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Close Counts in Horseshoes and Hand Grenades, but Not in Chess, Checkers or Legal Ethics

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PLENARY SESSION

2022

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Close Counts In Horseshoes & Hand Grenades, But Not In Chess, Checkers, or Legal Ethics

Presented by:
Honorable Brian T. Fenimore, Western District of Missouri
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Close Counts In Horseshoes & Hand Grenades, But Not In Chess, Checkers, or Legal Ethics

Overall themes:

- Fed. R. Civ. Pro. Rule 11 and Fed.R.Bankr.P. Rule 9011;
- Section 105 of the United States Bankruptcy Code;
- Fed. R. Civ. Pro 37 and Fed.R.Bankr.P. Rule 7037;
- Sections 327 & 328 of the United States Bankruptcy Code; and
- Forms of Sanctions.

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Question 1: Is a decedent's estate qualified to file for bankruptcy?

1. Yes
2. No

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Question 1: Is a decedent's estate qualified to file for bankruptcy?

Answer: No. Only a "person" that resides or has a domicile, a place of business, or property in the United States, or a municipality may file for bankruptcy.11 U.S.C. Sec. 109(a).

A decedent's estate does not meet the definition of a "person" under Section 101(41) or the subset definitions of an "entity" or "corporation" under Sections 101(15) and 101(9), respectively.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

General Facts:

- Ernest Taplin, a widower, died intestate and left his son, California state prisoner Ernest Jubar Taplin as his heir.
- The imprisoned son gave his mother, Shirley Andrade, a power of attorney to handle his inheritance issues.
- On December 13, 2021, Attorney Foyil filed a chapter 11 petition under the incorrect name "Estate of Von Taplin, Ernest." (Von was decedent's middle name).

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

General Facts:

- The Petition signed by Attorney Foyil and Andrade (the Special Representative) asserted decedent's estate was a "corporation" with "0-$50,000" in assets and liabilities.
- Only a mortgagee and a foreclosure agent were listed as creditors.
- Attorney disclosed a $4,000.00 retainer from an undisclosed "other."

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

General Facts:

- As it appeared that a decedent's estate was not a "person" eligible to be a debtor under the Bankruptcy Code, an Order to Show Cause ("OSC") issued under **Fed.R.Bankr.P. 9011(c)(1)(B)** requiring Attorney and Andrade to explain why filing the petition did not violate **Fed.R.Bankr.P. 9011(b).**

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

General Facts:

- After the court issued its OSC, Attorney and the Special Representative **doubled down by filing an amended petition continuing to advocate eligibility for the debtor, this time as a "small business debtor"** despite the lack of the "commercial business activities" required by 11 U.S.C. § 101(51D). The Amended Petition also claimed to be "required to file periodic reports with the Securities and Exchange Commission."

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Question 2: Rule 9011(b) concerns a representation made to the Court_____?

1. In Writing
2. Orally
3. In writing or orally
4. None of the above

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Question 2: Rule 9011(b) concerns a representation made to the Court_____?

Answer: In Writing

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Question 3: Rule 9011(b) requires an attorney to make _____before presenting to the court a petition, pleading, written motion, or other paper?

1. A diligent inquiry under the circumstances
2. A thorough inquiry under the circumstances
3. A modest inquiry under the circumstances
4. A reasonable inquiry under the circumstances

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Question 3: Rule 9011(b) requires an attorney to make _____before presenting to the court a petition, pleading, written motion, or other paper?

Answer: A reasonable inquiry under the circumstances.

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- **Filing a chapter 11 petition certifies the filing is based on an "inquiry reasonable under the circumstances"** that: (1) it was not filed for an improper purpose; (2) the legal contentions were warranted by existing law or nonfrivolous argument for change to existing law; and (3) the factual contentions had evidentiary support or were likely to have evidentiary support after reasonable opportunity for investigation or discovery. **Fed.R.Bankr.P. 9011(b)(1)-(3).**

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- What is a "reasonable inquiry"?
- Rule 11 reasonableness is an objective standard for attorneys and for litigants.
- Whether a pre-filing inquiry is reasonable requires considering all the circumstances of the case, including the time available before a deadline compels filing.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- What is a "reasonable inquiry"?
- "As the Rules Advisory Committee explained, litigants must '**"stop-and-think' before making legal or factual contentions.**" **Fed.R.Civ.P. 11(b)**, Adv. Committee Note to 1993 Amendment; **Fed.R.Bankr.P. 9011**, Adv. Note to 1997 Amendment.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions
- Bankruptcy pleadings, motions, and other filed papers must be based on "inquiry reasonable under the circumstances."
- Positions that become untenable must not be "later advocated."
- Both these requirements of **Fed.R.Bankr.P. 9011(b)** were violated in this case filed for an entity that is ineligible for any form of bankruptcy relief.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions
- "Reasonable" inquiry, would have revealed a decedent's estate is not eligible to be a debtor under any Bankruptcy Code chapter and that it is an "improper purpose" to file a bankruptcy case to hijack the automatic stay for an ineligible entity.
- When the court questioned compliance with Rule 9011(b), the untenable position was "later advocated" in an Amended Petition that made other unresearched and untenable eligibility claims.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions- Deterrence
- Additionally, a spate of decedent's estate cases in this district, all of which have come to naught, signals a need for deterrence.
- Monetary sanctions designed to deter repetition of the offending conduct and of comparable conduct by others similarly situated were imposed on the court's own initiative under **Rules 9011(b)(1) and (b)(2)** because the nonsense needs to stop.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- "The purpose of sanctions under Rule 9011 is to deter rather than to compensate. Fed.R.Bankr.P. 9011(c)(2)."
- Accordingly, **Rule 9011(c)** requires that sanctions be limited to that which is "sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." Fed.R.Bankr.P. 9011 (c) (2); accord, Fed.R.Civ.P. 11 (c) (4) . Tailoring necessitates case-by-case treatment.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- Permissible sanctions may include an order to pay a penalty into court, as well as directives of a nonmonetary nature. Fed.R.Bankr.P. 9011(c)(2).
- Unfortunately for Attorney and Special Representative, a recent popularity of improper decedent's estate cases led the court to calculate the penalty to be paid into court with an eye to deterring others "similarly situated" from baseless filings.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- Attorney accepted a $4,000 fee to file a Petition with no merit and for an improper purpose. The court noted Attorney had been counsel in more than 2,000 bankruptcy cases since 1996, and he admitted to having made no pre-filing inquiry into the question of eligibility to be a debtor, and no post-filing inquiry into eligibility even after the court called the matter to his attention by way of an OSC.
- He "later advocated" his frivolous position by filing an unresearched Amended Petition "more ludicrous than the first Petition."

