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Ethics Panel

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Ethics in Bankruptcy

Recent court decisions on legal ethics - you should be aware...¹

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I. JUDICIAL AUTHORITY IN BANKRUPTCY: RULE 9011, SECTION 105, AND THE COURT’S INHERENT AUTHORITY TO SANCTION

Counsel and potential counsel for interested parties in a bankruptcy case must comply with multiple sources of rules and guidelines for ethics and professionalism. Specifically, counsel must comply with the relevant state’s ethical codes and rules, as well as the Bankruptcy Code or Bankruptcy Rules. Frequently, local bankruptcy courts also supplement the applicable rules and guidelines; therefore, counsel must also take care to examine the applicable local bankruptcy rules to ensure full compliance, as well.

Unprofessional behavior can lead to consequences initiated by the relevant bar association or court. Bankruptcy courts have exercised their discretion to sanction lawyers for unethical and unprofessional conduct pursuant to (1) the authority granted in Rule 9011 of the Federal Bankruptcy Rules of Procedure, and (2) the courts’ inherent authority to police practitioners before them.² This inherent authority to control the conduct of parties before it is based both in the inherent power of the federal courts and in 11 U.S.C. §105(a), which states:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude

² See, e.g., *In re First City Bancorporation of Texas Inc.* at 867 (affirming the bankruptcy court’s \$25,000 sanction against counsel for his “obnoxious behavior” and personal attacks against opposing counsel). See also *In re Seare*, 515 B.R. 599, 615 (9th Cir. BAP 2014) (holding that bankruptcy courts have the inherent authority to regulate the practice of attorney appearing before them and express authority to sanction attorney, including disbarment or suspension from practice).

the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Sanctions available to bankruptcy courts include, but are not limited to, disbarment, suspension from practice, and assessment of attorney fees against counsel.³ These available sanctions provide a mechanism for the courts to ensure compliance with the rules and standards imposed on counsel.

II. COURT CONDUCT

Guidelines for the expectations of counsel both in and out of the courtroom are intended to promote efficiency, professionalism, and civility. Particularly in the context of bankruptcy, where cooperation and negotiation are essential, professional conduct is an important aspect of judicial success. An attorney's need to zealously advocate for a client's interests does not excuse or permit hostile or overly aggressive behavior or statements.⁴ Thus, in an effort to combat the growing perception that advocates exhibit "Rambo" behavior, principles and standards have been instituted, through mandatory rules and ideal guidelines; to decrease disrespect and irreverence towards others engaged in litigation.

Despite attempts made by various institutions to increase civility in the legal profession, blatant examples of disrespect to the courts and

³ *Id.* at 151; *In re Seare*, 515 B.R. at 615.

⁴ *See, e.g., In re First City Bancorporation of Texas Inc.*, 282 F.3d 864, 865 (5th Cir. 2002) (affirming sanctions against attorney who "contends that his egregious behavior serves him well in settlement negotiations and is therefore appropriate.").

opposing counsel have, unfortunately, grown over time. One example is documented in the Transcript of Proceedings conducted in a Chapter 11 bankruptcy case out of Delaware earlier this year.⁵ During the hearing, the attorney for the US Trustee made disparaging remarks to the judge, including comments that the judge was wrong and comparing the judge to another judge who did not “fare[] too well historically.”

Bankruptcy courts may exercise their authority to sanction attorneys for contemptuous and uncivil conduct. The courts also have discretion in determining what behavior constitutes uncivil or sanctionable conduct.

The ABI Civility Task Force provided a list of Principles of Civility in its Report on Standards of Professional Courtesy and Conduct, intended to serve as a guide for the behavior expected from lawyers. The Report sets forth the general duties of professionals, the general duties of lawyers, the duties lawyers owe to the court and court personnel, and the duties of judges and court personnel to lawyers, parties, and witnesses. Included in the Principles of Civility is the standard that because a lawyer is both an officer of the court and an advocate, “a lawyer should always strive to uphold the honor and dignity of the profession, avoid disorder and disruption in the courtroom, and maintain a respectful attitude toward the court and its personnel.”

⁵ Transcript of Proceedings at 175-179, *In re: Nortel Networks Inc., et al.*, No. 09-10138 (KG) (Bankr. Del. January 24, 2017). The relevant portions of the transcript are included in the materials as Appendix 1.

While these Principles of Civility are aspirational rather than mandatory rules, the guidelines set forth provide realistic goals and standards for attorney conduct in bankruptcy matters. Accordingly, bankruptcy counsel should adhere to the principles when dealing with parties, opposing counsel, and the court.

III. HONESTY AND CANDOR

a. COUNSEL’S RELIANCE ON CLIENT’S REPRESENTATIONS

All counsel participating in bankruptcy cases have a codified obligation to ensure that the representations made to the court and other interested parties are truthful and accurate.

Pursuant to Rule 9011(b):

By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,

- (1) It is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
- (2) The claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
- (3) The allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

- (4) The denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

“An attorney has a duty to conduct a reasonable factual investigation” to ensure compliance with Rule 9011⁶; thus, counsel should not merely rely on the client's statements or representations as to the applicable facts. The “reasonableness” of an attorney’s conduct is an objective standard, “measured against that of a competent attorney admitted to practice before the involved court.”⁷ Accordingly, an attorney may merely act negligently in relying on certain statements or representations but still violate Rule 9011.⁸

While reliance on a client’s representations is not wrong *per se*, an attorney must use caution when determining what statements made by the client are objectively and reasonably reliable and what statements the attorney must independently investigate.⁹ Some objective factors that courts have looked to in determining the reasonableness to satisfy the requirements of Rule 9011 include: “ ‘the amount of time available to the signer for conducting the factual and legal investigation; the necessity for reliance on a client for the underlying factual information; the plausibility of the legal position advocated ... whether the case was referred to the

⁶ *In re Blue Pine Group, Inc.*, 457 B.R. 64, 75-76 (9th Cir. BAP 2011), *rev’d in part*, 526 Fed.Appx. 768 (9th Cir. 2013) (affirmed as to standards; reversed as to amount of sanctions).

⁷ *In re Martinez*, 393 B.R. 27, 33 (Bankr. D. Nev. 2008) (internal quotations omitted).

⁸ *In re Coquico, Inc.*, 508 B.R. 929, 946 (Bankr. E.D. Penn. 2014) (“The pure-heart-and-empty-head” defense is not available to anyone faced with Rule 9011 sanctions.”). *See In re Schivo*, 462 B.R. 765, 777 (Bankr. D. Nev. 2011) (finding counsel violated Rule 9001).

⁹ *Id.* at 946-947.

signed by another member of the bar ...; and the complexity of the legal and factual issues implicated.”¹⁰

Accordingly, counsel should take care to not merely rely on a client’s statements or representations, and should counsel file papers with the court based on erroneous facts or law, the signer should quickly and efficiently ensure to make necessary corrections with the court.¹¹

b. MEDIATION CONDUCT

Negotiations in bankruptcy are a vital component of the process. Frequently, negotiations occur in the context of mediation. The same concerns of attorneys to zealously advocate on behalf of their clients present a threat to the honesty and candor demonstrated by these attorneys. The rules for regulating representations of counsel during negotiations can be separated into three general categories of statements: (1) material facts, (2) non-material facts, and (3) opinions.¹²

In the interest of safeguarding the integrity and honesty of the judicial process, the Model Rules and the Bankruptcy Rules prohibit lawyers from lying about material facts. These rules similarly apply in the context of mediation.

¹⁰ *Id.* at 947, quoting *Mary Ann Pensiero, Inc. v. Lingle*, 847 F.2d 90, 95 (3d Cir. 1988).

¹¹ See e.g., *In re Miller Automotive Group Inc.*, 536 B.R. 828, 825 (8th Cir. BAP 2015) (imposing sanctions for counsel’s unprofessional conduct, including misnaming a debtor in the initial petition and failing to correct the debtor’s name).

¹² Donald C. Peters, *When Lawyers Move Their Lips: Attorney Truthfulness in Mediation and a Modest Proposal*, 2007 J.Disp. Resol. 119, 120 (2007), available at <http://scholarship.law.ufl.edu/facultypub/23/>. This article is also included in the attached materials.

