartial and free from the influence of any [other party], but the other [parties] must have faith and confidence in their impartiality and independence." *Id.* "[U]nder the case law construing the SIPA and [Bankruptcy] Code disinterestedness standards, it is clear that even a potential conflict of interest is of serious concern." *In re Blinder, Robinson & Co.,* 131 B.R. at 880 (citing cases). "Thus, in determining whether the trustee or his counsel meet the requirements of § 78eee(b)(6), even the appearance of impropriety may merit disqualification." *Id.* at 878.

B. Duty To Disclose

[5] "The court and parties police conflicts through mandatory disclosure." *In re Granite Partners, L.P.,* 219 B.R. at 34. While the Court agrees with SIPC that the *procedures* contained in section 327 of the Bankruptcy Code and Rule 2014 of the Bankruptcy Rules—governing disclosure by professionals retained under sections 327, 1103 or 1114, and requiring disclosure of "all of the person's connections with the debtor, creditors, any other party in interest, [and] their respective attorneys and accountants," FED. R. BANKR.P.2014(a)—do not apply to selection of a SIPA trustee and counsel, the Court's determination of "disinterestedness" requires full disclosure of relevant connections between the Trustee, Trustee's counsel, and other parties in interest. HHR acknowledges that it must provide and update such disclosures as necessary. *See* Third Disclosure Statement ¶¶ 65–66.

[6] [7] [8] Because SIPC's filing of a petition seeking liquidation of a broker-dealer—and its selection of a trustee and counsel to do so—may occur with little advanced planning or notice, often without access to information necessary for the proposed trustee and counsel to disclose, more time may be required to complete necessary disclosures and there may be a greater risk that disabling connections ***602** may subsequently come to light.[8] But SIPA's mandatory standard for disinterestedness would be rendered lifeless without a corresponding duty to disclose potential adverse interests, and update the disclosures if and when more information becomes available. Proper, timely disclosure allows the court to make an informed decision whether the trustee and his retained professionals meet the standard for disinterestedness. *See Rome v. Braunstein,* 19 F.3d 54, 59 (1st Cir.1994); *In re Leslie Fay Cos.,* 175 B.R. 525, 533 (Bankr.S.D.N.Y.1994). Indeed, a lack of candidness in "disclosing [ ] potential problem[s] for independent court review before [a SIPA Trustee's and his counsel's] appointment ... in itself, presents an appearance of impropriety." *In re Blinder, Robinson & Co.,* 131 B.R. at 881. Although the Court agrees that disinterestedness under § 78eee(b)(6) "is determined at the time the trustee and counsel are appointed," *see id.* at 879, without adequate disclosure, both SIPC and the Court have no way of assessing a Trustee's disinterestedness.

[9] Although the SIPA and Bankruptcy Code disinterestedness standards require a "materially adverse" interest for a trustee or his professionals to be disqualified, a trustee and his or her professionals may not

"usurp the court's function by choosing, *ipse dixit,* which connections impact disinterestedness and which do not." *In re Granite Partners, L.P.,* 219 B.R. at 35 (citing *In re Blinder, Robinson & Co.,* 131 B.R. at 883). In determining what constitutes a "materially adverse" interest, the *Blinder* court recognized that "magnitude, amount, and materiality [of adverse relationships] are not synonyms." *In re Blinder, Robinson & Co.,* 131 B.R. at 883. "While the amount involved might, in some cases, be determinative, more cases will be determined on the basis of communications made, knowledge derived from the representation and the length of the relationship involved." *Id.*

In support of the Application, the Trustee and his counsel initially submitted declarations confirming that neither the Trustee nor anyone in his retained law firm was a current creditor, stockholder, or partner of MFGI; had not underwritten outstanding securities for MFGI or had not underwritten securities for MFGI within five years; and had not served in the capacity of director, partner, or employee of MFGI or its underwriters within two years prepetition, satisfying the first three prongs of section 78eee(b)(6)(A). *See* Application, Ex. A ¶ 5 & Ex. B ¶ 7. In addressing section 78eee(b)(6)(A)(iv), the declarations each denied any materially adverse interests by way of direct or indirect relationships with any class of creditors or stockholders. *Id.* Although the Trustee's declaration specifically disclosed litigation against MFGI in which he is involved in his role as Trustee in a separate SIPA liquidation, his counsel's declaration contained a brief, vague boilerplate disclosure:

> As a general practice firm of over 300 attorneys, the Firm represents many entities, including financial entities or investors, who may have been involved in the past with transactions in which MFGI, MFGI's parent, or some MFGI affiliate was involved or was the counterparty. Some of these entities which the ***603** Firm may from time to time represent on other, unrelated matters may be claimants in the MFGI estate or parties against which the estate may potentially have claims. In the event that actual, material disputes of an adversarial nature arise with any such entities at a time when they are still active Firm clients, [the Firm] will make such further disclosure and take such further steps as may be required to eliminate any potential conflict.

Application, Ex. B ¶ 8. But even "if boilerplate disclosure [at the start of the proceedings] covers, at most, inadvertent omissions of insignificant connections, boilerplate disclosure of prospective connections is rarely satisfactory." *In re Granite Partners, L.P.,* 219 B.R. at 36.

At the November 22, 2011 hearing, the Trustee's counsel acknowledged that HHR had represented JPMC in other matters; therefore, the Court ordered further disclosure. In his Supplemental Declaration, the Trustee's counsel identified two parties-in-interest, JPMC and PwC, with which the Trustee's law firm has relationships. *See* Supplemental Declaration ¶ 2. While providing limited information regarding the percentage of fees generated through representation of JPMC, as a percentage of total firm revenue, the disclosure provided no details about (i) the nature of that representation; or (ii) whether the firm currently represents JPMC, PWC, or any other creditor of MFGI; or (iii) whether litigation between MFGI and JPMC, PWC, or any other creditor of MFGI who is also a client is foreseeable or inevitable; or (iv) any other information that would enable the Court to make a determination of the presence of materially adverse interests and the disinterestedness of the Trustee and his counsel.

After the Court ordered still further disclosure, the Trustee submitted additional information about the relationships between HHR, JPMC, PwC, and other current or former clients that may also be creditors of MFGI. *See* Third Disclosure Statement ¶¶ 68–78. Based upon the most recent disclosures, the Court now has sufficient information to make determinations regarding the presence of conflicts of interest and the disinterestedness of the Trustee and his counsel.

C. Giddens' and HHR's Disinterestedness

When assessing conflicts of interest, the rules regarding representation of current and former clients are clear. Generally,

> [u]nless all affected clients and other necessary persons consent to the representation ..., a lawyer may not represent a client if the representation would involve a conflict of interest. A conflict of interest is involved if there is a substantial risk that the lawyer's

> representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person.

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 121 (2000). Additionally, "[u]nless all affected clients consent to the representation ... a lawyer in civil litigation may not ... 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." *Id.* § 128.

In New York, the rules of professional conduct, adopted by the Appellate Divisions of the Supreme Court and based primarily on the American Bar Association's Model Rules of Professional Conduct, address conflicts of interest regarding current clients:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a ***604** reasonable lawyer would conclude that either:
>
> (1) the representation will involve the lawyer in representing differing interests; or
>
> (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.
>
> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law; the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (3) each affected client gives informed consent, confirmed in writing.

JOINT RULES OF THE APPELLATE DIVISIONS OF THE SUPREME COURT, RULES OF PROF'L CONDUCT R. 1.7 (2009); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.7 & cmt. (2010). Rule 1.9 addresses an attorney's duties to former clients. In pertinent part, the rule states:

> (a) a lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

JOINT RULES OF THE APPELLATE DIVISIONS OF THE SUPREME COURT, RULES OF PROF'L CONDUCT R. 1.9(a) (2009); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.9 & cmt. (2010).

[10] In the Third Disclosure Statement, the Trustee unequivocally states that JPMC "is no longer a current client of HHR in any sense," and the nature of the past representation bore "no relationship to MFGI." Third Disclosure Statement ¶ 68. HHR's past representation of JPMC was also not material to the scope of HHR's practice and revenues. Evidencing a lack of conflict with JPMC, the Trustee's counsel noted:

> HHR has been adverse to JPM in disputes between financial entities. For example, in its role as counsel for the Trustee for the SIPA liquidation of Lehman Brothers Inc. ("LBI"), HHR investigated and actively pursued claims against JPM, resulting in a settlement that returned over $860 million in customer property to the LBI Estate.

Third Kobak Declaration ¶ 2.

The Trustee acknowledges that PwC, on the other hand, "is a current client and auditor of HHR," but that "[i]t is not yet known whether JPM or PwC are creditors of MFGI." Third Disclosure Statement ¶¶ 69 & 73. In addition to stating that "[t]wo of the ten secured credit facility lenders [of MFGI] are or may become current clients of HHR," the Trustee nevertheless maintains that he is "free to be adverse to most of the significant parties in this liquidation." *Id.* ¶¶ 70 & 80.

Consistent with the rules of professional conduct, as a remedy to potential conflicts, the Trustee states:

> HHR will not, without the consent of the adverse party and SIPC, represent a client in actual or threatened assertion (or defense) of disputed claims as against another client, even if the matters ***605** are unrelated. In appropriate cases, HHR will not handle matters involving client [sic] but will work with SIPC to have conflicts counsel appointed.

Third Disclosure Statement ¶ 25.[9]

[11] [12] [13] SIPC also advanced the options of use of conflicts counsel, with the approval of the bankruptcy court, or SIPC's appointment of a co-trustee, to handle specific matters in the event a conflict arises. *See* SIPC Memorandum at 6, 9. Because the conduct of auditors, such as HHR's current client, PwC, is frequently a subject for scrutiny in matters such as this one, SIPC, in the first instance, and the Court if necessary, may have to explore remedial options concerning Giddens' and HHR's role with respect to PwC, or for that matter, other current clients of HHR.[10] Replacement of a trustee or counsel in the event of a serious conflict is also possible, but because of the disruption and delay that may result, it should be viewed as a last resort. *See, e.g., In re Lee Way Holding Co.,* 102 B.R. 616, 625 (S.D.Ohio 1988) (declining to disqualify SIPA trustee's counsel because of risk of disruption in proceedings where there has been no deceptive conduct or behavior that shocks the conscience); *In re REA Holding Corp.,* 2 B.R. 733, 735 (S.D.N.Y.1980) (finding removal of trustee appropriate only when the administration of the estate would suffer more from the discord created by the present trustee than from a change in administration). SIPC has the responsibility for selecting a trustee and counsel, subject to the disinterestedness determination by the Court; it must be vigilant to assure that a trustee and counsel are and remain unconflicted. The integrity and credibility of the process depends upon it.

The Court is satisfied that the Trustee has presented sufficient information for the Court to conclude that the Trustee and his counsel are "disinterested" for the purpose of section 78eee(b)(6) of SIPA. The potential for conflicts nevertheless remains, particularly with respect to PwC or other "financial institutions" that are current clients of HHR and may be possible defendants in avoidance actions, but the ***606** risk is too attenuated at this time to require that Giddens or HHR step aside or that conflicts counsel or a co-trustee be appointed.

The two *pro se* Objectors raised important issues that were insufficiently addressed in the Trustee's and HHR's disclosures, until the Third Disclosure Statement filed in response to an order of the Court. *In re Blinder, Robinson & Co.* highlights the importance of disclosure: selective disclosure of information required for an objective determination of disinterestedness "fails to acknowledge the high fiduciary standard to which [the trustee] must abide to the point of punctilio." 131 B.R. at 883.

The Court concludes that the Trustee and his counsel have now made sufficient disclosures to permit an objective determination of their disinterestedness. This does not relieve SIPC, the Trustee, and HHR from an ongoing obligation to identify, evaluate, and disclose any additional "connections" or conflicts of which they become aware. "[E]arly, full disclosure of all potentially adverse interests should be a principle of first magnitude in all [SIPA liquidations]." *Id.* at 883. In some circumstances, at least, appointment of conflicts counsel or a co-trustee, with approval of the Court, to handle particular matters that Giddens and HHR cannot handle may resolve the problems, but conflicts counsel may not cure conflicts in all cases. *See, e.g., In re Perry, Adams & Lewis Sec., Inc.,* 5 B.R. at 65 (disqualifying SIPA Trustee after finding that use of conflicts counsel could not resolve problems of conflicts of interest).

CONCLUSION

For the reason stated above, the Application requesting the entry of an order regarding the disinterestedness of the Trustee and his counsel is GRANTED.

Parallel Citations

55 Bankr.Ct.Dec. 249

Footnotes

1 Although the district court issued the order appointing Giddens as Trustee, and his law firm, HHR, as counsel to the Trustee, the selection of the Trustee and his counsel is at the sole discretion of SIPC. *See* 15 U.S.C. § 78eee(b)(3) ("If the court issues a protective decree under paragraph (1), such court shall forthwith appoint, as trustee for the liquidation of the business of the debtor and as attorney for the trustee, such persons as SIPC, in its sole discretion, specifies. The persons appointed as trustee and as

attorney for the trustee may be associated with the same firm.").

2 *See, e.g.,* Ben Protess & Azam Ahmed, *Money Found in Britain May Belong to MF Global,* DEALBOOK, Nov. 28, 2011, http://dealbook.nytimes. com/2011/11/28/money-found-in-britain-may-belong-to-mf-global/ ("About $200 million in customer money that vanished from MF Global is believed to have surfaced at JPMorgan Chase in Britain, according to people briefed on the matter.").

3 *See, e.g.,* Silla Brush & Robert Schmidt, *Bank Funds Won't Cover MF Global Shortfall, Trustee Says,* Bloomberg Businessweek, Dec. 1, 2011, http://www.businessweek.com/news/2011-12-02/bank-funds-won-t-cover-mf-global-shortfall-trustee-says.htm (" 'There is no big pile of money we're going to find in the U.S. depositories now that we don't know about,' [spokesman for Trustee] said in a telephone interview today. 'When it comes to overseas assets that we believe we have a right to claim on behalf of our customers we will do everything we can to recover that.' ").

4 The Bankruptcy Act of 1938, in effect at the time that Congress enacted SIPA, was superceded by section 101 of the Bankruptcy Reform Act of 1978 to become the current Bankruptcy Code. *See* Pub. L. No. 95–598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. § 101 *et seq.* (2006)). The current definition of "disinterested person" is located in section 101(14) of the Bankruptcy Code and "is adapted from section 158 of chapter X [corporate reorganization provisions of the Bankruptcy Act] [section 558 of former Title 11], though it is expanded and modified in some respects." 11 U.S.C.A. § 101 (historical and statutory notes). Nothing in the legislative history of SIPA indicates Congress has reversed its course on how courts should interpret the term "disinterested person." In light of evidence indicating congressional intent to apply the same meaning to "disinterested person" and subsequent case law involving SIPA liquidations to the contrary, *see* discussion *infra,* this Court is hard-pressed to accept SIPC's argument that the term "disinterested" should be accorded two separate meanings, one under SIPA and one under the Bankruptcy Code. *See* SIPC Memorandum, at 6 ("[T]he disinterestedness standards under SIPA should not be confused with those of the Bankruptcy Code.").

5 Section 327(a) of the Bankruptcy Code allows a trustee to retain professionals "that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title." 11 U.S.C. § 327(a). Although the Court agrees with SIPC that section 327(a) does not apply in a SIPA liquidation, *see* SIPC Memorandum at 6, congressional intent to accord the meaning of the term "disinterested person" as it is defined by the Bankruptcy Code necessarily warrants an examination of the evolution of the term in the Bankruptcy Code and through courts' interpretations of the Bankruptcy Code.

6 HHR added to the uncertainty whether its representation of JPMC presents a disabling conflict when its initial disclosure did not mention JPMC. The Objectors then offered the limited information on HHR's web site identifying JPMC as a client. In the Supplemental Disclosure, HHR focused on the minimal revenue HHR received from JPMC in 2009, 2010, and 2011, without clearly indicating whether JPMC is a *current* client of HHR. Finally, in its Third Disclosure Statement, HHR established that JPMC is *not* a current client of HHR, and its work for JPMC in the past has been limited. HHR also argued that Giddens and HHR have been adverse to JPMC in the Lehman Brothers SIPA liquidation. *See* Third Kobak Declaration ¶ 2.

7 The *Schreiber Bosse* court articulated the special customer-focus principle underlying and guiding all SIPA liquidations:

> It is clear that the proceedings under the 1970 [Securities Investor Protection] Act are basically oriented toward the protection of the customer of the broker or dealer. This is in conformity with the basic purpose of the 1970 Act—that is, "to afford protection to public customers in the event broker-dealers with whom they transact business encounter financial difficulties and are unable to satisfy their obligations to their public customers."

SEC v. Schreiber Bosse & Co., 368 F.Supp. 24, 26 (N.D.Ohio 1973) (quoting *SEC v. Alan F. Hughes, Inc.,* 461 F.2d 974, 977 (2d Cir.1972)).

8 The Court is cognizant of the chaotic events and need for prompt action in appointing a qualified trustee in the event that a broker-dealer requires liquidation under SIPA, such as occurred in this case. *See* SIPC Memorandum at 7–8. Nevertheless, the "paucity of information available [to SIPC] at the time SIPA counsel is selected," *see id.* at 6, does not relieve the Court of its statutory duty to evaluate the disinterestedness of the SIPA trustee and its counsel under section 78eee(b)(3) and (6).

9 Although the issue need not be decided at this time, the Court notes that in a retention approved pursuant to section 327 (which does not apply to SIPA trustee and counsel retention), conflicts waivers rarely suffice to trump the strict requirement of disinterestedness. *See, e.g., In re Perry,* 194 B.R. 875, 880 (E.D.Cal.1996); *In re Project Orange Assocs., LLC,* 431 B.R. at 374–75; *In re Granite Partners, L.P.,* 219 B.R. at 34. Because of the trustee and counsel selection and oversight roles played by SIPC in a SIPA liquidation, conflicts waivers may stand on a stronger footing.

10 Again, although this issue need not be decided now, the fact that Giddens' role is that of a trustee and not an attorney may not shield him from the problem of conflicts of interest. "Ordinarily, a trustee must take reasonable steps to enforce all claims held in trust." 3 Scott & Ascher on Trusts § 17.9 (5th ed. 2006). Whether the Trustee or HHR can be adverse to PwC, or to other current

clients of HHR, is questionable in light of the rules of professional conduct for attorneys regarding representation of current clients. Generally, "[a]n attorney's conflicts are ordinarily imputed to his firm based on the presumption that 'associated' attorneys share client confidences." *Pierce & Weiss, LLP v. Subrogation Partners LLC,* 701 F.Supp.2d 245, 257 (E.D.N.Y.2010) (citations and quotations omitted). "There is a presumption that if one attorney is conflicted, then the entire firm is conflicted; this presumption may, however, be rebutted if a screen is in place or the conflicted attorney is only partially associated with the firm (i.e. has 'of counsel' status)." *Id.* Notably, at least one court has applied the rules of professional conduct of the forum state in determining that an attorney acting as a trustee had an impermissible conflict of interest. *See, e.g., In re Grieb Printing Co.,* 297 B.R. 82, 87 (Bankr.W.D.Ky.2003).

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441 B.R. 742
United States Bankruptcy Court,
D. Delaware.

In re IH 1, INC., et al., Debtors.
George L. Miller, Chapter 7 Trustee, Plaintiff,
v.
Sun Capital Partners, Inc., et al., Defendants.

Bankruptcy No. 09–10982 (PJW). | Adversary No. 10–52279 (PJW). | Jan. 25, 2011.

Synopsis
Background: Chapter 7 trustee brought adversary proceeding to set aside certain prepetition payments by debtors and moved to disqualify law firm from representing defendants based on its prior representation of debtors.

Holdings: The Bankruptcy Court, Walsh, J., held that:

[1] avoidance proceeding was "substantially related" to that in which defendants' attorneys had previously represented debtors;

[2] debtors' narrow and specific waiver of future conflicts of interest by law firm was effective, but only as to named entity and its affiliates and portfolio companies; and

[3] trustee did not delay unduly in seeking to disqualify law firm and did not impliedly waived disqualification argument.