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- The court found:
- Deterring the Attorney's initial disregard of Rule 9011 warranted adding $2,000 to the $4,000 penalty related to the fee attorney accepted.
- Attorneys "later advocating" the same frivolity in an Amended Petition filed for an improper purpose elevated his to defiance that merited adding another $2,000 in sanctions.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- The court further found:
- "The parade" of 17 decedent's estate cases in the judicial district since November 2019 reveals that there are "others similarly situated" in need of deterrence. A situation exacerbated by the abusive pattern of cases being filed without payment of the filing fee, which cases are dismissed before the fee is collected.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- The court further noted:
- Other lawyers and potential special representatives need to know that this illegitimate bankruptcy strategy for decedent's estates could expose them to significant financial penalties. That knowledge will come in two forms.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- The court ruled:
- First, a copy of the court's opinion was to be served on attorneys who had been identified as representing offending special representatives in probate court.
- Second, the "others similarly situated" component of deterrence is an additional $2,000 to the penalty amount to Attorney.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- In sum, **Attorney was ordered to pay a monetary penalty of $10,000 into court**.
- Additionally, the **Special Representative was ordered to pay $4,000**, which was to be paid subject to Attorney refunding his fee for the case to the Special Representative.

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In Re Estate of Taplin, 641 B.R. 236 (Bankr. E.D. Cal. 2022)

- Court's Sanctions – Deterrence
- The Special Representative also violated **Rule 9011(b) (2)** twice. First, she signed a Chapter 11 Petition making frivolous assertions not warranted by law. Second, she signed an Amended Petition making similarly frivolous assertions of law.

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Bankruptcy Courts Power to Sanction Under: (1) Statutory Civil Contempt Authority Under Section 105(a), and (2) Inherent Sanction Authority

- Federal courts' have inherent authority to sanction for bad faith conduct. This authority includes bankruptcy courts.
- Section § 105(a) also provides a bankruptcy court with broad authority to "exercise its equitable powers - where 'necessary' or 'appropriate' - to facilitate the implementation of other Bankruptcy Code provisions." This gives bankruptcy courts the "inherent power to sanction abusive litigation practices."
- However, § 105(a) does not "allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code" or to "contravene specific statutory provisions."

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- In re BCB Contracting Servs., 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sep. 17, 2021), was marked "not for publication," but Westlaw published a slip copy anyway.
- In In re BCB Contracting Servs., Judge Dan Collins (Dist. of Arizona) gives a very comprehensive overview of Section 105.
- The Federal courts' have inherent authority to sanction for bad faith conduct, and
- Due Process / Safe Harbor provisions when seeking sanctions under Rule 9011 (i.e. 21 days' notice prior to filing with the court) other than where the conduct alleged is the filing of a petition in violation of subdivision (b).

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Before the court was the Ch. 7 trustee's Motion for Sanctions pursuant to **11 U.S.C. § 105(a) and Fed.R.Bankr.P. 9011(c)** against attorney, Stanley and others. Prior to the ruling, the Bankruptcy Court approved a settlement agreement between the Trustee and the majority of the parties subject to the Motions for Sanctions, and the Sanctions Motion remained outstanding as to attorney, Stanley.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Stanley, is an attorney licensed in the State of Arizona.
- He represented Debtor in BCB Contracting Services, LLC v. Payam D. Khosbin, which was filed on in late 2017 in the Arizona Superior Court, Maricopa County ('State Court Action').
- He also represented the Debtor in Debtor's Ch. 7 bankruptcy proceeding.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- The Trustee sought sanctions against attorney, Stanley under Rule 9011 and § 105(a) for his bad faith conduct and for the express misrepresentations and material omissions in the Petition, Schedules, and Statements filed by him with the Court.
- The Trustee asserted Stanley filed the Petition not for the purpose of appropriately addressing the Debtor's debts through the bankruptcy process but, rather, for the improper purpose of unnecessarily delaying the ultimate enforcement of two judgments and avoiding subpoenas entered in the State Court Action.

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Question 4: After a would-be debtor files for bankruptcy protection, the pre-petition attorney-client privilege belongs to and can be waived by the case trustee?

1. True
2. False

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Question 4: After a would-be debtor files for bankruptcy protection, the pre-petition attorney-client privilege belongs to and can be waived by the case trustee?

Answer: True.

See CFTC v. Weintraub, 471 U.S. 343 (1985) (holding the trustee of a corporation in bankruptcy has the power to waive the corporation's attorney-client privilege with respect to pre bankruptcy communications).

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Stanley was perhaps unaware of Weintraub and its greater implications when he emailed Ms. Holbrook, a member of the Debtor:
- "The state superior court judge ruled against us on the subpoenas. We could challenge his ruling by means of a special action (cost, $2 to 5K) …alternatively, we could just go ahead with putting BCB Contracting into Ch. 7 bankruptcy ($1,250 to start - and that should be about it unless Csontos/Khoshbin gets involved in the bankruptcy case and succeeds in getting the bankruptcy trustee to try to pursue you for money or property allegedly diverted from BCB Contracting)."