Model Rules of Professional Conduct 4.1 (Truthfulness in Statements to Others)

In the course of representing a client a lawyer shall not knowingly:

- (a) Make a false statement of material fact or law to a third person; or
- (b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6

Moreover, misrepresentations made by counsel include statements of another person that the lawyer incorporates or affirms despite knowing the statement is false, as well as partially true but misleading statements or omissions that are the equivalent of affirmative false statements.¹³

Potential consequences of making misrepresentations during mediation can range from suffering a damaged reputation; facing ethical discipline for violating Rule 4.1 and/or assisting clients in committing fraud; liability for fraud, deceit, legal malpractice; to having negotiated agreements set aside.¹⁴

One option for combatting dishonesty in mediation such that negotiation efforts would be thwarted is “to include representation or warranty provisions in mediated agreements for fact statements that are essential to inducing acceptance of proposals.”¹⁵ By committing advocates to certain material statements or facts, the need to base

¹³ Model Rules of Professional Conduct R. 4.1 cmt. 1.

¹⁴ *When Lawyers Move Their Lips*, pp. 122-123, 127.

¹⁵ *Id.* at 125.

agreements solely on trust is decreased and resolution may be more attainable.¹⁶

Rule 4.1 does not apply to immaterial facts or opinions, such as estimates of price and value.¹⁷ Due to the importance of valuation in the bankruptcy context, this flexibility in the rule can present significant problems. Additionally, while not outright prohibited, misrepresentations of these sorts can present larger problems when a participant in the negotiation is unrepresented or unsophisticated in the negotiation subjects, especially when faced with the complex issues frequently involved in bankruptcy cases.

While lawyers are tasked with effectively representing and negotiating on behalf of their clients, they must still take care to embody honesty and candor necessary to prevent injustice and avoid impropriety.

IV. BUSINESS CONFLICTS

A critical aspect of an ethical practice in bankruptcy involves the handling of potential conflicts of interest. The uncertainty regarding the scope of what constitutes an actual or potential conflict of interest in the context of bankruptcy creates ambiguity as to the relationship necessary to create a conflict and the extent to which an attorney is precluded from representing certain individuals or businesses in a specified industry.

¹⁶ *Id.*

¹⁷ *Id.* at 128-129; Model Rules of Professional Conduct R. 4.1 cmt. 2.

As previously stated, counsel and potential counsel in bankruptcy cases must examine applicable state rules, the Bankruptcy Code and Rules, and local rules to ensure full compliance with the requisite standards of professionalism. Several of the Model Rules of Professional Conduct apply in the context of potential conflicts of interest.

Model Rules of Professional Conduct 1.7 (Conflict of Interest: Current Clients)

- (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.

Model Rules of Professional Conduct 1.9 (Duties to Former Clients)

- (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.

While states have adopted their own versions of the Model Rules, the Bankruptcy Code and Bankruptcy Rules also create specific standards for determining the possibility of conflicts of interest due to the complicated nature of the interested parties in bankruptcy matters. In fact, the bankruptcy standards pertaining to potential conflicts set forth much

broader and stricter disclosure and disqualification requirements. These strict standards in the bankruptcy context intend to provide absolute and “undivided loyalty and untainted advice.”¹⁸

To participate in a particular bankruptcy case, potential counsel must qualify under 11 U.S.C. § 327. Section 327 states, in relevant part:

- (a) 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.
[...]
- (c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person’s employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
[...]

Similar in structure, 11 U.S.C. § 1103 applies for employment applications to represent a creditors’ committee.

To implement sections 327 and 1103, Rule 2014 sets forth mandatory disclosure requirements for counsel seeking employment so the court and trustee may determine whether employment is permissible and appropriate. Pursuant to Federal Rule of Bankruptcy Procedure 2014(a), an applicant for employment in a bankruptcy case must disclose “to the best of the applicant’s knowledge, all of the person’s connections with the debtor, creditors, any other party in interest, their respective attorneys and

¹⁸ *In re Miners Oil Co., Inc.*, 502 B.R. 285, 302 (Bankr. W.D.Va. 2013) (internal quotations omitted).

accountants, the United States trustee, or any person employed in the office of the United States trustee.” Courts have consistently held that the disclosure requirements under Rule 2014 are to be strictly construed.¹⁹

Not all required disclosures under Rule 2014 are grounds for disqualification under section 327.²⁰ However, counsel does not have the authority or discretion to omit particular “connections” it considers trivial or tenuous.²¹ The lack of discretion on the part of an applicant and absence of clarity regarding what constitutes a “connection” that would require disclosure under Rule 2014 has led to uncertainty as to the extent of disclosures required.

Thus, whether an attorney’s former relationship to an individual or entity in a particular industry or business constitutes a “connection” to any other individual or entity in the same industry is not straightforward. While most courts have erred on the side of caution in requiring full disclosure of any and all potential connections to a party of interest, some courts have still maintained that the disclosure requirements of Rule 2014 are not boundless. Significantly, some courts have held that “[a]n attorney need not disclose every past or remote connection with every party in interest.”²² Even those courts have emphasized, however, that counsel “must disclose those presently or recently existing, whether they are of

¹⁹ *In re Tribeca Market, LLC*, 516 B.R. 254, 278 (Bankr. S.D. N.Y. 2014) (internal citations omitted).

²⁰ *In re Molten Metal Technology, Inc.*, 289 B.R. 505 (Bankr. D. Mass. 2003).

²¹ *In re Tribeca Market, LLC*, 516 B.R. at 278.

²² *Id.* at 279 (internal quotations omitted).

business or personal in nature, which could reasonably have an effect on the attorney's judgment in the case."²³

The Final Report of the ABI National Ethics Task Force analyzed the confusion under Rule 2014, and recommended an amended Rule 2014, which has yet to be adopted.²⁴ In an attempt to remedy the ambiguity over what may constitute a "connection" under Rule 2014, the proposed amended rule limits the persons, parties, or entities to which the applicant may have a connection in specific categories.²⁵ Moreover the proposed rule includes specific guidelines for what constitutes a relevant "connection."²⁶

Moreover, the threshold for "disinterested" as is required to avoid disqualification under section 327 is similarly not straightforward, and the definition included in section 101 does little to alleviate the confusion.²⁷ In fact, courts have determined that the standard for determining whether counsel is sufficiently "disinterested" must be based on a case-by-case examination. At the same, some consistent guidelines have emerged in the application of section 327.

²³ *In re Molten Metal Technology, Inc.*, 289 B.R. 505 (Bankr. D. Mass. 2003).

²⁴ ABI National Ethics Task Force, *Final Report of the American Bankruptcy Institute National Ethics Task Force*, Lois R. Lupica and Nancy B. Rapoport, Co-Reporters, 2013, p. 3.

²⁵ *Id.* at 5-6.

²⁶ *Id.* at 6.

²⁷ 11 U.S.C. 101(14):

The term "disinterested person" means a person that –

- (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.

Bankruptcy courts exhibit caution when disqualifying counsel because the remedy is considered severe. The courts also recognize the potential for a party to seek disqualification of an opposing counsel as a tactical maneuver to prejudice the opposing party.

Greater clarity is afforded by Rule 2014. Counsel should err on the side of caution when disclosing potential “connections” to parties of interest, especially in light of the fact that failure to comply with the duty to disclose relevant connections is in and of itself a sanctionable offense.²⁸ Because bankruptcy courts require strict compliance with Rule 2014 and interpret the term “connections” broadly²⁹, a prudent attorney will consider the context and potential industry relationships to disclose any connection to the court, “[n]o matter how trivial it appears.”³⁰

V. SENIOR AND JUNIOR LAWYERS

A senior attorney is not relieved of his or her professional and ethical duties by delegating work or tasks to a junior attorney or associate.³¹ Concurrently, a junior attorney has certain obligations and guidelines while practicing at the direction of a senior attorney. The Model Rules of Professional Conduct provide some guidelines for the practice standards expected of senior and junior attorney.

²⁸ *In re Harris Agency, LLC*, 451 B.R. 378, 391 (Bankr. E.D. Pa. 2011).

²⁹ *In re Condor Systems, Inc.*, 302 B.R. 55, 70 (Bankr. N.D. Cal. 2003).

³⁰ *Id.* at 71 (internal quotations omitted).

³¹ *In re Engel*, 346 B.R. 784, 794 (Bankr. M.D. Pa. 2000) (applying the Model Rules of Professional Conduct for determining that the senior attorney’s “attempt to minimize his culpability for these incorrect filings by shifting the responsibility for the errors on the alleged drafter, be it an associate or a nonlawyer assistant, is of little account.”).