Motion granted in part and denied in part.

West Headnotes (11)

[1] **Attorney and Client**
Interests of former clients

Prohibition, under the Delaware Rules of Professional Conduct, against an attorney who has represented client in any matter from later representing, in same or any substantially related matter, any party with interests materially adverse to those of former client is in nature of prophylactic rule, which is designed to prevent even the potential that former client's confidences and secrets may be used against him. Del.Rules of Prof.Conduct, Rule 1.9(a).

Cases that cite this headnote

[2] **Attorney and Client**
Interests of former clients

Prohibition, under the Delaware Rules of Professional Conduct, against an attorney who has represented client in any matter from later representing, in same or any substantially related matter, any party with interests materially adverse to those of former client serves to promote sharing of confidences by clients who might otherwise be reluctant to confide completely in their attorneys, is important to maintenance of public confidence in integrity of bar, and safeguards client's right to expect loyalty of his attorney in matter for which he has been retained. Del.Rules of Prof.Conduct, Rule 1.9(a).

Cases that cite this headnote

[3] **Attorney and Client**
Interests of former clients

Matters may be "substantially related," within meaning of Delaware Rule of Professional Conduct barring attorney who has represented client in any matter from later representing, in same or any "substantially related matter," any party with interests materially adverse to those of former client: (1) because they involve the same transaction, or (2) because there is risk that attorney gained confidential, relevant information from former client. Del.Rules of Prof.Conduct, Rule 1.9(a).

1 Cases that cite this headnote

[4] **Attorney and Client**
Bankruptcy

Avoidance proceeding brought by Chapter 7 trustee against companies and individual officers and directors that received payments following leveraged buyout (LBO), which focused on $76.6 million dividend that allegedly rendered operating debtors insolvent, was "substantially related" proceeding to that in which defendants' attorneys had previously represented debtors, within meaning of state law disqualification rule, where dividend was paid on basis of solvency opinion reviewed by attorneys on debtors' behalf, and attorneys, as reflected in their billing statements to debtors, had also drafted board resolution authorizing dividend. Del.Rules of Prof.Conduct, Rule 1.9(a).

Cases that cite this headnote

[5] **Attorney and Client**
Disclosure, waiver, or consent

Under Delaware law, lawyer, as general rule, may litigate against former client only with that client's informed consent, confirmed in writing. Del.Rules of Prof.Conduct, Rule 1.9.

Cases that cite this headnote

[6] **Attorney and Client**
Disclosure, waiver, or consent

Under Delaware law, client may consent to conflicts of interest, whether present or future, by signing a waiver; however, effectiveness of waiver will depend on extent to which client reasonably understands the material risks. Del.Rules of Prof.Conduct, Rule 1.7.

Cases that cite this headnote

[7] **Attorney and Client**
Disclosure, waiver, or consent

Under Delaware law, while general and open-ended waivers of conflicts of interest by attorney's clients are generally ineffective, comprehensive waivers are more likely to be effective, as are those agreed to by sophisticated clients. Del.Rules of Prof.Conduct, Rule 1.7.

Cases that cite this headnote

[8] **Attorney and Client**
Disclosure, waiver, or consent

Chapter 7 debtors' narrow and specific waiver of future conflicts of interest by law firm which represented debtors in connection with transactions underlying avoidance claims asserted by trustee, which debtors, as sophisticated entities, granted in favor of specifically identified company and "its affiliates or portfolio companies," was effective as to this specifically identified company and other affiliates named as defendants on trustee's avoidance claims, but not as to companies which were not affiliates of the named company, but identified only as shareholders of one or more debtors, and as to individual defendants; accordingly, waiver provision in law firm's employment agreement with debtors did not prevent trustee from seeking firm's disqualification from representing these shareholder entities and individual defendants. Del.Rules of Prof.Conduct, Rules 1.7, 1.9.

Cases that cite this headnote

[9] **Attorney and Client**
Disclosure, waiver, or consent

Under Delaware law, valid grounds for disqualification of attorney by former client may

be deemed waived if former client fails to raise issue promptly. Del.Rules of Prof.Conduct, Rule 1.9.

Cases that cite this headnote

[10] **Attorney and Client**
Disclosure, waiver, or consent

Under Delaware law, courts may find waiver by former client of grounds for attorney's disqualification when there is unreasonable delay in bringing motion to disqualify, suggesting that motion is being used as litigation tactic.

Cases that cite this headnote

[11] **Attorney and Client**
Disclosure, waiver, or consent

Chapter 7 trustee did not delay unduly in seeking to disqualify law firm from representing defendants in avoidance proceeding, based on firm's prior representation of debtors in a substantially related matter, where trustee filed motion to disqualify less than one month after defendants filed their answer to trustee's complaint, and especially where trustee, in agreeing to grant defendants an extension to file their answer, specifically indicated that this extension should not be construed as his acquiescence to firm's representing any or all of defendants on avoidance claims; accordingly, trustee did not impliedly waive disqualification argument. Del.Rules of Prof.Conduct, Rule 1.9.

Cases that cite this headnote

Attorneys and Law Firms

***744** Thaddeus Weaver, Dilworth Paxson LLP, Wilmington, DE, Maura Fay McIlvain, Dilworth Paxson LLP, Philadelphia, PA, for Plaintiff.

John F. Hartmann, P.C., Michael A. Duffy, Kirkland & Ellis LLP, Chicago, IL, Daniel J. DeFranceschi, Drew G. Sloan, Richards, Layton & Finger, P.A., Wilmington, DE, for Defendants.

MEMORANDUM OPINION

WALSH, Bankruptcy Judge.

This opinion is with respect to the motion of George L. Miller, as chapter 7 trustee ("Trustee") of IH 1, Inc., *et al.,* to disqualify the law firm of Kirkland & Ellis LLP ("Kirkland") from representing certain of the Defendants in the instant adversary proceeding. (Doc. # 43.) The Complaint identifies eight company Defendants and 14 individual Defendants. Kirkland represents all eight of the company Defendants and 12 of the 14 individual Defendants. Two of the Defendants, Timothy R.J. Stubbs and Patrick Lawlor, are not represented by Kirkland. For the reasons discussed below, I will deny the motion as to Kirkland's representation of six company Defendants; and I will grant the motion as to the other two company Defendants; and I will grant the motion as to the individual Defendants.

Background

On September 16, 2005, Defendant Sun Capital Partners, Inc. ("Sun"), through an affiliate, entered into a certain stock purchase agreement with Honeywell International Inc. pursuant to which it acquired all of the outstanding capital stock of two operating entities, Indalex Inc. and Indalex Limited. The stock purchase transaction closed on February 2, 2006. Prior to the stock purchase transaction neither Sun nor any of its affiliates had a relationship with Indalex Inc. or Indalex Limited.

On March 20, 2009, Indalex Holdings Finance, Inc., Indalex Holding Corp., Indalex Inc., Caradon Lebanon, Inc. and Dolton Aluminum Company, Inc. (collectively, "Indalex" or the "Debtors") filed for bankruptcy protection under chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* On July 20, 2009, this Court approved the sale of substantially all of Debtors' assets. As part of that sale agreement, Debtors changed their names to IH 1, Inc., etc. On October 30, 2009, these cases

were converted to cases under Chapter 7.

On July 30, 2010, Trustee commenced this adversary proceeding against eight companies and 14 individuals to recover certain transfers and damages for breaches of fiduciary duties. The Complaint focuses on transactions following Sun's, or its affiliate's, leveraged buyout of the two operating companies, Indalex Inc. and Indalex Ltd. Sun, or its affiliates, came to control these acquired operating companies. Trustee alleges that the Defendants exercised this control to extract money from these entities, in the form of transaction fees, management fees, and improperly declared dividends. In addition, Trustee alleges that Defendants improperly characterized equity infusions in Debtors as secured loans.

The Complaint identifies the following Defendant entities as affiliates of Defendant Sun: Sun Indalex, LLC, Sun Indalex Finance LLC, Sun Capital Partners III, QP, LP, Sun Capital Partners IV, LP and ***745** Sun Capital Partners Management III, LP. Two other Defendant companies, namely, Indalex Co–Investment, LLC and HIG Sun Partners, Inc., are not identified as affiliates of Sun, but rather are identified as shareholders of one of the Debtors. The 14 individual defendants are variously identified as officers, board members or managers of Debtors and/or Sun or affiliates of Sun.

Trustee has moved to disqualify Kirkland as counsel for the Defendants, based on pre-petition legal work Kirkland performed for Debtors. Trustee alleges that Kirkland represented Debtors on matters substantially related to the adversary proceeding, thus requiring disqualification under Model Rule of Professional Conduct 1.9 ("Model Rule 1.9"), which rule governs the practice of law before this Court. *In re Meridian Automotive Systems–Composite Operations, Inc.,* 340 B.R. 740, 744 (Bankr.D.Del.2006). Specifically, Trustee asserts that disqualification is appropriate based on Kirkland's services for Debtors concerning the dividend payment, the management services agreement, and the purported loans to Debtors.

Defendants oppose the motion to disqualify on the following five grounds: (i) Debtors had waived any potential conflict; (ii) Trustee's claims are not substantially related to Kirkland's work for Debtors; (iii) Trustee has not shown that Kirkland obtained any confidential information during its representation of Debtors; (iv) Trustee's delay in seeking disqualification waived any conflict; and (v) disqualification would unfairly prejudice Defendants and unfairly reward Trustee.

Briefing in this matter is complete, and the issue is ripe for decision and falls within this Court's jurisdiction as a core proceeding under 28 U.S.C. § 157(b)(2)(A). *In re Meridian,* 340 B.R. at 744.

Discussion

[1] [2] Model Rule 1.9 provides the duties a lawyer owes to former clients. It provides that

> A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

This rule serves three purposes:

> First, it is a prophylactic rule to prevent even the potential that a former client's confidences and secrets may be used against him. Without such a rule, clients may be reluctant to confide completely in their attorneys. Second, the rule is important for the maintenance of public confidence in the integrity of the bar. Finally, and importantly, a client has a right to expect the loyalty of his attorney in the matter for which he is retained.

In re Meridian, 340 B.R. at 747 (quoting *In re Corn Derivatives Antitrust Litigation,* 748 F.2d 157, 162 (3d Cir.1984)).

The issues presented here are (i) whether Trustee's adversary proceeding concerns matters that are substantially related to Kirkland's pre-petition representation of Debtors, and, if so, (ii) whether Debtors gave informed, written consent or (iii) whether Trustee has waived this ground for disqualification.

Substantially Related

[3] Comment 3 to Rule 1.9 clarifies what "substantially related" means:

> Matters are "substantially related" for purposes of this Rule if they involve the same transaction or legal dispute or if there otherwise is a substantial risk that confidential factual information as would normally have been obtained in the prior ***746** representation would materially advance the client's position in the subsequent matter.

That is, matters may be "substantially related" on two separate bases: (1) if they involve the same transaction or (2) if there is a risk that the attorney gained confidential, relevant information from the former client. *See In re Meridian,* 340 B.R. at 747 ("Thus, while the risk of a breach of client confidences is a sufficient condition for 'relatedness,' it is not a necessary one.").

[4] Trustee's adversary proceeding focuses on a series of pre-petition transactions, including (i) a $76.6 million dividend payment, (ii) payment of management and transaction fees, and (iii) the granting of security interests. According to Kirkland's bills produced to Trustee, Kirkland performed legal services for Debtors relating to each of these three transactions.

Kirkland became counsel for Sun and its affiliates in February 2000 and Sun and its affiliates represent one of Kirkland's largest clients. (Doc. # 56, p. 1.) According to Trustee's calculations, Debtors paid legal fees to Kirkland in the amount of $1,666,000 during the period of 2006 through 2009.

Defendants contend that Kirkland's work for Debtors was not substantially related to Trustee's action. Defendants describe Kirkland's work on the dividend payment and the SEC disclosures as limited to their "technical" compliance with applicable laws and regulations. (Doc. # 54, pp. 21–22).

I find that Trustee has established that Kirkland's work for Debtors following the stock acquisition is substantially related to the issues in this adversary proceeding. Kirkland's legal bills to Debtors demonstrate that the firm had extensive dealings with Debtors. These dealings directly relate to the matters at issue in the adversary proceeding. A central claim in the adversary proceeding is that Debtors issued a $76.6 million dividend that rendered the operating Debtors insolvent. Payment of that dividend was justified on the basis of a solvency opinion prepared by FTI. Kirkland's billings reflect that Kirkland reviewed that solvency opinion and drafted the board resolution authorizing the dividend payment. Therefore, Trustee's causes of action concerning the dividend payment are substantially related to Kirkland's prior representation of Debtors.

Because the Court finds that the matters in this adversary proceeding are substantially related to the matters on which Kirkland had previously represented Debtors, it is not necessary for Trustee to identify any confidential information Kirkland obtained from this prior representation. Disqualification, therefore, is appropriate unless Debtors consented or Trustee has waived the grounds for disqualification.

Consent

[5] Generally, a lawyer may litigate against a former client only with that client's "informed consent, confirmed in writing." Model Rule 1.9. " 'Informed consent' denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." Model Rule 1.0(e).

[6] [7] A client may consent to conflicts, whether present or future, by signing a waiver. The effectiveness of a waiver depends on "the extent to which the client reasonably understands the material risks that the waiver entails." Model Rule 1.7, comment 22. General and open-ended waivers are generally not effective. *Id.* Comprehensive waivers are more likely to ***747** be effective, as are those agreed to by sophisticated clients. *Id.*

[8] Defendants assert that Debtors gave their informed consent when they signed the Kirkland engagement letter on February 2, 2006. That engagement letter contains the following consent by Debtors:

> *As you know, [Kirkland & Ellis] have represented and represent Sun Capital Partners, Inc., and its affiliated investment funds and management companies (together, "Sun")* on a variety of matters, including Sun's investment in you and anticipate that we will represent Sun in future matters. You are a portfolio company of Sun. This confirms that [Kirkland] has informed you of its representation of Sun on a variety of matters, including Sun's investment in you, and that *you consent to, and waive any conflict or other objection with respect to [Kirkland's] representation of Sun, its affiliates or portfolio companies* in connection with any and all ... (iii) *future matters in which [Kirkland] might represent Sun.* ... In addition, you understand and agrees (sic) that in the event that [Kirkland] or Sun determine that any conflict exists in

> connection with [Kirkland's] representation of you, [Kirkland] may terminate its representation of you and continue its representation of Sun in any matter (whether or not such matter is related to the Indalex Matters). (Emphasis added.)

(Doc. # 44, Ex. 6.)

The consent is explicit and narrow, as it specifically identifies the possibility of future conflicts with Sun and its affiliates. It was signed by Michael E. Alger, the Chief Financial Officer of one of the Debtors at the time, whose declaration sufficiently demonstrates that he is a sophisticated business person with considerable experience in large businesses and who is knowledgeable about retaining counsel for those businesses. (Doc. # 55.) Accordingly, the consent is effective as to Kirkland's representation of Sun and its affiliates. This conclusion is consistent with that reached by Judge Gross in an unreported decision involving a similar motion to disqualify Kirkland, involving nearly identical waiver language. *The Official Committee of Unsecured Creditors of Mervyn's Holdings, LLC et al. v. Lubert–Adler Group IV, LLC et al.* No. 08–51402, slip op. at 13 (Bankr.D.Del. Oct. 1, 2009). There, Judge Gross found that the consent was sufficiently narrow because it was limited to future conflicts only with Sun companies. *Id.* As in that case, the consent is effective and Debtors have consented to Kirkland's representation of Sun companies in future disputes, including the present one.

The consent, however, is limited to Kirkland's "representation of Sun, its affiliates or portfolio companies." The consent language does not identify any individuals, such as officers and directors of Sun, its affiliates or Debtors. The consent, therefore, does not apply to the 14 individual Defendants. As alleged in the Complaint, the alleged wrongdoings of these individuals occurred during Kirkland's representation of Debtors and concerned matters substantially related to that representation, Kirkland is disqualified from representing the individual Defendants.

Two of the corporate Defendants, Indalex–Co Investment, LLC and HIG Sun Partners, Inc., are not identified in the Complaint as affiliates to Sun, but are simply identified as shareholders of one or more of Debtors. Thus, I conclude that the consent does not apply to these two entities.

Waiver

[9] [10] Finally, valid grounds for disqualification may be deemed waived if the ***748** former client fails to raise the issue promptly. *In re Kaiser Group International, Inc.,* 272 B.R. 846, 851–52 (Bankr.D.Del.2002). Courts may find waiver when there is an unreasonable delay in bringing a motion to disqualify, suggesting that the motion is being used as a litigation tactic. *Id.* at 852 (finding no reason for a four-month delay in moving to disqualify and concluding that the motion was "a strategic ploy"); In re Muma Services, Inc., 286 B.R. 583, 589 (Bankr.D.Del.2002) (finding that former client waived any conflict by delaying nearly one year in filing a motion to disqualify).

Here, Defendants complain that the motion was filed late in these proceedings and that this should be grounds for finding implied waiver. As part of the basis for this argument, Defendants contend that this adversary proceeding was contemplated first by the Official Committee of Unsecured Creditors (the "Committee") and then, following conversion to chapter 7, by Trustee. (Doc. # 54, pp. 26–29.) The Committee, who drafted a similar complaint, did not seek to disqualify Kirkland, and Trustee did not mention the disqualification issue during the parties' pre-complaint settlement negotiations. The Committee's actions and the Trustee's pre-complaint dealings with Sun, however, are not relevant. Trustee's actions following the filing of the Complaint are the focus of this analysis.

[11] Trustee commenced the adversary proceeding on July 30, 2010. Defendants' answer was due on September 2, 2010, but the parties stipulated to extend that date. In discussing that extension, Trustee's counsel emailed Kirkland on August 16, 2010, stating that "although the Trustee is agreeing to the requested extension of time, this agreement should not be construed as his acquiescence to Kirkland representing any or all of the defendants in this action." (Doc. # 57, Ex. K.) Defendants filed their answer on October 18, 2010, and Trustee filed the motion to disqualify less than a month later. This is not an unreasonable amount of time, especially considering that Trustee had alerted Kirkland to the disqualification issue in August 2010. Accordingly, the Court finds that Trustee has not impliedly waived this disqualification argument.

Conclusion

For the foregoing reasons, I will (1) deny Trustee's motion to disqualify Kirkland from representing Sun and its affiliates, (2) grant the motion as to Indalex Co–Investment, LLC and HIG Sun Partners, Inc. and (3) grant the motion as to the individual Defendants.

While Kirkland will have to exercise its own judgment on

the issue, Kirkland may find itself in the awkward position of being a fact witness if Trustee elects to waive the attorney/client privilege as a chapter 7 trustee is entitled to do. *See Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 358, 105 S.Ct. 1986, 85 L.Ed.2d 372 (1985).

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, Trustee's motion (Doc. # 43) to disqualify Kirkland & Ellis LLP from representing Defendants is (1) **denied** as to Sun Capital Partners, Inc. and its affiliates, (2) **granted** as to Defendants Indalex Co–Investment, LLC and HIG Sun Partners, Inc. and (3) **granted** as to the 12 individual Defendants.

Parallel Citations

54 Bankr.Ct.Dec. 61

End of Document

441 B.R. 222
United States Bankruptcy Court,
S.D. New York.

In re JMK CONSTRUCTION GROUP, LTD., Debtor.
In re John Varacchi, Debtor.
In re George Donohue, Debtor.
In re Jacob M. Kopf, Debtor.

Nos. 10–13968(MG), 10–13965(MG), 10–13959(MG), 10–14847(MG). | Dec. 9, 2010.

Synopsis
Background: Professionals filed applications for leave to simultaneously represent multiple Chapter 11 debtors with potential contribution and other claims against each other.

[Holding:] The Bankruptcy Court, Martin Glenn, J., held that law firm and other professionals were disqualified, on adverse interest theory, from simultaneously representing construction company, its principal, and other individuals associated therewith in their separate Chapter 11 cases, based not only upon debtors' continuing right to seek contribution from each other on damages award entered in state court fraud action, but on existence of inter-debtor claims for repayment of prepetition loans.