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- The next day, Stanley stated in a follow-up email to Mrs. Holbrook:
- **"We should file the bankruptcy by the end of next week to avoid the need to comply with the subpoenas**."
- Mrs. Holbrook also testified at the Evidentiary Hearing that Stanley advised her to file the Debtor's bankruptcy even though she did not want to.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- The emails and Mrs. Holbrook's testimony supported the Court's finding that Stanley filed the Petition in bad faith and for the improper purpose of avoiding subpoenas in the State Court Action, delaying a creditor from collecting on his judgment, and acting as a substitute for appealing the State Court's order denying the Motion to Quash the Subpoenas and posting a bond for the appeal.
- Moreover, Stanley failed to make a reasonable inquiry as to the information in the Schedules and Statements (outlined in the opinion).
- Taken together, these facts supported the Court finding Stanley's filing of the Petition, Schedules, and Statements were frivolous.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- **An attorney may not delegate his duty to validate the truth and legal reasonableness of papers filed with the court**.
- The signing attorney cannot leave it to another to satisfy himself that the filed paper is factually and legally responsible; **by signing he represents not merely the fact that it is so, but also the fact that he personally applied his own judgment.**... [T]he text [of Rule 9011] establishes a duty that cannot be delegated.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- The Bankruptcy Court also found that Stanley acted in bad faith by his conduct throughout the proceeding and **engaged in abusive litigation tactics after the case was filed.**
- Stanley, Debtor, (and Holbrook) got the benefit of the automatic stay to thwart a creditor's collection efforts yet failed to fulfill the debtor's duties imposed by the Code.
- Debtor, represented by Stanley, failed to provide Trustee with the necessary financial information for the § 341(a) meeting of creditors.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Trustee had to file motions to compel before documents that were the subject of his Rule 2004 examinations were produced. Trustee was also forced to subpoena bank records.
- Immediately after his withdrawal as Debtor's bankruptcy attorney, Stanley filed a special action as a means to get Debtor's bankruptcy case dismissed "after it became apparent that putting Debtor in chapter 7 was not such a great idea."

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Stanley then, without seeking leave from the bankruptcy court, **sued the Trustee in federal district** court over what he erroneously viewed as Trustee's improper involvement in the special action, and refused to voluntarily dismiss what Trustee warned was a frivolous lawsuit against him. The Trustee had to file a motion to dismiss.
- The district court dismissed the action as barred by Barton. Stanley was later sanctioned by the bankruptcy court for the frivolous filing, which the district court affirmed.

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In re BCB Contracting Servs., LLC, Ch. 7 Case No. 2:19-bk-15555-DPC, 2021 WL 4296164 (Bankr. D. Ariz. Sept. 17, 2021)

- Court's Sanctions: The **award of Trustee's attorneys' fees and costs in the amount of $15,523.31 was an appropriate deterrent** of a repetition of Stanley's misconduct, upholding the Bankruptcy Court's award.

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Employment Of Professional Persons & Limitation of Compensation Of Professionals

- And now, many, many, many words about…
- Fed.R.Bankr.P. 2014(a), "Employment of Professional Persons and its interplay with
- Section 327(a), "Employment of Professional Persons," and
- Section 328 (c), "Limitation on compensation of professional persons."

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Employment Of Professional Persons & Limitation of Compensation Of Professionals

- Section 327(a) limits the employment of attorneys by a debtor serving as the debtor in possession to those: (1) who do not hold or represent an interest adverse to the interest of the estate; and (2) who are disinterested. See 11 U.S.C. § 327(a).
- A debtor in possession is the functional equivalent of a trustee for purposes of employing attorneys under § 327.

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Employment Of Professional Persons & Limitation of Compensation Of Professionals

- Section 328(c) permits the bankruptcy court to deny compensation and reimbursement of expenses to attorneys employed under § 327(a) if, **at any time** during the attorneys' employment, **the attorneys represent or hold an interest adverse to the interest of the estate with respect to the matter on which the attorneys are employed**. See 11 U.S.C. § 328(c).
- Section 328(c) further permits the bankruptcy court to **deny all compensation and reimbursement of all expenses**. 11 U.S.C. § 328(c).

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Employment Of Professional Persons & Limitation of Compensation Of Professionals

- **Federal Rule of Bankruptcy Procedure 2014** provides **an equally powerful tool to remedy nondisclosure or the incomplete disclosure of connections that give rise to an adverse interest discovered during a bankruptcy case**.
- Rule 2014(a) states that an employment application filed under § 327 shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, or any other party in interest. See Fed. R. Bankr. P. 2014 (a).

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- The disclosure requirements of Bankruptcy Rule 2014(a) are strictly applied with the burden on the applicant to come forward and make full, candid, and complete disclosure of all connections with the debtor, debtor in possession, insiders, creditors, and parties in interest regardless of how old or trivial the connections may be.
- Disclosure is also an ongoing obligation, and it must be discharged promptly when circumstances change or otherwise warrant.
- The bankruptcy court has "inherent" authority to remedy nondisclosure or disclosure that is less than complete.

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Question 5: The worst word or phrase in the bankruptcy lexicon is_____?

- Priming lien
- Administratively insolvent
- Disgorgement
- Cramdown

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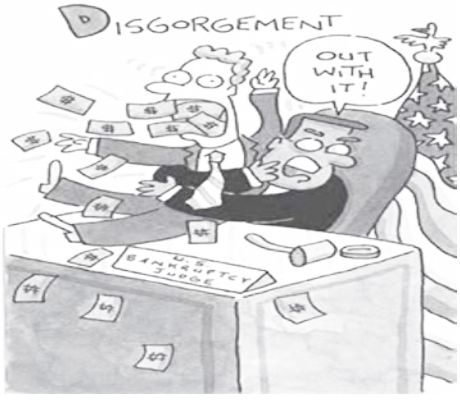
Question 5: The worst word or phrase in the bankruptcy lexicon is_____?