Model Rules of Professional Conduct 5.1 (Responsibilities of Partners, Managers, and Supervisory Lawyers)

- (a) A partner in a law firm, and a lawyer who individually or together with other lawyers possess comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.
- (b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.
- (c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:
 - (1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or
 - (2) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Model Rules of Professional Conduct 5.2 (Responsibilities of a Subordinate Lawyer)

- (a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person.
- (b) A subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

Omissions and misrepresentations contained in court documents or filings prepared by associates or junior lawyers can lead to sanctions against the senior attorneys due to the failure to

adequately supervise the preparation of the documents.³²

Moreover, placing too much emphasis on high-volume practices at the expense of providing adequate guidance to junior associates can lead to Rule 9011 violations.³³

Accordingly, senior attorneys should not leave junior attorneys or associates to their own devices without the necessary and requisite level of guidance. To ensure compliance with the standards required for effective adequacy, senior counsel should ensure that all individuals working on a particular case or for a client's interest is well-prepared and adequately managed.

³² *In re Engel* and *In re Corkery*, 246 B.R. 784 (Bankr. W.D. Pa. 2000)

³³ *See in re Taylor*, 407 B.R. 618, 648-649 (Bankr. E.D. Pa. 2009), *aff'd in part, vacated in part, and rev'd in part*, 655 F.3d 274 (3d Cir. 2011) ("The culture of the firm he has fostered appears to value production over professionalism, a priority acceptable for a business but potentially antagonistic to the practice of law.").

VI. INTERSECTION BETWEEN STATE ETHICS RULES ON FEE ENTITLEMENT AND THE BANKRUPTCY COURT'S ROLE OVER FEES AND DISTRIBUTIONS OF PROPERTY OF THE ESTATE

As an example:

Rule 4-1.5 of the Rules Regulating the Florida Bar (Fees and Costs for Legal Services) (see last page of outline and subsection (f) of the attached document for contingency fee regulation)

(f) Contingent Fees. As to contingent fees:

A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by subdivision (f)(3) or by law. A contingent fee agreement shall be in writing and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial, or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated...

(4)

(A) The contract shall contain the following provisions:

- i. "The undersigned client has, before signing this contract, received and read the statement of client's rights and understands each of the rights set forth therein. The undersigned client has signed the statement and received a signed copy to refer to while being represented by the undersigned attorney(s)."
- ii. "This contract may be cancelled by written notification to the attorney at any time within 3 business days of the date the contract was signed, as shown below, and if cancelled the client shall not be obligated to pay any fees to the attorney for the work performed during that time. If the attorney has advanced funds to others in representation of the client, the attorney is entitled to be reimbursed for such amounts

as the attorney has reasonably advanced on behalf of the client."

(B) The contract for representation of a client in a matter set forth in subdivision (f)(4) may provide for a contingent fee arrangement as agreed upon by the client and the lawyer, except as limited by the following provisions:

- i. Without prior court approval as specified below, any contingent fee that exceeds the following standards shall be presumed, unless rebutted, to be clearly excessive:
 - a. Without prior court approval as specified below, any contingent fee that exceeds the following standards shall be presumed, unless rebutted, to be clearly excessive:
 1. 33 1/3% of any recovery up to \$1 million; plus
 2. 30% of any portion of the recovery between \$1 million and \$2 million; plus
 3. 20% of any portion of the recovery exceeding \$2 million.
 - b. After the filing of an answer or the demand for appointment of arbitrators or, if no answer is filed or no demand for appointment of arbitrators is made, the expiration of the time period provided for such action, through the entry of judgment:
 1. 40% of any recovery up to \$1 million; plus
 2. 30% of any portion of the recovery between \$1 million and \$2 million; plus
 3. 20% of any portion of the recovery exceeding \$2 million.

- c. If all defendants admit liability at the time of filing their answers and request a trial only on damages:
 - 1. 33 1/3% of any recovery up to \$1 million; plus
 - 2. 20% of any portion of the recovery between \$1 million and \$2 million; plus
 - 3. 15% of any portion of the recovery exceeding \$2 million.
- d. An additional 5% of any recovery after institution of any appellate proceeding is filed or post-judgment relief or action is required for recovery on the judgment.

Does it conflict with,

11 U.S.C. § 726 (Distribution of the property of the estate)
(see attached document)

**VII. ALL PROFESSIONALS ENGAGED IN BANKRUPTCY CASES
MUST EXHIBIT ETHICAL CONDUCT**

Attorneys retained to represent parties with an interest in bankruptcy estates are not the only parties held to a level of professionalism and ethical conduct. Other professionals involved in the bankruptcy cases may incur significant consequences for their violations of the applicable laws and ethical rules, which may go so far as to result in criminal jeopardy.

This exact circumstance arose in 2011 when Marika Tolz, a Chapter 7 bankruptcy trustee and a court-appointed receiver, was sentenced to 81 months in jail, followed by 18 months of house arrest for conspiracy to commit wire fraud.³⁴ For several years during her tenure as a member of the panel of Chapter 7 trustees for the U.S. Bankruptcy Court, Southern District of Florida, Tolz conspired to misappropriate money from bankruptcy estates, receiverships, and other matters in which she was involved as a trustee, receiver, or personal representative. She, along with others, used the funds for her own benefit and to conceal her previous misappropriations by using the money to restore the balance of other accounts from which she had previously taken funds. Tolz also submitted and caused others to submit falsified estate reports required by her appointments.³⁵ In all, Tolz

³⁴ See *United States of America v. Marika Tolz*, No.: 1:11-CR -20160 (S.D. Fla. 2011). See also *Former Trustee Sentence for Fraud*, 21 CONS. BANKR. NEWS (ISSUE) 20 (2011).

³⁵ Information, *United States of America v. Marika Tolz*, 2011 WL 773587 (S.D. Fla. 2011).

misappropriated at least \$16 million, resulting in approximately \$2.4 million in losses to numerous fiduciary matters.

While an extreme case, the Tolz matter demonstrates the potential for individuals involved in a bankruptcy procedure to take advantage of the process for their own personal gains. The obligations and duties entrusted to professionals engaged in bankruptcy cases require integrity and professional responsibility and deference should not be given to parties merely based on their role in the particular case. The Model Rules, the Bankruptcy Code, and the ABI Civility Task Force's Principles of Civility guide and model behavior to aid professionals engaged in bankruptcy matters to exhibit professional and ethical practice.



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FINAL REPORT OF THE ABI NATIONAL ETHICS TASK FORCE

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Final Report of the American Bankruptcy Institute National Ethics Task Force

April 21, 2013

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Introduction

In 2011, then-American Bankruptcy Institute President Geoffrey L. Berman established the ABI's National Ethics Task Force¹ to address a problem familiar to all bankruptcy professionals and judges: state ethics rules do not always “fit” with the realities of bankruptcy practice. State ethics rules may also not be a perfect fit in the context of other types of practice, either—for example, states may not yet know how best to handle the increasingly interconnected digital and virtual world—but it is clear that the Model Rules do not fit neatly with the realities of a bankruptcy practice that involves numerous parties with changing allegiances, often departing from the classic two-party adversarial proceeding.²

Shortly after President Berman appointed the Task Force's members, the Task Force met to discuss the best way to approach its assignment. At its first meeting, the Task Force promulgated its mission statement:

The ABI National Ethics Task Force will consider ethics issues in bankruptcy practice and will make recommendations for uniform standards, where appropriate.

In essence, the Task Force was charged with answering the question of whether there is a need for national ethics rules, standards, and general practice guidance in the bankruptcy context.³

As the Task Force considered the various topics and issues that could potentially be addressed, a few “jumped out.”⁴ These included the conflicts-related issues that result from the shifting allegiances that can arise during the life of a bankruptcy case, the complexity of disclosure of “connections” when seeking approval of employment, the fleshing out of the duties of counsel for a debtor in possession, and the role of conflicts counsel in business reorganization cases. Other issues implicated in the context of bankruptcy practice, while not specifically at odds with state ethics rules—for example, the concept of attorney competency and the pressing question of how to balance the need for a capable and skilled bar with the need to provide consumers in financial distress access to the bankruptcy system—were addressed in order to provide needed guidance to bankruptcy attorneys.

¹ Past-President Berman and current President James Markus—with the help of the ABI's Anthony H. N. Schnelling Endowment Fund—have provided significant support for the Task Force's work.