Applications denied.

West Headnotes (20)

[1] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

For trustee or debtor-in-possession to retain a professional, professional must both be disinterested and not hold or represent any interest adverse to estate. 11 U.S.C.A. § 327(a).

1 Cases that cite this headnote

[2] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

While professional must both be disinterested and not hold or represent any interest adverse to estate in order to be eligible for employment by trustee or debtor-in-possession, inasmuch as "disinterested" is statutorily defined as not having any interest materially adverse to estate, courts apply a single test, focusing on existence of conflicts of interest. 11 U.S.C.A. §§ 101(14)(C), 327(a).

1 Cases that cite this headnote

[3] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Professional "holds or represents an adverse interest," and is thus disqualified from employment by trustee or debtor-in-possession, if he (1) possesses or asserts any economic interest that would tend to lessen value of bankruptcy estate or that would create either an actual or potential dispute in which estate is rival claimant; or (2) possesses a predisposition under circumstances that render this a bias against estate. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[4] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy courts examine only present interests in deciding whether a professional holds an adverse interest, such as will disqualify him from employment by trustee or

debtor-in-possession. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[5] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Generally, "adverse interest" test for employment as a bankruptcy professional is objective and precludes any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required of professional by the Bankruptcy Code and Bankruptcy Rules. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[6] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Professional seeking employment by trustee or debtor-in-possession has a disabling conflict, if he has either a meaningful incentive to act contrary to best interests of estate and its sundry creditors, i.e., an incentive sufficient to place those parties at more than an acceptable risk, or the reasonable perception of one. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[7] **Attorney and Client**
Bankruptcy

Disqualification is appropriate if it is plausible that representation of another interest may cause debtor's attorneys to act any differently than they would without other representation. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[8] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Courts determine whether adverse interest exists, of kind sufficient to disqualify professional from representing trustee or debtor-in-possession, on case-by-case basis, examining specific facts in case. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[9] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy courts may consider interests of estate and its creditors, accounting for the expeditious resolution of case, when ruling on motion to retain professional. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[10] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Statutory requirements for employment of professional are to be taken seriously, and bankruptcy courts lack the power to authorize employment of professional who has conflict of interest. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[11] **Bankruptcy**

Employment of Professional Persons or Debtor's Officers

Bankruptcy courts closely scrutinize the existence of claims among debtors when ruling on application to retain professional to represent multiple debtors in reorganization proceedings. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[12] **Attorney and Client**
Bankruptcy

Statutory requirements for retention of professional, that professional may not hold or represent an interest adverse to estate, apply equally to retention of special counsel. 11 U.S.C.A. § 327(a, e).

1 Cases that cite this headnote

[13] **Attorney and Client**
Bankruptcy
Bankruptcy
Employment of Professional Persons or Debtor's Officers

Law firm and other professionals were disqualified, on adverse interest theory, from simultaneously representing construction company, its principal, and other individuals associated therewith in their separate Chapter 11 cases, based not only upon debtors' continuing right to seek contribution from each other on damages award entered in state court fraud action, but on existence of inter-debtor claims for repayment of prepetition loans; mere fact that time for filing proofs of claim had passed, without assertion of any contribution claims, did not ameliorate problem, especially given that debtors were represented by conflicted counsel during time when such claims could have been filed, prior to expiration of claims bar date. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[14] **Contribution**
Joint Wrongdoers
Contribution
Common liability

Under New York law, contribution claim may be interposed when two or more parties are allegedly liable for damages for same injury.

Cases that cite this headnote

[15] **Contribution**
Joint Wrongdoers

Under New York law, contribution is available regardless of whether the culpable parties are allegedly liable for injury under the same or different theories.

Cases that cite this headnote

[16] **Contribution**
Joint Wrongdoers
Contribution
Absence of intent or moral turpitude; negligence

Under New York law, contribution may be invoked against concurrent, successive, independent, alternative and even intentional tortfeasors.

Cases that cite this headnote

[17] **Torts**
Joint and several liability

Under New York law, when two or more tortfeasors act concurrently or in concert to produce a single injury, they may be held jointly

and severally liable.

Cases that cite this headnote

[18] **Torts**
Comparative fault; apportionment
Torts
Joint tortfeasors in general

Under New York law, when two or more joint tortfeasors act independently and cause distinct or single harm, for which there is reasonable basis for division according to contribution of each, then each is liable for damages only for his or her own portion of harm.

Cases that cite this headnote

[19] **Contribution**
Joint Wrongdoers

Under New York law, jury's apportionment of fault or damages does not necessarily determine the type of liability, joint and several or independent and successive, and thus does not necessarily determine ability of parties against whom judgment was entered to seek contribution from other defendants.

Cases that cite this headnote

[20] **Attorney and Client**
Bankruptcy
Bankruptcy
Rights of Action; Contract Rights Generally

Contingent contribution claims which debtors possessed against each other in connection with prepetition judgment entered against them in state court fraud action, as prepetition claims included in property of their respective Chapter 11 estates, could not be waived without court approval, such that purported waiver introduced by law firm seeking to represent each of these debtors simultaneously was insufficient to cure conflict of interest and to permit law firm to appear on behalf of multiple debtors with claims against each others' Chapter 11 estates. 11 U.S.C.A. §§ 363, 541(a)(1).

Cases that cite this headnote

Attorneys and Law Firms

***225** Pick & Zabicki LLP, New York, NY, by Douglas J. Pick, Esq., Eric C. Zabicki, Esq., for JMK Construction Group, Ltd., John Varacchi, George Donohue and Jacob M. Kopf.

Tracy Hope Davis, New York, NY, by Serene K. Nakano, Esq., United States Trustee for Region 2.

Catafago Law Firm, P.C., New York, NY, by Jacques Catafago, Esq., for Creditor Air China, Ltd.

Shafferman & Feldman LLP, New York, NY, by Joel M. Shafferman, Esq., for the Official Committee of Unsecured Creditors of JMK Construction Group, Ltd.

MEMORANDUM OPINION AND ORDER DENYING RETENTION OF: (1) PICK & ZABICKI LLP AS COUNSEL TO EACH OF THE DEBTORS; (2) EDWARD WEISSMAN, ESQ. AS SPECIAL COUNSEL TO DEBTORS JOHN VARACCHI AND GEORGE DONOHUE; AND (3) PETER A. MORALES, CPA, PC AS ACCOUNTANT TO JMK CONSTRUCTION GROUP, LTD. AND JACOB M. KOPF

MARTIN GLENN, Bankruptcy Judge.

This opinion addresses the proposed retention by multiple debtors of a single professional under section 327(a) of the Bankruptcy Code where the debtors in these four cases may hold claims for contribution against one another and some of the debtors are creditors of others. The debtor in each of four related bankruptcy proceedings, *In re JMK Construction Group, Ltd., In re George Donohue, In re John Varacchi,* and *In re Jacob M. Kopf,* filed an application (the "P & Z Retention

Applications") to retain Pick & Zabicki LLP ("P & Z") as counsel to the debtor in each case (collectively, the "Debtors"). Two of the debtors, Varacchi and Donohue, also seek to retain The Law Offices of Edward Weissman ("Weissman") as special litigation counsel pursuant to section 327(e) of the Bankruptcy Code in connection with a judgment rendered against the Debtors in a federal court action entitled *Air China Limited v. Nelson Li, et al.,* Docket No. 07–cv–11128 (LTS) (DFE) (the "Air China Case") that was the impetus for the filing of these bankruptcy petitions. Two debtors, JMK Construction Group, Ltd. ("JMK") and Kopf, also filed applications for retention of Peter A. Morales, CPA, PC ("Morales") as accountant in the JMK and Kopf bankruptcy cases pursuant to section 327(a) of the Bankruptcy Code. The United States Trustee (the "U.S. Trustee") opposes the retention of P & Z as counsel, Weissman as special counsel and Morales as accountant, arguing that there are disabling conflicts of interest that preclude representation by the professionals of more than one debtor. Air China, Ltd. ("Air China"), as a judgment creditor to the Debtors, opposes the retention of P & Z and Morales based on what it perceives as P & Z's failure to disclose material facts relating to the relationships between the Debtors, and, as a result of such relationships, ongoing irremediable conflicts of interest. The Court held a hearing on the applications on November ***226** 16, 2010 and took the matters under submission.

As a result of the judgment against the Debtors in the Air China Case, the Debtors may continue to have a right of contribution against each other under New York law. Even though inter-debtor claims were purportedly "waived" by a letter filed with the Court, such waiver is both ineffective and insufficient to waive the actual conflicts of interest present here. For the reasons discussed below, the Court agrees with the U.S. Trustee and Air China and denies the retention applications of P & Z, Weissman and Morales. P & Z, Weissman and Morales may seek retention as counsel to only one of the Debtors in their reorganization cases.

I. BACKGROUND

JMK, Donohue, Varacchi and Kopf each filed voluntary petitions for bankruptcy protection after a jury returned a verdict against them in the Air China Case, tried before the Hon. Laura Taylor Swain in the United States District Court for the Southern District of New York (the "District Court"). JMK, Donohue and Varacchi filed voluntary petitions on July 23, 2010. (JMK ECF # 1; Donohue ECF # 1; Varacchi ECF # 1.) Kopf filed a voluntary petition on September 14, 2010. (Kopf ECF # 1.) All parties acknowledge that it was the jury verdict in the Air China Case that served as the primary motivation for the filing of all four bankruptcy petitions.

A. The Air China Case

On July 14, 2010, a jury returned a verdict in favor of Air China against the Debtors for fraud in the inducement, unjust enrichment and conversion. (Objection of the United States Trustee to the Retention Appls. of Pick & Zabicki LLP, Edward Weissman, Esq. and Peter A. Morales, CPA, PC (the "U.S. Trustee Objection") at 3–4, Ex. A; JMK ECF # 63; Kopf ECF # 62; Donohue ECF # 66; Varacchi ECF # 59.) The jury also awarded punitive damages against Varacchi, Donohue and Kopf in connection with a scheme to defraud Air China and the general public into believing that the defendants were representatives of the William B. May Real Estate Company. (*Id.*) On August 10, 2010, judgment was entered in the District Court against Kopf in the amount of $1,473,307.89 (Air China Case ECF # 201.) On September 15, 2010, judgment was entered against Varacchi in the amount of $70,005.95, and against Donohue in the amount of $50,804.41. (*Id.;* Air China Case ECF # 223.) On October 13, 2010, this Court lifted the automatic stay to permit the Debtors to prosecute their appeal in the Air China Case and to permit entry of judgment against JMK. (JMK ECF # 41; Donohue ECF # 60; Kopf ECF # 33; Varacchi ECF # 55.) On October 14, 2010, judgment was entered in the District Court against JMK in the amount of $261,449.59. (U.S. Trustee Objection at 5; Air China Case ECF # 225.) The Debtors have appealed the judgments to the United States Court of Appeals for the Second Circuit. (U.S. Trustee Objection at 5.) Air China has also cross-appealed.

B. The Satin Case

JMK and Kopf were among the parties sued on September 21, 2009 in the Supreme Court of the State of New York by plaintiff Adam Satin (the "Satin Case"). (U.S. Trustee Objection at 5, Ex. C.) Satin alleges that JMK and Kopf granted him a 25% ownership interest in JMK, and seeks a declaratory judgment of Satin's ownership rights, damages for breach of fiduciary duty and unjust enrichment. (*Id.*) On February 5, 2010, the defendants' motion to dismiss the breach of fiduciary duty and ***227** unjust enrichment claims was denied. (*Id.*) According to the U.S. Trustee, JMK and Kopf have not asserted cross-claims against each other.

C. The Inter–Debtor Claims

The P & Z Retention Applications, accompanying affidavits in support of retention and schedules filed by certain of the Debtors indicate the existence of inter-debtor claims. According to Kopf's schedules, JMK owes approximately $38,000 to Kopf. (Kopf ECF # 8, Schedule B; Kopf ECF # 23 ¶ 4(e).) JMK also owes approximately $270,000 to CMA ("CMA"), a corporation solely owned by Kopf. (Kopf ECF # 23 ¶ 4(e).) The indebtedness incurred by JMK is for advances and capital infusions that Kopf made to JMK, and an initial capital contribution made by CMA to start up and sustain JMK's operations. (Aff. of Douglas J. Pick in Resp. to Objections of the United States Trustee to Debtors' Appls. For Authority to Retain Pick & Zabicki LLP as Counsel (the "Pick Response") ¶ 12; JMK ECF # 65.) In addition, Varacchi owes Kopf $16,000 on account of a personal loan. (Kopf ECF # 23 ¶ 4(e).) Therefore, P & Z seeks to be retained by both debtors (JMK and Varacchi) and creditors (Kopf) in these related reorganization proceedings.

In an apparent attempt to remedy any conflicts as a result of the inter-debtor claims, Kopf filed a letter with the Court purporting to irrevocably waive his right to repayment from JMK. (Kopf ECF # 45; JMK ECF # 46.) Kopf also filed a letter on behalf of CMA purporting to waive its right to repayment by JMK. (JMK ECF # 47.) To date, there has been no waiver of the $16,000 claim that Kopf has against Varacchi.

D. The Retention Applications

1. Retention of P & Z as Counsel to Each of the Debtors

P & Z filed retention applications for its retention as counsel to each of the Debtors pursuant to section 327(a) of the Bankruptcy Code. (JMK ECF # s 14, 21, 22, 33, 36; Kopf ECF # s 12, 23; Donohue ECF # s 31, 33, 42; Varacchi ECF # s 23, 26, 37.) Attached to each of the applications is an affidavit of Douglas J. Pick in Support of Application For Authority to Retain Pick & Zabicki LLP, *Nunc Pro Tunc,* as Counsel to the Debtor (the "Initial Pick Affidavit"). (JMK ECF # 14; Kopf ECF # 12; Donohue ECF # 21; Varacchi ECF # 23). The Initial Pick Affidavit, filed on August 19, 2010 in the JMK matter, recognized that P & Z was also seeking to represent the other debtors in connection with their bankruptcy proceedings.[1] (Initial Pick Affidavit ¶ 3.) The Initial Pick Affidavit attached to each of the P & Z Retention Applications also states that "P & Z does not, and has not, represented any of the parties related to the Debtor, its creditors and other parties-in-interest." (*Id.*) Finally, as a catch-all, Pick affirmed that "[a]lthough P & Z has attempted to identify all such representations, it is possible that P & Z may have represented certain of the Debtors' creditors or other entities that consider themselves parties-in-interest in matters unrelated to this chapter 11 case." (Initial Pick Affidavit ¶ 4.)

On August 30, 2010, Pick filed a supplemental disclosure affidavit further disclosing the nature of the relationship between the Debtors (the "Second Pick Affidavit"). (JMK ECF # 22; Donohue ECF # 33; Varacchi ECF # 26.) The Second Pick Affidavit readily disclosed that JMK has a general unsecured obligation to Jacob ***228** Kopf, a debtor in a related proceeding, in the amount of $307,833, with $270,000 being owed to CMA, an entity solely owned by Kopf, and the balance of approximately $38,000 being owed to Kopf individually. (JMK Second Pick Affidavit ¶ 4.) In addition, Pick disclosed that Varacchi owed Kopf (who at the time of the filing of the Second Pick Affidavit had not yet filed for bankruptcy protection) $16,000 for a personal obligation. (Varacchi Second Pick Affidavit ¶ 4.) Finally, Pick purports to have received a waiver from the Debtors of any conflict of P & Z's representation of JMK, Donohue and Varacchi and, to the extent applicable, Kopf. (JMK Second Pick Affidavit ¶ 5; Donohue Second Pick Affidavit ¶ 5; Varacchi Second Pick Affidavit ¶ 5.)

On September 17, 2010, Pick filed a second supplemental affidavit further disclosing, among other things, that P & Z had conferred with other non-debtor entities that were defendants in the Air China Case (the "Second Supplemental Pick Affidavit"). (JMK ECF # 33; Varacchi ECF # 37; Donohue ECF # 42.) The Second Supplemental Pick Affidavit acknowledged that P & Z assisted Kopf with filing his bankruptcy petition on September 14, 2010. (Second Supplemental Pick Affidavit ¶ 2(a).) P & Z also revealed that it had conversations with Nelson Li and WBM–JMK Development LLC ("WBMID"), both defendants in the Air China Case, about the possibility of their filing for bankruptcy protection. (Second Supplemental Pick Affidavit ¶ 2(b), (c).) Finally, Pick affirmed that none of the Debtors had any objection to representation of multiple parties in their reorganization cases. (Second Supplemental Pick Affidavit ¶ 4.) ("I have been advised that none of [the Debtors] has any objection or protest to P & Z's simultaneous representation of [JMK, WBMID and Messrs. Varacchi, Donohue, Kopf, and Li].")

2. Retention of Edward Weissman, Esq. as Special

Counsel to Donohue and Varacchi

P & Z filed retention applications on behalf of Donohue and Varacchi to retain Edward Weissman, Esq. to represent them as special litigation counsel in connection with the continued prosecution of the Air China Case before this Court under section 327(e) of the Bankruptcy Code. (Donohue ECF # s 22, 25; Varacchi ECF # s 17, 21.) The basis for these applications was Weissman's pre-petition representation of Donohue and Varacchi in the Air China Case. (*Id.*) According to P & Z, Weissman's knowledge and familiarity with the issues tried before the District Court made him the ideal candidate to represent Donohue and Varacchi before this Court. (*Id.*)

3. Retention of Peter A. Morales, CPA, PC as Accountant to JMK and Kopf

P & Z also filed a retention application on behalf of JMK and Kopf for Peter A. Morales to serve as accountant to the debtors pursuant to section 327(a) of the Bankruptcy Code. (JMK ECF # s 15, 44; Kopf ECF # s 11, 43.) P & Z submits that Morales's pre-petition representation of JMK and Kopf makes him the best candidate to represent those parties in their reorganization proceedings. (*Id.*)

II. DISCUSSION

A. Retention of Professionals Under Sections 327(a) and 327(e) of the Bankruptcy Code

[1] Section 327(a) of the Bankruptcy Code governs the employment of professionals to represent the estate during bankruptcy with court approval. *In re WorldCom, Inc.,* 311 B.R. 151, 163 (Bankr.S.D.N.Y.2004). The statute reads:

> ***229** Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). To be retained under section 327(a), professionals must be both disinterested and not hold or represent any interest adverse to the estate. *Vouzianas v. Ready & Pontisakos (In re Vouzianas),* 259 F.3d 103, 107 (2d Cir.2001) (citing *Bank Brussels Lambert v. Coan (In re AroChem Corp.),* 176 F.3d 610, 621 (2d Cir.1999)); *see also In re Project Orange Assocs., LLC,* 431 B.R. 363, 369 (Bankr.S.D.N.Y.2010).

[2] The structure of the Bankruptcy Code distills these dual requirements into a single test for analysis of a conflict of interest. Bankruptcy Code § 101(14) defines disinterested persons. Under section 101(14)(C) a disinterested person is one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors" for any reason. 11 U.S.C. § 101(14)(C). This definition overlaps with the adverse interest requirement of section 327(a), creating a single test for courts to employ when examining conflicts of interest. *Hogil Pharm. Corp. v. Sapir (In re Innomed Labs, LLC),* No. 07 Civ. 4778(WCC), 2008 WL 276490, at *2 (S.D.N.Y. Jan.29, 2008) (citing *WorldCom,* 311 B.R. at 164). A professional must not "hold or represent an interest adverse to the estate." *See AroChem,* 176 F.3d at 622–23 (observing that the "adverse interest" language appears in section 327(a) and in the definitions in section 101 regarding disinterested persons and articulating the relevant test as whether an entity "holds or represent[s] an interest adverse to the estate"); *Innomed Labs,* 2008 WL 276490, at *2 (same); *see also In re Granite Partners, L.P.,* 219 B.R. 22, 33 (Bankr.S.D.N.Y.1998) (observing that "the two prongs of section 327(a) are duplicative and form a single test to judge conflicts of interest") (internal citation omitted).