- Answer:



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The worst word or phrase in the bankruptcy lexicon is - Disgorgement

- Disgorgement - The word that strikes knee-knocking terror in the minds and hearts of bankruptcy professionals. An order by the bankruptcy court that professionals must "disgorge" fees they have been paid on an interim basis prior. This may occur in situations where professionals are found to have (1) violated disinterestedness standards, (2) failed to keep detailed and adequate time records, or (3) been paid an excessive interim amount in light of ultimate results in the case. (https://devilsdictionary.polsinelli.com/?s=DISGORGEMENT)

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- This case highlights the famous first law of holes: when you're in one, stop digging.
- "The appellant, a law firm representing a small, LLC in a bankruptcy matter, ignored that law, and a few others, to its shame."
- The U.S. Bankruptcy Court for the District of New Jersey **ordered the disgorgement of fees paid to the firm, denied its request for further payment from the bankrupt debtor's estate, and referred the firm's principal to the District Court for possible disciplinary action**. The District Court and the Court of Appeals upheld the Bankruptcy Court.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Debtor was single-member LLC wholly owned by Lingyan Quan.
- Aside from a few thousand dollars in cash and accounts receivable, its only asset is a multi-family dwelling in New Jersey, and its two sole creditors held ~$1.85 million in judgment liens arising out of a state-court judgment.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- Simultaneous with the Debtor's petition, Debtor's counsel, KKT filed a **statement of compensation, pursuant to § 329(a)** of the Code and **Rule 2016(b) of the Fed.R.Bankr.P.**, disclosing receipt of a $3,000 retainer payment by the Debtor.
- The Debtor then filed a Retention Application **under § 327(a) of the Code**, seeking permission to retain KKT as counsel in the Ch. 11 proceedings.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Retention Application stated KKT's services were necessary because the Debtor had previously had KKT as its defense counsel in the state-court action leading to the judgment, so KKT was "fully knowledgeable" of "the debtor's situation."
- It further represented that KKT had "rich experience in bankruptcy[.]"

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Retention Application disclosed the parties' compensation arrangement and declared, other than the $3,000 retainer, no other agreement had been made between KKT and the Debtor, or anyone acting on either party's behalf.
- It also certified that KKT would comply with applicable bankruptcy laws and court procedures when applying for compensation.
- Lastly, it stated that KKT was disinterested and neither held nor represented an interest adverse to the Debtor or the Debtor's estate under **§ 327(e) of the Code**.
- The Bankruptcy Court approved the Retention Application.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Debtor the asked the Bankruptcy Court to lift the automatic stay on its appeal of the state-court judgment and to hold the bankruptcy proceeding in abeyance.
- The Court denied that request, concluding that the Debtor "was using the bankruptcy case as a substitute for posting a supersedeas bond …without first attempting to pay or obtain a waiver of the bond requirement."

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- A year into the proceeding, the Debtor had yet to file a Ch. 11 disclosure statement and plan, so the Bankruptcy Court ordered the parties to show cause why the proceeding should not be dismissed or converted into a Chapter 7 liquidation.
- Debtor admitted that "the only reason [it] filed the…bankruptcy [was] to secure a stay so that [it could] pursue its appeal in State Court without losing the property at issue."
- Because it had not been successful in securing that relief, it sought dismissal of its Ch. 11 case.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Bankruptcy Court refused to dismiss the case because it believed it was in the best interest of the creditors and the estate to convert to Ch.7 liquidation and appoint a trustee to manage the estate.
- Soon thereafter, the Ch. 7 Trustee moved to sell the Debtor's only known asset, the multi-family house.
- The Court approved the property's public sale for $725,000 two months later.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- After the conversion, and over a year and half after the Debtor declared bankruptcy, Debtor's counsel filed its first and only Fee Application, seeking payment of $31,819 in fees and expenses from the Debtor.
- Notably, the Fee Application also disclosed that KKT, without Bankruptcy Court approval, had already received payments totaling $19,400 from the "personal bank account" of Quan - Debtor's sole shareholder - as "prepayment for the legal services rendered" to the Debtor.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- Counsel requested the Court approve its fees so that it could pay Quan back.
- Both the Chapter 7 Trustee and Debtor's creditors objected, arguing, among other things, the previously undisclosed payments violated the Code and the Bankruptcy Rules.
- At the hearing on the Fee Application, things went from bad to worse for Debtor's counsel.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- First, Counsel repeatedly evaded the Bankruptcy Court's questions regarding Quan's undisclosed payments.
- Counsel attempted to characterize the payments as something other than an unauthorized loan incurred by the Debtor.
- When pressed, counsel admitted the payments were indeed a loan, only to reverse course after the Bankruptcy Court reminded him that any debt incurred by the Debtor had to be pre-approved by the Court.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- Next, Counsel conceded Debtor intentionally omitted the payments from the Debtor's Monthly Operating Reports, in violation of §§ 704(a)(8) and 1106(a) (1) of the Code, because, if the Debtor had owed post-petition money for legal fees, then "the monthly operating reports most likely would have gone negative and, at the time [Debtor was] talking about reorganization."
- In other words, Debtor intentionally withheld required information to mislead the Court and avoid either the conversion or the dismissal of the case.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Bankruptcy Court issued a second order for KKT and attorney, Tung, in his individual capacity, to show cause why the Court should not sanction them for violations of the New Jersey Rules of Professional Conduct, the Code, and the Bankruptcy Rules.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- KKT and Tung responded their conduct had not violated any legal or ethical obligations.
- KKT contended, among other things, that acceptance of legal fees from Quan was not a *per se* violation of § 327(a) of the Code, that it made the appropriate disclosures in its Fee Application under Bankruptcy Rule 2016, and that there was no conflict of interest because the interests of Quan and the Debtor were united.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- At the second hearing on the issue, Tung, speaking on behalf of both KKT and himself, first argued that the failure to timely disclose the payments was merely a "technical failure to disclose, … [which] shouldn't warrant any sanctions."
- He then "changed his tune", saying he did not believe KKT needed to disclose anything about the payments until it filed the Fee Application.
- After finally agreeing earlier disclosure was required, he gave a series of contradictory responses on how the undisclosed payments should be characterized.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Bankruptcy Court noted that Tung did not really understand the laws that govern a bankruptcy proceeding, and, rather than show contrition for his mistakes, was "very defensive, flip flopping in [his] statements, … and …unhelpful[.]"