² Cf. *In re* Nguyen, 447 B.R. 268, 277 (9th Cir. Bankr. 2011) (“[T]he ABA Standards, which were developed primarily for nonfederal, nonbankruptcy courts by unelected and nonjudicial parties, are ill-adapted to federal bankruptcy proceedings. The ABA Standards were not drafted to address the distinctive context of bankruptcy where, as here, administrative matters rather than litigation may be the focus of an attorney's work.”) (referring to the American Bar Association Standards for Imposing Lawyer Sanctions and citing *In re* Brooks-Hamilton, 400 B.R. 238 (9th Cir. Bankr. 2009) (citation omitted)).

³ The ABI has established a separate Civility Task Force, chaired by James Patrick Shea of Shea & Carlyon.

⁴ The Task Force also adopted a set of bylaws.

The Task Force began its work by forming several committees, each focused by topic. Each committee developed initial memoranda on issues that fell within the purview of its subject area. The committees' topics included (1) conflicts of interest, (2) disclosure, retention, and fee issues, (3) consumer issues, (4) committee solicitation issues, and (5) discipline, sanctions, competence, and multi-jurisdictional practice issues. Each committee member attended regular committee meetings, in addition to teleconferences and quarterly meetings of the entire Task Force. The Reporters also held quarterly retreats at which the Reports were researched and drafted.⁵ Each Task Force member had the opportunity to comment on the Reporters' draft Reports, and each draft Report was ultimately voted on and approved by the entire Task Force. Although, in its work, the Task Force reviewed several 50-state surveys of particular state ethics rules,⁶ it used the American Bar Association's MODEL RULES OF PROFESSIONAL CONDUCT in addressing the issues discussed in this Final Report.⁷

The Task Force also found several worthy topics—including the issue of retainers and employment, standards for practice competency for creditors' counsel, and the issue of ghostwriting a debtor's petition and schedules as a way of addressing bankruptcy access—that the constraints of this Task Force prevented it from fully developing. It is our expectation that these important issues will be taken up in the near future by another ABI working group or committee.

All of the Reporters' White Papers and Proposals are compiled within this Final Report. They are as follows:

1. Proposed Amendments to Rule 2014.⁸
2. Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate.
3. A Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328.
4. The Use of Conflicts Counsel in Business Reorganization Cases.
5. Best Practices for Limited Services Representation in Consumer Bankruptcy Cases.
6. Competency for Debtors' Counsel in Business and Consumer Cases.
7. Report on Best Practices on Creditors' Committee Solicitation.

⁵ The Reporters were ably assisted by Research Assistants Bridget McMahon, University of Maine School of Law, Class of 2014, and by David Rothenberg and Nicole Scott, William S. Boyd School of Law, UNLV, Class of 2014. The Reporters would also like to thank Heidi Gage for her excellent research and administrative assistance.

⁶ The Task Force gratefully acknowledges the research support provided by the reference librarians of the Wiener-Rogers Law Library at the William S. Boyd School of Law.

⁷ The Task Force recognizes that the Model Rules do not have the force of law; however, so many states have adopted the Model Rules in part or in whole that the Task Force determined that the discussion of the Model Rules, rather than state ethics rules, would be more useful to most ABI members.

⁸ One of the Task Force's Reports—the Report on Proposed Amendments to Rule 2014—has been transmitted to the Advisory Committee on Bankruptcy Rules, which will be reviewing the Report before its Fall meeting.

The Task Force recognizes that much more needs to be done in terms of ethics issues facing the bankruptcy bar and bankruptcy bench—and discussions have already begun with ABI's leadership as to how best to proceed with further review and discussion of ethics issues—but it is pleased to present to you this Final Report and it looks forward to the discussion that will follow.

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Proposed Amendments to Rule 2014

Introduction¹

Sections 327² and 1103³ of the Bankruptcy Code set forth specific standards that proposed professionals must meet in order to be retained as an estate or committee professional.⁴ Each of these provisions requires the professional in question to meet certain standards relating to their independence from parties other than their client in a case.⁵ As noted by several courts, “[t]he purpose of Rule 2014(a) is to provide the court and the United States trustee with information to determine whether the professional's employment is in the best interest of the estate. . . . Rule 2014 disclosures are to be strictly construed and failure to disclose relevant connections is an independent basis for the bankruptcy court to disallow fees or to disqualify the professional from the case.”⁶

In order for courts, the Office of the U.S. Trustee and other parties in interest to evaluate employment applications, Federal Rule of Bankruptcy Procedure 2014 requires professionals to disclose to the court those facts related to actual or potential conflicts of interests they may have.⁷ FRBP 2014 currently provides:

(a) Application for an order of employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing

¹ The Reporters are grateful to Chip Bowles for all of his hard work on this project.

² 11 U.S.C. § 327 (2013).

³ 11 U.S.C. § 1103 (2013).

⁴ See, e.g., *In re Crivello*, 134 F.3d 831, 836 (7th Cir. 1998).

⁵ See 11 U.S.C. § 101(14) (2013) (definition of disinterested person); *In re Marvel Entertainment Corp.*, 140 F.3d 463, 476 (3rd Cir. 1998) (discussing adverse interests and actual vs. potential conflicts of interest).

⁶ See, e.g., *Exco Res. v. Milbank (In re Enron Corp.)*, No. 02 Civ. 5638 (BSJ), 2003 U.S. Dist. WL 223455, at *4 (S.D.N.Y. Jan. 28, 2003); *Banner v. Cohen, Estis & Assocs., LLP. (In re Balco Equities Ltd.)*, 345 B.R. 87, 111 (Bankr. S.D.N.Y. 2006).

⁷ Of course, there are state ethics rules that are implicated as well, including issues related to conflicts of interest and candor to the tribunal. We are focusing here on the bankruptcy issues. For a discussion of the application of Rule 2014, see generally, *U.S. v. Gellene*, 182 F.3d 578, 582 (7th Cir. 1999); *Halbert v. Yousif*, 225 B.R. 336, 346 (E.D. Mich. 1998). See also *In re Plaza Hotel Corp.*, 111 B.R. 882, 883 (Bankr. E.D. Cal. 1990), *aff'd* without op., 123 B.R. 466 (9th Cir. BAP 1990); *In re Gluth Bros. Constr.*, 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011); *In re Bellevue Place Assocs.*, 171 B.R. 615, 626 (Bankr. N.D. Ill. 1994) (holding that purpose of 2014 “is to avoid even appearance of a conflict regardless of the integrity of the professional seeking to be employed”).

the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of 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. The application shall 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.

(b) Services rendered by member or associate of firm of attorneys or accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation or individual may act as attorney or accountant so employed, without further order of the court.

Currently, FRBP 2014 does not limit the extent of disclosure of a professional's connections⁸ with: (i) the debtor; (ii) any creditors of the debtor; (iii) other parties in interest; (iv) attorneys of the debtor, creditors, and parties in interest; (v) accountants for the debtor, creditors, and parties in interest; and (vi) the United States Trustee and persons employed by the U.S. Trustee's office (collectively, "2014 Parties"). Indeed, most courts that have addressed this issue have held that professionals have little, if any, discretion in determining whether a connection is "relevant" to their employment application.⁹

⁸ See *In re Gluth Bros. Constr.*, 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011), where the court stated:

The term "connections" used in Rule 2014(a) is considerably broader than the terms "disinterested" and "interest adverse to the estate" used in Section 327(a). Thus an attorney must disclose a connection even if he does not believe it would disqualify him under Section 327(a). As the Seventh Circuit Court of Appeals has stated, professionals "cannot pick and choose which connections are irrelevant or trivial." *U.S. v. Gellene*, 182 F.3d 578, 588 (7th Cir. 1999) (internal citation omitted). Instead, no "matter how trivial a connection appears to the professional seeking employment, it must be disclosed." *In re Envirodyne Indus.*, 150 B.R. 1008, 1021 (Bankr. N.D. Ill. 1993) (Schwartz, J.). Counsel who "fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation." *Gellene*, 182 F. 3d at 588 (quoting *In re Crivello*, 134 F.3d 831, 836 (7th Cir. 1998)). Thus "denial of fees or disqualification may be justified [33] even when the professional is in fact disinterested." *In re Raymond Professional Group, Inc.*, 421 B.R. 891, 906 (Bankr. N.D. Ill. 2009) (quoting *In re Midway Indus. Contractors*, 272 B.R. 651, 662 (Bankr. N.D. Ill. 2001)).