[3] [4] [5] [6] [7] The Second Circuit has defined "hold or represent an adverse interest" as

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

AroChem, 176 F.3d at 623 (quoting *In re Roberts,* 46 B.R. 815, 827 (Bankr.D.Utah 1985), *aff'd in part and rev'd in part on other grounds,* 75 B.R. 402 (D.Utah 1987)). The test is not retrospective; courts only examine present interests when determining whether a party has an adverse

interest. *AroChem,* 176 F.3d at 623–24 (observing that Congress intended only to proscribe those who presently have an adverse interest from representing a debtor under § 327(a)). Generally stated, the adverse interest test is objective and precludes "any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules." *Granite Partners,* 219 B.R. at 33; *see also In re Angelika Films 57th, Inc.,* 227 B.R. 29, 38 (Bankr.S.D.N.Y.1998) ("The determination of adverse interest is objective and is concerned with the appearance of impropriety.") (citation omitted). Further, courts have recognized that a professional has a disabling conflict if it has "either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors—an incentive sufficient ***230** to place those parties at more than acceptable risk—or the reasonable perception of one." *Granite Partners,* 219 B.R. at 33 (quoting *In re Martin,* 817 F.2d 175, 180 (1st Cir.1987)). Thus, disqualification is appropriate "if it is plausible that the representation of another interest may cause the debtor's attorney to act any differently than they would without other representation." *In re Leslie Fay Cos.,* 175 B.R. 525, 533 (Bankr.S.D.N.Y.1994).

[8] [9] [10] Courts determine whether an adverse interest exists on a case-by-case basis, examining the specific facts in a case. *AroChem,* 176 F.3d at 623 ("Whether an adverse interest exists is best determined on a case-by-case basis."); *Angelika Films 57th,* 227 B.R. at 39 (stating that "the determination of counsel's disinterestedness is a fact-specific inquiry"). Bankruptcy courts may consider the interests of the estate and the debtor's creditors, accounting for the expeditious resolution of a case when analyzing a retention order. *Vouzianas,* 259 F.3d at 107 (citing *AroChem,* 176 F.3d at 621). Courts, however, must take the requirements of section 327 seriously, as they ensure that a professional fulfills his duties in accordance with his fiduciary duties to the estate. *Leslie Fay Cos.,* 175 B.R. at 532 ("The requirements of section 327 cannot be taken lightly, for they 'serve the important policy of ensuring that all professionals appointed pursuant to [the section] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.' ") (quoting *Rome v. Braunstein,* 19 F.3d 54, 58 (1st Cir.1994)). Moreover, courts lack the power to authorize the "employment of a professional who has a conflict of interest." *In re Mercury,* 280 B.R. 35, 55 (Bankr.S.D.N.Y.2002) (citations omitted).

[11] The existence of claims among debtor individuals or entities is scrutinized closely as it relates to representation of multiple parties (creditors and debtors) in reorganization proceedings. A leading treatise notes that "[o]ne problem area that does influence courts to disqualify attorneys or deny their requests for compensation is the potential assertion of intercompany claims among the debtor entities." 3 COLLIER ON BANKRUPTCY ¶ 327.04[5][b] (16th ed. rev. 2010). Courts are to review the potential conflicts on a case-by-case basis in connection with claims between debtors. *Id.* (multiple representation of debtors and/or creditors not a per se conflict of interest); *see also In re Interwest Bus. Equip., Inc.,* 23 F.3d 311, 316 (10th Cir.1994) (concluding that bankruptcy court did not abuse its discretion in denying employment of single law firm to simultaneously represent interrelated debtors where debtor-creditor relationship was established as a result of prepetition debts "from one estate to the other").

[12] Debtors may also retain attorneys for a "specified special purpose" under section 327(e) of the Bankruptcy Code. *See In re Quality Beverage Co.,* 216 B.R. 592, 594 (Bankr.S.D.Tex.1995) (noting that "the plain language of the statute limits its application to attorneys"). Section 327(e) provides as follows:

> The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327(e). The requirements for retention under section 327(a) that a professional not hold or represent an interest adverse to the estate apply equally to retention ***231** under section 327(e). *See In re Homesteads Cmty. at Newtown, LLC,* 390 B.R. 32, 47–48 (Bankr.D.Conn.2008) ("[I]n applying Section 327(a) ... [to a 'special counsel' situation, courts] should reason by analogy to [Section] 327(e), so that where the trustee seeks to appoint counsel only as 'special counsel' for a specific matter, there need only be no conflict between the trustee and counsel's ... client with respect to the specific matter itself.") (quoting *AroChem,* 176 F.3d at 622 (internal quotation marks omitted)).

B. The Debtors' Continuing Right to Seek

Contribution Precludes P & Z From Representing More Than One Debtor Under § 327(a)

[13] P & Z endeavors to mitigate any actual conflict by disavowing the Debtors' continuing right to seek contribution from one another as a result of the judgment rendered against them in the Air China Case. (Pick Response ¶¶ 8–16.) The U.S. Trustee argues that a contribution claim under New York law may lie against any one of the Debtors at an undetermined time in the future on account of the Air China judgment. (U.S. Trustee Objection at 9–11.) Thus, P & Z would represent an adverse interest to the estates of the other Debtors in violation of section 327(a). (*Id.*) Air China also argued in its objection that the Debtors may have "potential claims against each other for common law contribution based on the verdict rendered against them." (Opp'n to the Appl. For Authority to Retain Pick & Zabicki LLP, *Nunc Pro Tunc,* as Counsel to the Debtor (the "Air China Objection") ¶ 17; (JMK ECF # 26; Kopf ECF # 13; Donohue ECF # 34; Varacchi ECF # 27).) Directing the Court to the jury verdicts rendered against the individual defendants in the Air China Case, P & Z argues that "the jury had made specific findings as to the liability and damages of *each defendant* to the Air China Case, and, thus, no rights to contribution exist between and among the Debtors in connection with the specific amounts awarded against them." (Pick Response ¶ 9.)

The U.S. Trustee also argues that JMK and Kopf would also have a right of contribution against each other in the Satin Case if a judgment is rendered against them on the claims of breach of fiduciary duty and unjust enrichment. (U.S. Trustee Objection at 11.) P & Z counters by averring that there is no real claim against Kopf as Satin is only seeking an entitlement to a shareholder interest in JMK with the implication that there would be no monetary damages due to Satin. (Pick Response ¶ 11.)

A review of the New York law on contribution shows that there may be a continuing right of contribution between the Debtors in the Air China Case notwithstanding the fact that the jury apportioned damages to each defendant individually. Further, it is not unreasonable to expect that the causes of action asserted in the Satin Case may result in damages against both JMK and Kopf, thus creating a right of contribution under New York law. This right of contribution may "create ... [a] potential dispute in which the estate is a rival claimant," and preclude retention of P & Z under section 327(a). *Project Orange,* 431 B.R. at 370 (internal quotation marks omitted).

1. The New York Law of Contribution Precludes Representation of More Than One Debtor by P & Z

[14] [15] [16] With regard to the right of contribution, New York law—which governs the jury verdict in the Air China Case—provides that "[a] contribution claim may be interposed when two or more parties are alleged to be liable for damages for the same injury." *See* ***232** *Int'l Bus. Machines Corp. v. Liberty Mut. Fire Ins. Co.,* 303 F.3d 419, 423 (2d Cir.2002); *Santalucia v. Sebright Transp., Inc.,* 232 F.3d 293, 296 (2d Cir.2000); N.Y. C.P.L.R. § 1401 (McKinney 2009). Section 1401 of the New York Civil Practice Law and Rules provides that "two or more persons who are subject to liability for damages for the same personal injury, injury to property or wrongful death, may claim contribution among them whether or not an action has been brought or a judgment has been rendered against the person from whom contribution is sought." N.Y. C.P.L.R. § 1401. Under New York law, "contribution is available whether or not the culpable parties are allegedly liable for the injury under the same or different theories"; and "contribution may be invoked against concurrent, successive, independent, alternative and even intentional tortfeasors." *Calcutti v. SBU, Inc.,* 273 F.Supp.2d 488, 493 (S.D.N.Y.2003) (citing *Steed Finance LDC v. Laser Advisers, Inc.,* 258 F.Supp.2d 272, 283 (S.D.N.Y.2003) (internal quotation marks omitted)).

[17] [18] When two or more tortfeasors act concurrently or in concert to produce a single injury, they may be held jointly and severally liable. *See Sweeney, Cohn, Stahl & Vaccaro v. Kane,* 6 A.D.3d 72, 773 N.Y.S.2d 420, 426 (App.Div. 2d Dep't 2004). Joint and several liability extends from the principal that "such concerted wrongdoers are considered 'joint tort-feasors' and in legal contemplation, there is a joint enterprise and a mutual agency, such that the act of one is the act of all and liability for all that is done is visited upon each." *See Cayuga Indian Nation of New York v. Pataki,* 79 F.Supp.2d 66, 72 (N.D.N.Y.1999) (citing *Ravo by Ravo v. Rogatnick,* 70 N.Y.2d 305, 520 N.Y.S.2d 533, 514 N.E.2d 1104 (1987)). On the other hand, where two or more joint tortfeasors act independently and cause a distinct or single harm, for which there is a reasonable basis for division according to the contribution of each, then each is liable for damages only for his or her own portion of the harm. *See* RESTATEMENT (SECOND) OF TORTS § 433A (1965) ("(1) Damages for harm are to be apportioned among two or more causes where (a) there are distinct harms, or (b) there is a reasonable basis for determining the contribution of each cause to a single harm. (2) Damages for any other harm cannot be apportioned among two or more causes."); *see also Becker v. Poling Transp. Corp.,* 356 F.3d 381, 390–91 (2d Cir.2004).

[19] Courts have recognized that a jury's apportionment of fault (or, in this case, damages) does not necessarily determine the *type* of liability (joint and several or independent and successive), and thus does not necessarily determine the ability of the parties against whom judgment was entered to seek contribution from other defendants. *See Ravo,* 520 N.Y.S.2d 533, 514 N.E.2d at 1108–09 ("[T]he jury's apportionment of fault, however, does not alter the joint and several liability of defendants for the single indivisible injury. Rather, that aspect of the jury's determination of culpability merely defines the amount of contribution defendants may claim from each other, and does not impinge upon plaintiff's right to collect the entire judgment award from either defendant...."); *see also In re September 11 Litig.,* 621 F.Supp.2d 131, 146–47 (S.D.N.Y.2009) (stating that "even an apportionment of fault between the tortfeasors does not alter the joint and several liability of each defendant for the entire single indivisible injury") (internal quotation marks omitted).

Applying these principles, the Court cannot conclude that there is no longer a right of contribution under New York law between the Debtors. In support of their argument that the jury determined that ***233** the defendants were liable on an independent basis and that no joint and several liability exists, P & Z submitted the verdict forms from the Air China Case indicating the amount of damages Air China is entitled to recover from each defendant. (Pick Response, Ex. A.) While the amount of damages awarded by the jury was determined on a defendant-by-defendant basis, the verdict form clearly directed the jury to apportion liability between the defendants and no judgment can be made regarding the type of liability (joint and several or independent) ascribed to the defendants. *See Ravo,* 520 N.Y.S.2d 533, 514 N.E.2d at 1108 (analyzing jury instructions and interrogatories related thereto to determine respective responsibility between defendants for purposes of contribution). The Court makes no judgment about the merits of an action for contribution between the Debtors, but only notes that the apportionment of damages is not dispositive of the Debtors' rights to seek contribution from one another. In sum, the Court cannot conclude that there is no longer a right of contribution between the Debtors on account of the judgment rendered in the Air China Case. The right of contribution between Debtors is sufficient to disqualify P & Z from being retained pursuant to section 327(a) by more than one debtor.[2] *See, e.g., In re Wiley Brown & Assocs. LLC,* No. 06–50886, 2006 WL 2390290, at *2–5 (Bankr.M.D.N.C. Aug.14, 2006) (concluding that counsel could not represent debtor and debtor's creditor where debtor had right of contribution against creditor each time that debtor made a payment on debt to which both parties were obligated).

In addition to the continuing right of contribution between the Debtors in the Air China Case, there may be a right of contribution between JMK and Kopf on account of the Satin Case. A review of the complaint in the Satin Case indicates that Satin is seeking compensatory and punitive money damages on his second and third causes of action, breach of fiduciary duty and unjust enrichment. As discussed *supra,* if Satin is successful in his action and a fact-finder determines that monetary damages should be awarded, JMK and Kopf may have a right of contribution against each other. *See* N.Y. C.P.L.R. § 1401. JMK and Kopf would be adverse to one another, and P & Z would represent interests adverse to their estates, in violation of section 327(a).

C. The Inter–Debtor Claims Preclude P & Z From Representing More Than One Debtor Under § 327(a)

As further justification for denial of the P & Z Retention Application, the U.S. ***234** Trustee and Air China direct the Court to the debtor-creditor relationship that exists between JMK, Kopf and Varacchi. (U.S. Trustee Objection at 11–13; Air China Objection ¶ 17.) As described above, JMK owes approximately $38,000 to Kopf and $270,000 to CMA, a corporate entity solely owned by Kopf. Varacchi also owes Kopf $16,000 for personal advances. Simply stated, Kopf is a creditor of both JMK and Varacchi. P & Z would have the Court look past the inter-debtor claims in favor of judicial economy and minimizing the costs to the estate. (Pick Response ¶¶ 16–17.) P & Z submits that representation of multiple Debtors in this case is not unlike many of the large multi-debtor reorganization cases in this district and others. *See* 3 COLLIER ON BANKRUPTCY ¶ 327.04[5]. However, as is the case here, "[t]he potential problems inherent in multi-debtor representations become more acute when each debtor has its own creditors, different officers from other debtor entities, separate directors and, perhaps, different ownership interests as well as significant intercompany claims. Very close, if not totally intertwined, corporate and financial affairs also create problems." *Id.* While the Court recognizes its obligation to examine the specific facts to determine whether an adverse interest exists, the paramount interest of creditors, including Air China and the committee of unsecured creditors (the "Creditors Committee") appointed in the JMK case, would be better served if more than one law firm was retained to represent the Debtors.[3] *See Project Orange,* 431 B.R. at 370.

1. P & Z May Not Represent Both Debtors and Creditors

The representation of both debtors and creditors may create an irremediable conflict of interest. Other courts have likewise concluded that representation of both a debtor and a creditor may present a disabling conflict of interest in violation of section 327(a) of the Bankruptcy Code. *See, e.g., In re Bolton–Emerson, Inc.,* 200 B.R. 725, 731 (D.Mass.1996) ("Several courts have flagged the potential conflict of interest which arises when counsel represent both a corporate debtor and its officers."); *In re American Printers & Lithographers, Inc.,* 148 B.R. 862, 865–66 (Bankr.N.D.Ill.1992) (noting that "[s]everal courts have refused to allow attorneys to represent a debtor while simultaneously representing a principal of that debtor" even in unrelated matters) (citing cases); 2 NORTON BANKRUPTCY LAW AND PRACTICE 3D § 30:5 (3d ed. 2010) (observing that the "most common areas in which conflicts arise are where the professional also represents ... creditors of the debtor").

In *In re Big Mac Marine, Inc.,* 326 B.R. 150, 154–55 (8th Cir. BAP 2005), the Eighth Circuit Bankruptcy Appellate Panel considered whether the bankruptcy court properly disqualified an attorney from representing Big Mac Marine, Inc. ("Big Mac Marine") because the same attorney had been approved to represent the debtor's principals in their pending cases. William Needler and Associates, Ltd. ("Needler") sought to be retained as debtor's counsel after Big Mac Marine filed for bankruptcy protection in 2003. *Id.* at 151. Prior to seeking approval of its retention for Big Mac Marine, Needler was retained as counsel to Edward and Shirley Schmidt ("the Schmidts"), who were the 100% owners of Big Mac Marine. *Id.* at 152. According ***235** to Big Mac Marine's schedules, the Schmidts were the largest creditors in the case, holding secured debt of $596,127.27. *Id.* at 151. In support of the retention application, Needler stated "to the best of his knowledge this representation did not create a conflict of interest." *Id.* at 152. Needler also disclosed that it represented the Schmidts in their personal bankruptcy proceedings; and the Schmidts were the 100% shareholders of Big Mac Marine and creditors of the debtor. *Id.* The bankruptcy court concluded that Needler "could not represent both sets of debtors without having conflicting allegiances." *Id.* at 153. In light of the potential dispute between the Schmidts and Big Mac Marine whether the Schmidts' claim was secured or unsecured, the Bankruptcy Appellate Panel affirmed and concluded that Needler had an irremediable conflict of interest. *Id.* at 154–55. Needler would "have an obligation to represent all [of Big Mac Marine's] creditors and to objectively analyze the validity of the Schmidts' claims to secured status, or indeed to being a creditor at all" as well as the interests of Big Mac Marine. *Id.* Ultimately, the Bankruptcy Appellate Panel concluded that there was an actual conflict of interest and "[m]ultiple representation in these two cases was out of the question." *Id.*

The issue of multiple representations also was considered in *Wiley Brown & Assocs., LLC,* 2006 WL 2390290, at *2–5. The debtor, Wiley Brown & Associates, LLC ("Wiley Brown"), filed an application to employ A. Carl Penney ("Penney") as Wiley Brown's attorney in the bankruptcy proceedings. *Id.* at *1. At the time the retention application was filed, Penney also represented Cecil Dorrel Brown ("Brown") in his individual chapter 13 bankruptcy case. *Id.* Brown listed Wiley Brown as his employer in his schedules. *Id.* Penney's Wiley Brown retention application attached an affidavit indicating "he has no connection with said Debtor, the creditors, or any other party in interest, or their respective attorneys and that he represents no interest adverse to said Debtor, or the estate in which the matters upon which (sic) he is to be engaged." *Id.* at *2. The affidavit failed to state, among other things, that Penney represented Brown, a 50% owner of the debtor in his own chapter 13 case, Brown derived his income from Wiley Brown, Wiley Brown was contributing $6,000 each month to Brown's individual case, Brown and Wiley (the other owner) were co-obligors, along with Wiley Brown, on the largest debt in both bankruptcies, or that Brown was a co-obligor with debtor on the second largest debt in Wiley Brown's bankruptcy. *Id.* The bankruptcy court concluded that Penney's representation of Brown in his individual case constituted a conflict with representation of Wiley Brown as Brown derived his income from Wiley Brown, Brown relied on Wiley Brown's funding of his chapter 13 case and Wiley Brown continued to pay their co-obligation under the debt owed to their two largest creditors. *Id.* Thus, Penney was not permitted to simultaneously represent Wiley Brown and its owner as it is "a conflict of interest to represent a debtor and an owner of the debtor," nor could Penney represent Wiley Brown and its creditor as "an attorney cannot simultaneously represent a debtor and a creditor of the estate." *Id.* at *4–5.