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- Each time the negative implications of his proposed characterization became apparent, Tung would change his response: Here are some of the low lights:
- The undisclosed payments were "definitely not a loan"; they "could be characterized" as an infusion of capital; "the assumption should be [that they were] not [an] infusion of capital"; they were an "investment" they "w[ere]n't treated as [an] investment"; they "could be" a gift to the debtor; "[n]obody said to me it was a gift;" "[i]t's a gift" (App. at 928); "I'm not saying it's a gift."

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Court's Sanctions:
- Denied with prejudice the Fee Application,
- Ordered the payments to KKT to be disgorged to the estate,
- Determined KKT and Tung failed to make timely and adequate disclosures under Rules 2014 and 2016, and had "purposefully and strategically decided to omit pertinent information…"

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Court's Sanctions:
- Found KKT and the attorney, individually, had violated their **duty of candor** under New Jersey Rule of Professional Conduct 3.3.
- Lastly, because of the egregiousness of counsel's conduct, the Court **referred the case to the Chief Judge of the District Court for potential disciplinary action**.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- On appeal to the District Court, KKT and the attorney actually made matters worse by arguing, in part, the Bankruptcy Judge was biased.
- KKT argued the Bankruptcy Court, as a non-Article III court, lacked jurisdiction to order disgorgement of KKT's fees and, even if it had the authority to do so, that it abused its discretion and was improperly biased in the Debtor's bankruptcy.
- The basis of the allegation was a photograph taken of the Judge with the Ch. 7 Trustee at a New Jersey Bankruptcy Lawyers Foundation event.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The District Court held **disgorgement was within the Bankruptcy Court's jurisdiction** under Stern v. Marshall, as "**these proceedings were core and flowed directly from the bankruptcy scheme**[.]"
- And because KKT breached its disclosure obligations, the Bankruptcy Court was well within its discretion to order disgorgement and deny the Fee Application.

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The District Court struck from the record, as irrelevant and meritless, a supplemental letter filed by KKT alleging that the Bankruptcy Judge was improperly biased.
- The District Court also affirmed the Bankruptcy Court's holding that KKT violated New Jersey Rule of Professional Conduct 3.3

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- The Court of Appeal affirmed both the District and Bankruptcy Courts, noting: "**The Code and associated Rules impose a rigorous structure of oversight on a debtor, its professionals, and the estate. At the heart of that structure is a baseline presumption - and an expectation - of disclosure and candor.**"
- Fed.R.Bankr.P. 2014(a) – Requires counsel to disclose "any proposed arrangement for compensation;"
- Fed.R.Bankr.P. 2016(b) – Requires compensation be disclosed "within 14 days after any payment or agreement not previously disclosed" (NOTE the ongoing nature of the disclosure);

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In re 38-36 Greenville Ave LLC, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

- "**The Code and associated Rules impose a rigorous structure of oversight on a debtor, its professionals, and the estate. At the heart of that structure is a baseline presumption - and an expectation - of disclosure and candor.**"
- 11 U.S.C. § 329(a) – Requires comprehensive disclosure of payments in connection with bankruptcy; and
- Section § 330(a) – Requires counsel to file fee applications when seeking payment for services rendered.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- The message In re NIR W. Coast, Inc., is twofold.
- "First, when employment violates 11 U.S.C. § 327(a), the bankruptcy court may invoke 11 U.S.C. § 328(c) to deny all compensation and the reimbursement of all expenses."
- "Second, the bankruptcy court has **inherent authority to deny all compensation and the reimbursement of all expenses under Bankruptcy Rule 2014 (a) for nondisclosure or when disclosure is delayed or less than complete.**"

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Before the Court were two fee applications - Initial Application and Revised Application filed by Law Firm. The service period was from November 4, 2020, to November 24, 2021.
- The Initial Application requested attorney's fees in the amount of $111,639.00 and reimbursement of expenses in the amount of $1,842.92 for a **total of $113,481.92.**
- The Revised Application included **a $35,000.00 reduction in requested attorney's** for a reduced total of $78,481.92. The reason for the reduction in the Revised Application was not explained other than to state it is a voluntary reduction to avoid objections by the United States and subchapter v trustees.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- The problem was the Law Firm represented an interest adverse to the interest of the bankruptcy estate during the term of its employment as the Debtor's general bankruptcy counsel.
- The connection giving rise to the adverse interest was known when the Debtor filed its application to employ the Law Firm.
- The connection was not initially disclosed and it was not promptly disclosed after it was raised by a creditor and the subchapter v trustee during the course of the bankruptcy case.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Gregory T. Lynn ("Lynn") is the Debtor's sole shareholder, and he is identified in the schedules as a co-debtor with and guarantor of the Debtor, a recipient of preferential transfers, and a creditor in the bankruptcy case.
- Lynn and the Debtor are also co-defendants in a pre-petition state court class action case filed by the Debtor's employees to recover wages and other benefit.

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Question 6: Such a set of facts is not uncommon, you, as a bankruptcy lawyer should advise the potential Debtor Business _____?

1. You cannot advise either Debtor or Mr. Lynn?
2. You can represent Mr. Lynn or the Debtor, but not both given Lynn's status as a creditor and potential preference defendant of the Debtor?

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Question 6: Such a set of facts is not uncommon, you, as a bankruptcy lawyer should advise the potential Debtor Business _____?