⁹ See generally *In re Crivello*, 134 F.3d 831 (7th Cir. 1998); *In re Park-Helena Corp.*, 63 F.3d 877 (9th Cir. 1995); *Rome v. Braunstein*, 19 F.3d 54 (1st Cir. 1994); see also *In re Rusty Jones, Inc.*, 134 B.R. 321, 346 (Bankr. D. Ill. 1991) (noting the fact the professional owned a hot dog stand over 20 years before the bankruptcy with an indirect owner of the debtor was a *de minimis* connection).

The broad but undefined term “connection” has led to confusion¹⁰ over the appropriate level of inclusiveness in disclosures.¹¹ The uncertainty surrounding the meaning of “connection” has also led to attempts by professionals to argue that some important “connections are immaterial.”¹² The following proposed new FRBP 2014 is an effort to provide clarity to professionals concerning what relevant connections must be disclosed, as well as to provide improved information for courts and other parties to use in determining a professional’s eligibility for employment.

Current Rule 2014

Current Rule 2014 reads as follows:

(a) Application for and Order of Employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to §327, §1103, or §1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of 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. The application shall 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.

(b) Services Rendered by Member or Associate of Firm of Attorneys or Accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an

¹⁰ *In re Rusty Jones, Inc.*, at 346, 134 B.R. 321 (Bankr. D. Ill. 1991) (discussing whether ownership of a hot dog stand with a 2014 party 20 years before bankruptcy was filed was a connection required to be disclosed).

¹¹ *In re EWC*, 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992) (“duty of professionals is to disclose all connections with the debtor, debtor in possession, insiders, creditors and parties in interest . . . they cannot pick and choose which connections are irrelevant or trivial . . . No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it.”).

¹² *See In re Etoys Inc.*, 331 B.R. 176, 197 (Bankr. D. Del. 2005) (committee counsel, which was ultimately sanctioned \$750,000, argued failure to disclose business arrangement between committee counsel and the president of the debtor was not disqualifying as committee counsel was not required to be disinterested under 11 U.S.C. § 1103).

accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation, or individual may act as attorney or accountant so employed, without further order of the court.

Proposed Amended Rule 2014

In comparison, the proposed amended Rule 2014 provides:

(a) APPLICATION FOR AND ORDER OF EMPLOYMENT. An application for an order approving the employment of a professional under § 327, § 1103, or § 1114 of the Code shall be made in writing and shall be made by the trustee, debtor in possession, or committee.¹³ The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States Trustee. The application shall contain:

- (1) specific facts demonstrating the necessity for the employment;
- (2) the identity of the professional to be employed, the reasons for the selection of the professional, and the list of the professional's employees, members, owners, and partners most likely to work on the matter;
- (3) a description of the professional services to be rendered;
- (4) a description of any proposed arrangement for compensation, including a statement of whether the professional is seeking approval of compensation standards under 11 U.S.C. § 328(a);
- (5) a statement that, to the best of the applicant's knowledge, the professional is eligible under the Code for employment for the purposes set forth in the application;
- (6) a description of the investigation undertaken and the procedures used by the applicant to determine that the professional is eligible for the proposed employment, including specifically the actions that the professional undertook to identify those connections that are material under the circumstances, including personal, business, and professional connections, that would be relevant to the court in determining whether the professional was free of any disqualifying current or potential bias;
- (7) if the professional is to be employed in multiple affiliated cases, a description of relevant inter-company relationships, including any potential conflicts among the affiliated debtors and any proposed allocation of compensation of the professional to be paid by each affiliate; and
 - (8) for professionals seeking approval of employment by a committee,
 - (a) a statement of the process by which the professional sought employment by that committee, including interactions with other professionals; and

¹³ As for court-appointed experts, we expect that a court will set its own disclosure procedures for them.

- (b) a disclosure of any direct and indirect contacts and communications with a person eligible for the committee or who sought to be appointed to the committee.

(b) STATEMENT OF PROFESSIONAL. The application shall be accompanied by a verified statement by an authorized representative of the professional, made according to the best of that person's knowledge, information, and belief, and formed after an inquiry reasonable under the circumstances, that shall:

- (1) state that the professional is eligible under the Code for employment for the purposes set forth in the application;
- (2) describe the investigation undertaken and the procedures used by the professional in order to make its determination of eligibility for the employment set forth in the application;
- (3) describe any interest that the professional, or any employee, member, owner, or partner of the professional, holds or that the professional represents that is adverse to the estate;
- (4) describe any relationship that the professional, or any employee, member, owner, or partner of the professional, has that would implicate Federal Rule of Bankruptcy Procedure 5002 [Restrictions on Appointments];
- (5) state whether the professional, or any employee, member, owner, or partner of the professional, has shared or has agreed to share any compensation with any person, other than an employee, member, owner, or partner of the professional, and if so, describe the terms of any such arrangement;
- (6) disclose the source and describe the amount of any retainer to be paid, and if such retainer is to be paid from a creditor's collateral, whether such use is within the scope of authorized use of that collateral;
- (7) describe any guarantee of payment, enhancements of payment, or any collateral securing the payment of compensation and state the relationship of the guarantor with the debtor or committee and the professional;
- (8) disclose any payments for prepetition work received by the professional within 90 days of the petition's filing, and all facts that may be relevant to a preference analysis under 11 U.S.C. § 547;
- (9) disclose any conflicts waiver requested or obtained and the scope of that waiver, including any waiver limitations on actions the professional may or may not take during the case; and
- (10) describe the Relevant Connections, as defined in subsection (c) below, including any applicable materiality thresholds used, with the following persons, parties, or entities:
 - (A) the debtor;
 - (B) creditors of the estate;
 - (C) known or anticipated post-petition creditors of the estate;
 - (D) equity security holders of the debtor or of affiliates of the debtor;
 - (E) officers and directors of the debtor;
 - (F) parties that are insiders of the debtors or that were insiders of the debtor within 2 years before the date of the filing of the petition;
 - (G) any investment banker for any outstanding security of the debtor;
 - (H) the United States trustee;

- (I) customers of the debtor or vendors to the debtor whose transactions with the debtor as of the petition date constitute a material portion of the debtor's business;
- (J) parties to executory contracts and unexpired leases;
- (K) utility service providers;
- (L) governmental units and officials and employees thereof;
- (M) members of any committee appointed under 11 U.S.C. § 1102 or otherwise subject to disclosure under Rule 2019;
- (N) any identified potential asset purchasers; and
- (O) any professional employed by any of the above persons, parties or entities.

All disclosures made under this Rule shall be made in a format that describes the Relevant Connections in sufficient detail so the court and parties in interest may recognize potential biases and conflicts. For the Relevant Connections listed in subparagraph (b)(10), such disclosures should also be indicated in a grid substantially conforming to the New Proposed Official Form for Rule 2014 Disclosures, and that grid should cross-reference the relevant paragraphs in the narrative disclosure itself.

- (c) **RELEVANT CONNECTION.** For purposes of this Rule, and unless otherwise defined by the court, "Relevant Connection" means,
- (1) any connection with a person or entity listed in subsection (b) that:
 - (A) on or within two years of the filing of the petition, generated a material amount of income and/or transfers;
 - (B) involved or was related to property of the estate with a material value;
 - (C) involved a material business venture with the person or entity; or
 - (D) involved working for the person or entity as a professional and generating a material amount of fees in the two years prior to the filing of the petition;
 - (2) any connection with the court to which the employment application is being submitted;
 - (3) any connection with the United States Trustee or any person employed in the office of the United States Trustee; or
 - (4) any other connection constituting a personal, professional, or business relationship that could reasonably be determined to be significant in its evaluation of whether a professional is qualified to be employed.

With respect to each Relevant Connection, the applicant shall disclose personal and professional relationships and other connections relevant to determining the existence of bias or influence on professional judgment. Any materiality threshold used by the applicant for each Relevant Connection shall be set forth in the application. If the court directs use of a different threshold, the professional shall amend its disclosures to conform to such threshold. The list of Relevant Connections is intended to be comprehensive and encompass connections relevant to the court's consideration of the application. Any additional relevant connections necessary to prevent the application and the professional's verified statement from being materially misleading shall be included.

(d) SERVICE AND TRANSMITTAL OF APPLICATION. The applicant shall serve a copy of the application on:

- (A) the United States trustee;
- (B) the debtor and the debtor's attorney;
- (C) any committee elected under § 705 or appointed under § 1102, or, if the case is a chapter 9 case or a chapter 11 case and no committee of unsecured creditors has been appointed, on the creditors included on the list filed under Rule 1007(d); and
- (D) any other entity as the court may direct.