The case of *In re Coal River Res., Inc.,* 321 B.R. 184, 189 (W.D.Va.2005), is also instructive. In *Coal River,* four debtors owned by a single individual filed for bankruptcy and sought retention of a single law firm, Copeland & Bieger, P.C., as legal counsel. *Id.* at 186. The United States Trustee objected to the retention on the ground that "some or all of the debtors are creditors of one another." *Id.* The bankruptcy court determined that Copeland & ***236** Bieger was not qualified to represent two of the debtor entities under section 327 of the Bankruptcy Code. On appeal, the district court conducted a fact-intensive analysis and looked to the schedules of each of the

debtors to determine if there was a conflict of interest. *Id.* at 188–89. Because some of the debtors indicated on their schedules that they were creditors of the other debtors and there was intercompany indebtedness "consisting of charges for services and equipment, as well as cash loans," the district court concluded that the evidence "support[ed] the bankruptcy court's finding that a single attorney could not represent the interests of each debtor, and in particular the fiduciary obligation of each debtor to its own creditors." *Id.* The district court found there to be an actual conflict of interest. *Id.* Thus, Copeland & Bieger was disqualified from representing certain of the debtors. *Id.*

This Court also considered a similar issue in *In re Project Orange Assocs., LLC,* 431 B.R. 363, 365 (Bankr.S.D.N.Y.2010). The debtor sought to retain DLA Piper as general bankruptcy counsel pursuant to section 327(a) of the Bankruptcy Code. *Id.* at 365. DLA Piper represented certain General Electric entities ("GE") in other non-bankruptcy matters, and one of those GE entities was the largest general unsecured creditor of the debtor. *Id.* at 367–68. After analyzing the relationship between GE and the debtor, the Court concluded that DLA Piper could not represent both the debtor and GE given the nature of the issues between them as they weighed on the debtor's ability to restructure. *Id.* at 371–72. Further, the Court concluded that the conflict waiver entered between the debtor and GE was ineffective to remedy the actual conflict under section 327(a) of the Bankruptcy Code. *Id.* at 372–75. Ultimately, the Court concluded that DLA Piper could not represent the debtor in light of the actual conflict arising from DLA Piper's representation of GE in other non-bankruptcy related matters. *Id.* at 379.

In an effort to distinguish *Project Orange,* P & Z relies on the directive that a court should review whether an adverse interest exists on a case-by-case basis.[4] (Pick Response ¶¶ 16–17.) P & Z asserted that the facts of this case weigh in favor of finding that no adverse interest exists because permitting P & Z to represent both debtors and creditors could simplify administration of the estate. (*Id.*) While representation of multiple debtors may offer the advantage of keeping professional costs at a minimum, the Court finds the conflict between JMK, Kopf and Varacchi even more troublesome than the conflict that led to rejection of the retention application in *Project Orange.* Here, P & Z seeks to represent both debtors and creditors *in the same matter;* in *Project Orange,* DLA Piper's conflict arose from representing GE in unrelated non-bankruptcy matters. While there may be some cases where representation of debtors and creditors may be permissible, *see In re Global Marine, Inc.,* 108 B.R. 998, 1004 (Bankr.S.D.Tex.1987) (holding that intercompany ***237** claims among debtors do not necessarily requires disqualification), the relationship between debtors and creditors in this case is too intertwined to permit one law firm to represent more than one debtor. Questions have arisen here about the relationship between JMK and Kopf; counsel for the JMK Creditors Committee has raised the possibility of avoidance actions being filed against Kopf. Additionally, Air China has commenced adversary proceedings against Kopf, Varacchi and Donohue seeking to deny them a discharge based on fraud. Under all of these circumstances, the Court concludes that each Debtor must be represented by independent counsel.

The conflicts waivers offered by the Debtors in these cases to permit P & Z to represent all of the Debtors are clearly insufficient to overcome the mandatory requirements of section 327.

2. Kopf's Waiver is Ineffective to Cure the Conflict

[20] In an apparent attempt to remedy any actual or potential conflict of interest, Kopf purported to waive his claims against JMK by letter submitted to the Court. The purported waiver was confirmed by letter dated October 20, 2010, which stated as follows: "This letter will confirm my irrevocable waiver of repayment of the amounts listed as owed to me by JMK Construction Group Ltd. in its bankruptcy schedules." (Kopf ECF # 45; JMK ECF # 46.)

Courts have recognized that conflicts waivers are not effective for purposes of satisfying the "adverse interest" requirement of section 327(a) of the Bankruptcy Code. *See, e.g., Project Orange,* 431 B.R. at 374–75 (stating that a conflicts waiver "cannot trump the requirements of section 327(a)"); *In re Git–N–Go, Inc.,* 321 B.R. 54, 57–60 (Bankr.N.D.Okla.2004); *Granite Partners,* 219 B.R. at 34 (observing that while clients may in some instances waive conflicts, "the mandatory provisions of section 327(a) do not allow for waiver"); *In re Perry,* 194 B.R. 875, 880 (E.D.Cal.1996) (stating that "section 327(a) has a strict requirement of disinterestedness and absence of representation of an adverse interest which trumps the rules of professional conduct"). In *Git–N–Go,* 321 B.R. at 57–60, the bankruptcy court was asked to consider the retention application of a law firm seeking to be retained by the debtor under section 327(a) of the Bankruptcy Code. In the retention application, proposed counsel disclosed that it represented a holding company which owned approximately 87% of the debtor's stock and had

common officers and directors with the debtor. *Id.* at 57. The representation of the holding company related to a prepetition financing transaction where the debtor guaranteed the incurrence of debt by the holding company. *Id.* To remedy the potential conflicts stemming from the multiple representations, the law firm received conflicts waivers from the debtor and the holding company. *Id.* at 60. The court recognized that the debtor received the waiver to conform to rules of professional responsibility, but found the waivers insufficient to waive the adverse interests between debtors and creditors in bankruptcy. *Id.*

The purported waiver by Kopf of his claims against JMK is not sufficient to satisfy the requirements of section 327(a) of the Bankruptcy Code. As this Court held in *Project Orange,* a waiver of conflicts by one party does not trump the requirement that a professional not represent an interest adverse to the estate.

What Kopf has attempted here is arguably more repugnant than a simple conflicts waiver: after commencing separate bankruptcy cases, creating an estate in each case consisting of "all legal or equitable ***238** interests of the debtor in property as of the commencement of the case," 11 U.S.C. § 541(a)(1), Kopf purported to waive his right to recover the debt from JMK, but the debt from JMK is property of the estate in Kopf's individual chapter 11 case. Kopf clearly disposed of property "other than in the ordinary course of business," something that cannot be done without court approval.[5] *See* 11 U.S.C. § 363(b)(1). The purported waivers are ineffective as a waiver of property of the estates and insufficient to waive the actual conflict in representing the multiple debtors in these cases.

D. Mr. Morales Cannot Be Retained as Accountant to Both JMK and Mr. Kopf

For the same reasons discussed above, Morales cannot be retained by both JMK and Kopf. JMK and Kopf each seek to retain Peter Morales as their accountant pursuant to section 327(a) of the Bankruptcy Code. To be retained by the estate, Morales must not represent an interest adverse to the estate. 11 U.S.C. § 327(a). As noted above, Kopf is a creditor of JMK in the amount of approximately $310,000; waiver of these debts by letter to the Court is not effective for purposes of retention. Accordingly, Morales may not be retained by both JMK and Kopf.

E. Mr. Weissman Cannot Be Retained as Special Counsel to Both Donohue and Varacchi

Donohue and Varacchi have each filed applications to retain Mr. Weissman as special litigation counsel to represent their interests in connection with the Air China Case before this Court.[6] As demonstrated above, the New York contribution law may still apply, and Varacchi and Donohue may still have their right to assert contribution claims against each other in connection with the judgments rendered against them in the Air China Case. Therefore, Weissman's retention by more than one debtor would have Weissman represent interests adverse to the estate in violation of section 327(a) of the Bankruptcy Code.

III. CONCLUSION

Due to the possibility that the Debtors may still have a state law right to contribution against each other and the existence of inter-debtor claims, P & Z may not be retained by more than one debtor as general bankruptcy counsel in their reorganization proceedings. For the same reasons, Weissman and Morales may not represent more than one debtor. This Opinion, however, does not preclude the professionals from seeking retention by only one debtor. Thus, the P & Z Retention Applications and the retention applications for Weissman and Morales are **DENIED.**

IT IS SO ORDERED.

Parallel Citations

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Footnotes

1 No such disclosure was made in the retention applications filed on the same date in the Donohue or Varacchi matters. (*See* Donohue ECF # 31; Varacchi ECF # 23.)

2 P & Z also argues that because the claims bar date in each of the Debtors' cases (except the Kopf matter) has passed without a proof of claim for contribution being filed and none of the Debtors has asserted any claim for contribution against the others, the

right to seek contribution is somehow extinguished. (Pick Response ¶ 10.) Under New York law, the right to seek contribution does not accrue until payment of the underlying claim. *See Tetens v. Elston Realty Corp.,* 108 A.D.2d 981, 484 N.Y.S.2d 966, 967–68 (App.Div.3d Dep't 1985) (citing *Blum v. Good Humor Corp.,* 57 A.D.2d 911, 394 N.Y.S.2d 894 (App.Div.2d Dep't 1977)). The right to contribution may be a contingent claim under the definition of a claim in the Bankruptcy Code, 11 U.S.C. § 101(5). *See* 2 COLLIER ON BANKRUPTCY ¶ 101.05[1]. In light of the conclusion that P & Z may not represent more than one Debtor, it is apparent that each Debtor was represented by conflicted counsel prior to expiration of the bar dates and may not have received independent advice regarding whether they should file a proof of claim. (U.S. Trustee Objection at 11.) Additionally, the right to contribution is property of each estate and cannot be waived or relinquished by the Debtors without Court approval. *See* 11 U.S.C. § 363(b)(1).

3 Counsel to the Creditors Committee in the JMK case appeared at the hearing on the retention applications and supported the U.S. Trustee's and Air China's objections. Counsel stated that he believed this case "cried out" for independent counsel, particularly in light of the possibility of avoidance actions being filed by one debtor against another.

4 P & Z argues that, in addition to being cost-effective, it is in the best interest of the Debtors and their creditors to have P & Z retained as counsel to each Debtor for several reasons, including: (1) the bankruptcy cases were all precipitated for the same reason, namely the entry of judgments in the Air China Case; (2) Kopf and Varacchi will be submitting plans that pay all allowed claims in full, thereby presuming acceptance of the plan without a vote since there will not be any impaired class of creditors; and (3) Air China has filed an adversary proceeding asserting identical nondischarge complaints pursuant to section 523 of the Bankruptcy Code and single representation in those matters would benefit the estate. (Pick Response ¶¶ 16–17.)

5 Kopf and JMK belatedly filed a motion to approve the waiver of the debt as a settlement under Federal Rule of Bankruptcy Procedure 9019. (*See* MK ECF # 71.) P & Z represented both sides in documenting the proposed settlement. A hearing on the Rule 9019 motion is scheduled for December 21, 2010. In light of the rejection of the retention of P & Z, the Court will not consider approving a settlement in which P & Z represented multiple debtors.

6 Kopf has separately retained Duane Morris LLP as his special counsel in the Air China Case. (Kopf ECF # 57.) As of the date hereof, JMK has not retained special counsel.

End of Document

431 B.R. 363
United States Bankruptcy Court,
S.D. New York.

In re PROJECT ORANGE ASSOCIATES, LLC,
Debtor.

No. 10–12307(MG). | June 23, 2010.

Synopsis
Background: United States Trustee (UST) objected to Chapter 11 debtor's retention of law firm as general bankruptcy counsel, based on firm's representation in unrelated matters of debtor's largest unsecured creditor and essential supplier.

Holdings: The Bankruptcy Court, Martin Glenn, J., held that:

[1] debtor's execution of stipulation with creditor did not resolve conflict of interest between creditor and law firm;

[2] creditor's conflicts waiver did not permit law firm's employment under statute; and

[3] debtor's use of conflicts counsel did not allow debtor's employment of firm as general bankruptcy counsel.

Objection sustained.

West Headnotes (13)

[1] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Professionals must be both disinterested and not hold or represent any interest adverse to the estate to be employed to represent estate under Bankruptcy Code. 11 U.S.C.A. § 327(a).

6 Cases that cite this headnote

[2] **Attorney and Client**
Bankruptcy

Prohibition on adverse interests under conflicts of interests test for estate's employment of professionals includes economic and personal interests of an attorney. 11 U.S.C.A. § 327(a).

3 Cases that cite this headnote

[3] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Conflicts of interests test for estate's employment of professionals is not retrospective; courts only examine present interests when determining whether a party has an adverse interest. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[4] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Generally, the adverse interest test for estate's employment of professionals is objective and excludes any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by the Bankruptcy Code and rules. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[5] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Courts determine existence of adverse interest precluding estate's employment of professional on a case-by-case basis, examining the specific facts in a case. 11 U.S.C.A. § 327(a).

1 Cases that cite this headnote

[6] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy courts may consider the interests of the estate and the debtor's creditors, accounting for the expeditious resolution of a case, when analyzing a retention motion. 11 U.S.C.A. § 327(a).

Cases that cite this headnote

[7] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Courts must take the requirements of statute governing estate's employment of professionals seriously, as they ensure that a professional fulfills his duties in accordance with his fiduciary duties to the estate. 11 U.S.C.A. § 327.

Cases that cite this headnote

[8] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy courts lack the power to authorize estate's employment of a professional who has a conflict of interest. 11 U.S.C.A. § 327.

Cases that cite this headnote

[9] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy Code requires disqualification of a professional from employment by estate following an objection from United States Trustee (UST) or a creditor where there is an actual conflict of interest. 11 U.S.C.A. § 327(c).

Cases that cite this headnote

[10] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Bankruptcy statute governing estate's employment of professionals prevents disqualification based solely on professional's prior representation of or employment by a creditor, but does not obviate the essential requirement that a professional not have an interest adverse to estate. 11 U.S.C.A. § 327(c).

Cases that cite this headnote

[11] **Attorney and Client**
Bankruptcy

Chapter 11 debtor's execution of stipulation with creditor did not resolve disabling conflict of interest between creditor and law firm that debtor sought to retain as its general bankruptcy counsel where stipulation, by its terms, was not effective without court approval and adversity would still remain even if court approved stipulation, given requirement under parties' settlement that creditor repair turbine components before installing turbines at debtor's steam and electricity cogeneration facility, and given debtor's highly contentious state-court litigation with its landlord; debtor and creditor remained completely adverse until repair and installation of turbines was complete, and landlord's success in establishing prepetition lease termination would leave debtor without

assets to pay creditor. 11 U.S.C.A. § 327(a); Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.

1 Cases that cite this headnote

[12] **Attorney and Client**
Bankruptcy

Conflicts waiver obtained from creditor by law firm that Chapter 11 debtor sought to retain as general bankruptcy counsel did not, by contractually permitting firm to represent debtor on some matters adverse to creditor, trump statutory requirements governing estate's employment of professionals and severely limited firm's ability to act in debtor's best interests with regard to creditor, by barring law firm from bringing action and threatening to bring action against creditor or its affiliates for monetary damages or equitable relief, even within context of negotiations, and therefore waiver did not permit firm's employment under statute. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[13] **Attorney and Client**
Bankruptcy

Chapter 11 debtor's use of conflicts counsel did not allow debtor's employment, as general bankruptcy counsel, of law firm that had conflict of interest with creditor that was both debtor's largest creditor and central to debtor's reorganization, which hinged upon creditor's return and installation of turbines at debtor's steam and electricity cogeneration facility; given creditor's strong interests and active stance in case, addressing issues with creditor would take considerable time and skill on range of matters. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

Attorneys and Law Firms

***365** Diana G. Adams, by Elisabetta G. Gasparini, Esq., New York, NY, United States Trustee for Region 2.

DLA Piper LLP (US), by Timothy W. Walsh, Esq., Christopher R. Thompson, Esq., New York, NY, Proposed Attorneys for the Debtor and Debtor in Possession.

MEMORANDUM OPINION AND ORDER SUSTAINING THE UNITED STATES TRUSTEE'S OBJECTION TO DEBTOR'S APPLICATION FOR AN ORDER AUTHORIZING THE EMPLOYMENT AND RETENTION OF DLA PIPER LLP (US) AS COUNSEL *NUNC PRO TUNC* TO THE PETITION DATE

MARTIN GLENN, Bankruptcy Judge.

This opinion addresses an important issue whether the use of conflicts counsel to deal with the debtor's largest unsecured creditor and essential supplier is sufficient to permit court approval under section 327(a) of the Bankruptcy Code of a debtor's choice for general bankruptcy counsel that also represents that creditor in unrelated matters. Project Orange Associates, LLC ("Project Orange" or "Debtor") seeks to retain DLA Piper LLP (US) ("DLA Piper") as general bankruptcy counsel pursuant to section 327(a) of the Bankruptcy Code. The United States Trustee ("U.S. Trustee") objects, arguing that DLA Piper's representation of certain General Electric ("GE") entities, as well as inadequate disclosure about DLA Piper's relationship with other creditors, requires the Court to deny DLA Piper's employment application. GE is the Debtor's largest ***366** unsecured creditor. Perhaps more importantly, the Debtor has acknowledged that resolving all past and future issues with GE—the supplier of gas turbines to Debtor's operations—is essential to the Debtor's successful reorganization. DLA Piper argues that it does not have a disqualifying conflict with GE, and that, in any event, the Debtor's use of conflicts counsel to deal with certain aspects of the Debtor's relationship with GE, is sufficient to avoid DLA Piper's conflict and to permit its retention as general bankruptcy counsel. For the following reasons, the Court agrees with the U.S. Trustee and denies DLA Piper's employment application.

I. BACKGROUND

The Debtor filed for chapter 11 protection in this Court on April 29, 2010. On May 20, 2010, DLA Piper filed its employment application (the "DLA Employment Application"). (ECF # 58.) The U.S. Trustee filed its objection on May 27, 2010 (the "U.S. Trustee's Obj."). (ECF # 68.) The Court heard argument on the DLA Employment Application on June 7, 2010. Following the hearing, DLA Piper requested permission to file a supplemental brief in support of the DLA Employment Application. (ECF # 95.) The Court granted the request, permitting both DLA Piper and the U.S. Trustee to file supplemental briefs. (ECF # 96.)

The Debtor has retained ownership and continues to operate a steam and electricity cogeneration facility (the "Facility") in Syracuse, New York. (Affidavit of Adam Victor Pursuant to Rule 1007–2 of the Local Bankruptcy Rules ("Victor Local Rule 1007–2 Aff.") at ¶¶ 5–7 (ECF # 4).) The Debtor attributes its current financial predicament to the deregulation of the New York State energy market, ongoing litigation with Syracuse University (where the cogeneration facility is located pursuant to a lease and other agreements), and maintenance issues with two electric turbines (the "Turbines") manufactured and, until recently, maintained by GE. (*See id.* at ¶¶ 12–16.) The Debtor earns money by, *inter alia,* providing electrical services to the New York Independent System Operator ("NYISO"), an entity charged with overseeing New York's electricity markets. NYISO makes payments to the Debtor for (i) producing and supplying electricity to NYISO ("Energy Payments"); (ii) being available to produce electricity, if required ("Capacity Payments"); (iii) selling "Vars" or so-called "reactive power"; and (iv) permitting NYISO to control the load levels of the Debtor's generators while they are operational ("Regulation Payments"). The Debtor states that it is not generating sufficient income because of maintenance issues with its GE gas turbines.[1] (*Id.* at ¶ 24.)

A. The Debtor's History with GE

In 1992, Project Orange and GE entered into a maintenance agreement (the "Maintenance Agreement") for long term maintenance, including necessary repairs to the Turbines. The Debtor states that, starting ***367** in 2004, the Turbines began suffering from failures that impacted Project Orange's energy production. (*Id.* at ¶ 20.) The problems continued throughout 2004, and according to the Debtor, in April 2005 one of the Turbines suffered a "catastrophic failure." Following this event, GE and Project Orange amended the Maintenance Agreement. (*See id.* at ¶ 21.)

These contractual changes did not resolve the Debtor's issues with the Turbines. The Turbines allegedly continued to breakdown, and in 2008 one Turbine failed less than two days after being repaired by GE. GE removed the Turbine for repairs. Shortly afterwards the remaining Turbine failed, leaving Project Orange with no operational turbines and prompting GE to install a temporary loaned turbine. The Debtor, however, claims that it cannot operate this loaned turbine for extended periods of time due to faulty maintenance performed by GE. This negatively affects the Energy Payments the Debtor receives from NYISO for providing electricity as well as the Regulation Payments the Debtor receives in consideration for allowing NYISO to control load levels of its Turbines when operating. The Debtor also maintains that operating the replacement turbine at capacity would result in its failure, stripping the Debtor of the Capacity Payments NYISO makes in consideration of the Debtor's availability to produce electricity, if necessary. (*Id.* at ¶ 22.)