Answer: #2 : You can represent Mr. Lynn or the Debtor, but not both given Lynn's status as a creditor and potential preference defendant of the Debtor. The Debtor and Lynn should each have their own independent counsel.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Meanwhile, on December 4, 2020, the Debtor filed an application to employ the Law Firm as its general bankruptcy attorneys.
- The employment application and supporting declaration identify the Law Firm's attorneys responsible for providing services related to the bankruptcy case as, among others, Ms. Oelsner and Mr. Clary.
- The employment application AND supporting declaration, state except as disclosed in the supporting declaration, the Law Firm "does not have any connections ... that would preclude employment" and that it also "does not now hold or represent any interest materially adverse to the interests of the estate[.]"

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- The supporting declaration also states Ms. Oelsner "reviewed the Debtor in Possession's list of creditors, and made reasonable inquiries of [the Law Firm's] attorneys and staff to determine the nature of ... connections."
- And Law Firm's "staff has also performed a computerized conflict check of all the creditors and parties in interest in this case [and that Ms. Oelsner] reviewed the result of that computerized conflict check, and to the best of [her] knowledge neither [she] nor any other attorneys or employees of [the Law Firm] have any business or social connections with the Debtor in Possession, its creditors, their equity security holders, [ ] with any other parties in interest [or] their respective attorneys[.]"

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Less than two months after the court approved the Law Firm's employment, during a telephone conversation between Ms. Oelsner and an attorney for the Debtor's primary secured lender, Ms. Oelsner apparently referred to Mr. Lynn as a "client" of the Law Firm.
- Lender's attorney confirmed the telephone conversation and the reference to Mr. Lynn as the Law Firm's "client" in an email two days later.
- A little more than a week later, the subchapter v trustee advised Ms. Oelsner that the Law Firm's simultaneous representation of Mr. Lynn and the Debtor as the debtor in possession should be disclosed.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Ms. Oelsner waited some six months before she disclosed in an August 11, 2021 updated declaration, the Law Firm represented Mr. Lynn and the Debtor as the debtor in possession, **and that it represented both clients with regard to the state court litigation and the related claim.**
- The declaration also states that Ms. Oelsner learned that the Law Firm represented Mr. Lynn individually and with regard to the Tovar Litigation, and thus the Tovar Claim, "**during the last two days**."
- "Until this representation was brought to my attention ... two days ago, I was not aware that [the Law Firm] represented Mr. Lynn in the Tovar matter."

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- **The Court found, Ms. Oelsner's sworn statements** that she first learned that the Law Firm represented Mr. Lynn with regard to the Tovar Litigation and the Tovar Claim "two days" before the date of her August 11, 2021, supplemental declaration **were not credible**.
- Ms. Oelsner's February 2021 reference to Mr. Lynn as a "client" suggests-and the Law Firm's billing statements reflect-otherwise.
- Per billing records, on November 5, 2020, Ms. Oelsner and Mr. Clary had "internal discussions" and exchanged emails regarding the effect of the automatic stay on the Tovar Litigation."

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- The Court found, in part, the Law Firm had no business securing employment as attorneys for the Debtor in its capacity as the debtor in possession without disclosing its connection to Mr. Lynn, generally, and, specifically, its representation of Mr. Lynn in the Tovar Litigation.
- The connection was also not disclosed promptly after it was raised early in the case by a creditor and the subchapter v trustee.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Court's Sanctions: **The Court denied attorney's fees in the amount of $76,639.00 and reimbursement of expenses in the amount of $1,842.92.**
- Further, to the extent attorney fees or reimbursement of expenses could be requested for services the Law Firm provided after the Debtor was removed as a debtor in possession, the Court said they would also be denied under Lamie v. United States Tr., 540 U.S. 526, 124 S.Ct. 1023 (2004).
- In Lamie, the United States Supreme Court held that when a debtor is removed as the debtor possession its attorneys are no longer employed under § 327 and compensation may not be awarded under § 330.

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In re NIR W. Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022)

- Court's Sanctions: **Compensation and reimbursement of expenses for services** the Law Firm provided between November 4, 2020, and December 6, 2020, and thus **before its employment was approved, were also denied**.
- Additionally, the Law Firm was ordered to **transmit any retainer in its possession to the subchapter v trustee** within seven days of the date of this Opinion, which the subchapter v trustee was to hold subject to further order of the court.

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And Now For A Few Reminders On Discovery Sanctions

- A court has "broad discretion" in all discovery matters.
- When parties violate discovery orders, **Federal Rule of Bankruptcy Procedure 7037**, which incorporates Federal Rule of Civil Procedure 37, **allows for a broad range of sanctions against counsel and parties.** Fed. R. Civ. P. 37; Fed. R. Bankr. P. 7037.
- Specifically, **Rule 37(b)(2)** authorizes the court to impose a "**concurrent sanction of reasonable expenses, including attorney's fees**" caused by the violation of the discovery order. Fed. R. Civ. P. 37(b)(2).

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And Now For A Few Reminders On Discovery Sanctions

- Noncompliance with discovery orders is considered willful when the "court's orders have been clear, when the party has understood them, and when the party's noncompliance is not due to factors beyond the party's control.
- **In addition to fashioning sanctions according to the level of misconduct, i.e., assessing a penalty, a court may impose discovery sanctions as a deterrent.**
- See In Re: Express Grain Terminals, LLC, Ch. 11 Case No. 21-11832-SDM, 2022 WL 1136313 (Bankr. N.D. Miss. Apr. 15, 2022).

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Question 7: The costs of a lawyer's disciplinary proceedings are nondischargeable debts under Section 523(a)(7)?

1. Correct
2. Incorrect
3. It depends which circuit you ask

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Question 7: The costs of a lawyer's disciplinary proceedings are nondischargeable debts under Section 523(a)(7)?

Answer: It depends which circuit you ask.

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Attorney disciplinary proceeding costs as dischargeable vs. nondischargeable debts under Section 523(a)(7)?