(e) SERVICES RENDERED BY MEMBER OR ASSOCIATE OF FIRM OF EMPLOYED PROFESSIONAL. If the court approves the employment of an individual, partnership, corporation, or other business entity, then any employee, member, owner, or partner of the professional working with the professional so employed may act as a professional so employed, without further order of the court, provided that the employee, member, owner, or partner of the professional has not been screened off from the employment due to a conflict of interest. If a partnership is employed, a further order approving employment is not required if the partnership agreement has been amended solely because of the addition or withdrawal of a partner.

(f) SUPPLEMENTAL STATEMENT OF PROFESSIONAL.

- (1) The professional has a continuing duty to file a supplemental statement regarding any new Relevant Connections for as long as the professional is employed.
- (2) The professional shall regularly undertake a reasonable investigation to determine whether any additional Relevant Connections have developed and whether previously disclosed Relevant Connections should be updated, and in any event, shall undertake an investigation at the following times:
 - (A) before filing any adversary proceeding or before filing a response to any such adversary proceeding involving such professional;
 - (B) within 28 days after any amendment to bankruptcy schedules is filed;
 - (C) when a bidder for estate assets or purchase of estate assets outside the ordinary course of business is publicly identified; and
 - (D) before filing any interim or final fee application.
- (3) Such supplemental statements shall be served on each entity listed in Rule 2014(c), and, unless the case is a chapter 9 case, on the United States Trustee.
- (g) The court may set a threshold for materiality of Relevant Connections.

Comment on Proposed Amended Rule 2014

The appropriate threshold will vary depending on the size and type of case, and the applicable Relevant Connection. For a strip mall “mom & pop” debtor, a minimum threshold on size of creditor claims used to determine which names to check for conflicts would likely not be appropriate. A *Delta Airlines* or *Enron* case, on the other hand, would likely warrant a considerably higher threshold. Likewise, all equity owners would need to be disclosed for a small debtor, but for a publicly-traded debtor, a securities law threshold for identified equity owners would be an appropriate threshold. There will be significant variance in threshold levels given the range of case sizes. It is likely that Delaware and New York City courts would allow higher thresholds that would be considered unacceptable in other jurisdictions. If the thresholds used are set forth—and parties in interest and the court have the opportunity to question them—at the beginning of the case, the Rule is flexible enough to be used across the board in all parts of the country.

AMERICAN BANKRUPTCY INSTITUTE

New Proposed Official Form for Rule 2014 Disclosures

Name and position of professional with Relevant Connection ¹	Debtor	Creditor	Known or anticipated Pre-petition creditors	Equity security holders	Insiders	Investment bankers	U.S. Trustee	Customers /vendors	Parties to executory contracts or unexpired leases	Utility service providers	Governmental units and employees thereof	Committee members	Potential asset buyers	Any professional of any entity listed	Description of Relevant Connection ²
Mary White, Partner		X			X		X								See ¶ a., c, & f.
Bill Black, Partner		X		X		X				X					See ¶ a., d, g & h.
Deb Gray, Associate		X		X			X								See ¶ a., d, & i.
Sam Blue, Paralegal		X													See ¶ a.

¹ Cross-reference with paragraph in Application itself.

² Cross-reference with paragraph in Application itself.

This form is new and implements Revised Rule 2014, which relates to the disclosure of relevant connections for retention purposes. The individual completing the form must sign and date it. By doing so, he or she declares under penalty of perjury that the information provided is true and correct to the best of that individual's knowledge, information, and reasonable belief. The signature is also a certification that the standards of Rule 9011(b) are satisfied.

Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate

Introduction¹

The issue of the relationship between the DIP's fiduciary duties and the advice of counsel for the DIP has caused many courts to conclude that the DIP's attorneys are actually counsel for the "estate."² Perhaps those courts have relied on the concept of "counsel for the estate" as a way of expressing their frustration with cases in which counsel for DIPs have ratified the bad decisions of the individuals speaking for the DIPs. Although "counsel for the estate" is a convenient concept, a better way to address the matter of rogue DIPs and their counsel is to explain in methodical detail just what the DIP's fiduciary duties are and how counsel for a DIP can guide and advise a DIP to carry out its fiduciary duties.

In general, both the law about how fiduciaries should behave and the ethics rules governing how lawyers for fiduciaries should behave are well-settled.³ In the bankruptcy context, however, the issues are not as clear due to the complex and shifting nature of the relationship between and among the DIP, the estate, and the other parties in interest. At least one of the underlying purposes of the Bankruptcy Code is to maximize the value of the estate.⁴ The residual owners of the estate—typically, the unsecured creditors⁵—care deeply about the choices that the DIP makes during its reorganization, as do the individuals running the DIP. Each of these parties, however, may not have the same views about what might constitute acceptable decisions during the case. If one thinks of the DIP as being a fiduciary for multiple beneficiaries with possibly differing interests, then the need for more clarity in terms of the DIP's fiduciary duties and the duties of DIP counsel is evident.

¹ Susan Freeman took the laboring oar with a wonderful first draft of this topic, and we thank her. We also thank David Rothenberg and Nicole Scott, second-year law students at the William S. Boyd School of Law, UNLV, for their hard work in assisting us.

² See cases cited in n. 15, *infra*.

³ The ethics rule regarding lawyers who represent entities is also well-settled. For a starting point, see, e.g., MODEL RULES OF PROFESSIONAL CONDUCT ("MODEL RULES") R. 1.13.

⁴ See, e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 569 (1994) (referring to the "Bankruptcy Code purposes of augmenting the bankruptcy estate").

⁵ At least when there are enough funds to trickle down to the general unsecured creditors.

Fiduciary Duties in General

Fiduciary duties have a subject and an object: fiduciary duties do not exist in a vacuum. If someone owes a fiduciary duty, he must owe it to the beneficiary of that duty. Fiduciary duties are sometimes described as the obligation to act solely in the beneficiaries' interest.⁶ That generalization overlooks the right of a fiduciary to be self-interested in some respects. For example, a fiduciary may contract for its own compensation; it need not serve free of charge.

There are two core fiduciary duties: the duty of loyalty and the duty of care. In situations involving multiple beneficiaries, courts have also imposed a duty of impartiality.⁷

Duty of loyalty. The principle underlying the duty of loyalty is that "the agent [must] subordinate [his own] interests to those of the principal and place the principal's interests first as to matters connected with the agency relationship."⁸ A fiduciary acting in a matter involving personal interests and conflicts (such as compensation) may not obtain an *improper* personal benefit. The key here is the modifier "improper." The fiduciary may meet its duty of loyalty and still obtain some proper personal benefits by acting fairly, with full disclosure, and by obtaining approval or ratification of the action by disinterested persons.⁹

⁶ Pegram v. Hendrich, 530 U.S. 211, 244 (2000); 2A A. SCOTT & W. FRATCHER, TRUSTS § 170, 311 (4th ed. 1987).

⁷ See Brook Valley VII, Joint Venture v. Schropp (*In re Brook Valley VII, Joint Venture*), 496 F.3d 892, 900 (8th Cir. 2007) ("The fiduciary obligation consists of two duties: the duty of care and duty of loyalty."); *In re Microwave Prods. of Am.*, 102 B.R. 666, 672 (Bankr. W.D. Tenn. 1989) (noting DIP has fiduciary duties, such as duty to avoid conflicts, duty to avoid self-dealing, and the duty to avoid "negligent behavior"); John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1122 (2004) (recognizing core fiduciary duties of loyalty, impartiality, and prudence of conduct). In certain areas, such as the duties of non-profit boards, some courts have fine-tuned these two duties. See, e.g., *Summers v. Cherokee Children & Family Servs., Inc.*, 112 S.W.3d 486, 504 (Tenn. Ct. App. 2003) ("In particular, the duty of loyalty requires that a director or officer faithfully pursue the interest of the organization, and its nonprofit purpose, rather than his or her own financial or other interests, or those of another person or organization.")

⁸ See RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (2006); *id.* at § 8.01 ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."); see also *In re Bank of New York Mellon Corp. FOREX Transactions Litigation*, 2013 WL 440628, *16 n. 165 (S.D.N.Y. 2013) (describing a trustee's duty of loyalty as acting in the interests of his beneficiaries).