The Debtor's issues with GE eventually led to disagreements over invoices. On December 17, 2008, GE commenced an arbitration against Project Orange to recover approximately $2.5 million in outstanding fees and $5,249,604.93 plus interest for services rendered and termination of the Maintenance Agreement (the "Arbitration"). On April 11, 2010, the arbitrator concluded that GE properly terminated the Maintenance Agreement and awarded GE $4,113,017.35 plus interest. The Debtor's schedules reflect a claim in this amount in favor of GE. (*Id.* at ¶ 25.) GE filed a motion to have the arbitration award confirmed in New York State Supreme Court. Briefing in that matter is stayed as a result of the automatic bankruptcy stay. GE also filed a motion requesting relief from the automatic stay to permit the state court to confirm the arbitration award. (*See* U.S. Trustee's Obj. at ¶¶ 16–17.)

Despite these issues, the Debtor now maintains that "all major litigation with GE has been substantially resolved." (DLA Piper's Resp. to U.S. Trustee's Obj. at 1 (ECF # 84).) Indeed, the Debtor has presented a settlement stipulation (the "Stipulation") between itself and GE to the Court for approval. (ECF # 118.) The Stipulation recites that GE asserts that, at a minimum, $1,227,152.99 of the Arbitration award represents amounts invoiced for services in repairing one of the Turbines and is secured by a possessory artisan's lien on the Turbine and spare parts. (Stipulation at ¶ E.) The terms of the Stipulation call for certain payments to GE, funded by the Debtor's various insurers, to satisfy this lien and pay for the installation of certain Turbine components, a gas generator and

accompanying spare parts. (Stipulation at ¶ 3.) These payments, however, do not eliminate GE's entire claim against Project Orange, only the secured portion. (Stipulation at ¶ 3(c).) After receipt of these amounts, GE would deliver the gas generator and the spare parts to the Debtor. GE would then install these components after the completion of repairs and installation of another key Turbine component, the power turbine.

B. DLA Piper's Relationship with GE and other Potential Parties in Interest

The Debtor's application to employ DLA Piper is supported with three declarations ***368** from Timothy W. Walsh ("Walsh"), a partner and Vice Chair of DLA Piper's Restructuring Practice Group. The first Walsh Declaration (the "Initial Walsh Declaration") reveals that Walsh and his partners represent certain GE affiliates in matters unrelated to this bankruptcy. (Initial Walsh Declaration at ¶ 8 (ECF # 58).) Walsh maintains that the "vast majority" of work DLA Piper completes for GE entities is for General Electric Healthcare ("GEHC"). (*Id.*) The Initial Walsh Declaration also discloses that the GE affiliate which is a creditor in this case, General Electric International, Inc. ("GEII"), is not, and never has been, a client of DLA Piper, but instead is a client of DLA Piper International, LLP ("DLA Piper International"), a separate affiliate of DLA Piper. (*Id.*)

Walsh's second declaration (the "Supplemental Walsh Declaration") further explains the relationship between DLA Piper and DLA Piper International. (ECF # 84.) DLA Piper and DLA Piper International are the two components of DLA Piper Global, a Swiss verein entity.[2] The Supplemental Walsh Declaration claims that GEII is technically a client of Advokafirma DLA Piper Norway DA, which is a limited partner in DLA Piper International. Walsh argues that as a result DLA Piper receives no financial benefit from the work DLA Piper International and its components complete for GEII. (Supplemental Walsh Declaration at ¶¶ 2–3.)

The Walsh Declarations also state that DLA Piper has represented, and may currently represent, numerous other potential parties in interest including Syracuse University, AECOM, National Grid, JP Morgan Chase, U.S. Bank, City of Syracuse, Chartis National Union Fire Insurance Company of Pittsburgh, PA., and BP Energy Company (together with GEII, the "Conflict Parties"). (Initial Walsh Declaration at ¶ 8; Schedule 2 to Initial Walsh Declaration.) Walsh's Supplemental Declaration clarifies that DLA Piper may be adverse to Syracuse University. (Supplemental Walsh Declaration at ¶¶ 2–3.) Walsh further reveals that the Conflict Parties, with the exception of GE, represent less than 1% of the revenues generated by DLA Piper in 2008, 2009, and to date in 2010. (Initial Walsh Declaration at ¶ 8 n. 5.) Walsh also notes, however, that DLA Piper's work for GE entities constituted .92% of revenue in 2008, 1.6% of revenue in 2009, and has accounted for .90% of revenues to date in 2010. (*Id.* n. 6.)

Walsh's third declaration (the "Second Supplemental Walsh Declaration"), filed after the June 7, 2010 hearing on this motion, clarifies that DLA Piper would not sue certain Conflict Parties, specifically AECOM, Chartis National Union Fire Insurance Company of Pittsburgh, PA., BP Energy Company, and GEII. (Second Supplemental Walsh Declaration at Ex. A. (ECF # 101).)

The DLA Employment Application acknowledges that DLA Piper's relationship with GE gives rise to a conflict. (DLA Employment Application at ¶ 19.) At the June 7, 2010 hearing on the DLA Employment Application, DLA Piper affirmed its conflict with GE. (June 7, 2010 Tr. 55:23–56:5 ("The Court:.... Don't you agree you have a conflict [with GE]? Mr. Walsh: I do.").) Following the June 7, 2010 hearing, however, DLA Piper retreated from its position, and now argues that it has no ***369** conflict of interest in representing the Debtor. (Supplement to Application of Debtor for Order Authorizing Employment and Retention of DLA Piper LLP (US) ("DLA Supplemental Brief") at 2 (ECF # 102).) Notably, DLA Piper does not maintain that it doesn't have a conflict with GE. In fact, the Debtor has retained Golenbock Eisenman Assor Bell & Peskoe LLP ("Golenbock") to handle all matters for which DLA Piper cannot adequately represent the Debtor, including issues regarding GEII. (*See* Order Granting Application to Employ Golenbock as Conflicts Counsel, ECF # 106.)

Despite DLA Piper's current position, its relationship with GE caused it sufficient concern that it obtained a conflict waiver from GE to shield it from allegations of ethical wrongdoing (the "Conflict Waiver"). (*See* U.S. Trustee's Objection at ¶¶ 30–31.) A copy of the Conflict Waiver is attached as an Exhibit to the Supplemental Walsh Declaration. (*See* ECF # 84.) The Conflict Waiver is contained in a letter from DLA Piper, not DLA Piper International, and is addressed to GEII, care of senior general counsel for GE. The Conflict Waiver states that DLA Piper "will not bring any litigation or threaten any litigation for the recovery of monetary damages from GE or its affiliates or for any equitable relief against GE or any of its affiliates." (Conflict Waiver at 1.) The Conflict Waiver, however, would permit DLA Piper to

> (a) negotiate with GE on all

> matters, and (b) review loan, lease or other documents relating to the prepetition credit facilities or lease; provided, however that [the Debtor] has engaged special counsel of its own choosing ... with respect to the potential of bringing or prosecuting any such adversary proceeding or contested matter against GE....

(Conflict Waiver at 1–2.) Lastly, the Conflict Waiver indicates that DLA Piper may take positions regarding relief from the automatic stay, use of cash collateral, DIP financing, or confirmation of a plan that differ from that of GE "except to the extent that any such position taken by [the Debtor] may not be more inconsistent with any provision of any intercreditor agreement." (Conflict Waiver at 2.) DLA Piper claims that no such intercreditor agreement exists. (DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 7.)

II. DISCUSSION

A. Retention of Professionals under Section 327(a) of the Bankruptcy Code

[1] Section 327(a) of the Bankruptcy Code permits a debtor in possession to employ professionals to represent the estate during bankruptcy with court approval. *In re WorldCom, Inc.,* 311 B.R. 151, 163 (Bankr.S.D.N.Y.2004). The statute reads:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). Professionals must be both disinterested and not hold or represent any interest adverse to the estate to be employed under section 327(a). *Vouzianas v. Ready & Pontisakos (In re Vouzianas),* 259 F.3d 103, 107 (2d Cir.2001) (citing *Bank Brussels Lambert v. Coan (In re AroChem Corp.),* 176 F.3d 610, 621 (2d Cir.1999)).

The structure of the Bankruptcy Code distills these dual requirements into a single ***370** test for analysis of a conflict of interest. Bankruptcy Code § 101(14) defines a "disinterested person." *In re WorldCom,* 311 B.R. at 164. Under section 101(14)(C) a disinterested person is one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors" for any reason. 11 U.S.C. § 101(14)(C). This definition overlaps with the adverse interest requirement of section 327(a), creating a single test for courts to employ when examining conflicts of interest. *Hogil Pharm. Corp. v. Sapir (In re Innomed Labs, LLC),* No. 07 Civ. 4778(WCC), 2008 WL 276490, at *2 (S.D.N.Y. Jan.29, 2008) (citing *In re WorldCom,* 311 B.R. at 164). A professional must not "hold or represent an interest adverse to the estate." *See In re AroChem Corp.,* 176 F.3d at 622–23 (observing that the "adverse interest" language appears in section 327(a) and in the definitions in section 101 regarding disinterested persons and articulating the relevant test as whether an entity "hold[s] or represent[s] an interest adverse to the estate"); *In re Innomed Labs, LLC,* 2008 WL 276490, at *2 (same). *See also In re Granite Partners, L.P.,* 219 B.R. 22, 33 (Bankr.S.D.N.Y.1998) (observing that "the two prongs of section 327(a) are duplicative and form a single test to judge conflicts of interest") (internal citation omitted).

[2] [3] [4] The Second Circuit has defined "hold or represent an adverse interest" as

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

In re AroChem Corp., 176 F.3d at 623 (quoting *In re Roberts,* 46 B.R. 815, 827 (Bankr.D.Utah 1985), *aff'd in part and rev'd in part on other grounds,* 75 B.R. 402 (D.Utah 1987)). The prohibition on adverse interests includes "economic and personal interests of an attorney." *See In re Mercury,* 280 B.R. 35, 54 (Bankr.S.D.N.Y.2002) (citation omitted). The test is not retrospective; courts only examine present interests when determining whether a party has an adverse interest. *In re AroChem,* 176 F.3d at 623–24 (observing that Congress intended only to proscribe those who presently have an adverse interest from representing a debtor under section

327(a)). Generally stated, the adverse interest test is objective and excludes "any interest or relationship, however slight, that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules." *In re Granite Partners,* 219 B.R. at 33; *see also In re Angelika Films 57th,* 227 B.R. 29, 38 (Bankr.S.D.N.Y.1998) ("The determination of adverse interest is objective and is concerned with the appearance of impropriety.")

[5] [6] [7] [8] Courts determine whether an adverse interest exists on a case-by-case basis, examining the specific facts in a case. *In re AroChem Corp.,* 176 F.3d at 623 ("Whether an adverse interest exists is best determined on a case-by-case basis."); *In re Angelika Films 57th,* 227 B.R. at 39 (stating that "the determination of counsel's disinterestedness is a fact-specific inquiry"). Bankruptcy courts may consider the interests of the estate and the debtor's creditors, accounting for the expeditious resolution of a case when analyzing a retention order. *In re Vouzianas,* 259 F.3d at 107 (quoting *In re AroChem,* 176 F.3d at 621). Courts, however, must take the requirements of section 327 seriously, as they ensure that a professional fulfills his duties in accordance with his fiduciary duties to the estate. *In re Leslie Fay* ***371** *Cos.,* 175 B.R. 525, 532 (Bankr.S.D.N.Y.1994) ("The requirements of section 327 cannot be taken lightly, for they 'serve the important policy of ensuring that all professionals appointed pursuant to [the section] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.' ") (quoting *Rome v. Braunstein,* 19 F.3d 54, 58 (1st Cir.1994)). Moreover, courts lack the power to authorize the "employment of a professional who has a conflict of interest." *In re Mercury,* 280 B.R. at 55.

[9] [10] Congress has explicitly stated that a professional's representation of a creditor in another case does not automatically disqualify it from being retained under section 327. *See* 11 U.S.C. § 327(c) ("a person is not disqualified for employment under this section solely because of such person's employment or representation of a creditor"). The statute, however, *requires* disqualification of a professional following an objection from the U.S. Trustee or a creditor where there is an actual conflict of interest. *Id.* ("the court shall disapprove such employment if there is an actual conflict of interest"). Section 327(c) acknowledges the difficulties debtors have in large chapter 11 bankruptcies to retain competent attorneys with the resources to handle the scope of the cases. *See* 3 COLLIER ON BANKRUPTCY ¶ 327.04[7][b] (15th ed. rev.2010). The statute "prevents disqualification based *solely* on the professional's prior representation of or employment by a creditor" but does not obviate the essential requirement that a professional not have an interest adverse to the estate. *In re AroChem,* 176 F.3d at 621 (quoting *In re Interwest Bus. Equip.,* 23 F.3d 311, 316 (10th Cir.1994)). Thus, even where section 327(c) is applicable, if a court determines that there is an actual conflict of interest following an objection from the U.S. Trustee or a creditor the court must disapprove the employment.

B. DLA Piper's Relationship with GE Precludes it from Being Employed by the Debtor Under § 327(a)

DLA Piper attempts to distance itself from GE, maintaining that the creditor in this case, GEII, is not even a client of DLA Piper, but rather a client of DLA Piper International. (Initial Walsh Declaration at ¶ 8; Supplemental Walsh Declaration at ¶¶ 2–3.) But the Conflict Waiver severely undermines DLA Piper's effort to segregate its relationship to GEII. Specifically, the Conflict Waiver was sent by DLA Piper, not DLA Piper International. Moreover, it is addressed to GEII "care of" an attorney at GE itself. Lastly, the Conflict Waiver combines GEII and GE into a single entity, GE, when requesting a waiver. Thus, the Court does not accept DLA Piper's effort to draw artificial lines in an attempt to isolate itself from GEII. As DLA Piper's Conflict Waiver conflates GE and GEII as a single entity, this Court too will treat them as one and the same for purposes of this motion.[3]

***372** Using this approach the U.S. Trustee argues that DLA Piper's ongoing relationship with GE precludes it from being retained as general bankruptcy counsel in this matter. (U.S. Trustee Obj. at 1–2, 14.) Indeed, the Debtor and DLA Piper agree that DLA Piper cannot represent the Debtor in many matters regarding GE. Specifically, the DLA Employment Application admits that DLA Piper is conflicted from taking certain actions in the bankruptcy due to its representation of GE affiliates. (*See* DLA Employment Application at ¶ 19.) And, during the hearing on the retention application, counsel for DLA Piper confirmed the presence of a conflict with GE. (June 7, 2010 Tr. 55:23–56:5.) DLA Piper's Supplemental Brief also confirms the presence of conflict between the DLA Piper and GE. (DLA Supplemental Brief at 2 ("no conflict will exist between DLA Piper and GE going forward after a settlement is finalized regarding the turbine").)

Despite this acknowledged conflict, DLA Piper argues that it "does not have a conflict of interest in representing the Debtor." (*Id.* at 2.) It is only barred from acting in "litigation directly adverse to GE" and it has "no conflict with representing the Debtor opposite GE in developing and negotiating a plan of reorganization." (DLA Piper's

Resp. to U.S. Trustee's Obj. at 1–2.) In support of this position, DLA Piper argues that the Court should focus "on the actions DLA Piper proposes to take as to [Project Orange] in this bankruptcy case" and eschew DLA Piper's other relationships. (*See* DLA Supplemental Brief at 3.) DLA Piper apparently believes that the Stipulation with GE—which would provide for the eventual return of Turbine components to the Debtor, but not resolve GE's unsecured claim against the estate—combined with the Conflict Waiver and its use of conflicts counsel somehow permits DLA Piper to represent the Debtor as general bankruptcy counsel despite its close relationship and acknowledged conflict with GE. The Court disagrees with DLA Piper's assessment of the law.

1. The Debtor's Execution of the Stipulation did not Resolve DLA Piper's Conflict with GE

[11] DLA Piper argues in its Supplemental Brief—filed after the Debtor entered into the Stipulation with GE—that the Debtor's signing of the Stipulation resolved all conflicts between itself and GE. (DLA Supplemental Brief at 2.) DLA Piper is severely mistaken. The Stipulation, by its own terms, is not effective until this Court reviews the Stipulation in accordance with Federal Rule of Bankruptcy Procedure 9019 and approves the settlement. (Stipulation at ¶ 1.) Until then, no settlement exists and GE remains directly adverse to Project Orange. Notably, even if the Court approves the Stipulation, adversity would still remain. Under the terms of the settlement, GE must complete repairing a Turbine component before it can install the Turbine in accordance with other Stipulation provisions. Repairs on the component are anticipated to be completed by July 10, 2010, but the Stipulation states that this date is subject to change. If repairs are more difficult than anticipated, the return of the Debtor's Turbines to operation is not assured. Moreover, there would likely be contentious ***373** litigation over the installation of the Turbines. As summer is the Debtor's busiest months, any delay on GE's part would almost necessitate the Debtor to threaten a lawsuit to expedite the repair and installation process. Indeed, until the repair and installation of the Turbines is complete, GE and Project Orange remain wholly adverse.

Moreover, Project Orange is locked in highly contentious—but currently stayed—litigation in state court with its landlord, Syracuse University, regarding the validity of their lease. The University maintains that the lease was terminated prepetition as a result of several Project Orange defaults. Under the terms of the Debtor's lease with the University, arguments exist that termination of the lease would result in the entire Facility reverting to the University: Section 27.02(b)(ii) of the lease specifically allows the University to repossess both the leased property as well as the Facility on termination of the lease. As defined in other agreements between the two parties, the Facility includes the Turbines. Thus, even if the Stipulation and settlement become effective, if Syracuse University is successful in establishing that the lease terminated prepetition, Project Orange will have no assets to liquidate to pay its largest unsecured creditor.

DLA Piper, however, ignores these clear conflicts, suggesting that the Stipulation resolved all adversity in this case. DLA Piper cites to cases that distinguish between present and potential conflicts, arguing that because only the *potential* for adversity with GE exists, it may be retained in this case. But other bankruptcy judges in this district have refused to distinguish between actual and potential conflicts. *In re Angelika Films 57th,* 227 B.R. at 39 ("The distinction between 'potential' and 'hypothetical' conflicts merely confuses the analysis, and several courts have rejected it as artificial."); *In re Granite Partners,* 219 B.R. at 33 ("The distinction [between actual and potential conflicts] often seems artificial, and some courts have rejected it."). These judges instead focus on the facts of each case to determine whether an attorney has an adverse interest without limiting labels. *See, e.g., In re Leslie Fay Cos.,* 175 B.R. at 532–33 (rejecting the actual/potential dichotomy and observing that courts should focus on the facts of a case when reviewing retention applications).

Even if the Court ignores the disfavored actual/potential distinction, the cases cited by DLA Piper fail to persuade the Court that DLA Piper has no disabling conflict of interest with GE. Indeed, the two cases DLA Piper most heavily relies upon are easily distinguishable from the present case. In *In re Rockaway Bedding, Inc.,* No. 07–14890, 2007 WL 1461319 (Bankr.D.N.J. May 14, 2007), the court determined that a law firm that represented a debtor's biggest secured creditor in unrelated matters could be the debtor's general bankruptcy counsel. Central to the court's decision was the fact that there was no ongoing litigation between the debtor and the secured creditor and no such litigation was envisioned. *See id.* at *3–4 ("The Debtors are not in any active litigation against [secured creditor] or any other creditor ... and the Court is advised that no such litigation is envisioned."). Similarly, in *In re Dynamark, Ltd.,* 137 B.R. 380 (Bankr.S.D.Cal.1991), the court approved the retention of an attorney as general bankruptcy counsel who represented the estate's largest secured creditor in unrelated matters, finding no outstanding litigation between the parties. *See id.* at 381 ("it appears that no

actual conflict or adverse interest has surfaced in this case so far"). In stark contrast, here the Debtor had litigation pending with GE, DLA Piper's client, before the bankruptcy was even ***374** filed. The Debtor and GE are still directly adverse, as the Stipulation has not yet been approved by the Court. Moreover, enforcement and performance of the Stipulation will continue to place the Debtor and GE directly at odds and could well give rise to new litigation.