- Four circuits—the First, Seventh, Ninth, and Eleventh circuits—agree: The costs of a lawyer's disciplinary proceedings are nondischargeable debts under Section 523(a)(7).
- Under Sections 523(a)(7) and (c)(1), a debt is automatically excepted from discharge if it is a "fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a [particular] tax penalty."

MIDWESTERN BANKRUPTCY INSTITUTE

Osicka v. Office of Lawyer Regulation, 25 F.4th 501 (7th Cir. 2022)

- The Wisconsin Supreme Court had issued a public reprimand for negligence, not intentional wrongdoing. Attorney was ordered to pay $150 in restitution and $12,500 in costs. When the lawyer failed to pay the costs, the bar association suspended his license.
- The lawyer closed his practice and filed a chapter 7 petition, where he received a general discharge.
- Later, the lawyer applied for his license to be reinstated, but the bar association refused because he had not paid the costs.

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Osicka v. Office of Lawyer Regulation, 25 F.4th 501 (7th Cir. 2022)

- The lawyer reopened his bankruptcy and filed an adversary proceeding to declare that the costs had been discharged.
- The state disciplinary authority opposed, raising Section 523(a)(7) in defense.
- The Bankruptcy Court ruled on summary judgment that the costs were not discharged, and the District Court affirmed in Osicka v. Office of Lawyer Regulation, 20-478, 2021 WL 1115926 (W.D. Wis. Mar. 24, 2021).
- The lawyer appealed again to the 7th Circuit, which affirmed both the Bankruptcy and District Courts.

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Osicka v. Office of Lawyer Regulation, 25 F.4th 501 (7th Cir. 2022)

- Citing *Black's Law Dictionary*, Judge Scudder, writing for the 7th Cir. Court of Appeals, said that a "**penalty is a [p]unishment imposed on a wrongdoer 'that can take the form of a sum of money exacted as punishment for either a wrong to the state or a civil wrong**.'"
- He went on to say that the state's disciplinary code "unambiguously singles out attorney discipline as a penal endeavor," and Kelly v. Robinson, 479 U.S. 36 (1986), makes a broad exception to dischargeability for penal sanctions.

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Question 8: The Bankruptcy Code Has Primacy Over State Ethical Rules When Considering Potential Conflicts Of Interest?

1. True
2. False

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Question 8: The Bankruptcy Code Has Primacy Over State Ethical Rules When Considering Potential Conflicts Of Interest?

1. True, according to the Third Circuit Court of Appeals.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Absent an "actual conflict," disqualification is discretionary and is not required under Section 327(a), even if there is a potential conflict, and
- Bankruptcy courts have discretion to apply the state's rules of professional conduct when they are **relevant and compatible with federal law and policy.**

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- The Boy Scouts purchased primary insurance from an insurer that bought reinsurance from other insurers.
- The law firm at issue was the primary insurer's counsel in disputes with the Boy Scouts' reinsurers.
- At about the same time the primary insurer retained the law firm, Boy Scouts retained the same law firm to explore restructuring options.
- In agreeing to represent Boy Scouts, the law firm told the Boy Scouts it would not give counsel on insurance coverage.
- Boy Scouts retained **another firm for insurance matters.**

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Primary insurer first learned that the same law firm was representing it as well as the Boy Scouts upon reading an article in *The Wall Street Journal* about three months after hiring the firm for reinsurance disputes.
- The primary insurer did not object at the time.
- As counsel for Boy Scouts, lawyers from the firm attended some meetings with the primary insurer where the Boy Scouts were chiefly represented by the other firm.
- The primary insurer did not object at the time.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Approximately 10 months after reading that the firm was representing both the Boy Scouts and the primary insurer, the insurer told the firm that the dual representation was a conflict.
- The insurer also objected when the firm participated in mediation on the side of the Boy Scouts.
- The firm then responded by setting up a formal ethical screen between the firm's bankruptcy and insurance lawyers.
- Insurer refused to sign a waiver of the alleged conflict or consent to the firm's withdrawal. So, the firm withdrew from representing the insurer unilaterally.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- The firm then filed the Debtors' Ch.11 petition in February 2020.
- Debtors filed an application to retain the firm as its bankruptcy counsel, and the primary insurer objected.
- The Bankruptcy Court overruled the insurer's objection and authorized the firm's retention seeing no actual conflict and finding the firm's two teams of lawyers had not shared the insurer's confidential information.
- The District Court affirmed, and the insurer appealed to the Circuit Court of Appeals.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- In the meantime, the firm's bankruptcy lawyers moved to a new firm, taking the Debtors' case with them.
- Consequently, the firm was no longer representing either the Boy Scouts or the insurer by the time the Court of Appeals issued its ruling.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Arguably, the retention order was not a final order subject to appeal as of right. (See also Alix v. McKinsey & Co. Inc., 23 F.4th 196 (2d Cir. 2022).
- The Court of Appeals, however, said the retention of counsel implicates the integrity of the bankruptcy system and is extremely important to resolve.
- Additionally, although the firm no longer represented the Debtors, the Court of Appeals found constitutional and prudential standing because the possibility of disgorgement of fees gave the appeal "continuing implications" for Debtors and creditors.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Again, Section 327(a) provides, in part, to be eligible for employment, the professional may not: (1) "represent an adverse interest;" and (2) must be "disinterested."
- Per the Third Circuit, conflicts under Section 327 are divisible into three categories: (1) actual conflicts; (2) potential conflicts; and (3) appearances of conflict.
- If there is an actual conflict, counsel face *per se* disqualification.
- Conversely, disqualification is discretionary if the conflict is potential, and an attorney is not disqualified on the appearance of a conflict alone.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- The bankruptcy court had found no actual conflict under Section 327, and on appeal the insurer did not "meaningfully challenged the Bankruptcy Court's factual finding that [the firm] did not have an interest adverse to the estate."
- The insurer argued, however, that the bankruptcy court committed error by not also evaluating the dual representation under **Rules 1.7 and 1.9 of the ABA's Model Rules of Professional Conduct**.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- The Delaware Bankruptcy Court has adopted the American Bar Association's Model Rules of Professional Conduct. Bankr. D. Del. Ct. R. 9010-1(f).
- **Rule 1.7 governs concurrent conflicts of interest** and states that, unless certain listed exceptions apply, "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest." Model Rules of Pro. Conduct r. 1.7.
- **Rule 1.9 concerns obligations to former clients**.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- **Rule 1.7 governs concurrent conflicts of interest** and states unless certain listed exceptions apply, "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest." Model Rules of Pro. Conduct r. 1.7.
- This occurs when "(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."