⁹ A common example of this rule is the approval of corporate transactions with a board member by a vote of other disinterested board members. The corporate codes of most states protect conflict of interest transactions from being voided if: (1) they are fair, or (2) they are approved by a "disinterested" majority of the directors, or (3) they are ratified by the shareholders. See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.02(a) (1994) (indicating circumstances where duty of fair dealing is fulfilled); 3 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 915.10 (perm. ed. rev. vol. 2002) (discussing effects of state statutory provisions on transactions or contracts between interested direction and corporation); DEL. CODE ANN. tit. 8, § 144 (2001); cf. *In re Brook Valley*, 496 F.3d at 901 (noting fiduciary must prove transaction was fair when challenged for breach of duty of loyalty).

Duty of care. The fiduciary's duty of care requires that the fiduciary act with "such care and skill as a man of ordinary prudence would exercise in dealing with his own property."¹⁰

Duty of impartiality. When the fiduciary has multiple beneficiaries, courts also impose a duty of impartiality.¹¹ In the field of trust law, the trust instrument guides and explains the state law trustee's fiduciary obligations with respect to conflicting beneficiaries' interests.¹² The Bankruptcy Code and Rules provide much of the same guidance as a trust instrument in setting forth parameters for the exercise of fiduciary duties in Chapter 11 cases. When the DIP is exercising rights that are within the provisions (and intent) of the Code and Rules, typically the Code and Rules provide a safe harbor for the DIP's decisions.¹³ For example, parties may openly negotiate over how assets and future earnings will be allocated under a reorganization plan, with Code-specified priorities for creditor distributions and required terms for any forced plan provisions, and the DIP/debtor is permitted to participate actively in plan negotiations without violating its fiduciary obligations.¹⁴

In short, the state law of fiduciary duties provides a good description of the contours of fiduciary duties in general, and the Bankruptcy Code and Rules (and courts' interpretation of the Code and Rules) provide an enhanced description of the DIP's duties. The challenge is to determine what a DIP's counsel should do to assist the DIP in the understanding of its fiduciary duties, and how a DIP's counsel should behave when the DIP is in danger of violating those duties.

Relationship of Fiduciary Duties in General to Fiduciary Duties of the DIP

As observed in Part I above, many courts have stated that DIP counsel is "counsel for the estate," with separate fiduciary duties to the "estate" to independently (as in "separate from the

¹⁰ See *United States v. Aldrich (In re Rigden)*, 795 F.2d 727, 730 (9th Cir. 1986) ("A bankruptcy or reorganization trustee has a duty to exercise that measure of care and diligence that an ordinary prudent person would exercise under similar circumstances."); RESTATEMENT (SECOND) OF AGENCY § 379(1) (1958). In a corporate context of management fiduciary duties, the duty of care for corporate directors is substantially the same. They are to act "in a reasonably prudent manner, in the interest of the company," after obtaining adequate information and in good faith. MODEL BUS. CORP. ACT § 8.30(a) (2008).

¹¹ RESTATEMENT (THIRD) OF TRUSTS § 183 (1992) ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

¹² *Id.* § 183, cmt. a (1992) ("By the terms of the trust the trustee may have discretion to favor one or more beneficiaries over others. The court will not control the exercise of such discretion, except to prevent the trustee from abusing it.").

¹³ See *Fulton State Bank v. Schipper (In re Schipper)*, 933 F.2d 513, 515 (7th Cir. 1991) (holding DIP's fiduciary duty to creditors met by good faith compliance with Code and Rule provisions).

¹⁴ See *Casco N. Bank, N.A. v. DN Assocs. (In re DN Assocs.)*, F.3d 512, 516 (1st Cir. 1993) (noting DIP did not breach fiduciary duties because DIP pursued plans preserving interests of equity while paying creditors); *In re Water's Edge Ltd. P'ship*, 251 B.R. 1, 7 (Bankr. D. Mass. 2000) (stating Bankruptcy Code imposes no fiduciary obligations on DIP in plan negotiation process); see also *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 459–60 (D. Utah 1998) (noting that DIP may negotiate with creditors without violating fiduciary duties).

DIP”) determine what is in the estate’s best interest.¹⁵ Other courts have analyzed DIP counsel’s duties as a lawyer for a fiduciary client.¹⁶ Courts appear to use “fiduciary” terminology for its strong moral tone of fidelity and trustworthiness and to increase lawyer vigilance and sensitivity. But “fiduciary” is not just a synonym for careful attention to the effect of client decisions. Rather, it is a word with a specific legal meaning. Courts referring to the DIP’s lawyer as having fiduciary duties to the estate describe duties consisting of those held by a lawyer to a fiduciary client and by a lawyer to the court.¹⁷

¹⁵ E.g., *Everett v. Perez* (*In re Perez*), 30 F.3d 1209, 1219 (9th Cir. 1994) (“Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually. Counsel has an independent responsibility to determine whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor. While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate’s interests, he must seek to persuade his client to take a different course or, failing that, resign. Under no circumstances, however, may the lawyer for a bankruptcy estate pursue a course of action, unless he has determined in good faith and as an exercise of his professional judgment that the course complies with the Bankruptcy Code and serves the best interests of the estate”); *In re Count Liberty, LLC*, 370 B.R. 259, 280 (Bankr. C.D. Cal. 2007) (asserting “majority view” that DIP counsel is fiduciary of bankruptcy estate); see *Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am.* (*In re JLM, Inc.*), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (holding counsel’s duties are to estate in bankruptcy); see also *In re Delta Petroleum (P.R.), Ltd.*, 193 B.R. 99, 111 (D. P.R. 1996) (citing Model Rules R. 1.13(a) (1983) and holding bankruptcy attorney is counsel for estate, not trustee); *In re Rivers*, 167 B.R. at 301 (“When the interests of the [debtor] conflict with those of the [estate], it is the estate and the court to which the attorney owes his highest allegiance.”).

¹⁶ E.g., *Interwest Bus. Equip., Inc. v. U.S. Tr.* (*In re Interwest Bus. Equip., Inc.*), 23 F.3d 311, 316–17 (10th Cir. 1994) (fiduciary duty is of debtor in possession as trustee of estate, and professional’s obligation is “to independently serve the trustee” (quoting *In re McKinney Ranch Assocs.*, 62 B.R. 249, 254 (Bankr. D. Cal. 1986))); *Hansen, Jones & Leta, PC v. Segal*, 220 B.R. 434 (D. Utah 1998). For a discussion of the twin duties of bankruptcy lawyers, see Nancy B. Rapoport, *Seeing the Forest and The Trees: The Proper Role of the Bankruptcy Attorney*, 70 IND. L.J. 783 (1995).

¹⁷ E.g., *ICM Notes, Ltd. v. Andrews & Kurth, LLP*, 278 B.R. 117, 124–26 (S.D. Tex. 2002) (noting that some courts have determined that DIP counsel owes fiduciary duties to the bankruptcy estate as a whole, and explaining that an examination of these fiduciary duties reveals that they arise either from the role of counsel as an officer of the court or the derivative nature of fiduciary obligations owed by counsel to its client, the DIP; “The cases cited by *ICM Notes* do not support a finding that counsel for the debtor owes particular fiduciary duties to the estate or its creditors. The language in these cases referencing a duty to the estate or the creditors is often included without analysis or elaboration by the court and is cited in conjunction with the traditional bankruptcy concepts of a breach of counsel’s fiduciary duty to the client debtor-in-possession or counsel’s failure to provide services which benefit the estate . . . [or] are grounded in principles relating to the retention and compensation of bankruptcy professionals, including conflict of interest rules.”), *aff’d*, 324 F.3d 768 (5th Cir. 2003); *Zeisler & Zeisler, PC v. Prudential Ins. Co. of Am.* (*In re JLM, Inc.*), 210 B.R. 19, 25 (B.A.P. 2d Cir. 1997) (directing a “noisy withdrawal” and stating that “debtor’s attorney, while not a trustee, nevertheless is charged with the duty of counseling the debtor in possession to comply with its duties and obligations under the law. When a debtor in possession is in breach of its fiduciary obligations, counsel must advise the client “to follow a lawful course.”) (internal citations omitted); *In re Food Mgmt. Group, LLC*, 380 B.R. 677, 708 (Bankr. S.D.N.Y. 2008) (counsel’s duty “may not rise to the level of a policeman for the debtor’s postpetition conduct,” but he or she must advise the DIP of its responsibilities under the Code and assist its management in discharging those responsibilities).