2. DLA Piper's Conflict Waiver Does Not Permit DLA Piper's Employment Under 327(a)

[12] The Conflict Waiver does not save DLA Piper's application from these infirmities. Both commentators and courts conclude that disabling adverse interests may exist where the professional to be retained also represents creditors of the debtor. *In re American Printers & Lithographers, Inc.,* 148 B.R. 862, 865–66 (Bankr.N.D.Ill.1992) (finding adverse interest between debtor's proposed law firm and the debtor's secured creditor based on law firm's continuing representation of secured creditor in unrelated matters); 2 NORTON BANKRUPTCY LAW AND PRACTICE 3D § 30:5 (3d ed.2010) (observing that the "most common areas in which conflicts arise are where the professional also represents ... creditors of the debtor"). Indeed, in *American Printers,* the court concluded that a conflict existed because debtor's proposed counsel, who represented a secured creditor of the debtor in unrelated matters, could not negotiate with the secured creditor on the debtor's behalf. Thus, the proposed attorney was disqualified. *See In re American Printers,* 148 B.R. at 865–66. Here, DLA Piper contemplates engaging in the *exact conduct* the *American Printers* court determined created a disabling conflict between proposed counsel and the debtor's secured creditor—"developing and negotiating a plan of reorganization."[4] (DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 7.)

DLA Piper argues that because GE has contractually permitted DLA Piper to represent the Debtor on some matters adverse to GE that it cures *all* conflicts for purposes of section 327(a). But an agreement between DLA Piper and GE, *i.e.,* the Conflicts Waiver, cannot trump the requirements of section 327(a). Even if GE agreed that DLA Piper could act against GE on all issues, through litigation, negotiation or otherwise, DLA Piper must still satisfy the statutory requirements of section 327(a) to be retained as general bankruptcy counsel. *See, e.g., In re Granite Partners, L.P.,* 219 B.R. at 34 (observing that while clients may, in some instances, waive conflicts, "the mandatory provisions of section 327(a) do not allow for waiver"); *In re Perry,* 194 B.R. 875, 880 (E.D.Cal.1996) (stating that "section 327(a) has a strict requirement of disinterestedness and absence of representation of an adverse interest which trumps the rules of professional conduct").

***375** Moreover, the Conflict Waiver severely limits DLA Piper's ability to act in the best interests of the Debtor with regards to GE. Under the terms of the Conflict Waiver, DLA Piper is barred from both bringing suit and threatening to bring suit against GE or its affiliates for monetary damages or equitable relief. (Conflict Waiver at 1.) While the Conflict Waiver purportedly allows DLA Piper to negotiate with GE "on all matters" and review loan or lease documents relating to the Debtor's prepetition credit facilities and lease, the Court does not believe that DLA Piper can negotiate with full efficacy without at least being able to hint at the possibility of litigation. *In re American Printers & Lithographers, Inc.,* 148 B.R. at 865–66 ("Debtor's counsel must at least vigorously negotiate ... in order to fulfill its duties to Debtor, even if litigation is not warranted.").

This is particularly true with regards to the Stipulation. The Debtor's ongoing relationship with GE is a core issue for a successful reorganization of the Debtor. Specifically, return of the Turbines to operation is central to the Debtor's profitability. (*See* May 3, 2010 Tr. at 15–16, 19 ("Mr. Victor: Nobody's going to get paid unless we can run [both Turbines] and let ... us see how we can maximize [them].").) Yet, as indicated above, under the Stipulation there is a possibility that the installation date of the Turbines may slip. If this occurs, Project Orange will be forced to quickly and vigorously negotiate the installation schedule to take advantage of the summer electricity season. Valid negotiation strategies may include threatening lawsuits or withholding payments to be made under the Stipulation. It is unclear whether the Conflict Waiver would permit DLA Piper to take either course of action.

3. The Debtor's Use of Conflicts Counsel Does Not Warrant DLA Piper's Employment Under 327(a)

[13] In many cases, the employment of conflicts counsel to handle issues where general bankruptcy counsel has an adverse interest solves most questions regarding the retention of general bankruptcy counsel. Indeed, DLA Piper has identified cases where courts determined that the use of conflicts counsel could insulate proposed counsel from hypothetical and speculative conflicts that

may arise in the course of a bankruptcy case with entities that are not central to the debtor's reorganization efforts. *See, e.g., In re Enron Corp.,* No. 01–16034(ALG), 2002 WL 32034346, at *9–10 (Bankr.S.D.N.Y. May 23, 2002) (refusing to disqualify law firm on mere speculation that it had an adverse interest and finding that use of conflicts counsel was appropriate to handle certain limited investigations where firm had an adverse interest). But DLA Piper has not provided the Court with any case law indicating that the use of conflicts counsel warrants retention under section 327(a) where the proposed general bankruptcy counsel has a conflict of interest with a creditor that is central to the debtor's reorganization. The Court determines that this is such a case where the use of conflicts counsel does not allow the retention of the Debtor's chosen counsel under section 327(a).

Even if Golenbock performed *all* work related to GE in this case, the fig leaf of conflicts counsel does not convince the Court that retention of DLA Piper as general bankruptcy counsel is appropriate in these circumstances. As previously indicated, GE is central to this case. It is the Debtor's largest unsecured creditor. The return and installation of the Turbines, which are central to the Debtor's ability to reorganize, is currently subject to a Stipulation ***376** which may or may not be entered by the Court. Moreover, even if the Court approves the Stipulation, there is considerable uncertainty regarding the timeline for installation of the Turbines. Any disagreement on installation would likely give rise to highly contentious proceedings. In fact, GE has shown its willingness to vigorously defend itself in this forum by making multiple filings. GE has moved the Court to lift the automatic stay to confirm its $4.1 million arbitration award. (ECF # 13.) GE has also objected to the Debtor's request to pay prepetition wages, salaries, and taxes. (ECF # 15.) GE has further filed a motion to lift the automatic stay with regards to two checks issued by AIG to both the Debtor and GE. (ECF # 64.) Given GE's strong interests and active stance in this case, it is clear that addressing issues with GE will take considerable time and skill on a range of matters. Indeed, the Debtor essentially acknowledged that Golenbock would need to take numerous actions in this case by seeking to retain the firm pursuant to section 327(a) of the Bankruptcy Code and not the more limited "special purpose" contemplated by section 327(e). Thus, even assuming DLA Piper does not complete *any* work regarding GE, the Court does not believe DLA Piper's employment is permissible.

Other courts have determined that where proposed counsel is conflicted from representing a debtor with regards to matters central to the bankruptcy, even the presence of conflicts counsel does not make the retention appropriate.[5] In *In re Amdura Corp.,* 121 B.R. 862 (Bankr.D.Colo.1990), the court examined an attempt to use conflicts counsel to enable an otherwise conflicted general bankruptcy counsel to be retained under section 327(a). Winston & Strawn ("Winston") sought to represent the debtor. The primary creditor in the case, Continental Bank ("Continental"), had loaned the debtor $215 million. *Id.* at 866. Winston previously represented—and continued to represent—Continental during the bankruptcy in unrelated matters. Winston stated that it could not investigate the loan Continental made to the debtor but an examiner could be appointed to do so. Winston further stated that, to the extent the debtor needed to sue Continental, it could use separate counsel. *Id.* at 867. The court found that Winston's inability to be adverse to Continental constituted a conflict of interest disallowing its retention under section 327(a). *Id.* The court further found that this conflict could not be resolved through the use of separate counsel. While theorizing that the use of conflicts counsel may resolve conflicts issues where proposed general counsel previously represented smaller creditors whose interests were not central to the resolution of the case, the court concluded that because resolution of issues with Continental could be the "lynch-pin of the case," Winston had a conflict that could not be resolved through the use of alternative counsel. The court specifically questioned Winston's ability to adequately advise the debtor in negotiations with Continental and draft a plan of reorganization. *Id.*

***377** DLA Piper argues that *Amdura* is distinguishable because "DLA is willing and able if necessary to take positions opposed by [GE] and advance a plan of reorganization that is in the best interests of the Debtor." (*See* DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 9.) This argument erroneously assumes that DLA Piper can contractually obviate the mandatory requirements of section 327(a) with its Conflict Waiver. *See, e.g., In re Granite Partners, L.P.,* 219 B.R. at 34 (stating that "the mandatory provisions of section 327(a) do not allow for waiver"). Moreover, this case shares much in common with *Amdura:* in both cases, proposed counsel could not investigate and prosecute claims against the key creditor in the case; in both cases, the conflict existed with the largest creditor and raised issues central to the resolution of the bankruptcy case. As in *Amdura,* it does not appear that DLA Piper can "fairly and fully advise" in the negotiation and drafting of a plan when it may not even be able to advocate litigation against GE. *In re Amdura Corp.,* 121 B.R. at 867.

Similarly, in *In re Git–N–Go, Inc.,* 321 B.R. 54 (Bankr.N.D.Okla.2004), the bankruptcy court reviewed an employment application under section 327(a). The

proposed counsel was intimately involved with a holding company ("Holding Company") central to the bankruptcy. The relationship between the Holding Company and proposed counsel had lasted for decades and the parties intended to continue the arrangement following the bankruptcy case. *Id.* at 57. The Holding Company owned 87% of the debtor's stock and the debtor was forced to file for bankruptcy in part due its relationship with a wholly owned subsidiary of the holding company, 4 Front Petroleum, Inc. ("4 Front"). 4 Front purchased gas from Citgo and resold the gas to the debtor, who in turn sold the gas to consumers. Citgo, however, withheld hundreds of thousands of dollars in the debtor's gas sales to set off against debt 4 Front owed to Citgo. Despite the bankruptcy, Citgo continued to withhold and set off the debtor's gas sales. *Id.* at 57–58. Proposed counsel disclosed that it represented Citgo in unrelated matters and that Citgo accounted for approximately 1% of its revenues from the previous years. While proposed counsel had a waiver from Citgo allowing it to contest Citgo's withholding of gas sales from the debtor, it never did so and instead counseled the debtor to retain alternative counsel to challenge Citgo's actions. *Id.* at 58. The court determined that proposed counsel's relationship with the Holding Company and Citgo created conflicts of interest. *Id.* at 59, 61 (concluding that due to its relationship with the Holding Company, its subsidiaries and Citgo, Proposed Counsel "cannot provide the objective and independent advice ... required for the Debtor's performance of its fiduciary obligations"). With respect to proposed counsel's conflict with the Holding Company, the court determined that substituting the creditors' committee in its stead would not resolve the conflict. The court reasoned that investigating potential causes of action against the Holding Company was "among the primary duties assigned to the debtor in possession, and ... cannot simply be delegated to a creditors' committee when the debtor's counsel is unavailable because representation of the estate would implicate an adverse interest." *Id.* at 60–61. As to proposed counsel's conflict with Citgo, the court determined that proposed counsel's refusal to be directly adverse to Citgo could not be cured by the use of conflicts counsel. The court reasoned that conflicts counsel would need to represent the debtor in "core bankruptcy matters" and it would not be "appropriate or in the best interests of the estate" to use conflicts ***378** counsel to conduct the duties of general bankruptcy counsel. *Id.* at 61–62.

DLA Piper attempts to distinguish *Git–N–Go,* arguing that unlike the case at bar proposed counsel in *Git–N–Go* (i) represented both the debtor and "several" adverse parties; (ii) admitted it was ethically incapable of acting as counsel for the debtor in certain circumstances; and (iii) represented parties in interest in matters regarding the debtor prior to the petition date. (DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 10.) DLA Piper's distinctions fail. As an initial matter, proposed counsel in *Git–N–Go* only represented two parties in interest in the case prior to the petition date, the Holding Company and Citgo. *In re Git–N–Go, Inc.,* 321 B.R. at 56–58. The court found that both of these relationships created conflicts. *Id.* at 60–62. The conflict with the Holding Company could not be resolved by having the creditors' committee investigate potential claims against a creditor. *Id.* at 60–61. Nor could the conflict with Citgo be resolved through the use of conflicts counsel. *Id.* at 61–62. DLA Piper misreads *Git–N–Go,* implying that the fact that proposed counsel represented Citgo with regards to matters pending in the bankruptcy before the petition date was dispositive to the court's decision. (DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 10 ("unlike the firm involved in *Git–N–Go,* prior to the Petition Date, the only party in interest that DLA represented in matters involving the Debtor was the Debtor").) Rather, the court found that it was proposed counsel's unwillingness to represent the debtor in its dispute with Citgo that created a conflict of interest that could not be resolved through the use of other counsel. *In re Git–N–Go, Inc.,* 321 B.R. at 60–61 (observing "the fact that [proposed counsel] is unable or unwilling to represent the [d]ebtor in its dispute with Citgo also creates an actual disqualifying conflict of interest" which cannot be cured through the use of conflicts counsel). In fact, proposed counsel in *Git–N–Go* only represented Citgo in matters *unrelated* to the debtor. *Id.* at 58. Here, just as in *Git–N–Go,* DLA Piper represented GE prior to the petition in matters unrelated to the Debtor and is unable to take certain actions against GE pursuant to the Conflict Waiver.

Finally, the bankruptcy court in *In re Envirodyne Indus., Inc.,* 150 B.R. 1008 (Bankr.N.D.Ill.1993), analyzed a similar situation. The court analyzed a motion to vacate an order authorizing the employment of Cleary, Gottlieb, Steen & Hamilton ("Cleary"). *Id.* at 1011. Cleary had represented an investment bank, Salomon Brothers, Inc. ("Salomon"), in connection with a leveraged buy-out ("LBO") of the debtor. Salomon owned nearly two-thirds of the entity that purchased the debtor and held a majority of seats on the debtor's board of directors. Salomon was also a creditor of the debtor. After the LBO was completed Cleary represented the debtor in most matters requiring outside counsel, including two bond issues—both underwritten by Salomon—and in structuring a loan from Salomon to the debtor. Cleary also advised the debtor on debt restructuring and the possibility of seeking chapter 11 protection. *Id.* at 1011–12. When restructuring talks began counsel for a

committee of ad hoc bondholders began investigating causes of action related to the LBO. Cleary counseled Salomon to seek other attorneys to represent it with regards to these possible claims. *Id.* at 1012. Cleary, however, continued to represent Salomon in unrelated matters. *Id.* at 1013. Cleary argued that it could represent the debtor because it would not pursue an action against Salomon for claims arising out of the LBO and noted that any such action was a "remote contingency." *Id.* at 1019. The court rejected ***379** Cleary's position, stating that Cleary had an "affirmative duty to investigate potential claims" and that its characterization of a potential lawsuit as "remote" revealed that Cleary had already made a determination regarding the pursuit of claims against Salomon. *Id.*

DLA Piper's retention application suffers from the same issues faced by Cleary in *In re Envirodyne.* Like Cleary, DLA Piper argues it is "disinterested" for purposes of the Bankruptcy Code because it will not bring litigation against GE and because the Stipulation has allegedly resolved all disputes between the Debtor and GE. (*See* DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 7; *see also* DLA Supplemental Brief at 2.) Also like Cleary, DLA Piper seemingly assumes that developing and negotiating a plan of reorganization will not make it directly adverse to GE. (*See* DLA Piper's Resp. to U.S. Trustee's Obj. at ¶ 7; *see also* DLA Supplemental Brief at 2.) And just like Cleary, DLA Piper's assumption that it is not conflicted in developing a plan reveals that it has already made a determination regarding the status of matters with GE, specifically with regards to the Stipulation and the resolution of GE's unsecured claim. Prejudging the status of matters with a debtor's largest unsecured creditor, as the *Envirodyne* court noted, is not consistent with the Debtor's duty to investigate all possible claims.

On the facts of this case, as DLA Piper's conflict is with the Debtor's largest unsecured creditor that is central to the issues in this case, the Court concludes that it is inappropriate to approve the retention application. It is not a sufficient answer, as DLA Piper posits, that the firm has had a long-standing relationship with the Debtor. Conflicts rules do not apply only when application of the rules will not inconvenience the party seeking to retain conflicted counsel.

CONCLUSION

DLA Piper's representation of GE creates a conflict of interest with the Debtor. GE is the largest creditor in this case, has been highly active in the proceedings, and is certain to play a key role in any plan negotiations or confirmation hearing. Here, given DLA Piper's admitted conflict of interest with GE and GE's central role in this case, the Court does not believe that the use of conflicts counsel warrants DLA Piper's retention in this matter. Thus, the DLA Employment Application is **DENIED.**

IT IS SO ORDERED.

Parallel Citations

53 Bankr.Ct.Dec. 114

Footnotes

1 Debtor's cogeneration facility was built on property owned by Syracuse University. The Debtor and Syracuse University are parties to a written lease that by its terms is scheduled to expire in 2032. Syracuse University argues, however, and the parties have litigated in state court for several years, that the lease terminated prepetition because of Project Orange's defaults in the lease and other agreements between them. The details of the dispute are omitted from this Opinion. Suffice it to say, however, that if the lease terminated prepetition, the Debtor is unlikely to be able to reorganize as an operating business. Syracuse University has filed a motion to lift the automatic stay to permit it to proceed with the state court litigation. A separate opinion or order will be entered concerning that motion.

2 A Swiss verein is essentially an incorporated membership association, but has no precise counterpart in the United States. *In re Lernout & Hauspie Secs. Litig.,* 230 F.Supp.2d 152, 171 (D.Mass.2002); Megan E. Vetula, *From the Big Four to Big Law: The Swiss Verein and the Global Law Firm,* 22 GEO. J. LEGAL ETHICS 1177, 1180 (2009).

3 Since DLA Piper dealt with itself and its affiliates as one entity in negotiating a conflict waiver with GE entities (likewise treated as one entity), the Court does not need to consider whether different conflicts rules might apply in some circumstances where international law firms share a relationship through a Swiss verein. DLA Piper's website proclaims that "DLA Piper became one of the largest legal service providers in the world in 2005 through a merger of unprecedented scope in the legal sector. While large in scale, the merger strategy was simple—to create an international legal practice capable of taking care of the most important legal needs of clients wherever they do business.... DLA Piper today has 3,500 lawyers in offices throughout Asia, Europe, the Middle East and the United States. We represent more clients in a broader range of geographies and practice disciplines than virtually any

other law firm in the world." *See http://www.dlapiper.com/global/about/overview/* (last visited June 23, 2010). DLA Piper holds itself out to the world as one firm, although it now tries to separate itself into separate firms for conflicts purposes. Followed to its logical conclusion, this would lead to the anomalous result that DLA Piper, on behalf of one client, could be adverse to DLA Piper International, on behalf of one of its clients, without violating ethical standards.

4 DLA Piper's attorneys have also shown that they are tone-deaf when it comes to conflicts issues. During the June 7, 2010 hearing, counsel presented a proposed settlement between the Debtor and BP regarding the delivery of natural gas needed to operate the Debtor's Turbines. No objections were filed to the proposed settlement. The Court indicated that it would approve the settlement. Later in the hearing, however, almost in passing, counsel acknowledged that it could not be adverse to BP, an existing client of DLA Piper. The U.S. Trustee then questioned how DLA Piper could negotiate and present the settlement if it cannot be adverse to BP. Counsel then responded that it had identified BP as a conflict party in exhibits to its retention application, as if the disclosure could cure the conflict. The Court withdrew its approval of the settlement, which has since been resubmitted by Golenbock, Debtor's conflict counsel. Identifying conflicts does not involve a game of "gotcha," where disclosure of a conflict party in one schedule excuses counsel from the consequences of a conflict if no one finds the earlier disclosure and objects.

5 The Court is surprised at the dearth of precedent on this point. In addition to the case law discussed in this Opinion, at least one commentator concurs with the Court's assessment in an analogous setting. *See* Susan M. Freeman, *Are DIP and Committee Counsel Fiduciaries for their Clients' Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway?*, 17 AM. BANKR.INST. L. REV. 291, 367 (2009) ("Courts have allowed ... 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. If a creditor client's role is central to the case, such as carve-out of ... representation may be infeasible.") (footnotes omitted).