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- **Rule 1.9 concerns obligations to former** clients and states, absent consent, "[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." Model Rules of Pro. Conduct r. 1.9; see also **Model Rules of Pro. Conduct r. 1.10 (extending the obligations of Rules 1.7 and 1.9 to all attorneys within the same firm)**.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- The Court of Appeals found the Bankruptcy Court DID NOT err by not also evaluating the dual representation under Rules 1.7 and 1.9 of the MRPC.
- Holding "Section 327 and the Rules of Professional Conduct impose independent obligations," and the "[p]rofessional conduct rules may be relevant and 'consulted when they are compatible with federal law and policy . . . .
- Although ethics rules "may be informative in some cases," **the Third Cir. Court of Appeals (at least) has never stated that violations of the Rules of Professional Conduct are themselves sufficient to create a § 327 conflict.**"

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Further, the Court of Appeals noted, disqualification is never automatic.
- "Even when an ethical conflict exists (or is assumed to exist) [under state ethics rules], a court may conclude based on the facts before it that disqualification is not an appropriate remedy."

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- Considerations for when a court should not disqualify counsel (even if a conflict is assumed to exist), would include:
- the ability of litigants to retain loyal counsel of their choice,
- the ability of attorneys to practice without undue restriction,
- preventing the use of disqualification as a litigation strategy, and
- preserving the integrity of legal proceedings, and preventing unfair prejudice.
- "Sometimes disqualification is more disruptive than helpful even though an attorney may not have satisfied his or her professional obligations," according the Court of Appeals.

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In re Boy Scouts of America, 35 F.4th 149 (3d Cir. 2022)

- A Word or 100 about "**Disinterested Hot Potato**"
- Consider the case where a law firm drops an existing client (a bank, an insurance company) to avoid conflicts that would prevent it from taking on a more lucrative client (a potentially large Ch. 11debtor).
- Under this concept—known as the "hot potato" doctrine—courts are to apply the more stringent Rule 1.7 standards even though representation has formally ended **to discourage firms from dropping a client** (like a hot potato) for self-interested reasons. (See Merck Eprova AG v. ProThera, Inc., 670 F. Supp. 2d 201, 209 (S.D.N.Y. 2009)).

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Special / Conflicts Counsel

- For a further discussion of the interplay between Sections 327 and 328 as well as the use of "special" or "conflicts" counsel and how they too might, ultimately, fail to be disinterested, see Carickhoff v. Goodwin (In Re DECADE. S.A.C., LLC), Ch. 7 Case No. 18-11668, Adv. No. 19-50095, 2022 WL 486952 (Bankr. D. Del. Feb. 17, 2022).

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Thank you!

Faculty

Jonathan M. Dickey is a partner with Kutner Brinen Dickey Riley, P.C. in Denver and has specialized in the practice of bankruptcy law for over a decade. He represents chapter 11 debtors — both individual and corporate — and has guided many parties through the chapter 11 process to plan confirmation. In addition, Mr. Dickey has experience representing chapter 7 trustees and creditors across all chapters of the Bankruptcy Code. Prior to moving to Colorado in 2014, he practiced bankruptcy law in Indianapolis and was a frequent speaker on bankruptcy issues for the National Business Institute. Mr. Dickey received his B.S. in finance as a Chancellor's Scholar in 2005 from the University of Illinois, and his J.D. in 2008 from the University of Illinois College of Law, where he was a notes editor for the *Journal of Law, Technology and Policy*.

Hon. Brian T. Fenimore is a U.S. Bankruptcy Judge for the Western District of Missouri in Kansas City, appointed on Aug. 31, 2017. Previously, he was a partner in the Kansas City, Mo., office of Lathrop & Gage LLP for more than 25 years and co-chaired its Banking & Creditors' Rights practice area, representing debtors, creditors and many other parties in interest. He also represented borrowers and lenders in problem loan matters, including loan enforcement, guarantor liability, workouts, reorganizations and bankruptcies throughout the U.S. Judge Fenimore is admitted to practice in Kansas and Missouri, and before the U.S. Bankruptcy Courts for the Eastern and Western Districts of Missouri and the District of Kansas, as well as the U.S. District Courts for the District of Kansas and the Eastern and Western Districts of Missouri. He is AV-rated by Martindale-Hubbell and has been listed in *The Best Lawyers in America* every year since 2003, among other listings. He is also a frequent speaker and ABI member. Judge Fenimore received his B.S. *magna cum laude* in 1988 in agricultural economics from the University of Missouri-Columbia and his J.D. in 1990 from the University of Michigan Law School, after which he clerked for Hon. Arthur B. Federman.

Elizabeth M. Lally is a partner with Spencer Fane, LLC in Omaha, Neb. Her experience includes representing borrowers and lenders in complex financing transactions, debt restructurings and out-of-court workouts, as well as chapter 7, 12 and 11 reorganizations and liquidations. Ms. Lally regularly represents debtors-in-possession and unsecured creditors' committees in complex chapter 11 reorganizations and liquidations, and is a subchapter V trustee for Region 12, covering Iowa and South Dakota. She received her B.A. *cum laude* in English from Bradley University in 1999 and her J.D. in 2005 from DePaul University College of Law.