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK
----------X
KARAMVIR DHIYA and DAHIYA LAW OFFICES LLC,

Appellant,

JUDGMENT
13-CV-3079(DLI))

-against-

DEBRA KRAMER, as Trustee of the Estate of Shahara Khan,

Appellee.
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An Order of Honorable Dora L. Irizarry, United States District Judge, having been filed on March 27, 2014, affirming the March 11, 2013 Order of the Honorable Elizabeth S. Stong, United States Bankruptcy Judge for the Eastern District of New York, in In re Kahn, Docket No. 11-AP-1520 (ESS) and dismissing the appeal; it is

ORDERED and ADJUDGED that the March 11, 2013 Order of the Honorable Elizabeth S. Stong, United States Bankruptcy Judge for the Eastern District of New York, in In re Kahn, Docket No. 11-AP-1520 (ESS) is affirmed and the appeal is dismissed.

Dated: Brooklyn, New York
March 31, 2014

Douglas C. Palmer
Clerk of Court

by: Digitally signed by Michele Gapinski
DN: cn=Michele Gapinski, o=U.S. Courts, ou=NY-E, email=michele_gapinski@nyed.uscourts.gov, c=US
Michele Gapinski
Chief Deputy for
Court Operations

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK
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In re:	Chapter 7
SHAHARA KHAN,	Case No. 10-46901-ess
Debtor.	
----------x	
DEBRA KRAMER, AS TRUSTEE OF THE ESTATE OF SHAHARA KHAN,	Adv. Pro. No. 11-01520-ess
Plaintiff,	
-against-	
TOZAMMEL H. MAHIA,	
Defendant.	
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ORDER ON CHAPTER 7 TRUSTEE'S
MOTION FOR SUMMARY JUDGMENT

Upon the motion for summary judgment on the Amended Complaint filed by Debra Kramer, as Trustee of the Estate of Shahara Khan on January 31, 2014, the opposition filed by the Tozammel H. Mahia on March 24, 26, 27, and 28, 2014, and the reply filed by the Trustee on April 8, 2014; the hearings held on April 1, 2014 and April 25, 2014; and based upon the entire record; and for the reasons stated in the Court's Memorandum Decision and Proposed Findings of Fact and Conclusions of Law dated September 30, 2014 (the "Memorandum Decision"), it is hereby

ORDERED, that the Trustee's motion with respect to the First Cause of Action under Bankruptcy Code Section 542(a), directing the Defendant to account for and deliver the Sale Proceeds to the Trustee, is granted; and it is further

ORDERED, that the Trustee's motion with respect to the Eighth Cause of Action under Bankruptcy Code Section 542(a), directing the Defendant to account for and deliver the Mortgage Proceeds to the Trustee, is granted; and it is further

ORDERED, that the Trustee's motion with respect to the Fourth Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 274, seeking a declaratory judgment to set aside the Sale Proceeds Transfer as a fraudulent conveyance, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Fifth Cause of Action under Bankruptcy Code Section 550(a) and New York Debtor and Creditor Law Sections 274 and 278, seeking to set aside the Sale Proceeds Transfer and recover from the Defendant the value of that transfer, as well as a judgment against the Defendant in the amount of that transfer, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Sixth Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 275, seeking a judgment to set aside the Sale Proceeds Transfer as a fraudulent conveyance, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Seventh Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 276, seeking a judgment to avoid and recover the Sale Proceeds Transfer as a fraudulent conveyance made with actual intent to hinder, delay, or defraud the Debtor's creditors, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Eleventh Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 274, seeking a

declaratory judgment setting aside the Mortgage Proceeds Transfer as a fraudulent conveyance, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Twelfth Cause of Action under Bankruptcy Code Section 550(a) and New York Debtor and Creditor Law Sections 274 and 278, seeking to set aside the Mortgage Proceeds Transfer and recover from the Defendant the value of that transfer, as well as a judgment against the Defendant in the amount of that transfer, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Thirteenth Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 275, seeking a judgment to set aside the Mortgage Proceeds Transfer as a fraudulent conveyance, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Fourteenth Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 276, seeking a judgment to avoid and recover the Mortgage Proceeds Transfer as a fraudulent conveyance made with actual intent to hinder, delay, or defraud the Debtor's creditors, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Fifteenth Cause of Action under New York Debtor and Creditor Law Section 276-a, seeking an award of attorneys' fees incurred in this action, is denied; and it is further

ORDERED, that the Trustee's motion with respect to the Sixteenth Cause of Action under New York law for unjust enrichment, seeking a judgment against the Defendant in the amount of $64,190.25, is denied; and it is further

ORDERED, that pursuant to 28 U.S.C. § 157(c) and the December 5, 2012 Standing Order, *In the Matter of the Referral of Matters to the Bankruptcy Judges* issued in the Eastern District of New York, the Memorandum Decision shall serve as proposed findings of fact and conclusions of law as to the Trustee's motion with respect to the Second Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 273, seeking a declaratory judgment to set aside the Sale Proceeds Transfer as a fraudulent conveyance; and it is further

ORDERED, that pursuant to 28 U.S.C. § 157(c) and the December 5, 2012 Standing Order, *In the Matter of the Referral of Matters to the Bankruptcy Judges* issued in the Eastern District of New York, the Memorandum Decision shall serve as proposed findings of fact and conclusions of law as to the Trustee's motion with respect to the Third Cause of Action under Bankruptcy Code Section 550(a) and New York Debtor and Creditor Law Sections 273 and 278, seeking a judgment against the Defendant in the amount of the Sale Proceeds Transfer; and it is further

ORDERED, that pursuant to 28 U.S.C. § 157(c) and the December 5, 2012 Standing Order, *In the Matter of the Referral of Matters to the Bankruptcy Judges* issued in the Eastern District of New York, the Memorandum Decision shall serve as proposed findings of fact and conclusions of law as to the Trustee's motion with respect to the Ninth Cause of Action under Bankruptcy Code Section 544(b) and New York Debtor and Creditor Law Section 273, seeking a declaratory judgment to set aside the Mortgage Proceeds Transfer as a fraudulent conveyance; and it is further

ORDERED, that pursuant to 28 U.S.C. § 157(c) and the December 5, 2012 Standing Order, *In the Matter of the Referral of Matters to the Bankruptcy Judges* issued in the Eastern District of New York, the Memorandum Decision shall serve as proposed findings of fact and conclusions of law as to the Trustee's motion with respect to the Tenth Cause of Action under Bankruptcy Code Section 550(a) and New York Debtor and Creditor Law Sections 273 and 278, seeking a judgment against the Defendant in the amount of the Mortgage Proceeds Transfer; and it is further

ORDERED, that pursuant to Bankruptcy Rule 9033, the Clerk of the Court is directed to serve the Memorandum Decision on all parties by mail and to note the date of mailing on the Court's docket.

Dated: Brooklyn, New York
September 30, 2014

Elizabeth S. Stong
United States Bankruptcy Judge

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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KARAMVIR DAHIYA and
DAHIYA LAW OFFICES LLC,

Appellants,

-against-

DEBRA KRAMER AS TRUTEE OF THE ESTATE OF SHAHARA KHAN,

Appellee.

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MEMORANDUM AND ORDER
13-CV-3079 (DLI)

DORA L. IRIZARRY, United States District Judge:

Karamvir Dahiya and Dahiya Law Offices LLC (collectively, "Dahiya," or "Appellant") appeal from the March 11, 2013 Order and accompanying memorandum decision of the Honorable Elizabeth S. Stong, United States Bankruptcy Judge for the Eastern District of New York, in *In re Kahn*, Docket No. 11-AP-1520 (ESS), an adversary proceeding pending in the Bankruptcy Court.[1] Judge Stong's Order granted a motion for sanctions brought by Debra Kramer (the "Trustee") against Dahiya. *In re Khan*, 488 B.R. 515 (Bankr. E.D.N.Y. 2013). For the reasons set forth below, Dahiya's appeal is denied.[2]

BACKGROUND

Familiarity with the background of this case, as summarized in this Court's memorandum and order on Dahiya's motion to withdraw the reference to the Bankruptcy Court of the sanctions

[1] The adversary proceeding is related to the Chapter 7 bankruptcy proceeding *In re Khan*, Docket No. 10-BK-46901 (ESS).

[2] By motion dated July 2, 2013, Appellant requests that the Court take judicial notice of certain documents filed in this and related cases. (Docket Entry No. 13.) The Trustee does not oppose Appellant's request, although she disputes the relevancy of the documents. (Docket Entry No. 14.) The documents that Appellant urges the Court to consider do not affect the outcome of this appeal.

motion, is assumed. *See Kramer v. Mahia*, 2013 WL 1629254, at *1-2 (E.D.N.Y. Apr. 15, 2013). Thus, the Court relates only the facts relevant to the present appeal.

On December 3, 2011, Debra Kramer, in her role as trustee of the bankruptcy estate of Shahara Khan (the "Debtor"), filed an adversary proceeding in Bankruptcy Court to recover alleged fraudulent conveyances from Tozammel H. Mahia ("Mahia" or "Defendant"), the Debtor's son. (Compl., Docket No. 11-AP-1520,[3] Doc. Entry No. 1.) The Trustee alleged that Defendant received all of the net proceeds of the sale of real property jointly owned by Defendant, the Debtor, and a third party. (*Id.*) After missing the deadline to answer the Trustee's complaint, Defendant retained Dahiya to represent him in the adversary proceeding. (Scheduling Ord., Docket No. 11-AP-1520, Doc. Entry No. 5.) The Bankruptcy Court then granted Defendant an extension of time, *nunc pro tunc*, to January 31, 2012, to file an answer. (*Id.*)

On February 7, 2013, one week after the extended deadline to answer the complaint had passed, Dahiya filed an answer on behalf of Defendant, which brought two counterclaims against the Trustee and demanded a jury trial. (Ans., Docket No. 11-AP-1520, Doc. Entry No. 8.) The Defendant's counterclaims alleged abuse of process and "constitutional torts" (the "Counterclaims"). (*Id.* at 4-6.) Specifically, Defendant claimed that the Trustee failed to investigate properly before bringing the adversary proceeding, and acted "deliberately, maliciously, and oppressively" to intimidate and injure the Debtor's family. (*Id.*) Defendant requested: 1) an injunction barring the Trustee from bringing actions against a debtor's family unless she first demonstrates probable cause; 2) that the requirement to show probable cause be incorporated into the Local Bankruptcy Rules for this District; and 3) that the United States Trustee Office investigate whether lawsuits by panel trustees are abusive. (*Id.* at 6.)

[3] All references to "Docket No. 11-AP-1520" are to the adversary proceeding underlying the instant appeal.

On March 24, 2012, the Trustee responded to the Counterclaims by moving for sanctions against Dahiya pursuant to 28 U.S.C. § 1927 and 11 U.S.C. § 105 (the "Sanctions Motion"). (Sanctions Motion, Docket No. 11-AP-1520, Doc. Entry No. 15.) The Trustee asserted that the Counterclaims were baseless, made in bad faith, protracted the adversary proceeding, and caused her to incur additional legal fees and increased malpractice and liability insurance premiums. (*Id.*) Between April 2012 and November 2012, the Bankruptcy Court granted Dahiya numerous requests for adjournments of the evidentiary hearing on the Sanctions Motion and encouraged Dahiya to obtain counsel. Dahiya missed several deadlines to file prehearing statements on the Sanctions Motion, hired and fired counsel, and reneged on a tentative settlement that the parties had placed on the record. When Dahiya advised the Bankruptcy Court that he was having personal issues and was unable to defend himself, the Bankruptcy Court emphasized the serious nature of the sanctions motion and implored him to seek help from a bar associations' lawyer's assistance program and retain counsel. (*See* Transcript of June 13, 2012 Bankruptcy Court Hearing ("6/13/12 Tr.") at 23:25–24:9, 26:18–24, 38:19–25, Docket No. 12-MC-794,[4] Doc. Entry No. 9; Docket No. 12-MC-832,[5] Doc. Entry No. 9.) Nowhere in the record does it appear that Dahiya pursued the Bankruptcy Court's suggestions.

On November 19, 2012, Dahiya moved this Court to withdraw the reference to the Bankruptcy Court of the Sanctions Motion. (Docket No. 12-MC-794, Doc. Entry No. 1.) On November 30, 2012, the Bankruptcy Court held an evidentiary hearing on the Sanctions Motion, at which Dahiya appeared but refused to participate. (Transcript of November 30, 2012 Bankruptcy Court Hearing ("11/30/12 Tr."), Docket No. 11-AP-1520, Doc. Entry No. 68.) On

[4] All references to "Docket No. 12-MC-794" are to Appellant's motion to withdraw the reference to the Bankruptcy Court of the Sanctions Motion.
[5] All references to "Docket No. 12-MC-832" are to Appellant's motion to withdraw the reference to the Bankruptcy Court of the adversary proceeding.

December 5, 2012, Dahiya filed a separate motion to withdraw the reference to the Bankruptcy Court of the adversary proceeding itself. (Docket No. 12-MC-832, Doc. Entry No. 1.)

On March 11, 2013, the Bankruptcy Court granted the Sanctions Motion (the "Sanctions Order"). *See In re Khan*, 488 B.R. 515. The Bankruptcy Court found that Dahiya had acted in bad faith by bringing Counterclaims against the Trustee that lacked a colorable basis and imposed sanctions against Dahiya, including a fine in the amount of $15,000. (*Id.*) The sanctions were to be paid to the Trustee in three installments of $5,000, to be received by April 15, 2013, May 15, 2013, and June 17, 2013. (*Id.*)

On the evening of April 10, 2013 – two business days before the first sanctions payment was due and thirty days after the issuance of the Sanctions Order – Dahiya filed an Order to Show Cause in this Court seeking to enjoin the Sanctions Order pending resolution of the withdrawal of reference motions. (Docket No. 12-MC-794, Doc. Entry No. 11.) On April 15, 2013, this Court denied the motion to withdraw the reference of the Sanctions Motion, the motion to withdraw the reference of the adversary proceeding, and the motion to enjoin the Sanctions Order. (Docket No. 12-MC-794, Doc. Entry No. 14; Docket No. 12-MC-832, Doc. Entry No. 10.)

On May 24, 2013, Dahiya filed this appeal of the Sanctions Order. Appellant claims that the Bankruptcy Court lacked jurisdiction over the Sanctions Motion and that, even if the Bankruptcy Court had jurisdiction, the imposition of sanctions against Dahiya was unwarranted.

DISCUSSION

I. Standard of Review

A district court reviews a bankruptcy court's findings of fact for clear error and reviews its legal conclusions *de novo*. *Overbaugh v. Household Bank N.A.* (*In re Overbaugh*), 559 F.3d

125, 129 (2d Cir. 2009); Fed. R. Bankr. P. 8013. "A bankruptcy court's award of sanctions will not be set aside by [the reviewing court] in the absence of an abuse of discretion." *In re Kalikow*, 602 F.3d 82, 91 (2d Cir. 2010). A bankruptcy court abuses its discretion where "its decision (1) rests on an error of law (such as application of the wrong legal principle) or a clearly erroneous factual finding, or (2) cannot be located within the range of permissible decisions, even if it is not necessarily the product of a legal error or a clearly erroneous factual finding." *Schwartz v. Geltzer* (*In re Smith*), 507 F.3d 64, 73 (2d Cir. 2007) (quoting *Schwartz v. Aquatic Dev. Grp., Inc.* (*In re Aquatic Dev. Grp., Inc.*), 352 F.3d 671, 678 (2d Cir. 2003) (internal quotation marks and brackets omitted)).

II. Application

A. Authority to Issue Sanctions

The Bankruptcy Court found that it could impose sanctions under both its inherent authority and 28 U.S.C. § 1927 ("Section 1927"). *In re Khan*, 488 B.R. 515, 528 (Bankr. E.D.N.Y. 2013). Dahiya claims that: 1) the Bankruptcy Court does not possess "inherent authority" to issue sanctions because it is not an Article III court and 2) it is not authorized to impose sanctions under Section 1927 because it is not a "court of the United States." Since the Bankruptcy Court's finding that it had jurisdiction over the Sanctions Motion is a legal conclusion, this Court reviews the finding *de novo*.

First, Appellant appears to argue that the Bankruptcy Court did not have jurisdiction over the Sanctions Motion, because the "inherent authority" to impose sanctions is a judicial power that may only be exercised by Article III judges.[6] (App.'s Mem. at 8, Docket Entry No. 9.) This

[6] Article III § 1 of the United States Constitution requires that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." U.S. Const. art. III, § 1. The judges of such courts "shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their

argument is without merit. Although the category of cases that can constitutionally be assigned to bankruptcy judges to issue final judgment is limited, *see Stern v. Marshal*, __ U.S. __, 131 S. Ct. 2594 (2011); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989); *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53 (1982), bankruptcy courts "possess inherent authority to impose sanctions against attorneys and their clients." *In re Plumeri*, 434 B.R. 315, 327-28 (S.D.N.Y. 2010) (quoting *In re Evergreen Sec., Ltd.*, 570 F.3d 1257, 1263 (11th Cir. 2009)). The inherent power to sanction is not governed by a specific rule or statute, but instead "derives from the fact that courts are vested, by their very creation, with power to impose silence, respect, and decorum in their presence, and submission to their lawful mandates." *Id.* at 328 (quoting *Schlaifer Nance & Co., Inc. v. Estate of Warhol*, 194 F.3d 323, 336 (2d Cir. 1999)); *see also Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991). Despite Appellant's argument to the contrary, there is no support for the contention that the "inherent powers" of courts to issue sanctions "belong[] exclusively to the Article III courts." (App.'s Mem. at 8.)

Second, Appellant argues that the Bankruptcy Court did not have authority to sanction Dahiya under Section 1927, because the Bankruptcy Court is not a "court of the United States." (App.'s Mem. at 9-10.) Section 1927 provides that

> [a]ny attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

28 U.S.C.A. § 1927. Although there is a circuit split with respect to the question of whether Section 1927 applies to bankruptcy courts, *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 102

Continuance in Office." *Id.* Bankruptcy judges, in contrast, do not enjoy life tenure or protection against salary diminution as provided by Article III. *N. Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. at 61 (finding that "there is no doubt that . . . bankruptcy judges . . . are not Art. III judges").

(3d Cir. 2008) (collecting cases), the Second Circuit has found, albeit without discussion, that a bankruptcy court is a "court of the United States" and may issue sanctions under Section 1927. *Matter of Cohoes Indus. Terminal, Inc.*, 931 F.2d 222, 230 (2d Cir. 1991) (finding that "[a] bankruptcy court may impose sanctions pursuant to 28 U.S.C. § 1927 if it finds that an attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay"). Appellant has not presented any arguments or legal authority that persuade this Court otherwise.

Accordingly, the Court finds that the Bankruptcy Court correctly concluded that it had authority to impose sanctions under both its inherent authority and Section 1927.

B. Whether sanctions were warranted

The Bankruptcy Court found that the imposition of sanctions against Dahiya was warranted because Dahiya acted in bad faith by advancing counterclaims that lacked a colorable basis. *In re Khan*, 488 B.R. at 535. Appellant argues that his conduct was not sufficiently egregious to warrant sanctions. The Court reviews the Bankruptcy Court's award of sanctions for abuse of discretion. *In re Kalikow*, 602 F.3d at 91.

1. Legal Standard

Under its inherent powers to supervise and control its own proceedings, the Bankruptcy Court may impose sanctions where: 1) the challenged claim was without a colorable basis and 2) the claim was brought in bad faith, *i.e.,* motivated by improper purposes such as harassment or delay. *Enmon v. Prospect Capital Corp.*, 675 F.3d 138, 143-44 (2d Cir. 2012) (citing *Schlaifer Nance*, 194 F.3d at 336). A claim is colorable when it has some legal and factual support, considered in light of the reasonable beliefs of the individual making the claim. *Schlaifer Nance*, 194 F.3d at 337. Bad faith may be inferred "only if actions are so completely without merit as to