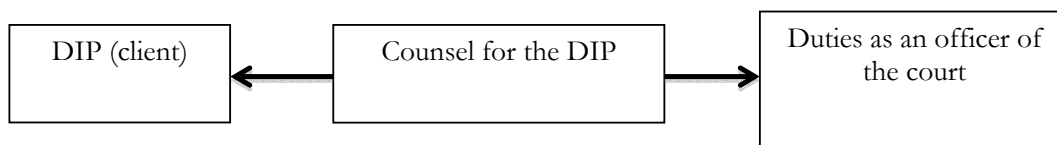
Rather than using “counsel for the estate” as a proxy for “attorney representing a fiduciary client who also owes duties as an officer of the court,” we propose to be more specific and precise about the duties that DIP’s counsel owe—and to whom—by applying state rules of professional responsibility and the Bankruptcy Code and Bankruptcy Rules.¹⁸ Otherwise, the DIP’s attorney runs the risk of facing a rule that simply proves too much. We cannot have a rule that links DIP’s counsel’s duties to claims of individual creditors who may assert that the DIP has violated fiduciary duties, nor can we have a rule that bootstraps representing the DIP to somehow representing the property interests constituting the bankruptcy estate.¹⁹ After all, the DIP’s attorney can only speak for the client who directs her and should be able to counsel her client on a privileged basis. The DIP’s attorney is not directed by creditors or by the *res* of estate property and cannot provide them with confidential and/or privileged advice.²⁰

¹⁸ While counsel have duties of honor and candor and truthfulness to courts, that does not make them fiduciaries to other parties in litigation before the court. Every lawyer is obliged by Rule 9011 not to file unsupported pleadings or pursue frivolous litigation. These duties to the court apply in every case, yet in most if not virtually all cases, counsel for one party is not a fiduciary for the adverse party. *See In re Brennan*, 187 B.R. 135, 151 (Bankr. D.N.J. 1995) (“The ultimate conflict of interest problem in chapter 11 cases is the tension between the concept of a debtor in possession as fiduciary and the reality that the debtor usually seeks to further its own interest at the expense of its creditors. The objections based on alleged conflicts of professionals in such situations often reflect confusion about the real problem, which is creditor mistrust of the debtor, and therefore of his, her or its professionals. However, unless such mistrust is sufficiently serious to warrant appointment of a trustee, requiring related debtors to change professionals, or to have different professionals, often fails to create the independent perspective which is intended by such requests.”); *see also In re SIDCO, Inc.*, 162, B.R. 299, 300 (Bankr. E.D. Cal. 1993), *aff’d*, 173 B.R. 194 (E.D. Cal. 1994) (notion that DIP counsel must represent interests, not only of client but also other parties whose interests may be adverse to those of client, is “flight into the absurd”); *In re Best Western Heritage Inn P’ship*, 70 B.R. 736, 740 (Bankr. E.D. Tenn. 1987) (“difficult to believe that Congress intended to require a disinterested attorney for a debtor-in-possession as a somewhat ineffective safeguard for the rights of creditors and investors other than management.”).

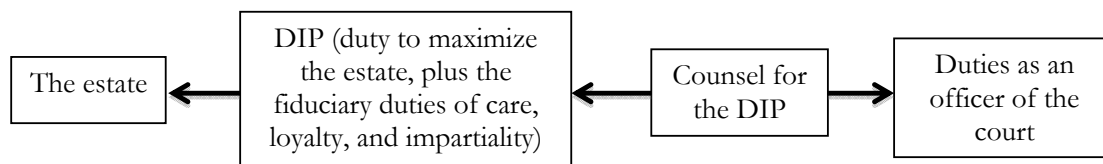
¹⁹ *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 457-60 (D. Utah 1998); *ICM Notes, Ltd. v. Andrews & Kurth, L.L.P.*, 278 B.R. 117, 126 (Bankr. S.D. Tex. 2002) (in a bankruptcy case, the debtor, secured creditors, unsecured creditors and other parties in interest have different and competing interests and are represented by counsel; if DIP counsel owed a fiduciary duty to a particular creditor, it would prevent counsel from representing his own client and would be contrary to the mandate that DIP counsel be disinterested); 9 NORTON BANKRUPTCY LAW & PRACTICE., *supra* note 34 § 172:6, at 172-35 (discussing duties of debtor-in-possession and his/her counsel); *see* ABA Comm. on Ethics and Prof’l Responsibility, *Formal Op.* 94-380 (1994) (lawyer with fiduciary client only has client relationship with that fiduciary, and owes to beneficiaries only those duties owed to third parties in general); *See CenTra, Inc. v. Estrin*, 538 F.3d 402, 413 (6th Cir. 2008) (“[A] lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other.” (quoting MODEL RULES OF PROFESSIONAL CONDUCT R. 1.7 cmt. [28] (2009))); *see also In re Jaeger*, 213 B.R. 578, 587 (Bankr. C.D. Cal. 1997) (stating attorney representing adverse clients can be disqualified if adverse to clients’ interests); MODEL RULES R. 1.7 cmt. [29] (2009).

²⁰ *See In re Rivers*, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994) (“Although the line separating advice or assistance in performing duties from the actual performance of those duties is not always bright, the line exists, and a professional has no business making decisions that are the responsibility of the fiduciary.”); *see also* Model Rules R. 1.14 (2009); *In re ABC Auto. Prods. Corp.*, 210 B.R. 437, 443 (Bankr. E.D. Pa. 1997) (“[T]he bankruptcy process is compromised when its attorney does not present the actual views of his clients but rather what he believes they should be.”). Model Rules R. 1.6 (“attorney must make reasonable effort to

The critical lesson from court statements about DIP lawyers' fiduciary duties is the fundamental importance of counseling and guiding DIP clients on the exercise of their fiduciary duties, while meeting the attorney's professional obligations to the court.²¹ In visual terms, the relationship looks like this:²²



Of course, this dual relationship—lawyer to client and lawyer to court—is one that every litigator has. What makes the DIP counsel's situation so tricky is the relationship of its client to the amorphous "estate." And, as discussed in part IV, below, the relationship is even trickier than it might first appear.



maintain confidentiality of attorney-client protected communications").

²¹ See Hansen, Jones & Leta, P.C. v. Segal, 220 B.R. 434, 464 (D. Utah 1998) (DIP counsel must exercise independent judgment in advising DIP client of its fiduciary duties to the estate and not favor the interests of management to the exclusion of creditors); see also *In re Count Liberty, LLC*, 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) (recognizing "debtor in possession's attorney must be proactive" and ready to provide advice even without being requested in order to ensure DIP carries out its fiduciary responsibilities properly); *In re Wilde Horse Enters., Inc.*, 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (highlighting how attorney for DIP has duty to remind DIP of debtor's duties under the Bankruptcy Code as a fiduciary of the estate); *In re Consupak, Inc.*, 87 B.R. 529, 549 (Bankr. N.D. Ill. 1988) (stressing where trustee's attorney has obligations to estate and to court, lawyer must be more active in advising his client of preventative and corrective measures available); *In re Harp*, 166 B.R. 740, 748 (Bankr. N.D. Ala. 1993) ("[D]ebtor's attorney must . . . provide guidance for management of the debtor." (quoting *In re Whitney Place Partners*, 147 B.R. 619, 620–21 (N.D. Ga. 1992)); *In re Sky Valley*, 135 B.R. 925, 937–38 (Bankr. N.D. Ga. 1992) (stating DIP's attorney has duties to supervise sale of property and advise professionals of responsibilities); but see *In re Dieringer*, 132 B.R. 34, 36 (Bankr. N.D. Cal. 1991) (holding DIP's attorney had no fiduciary duty to supervise DIP); see C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47 (1997) [hereinafter *Ultimate Creditors' Lawyer*].

²² Earlier musings on the graphical representation of the relationship between counsel's dual roles as officer of the court and fiduciary for the DIP appear in *Ultimate Creditors' Lawyer* at 93 n. 330 (1997).

Duties of the DIP's Attorneys

In fact, the drawing above does not tell the whole story. The DIP is also a bankruptcy debtor, and unlike a state-law defined trustee, is not required to be disinterested.²³ It files a plan as a “proponent” or “debtor,” with disclosure requirements but no obligation to discount the interests of equity in order to maximize creditor recoveries as long as Bankruptcy Code “cram-down” requirements are met (assuming a non-consensual plan).²⁴ As the court said in *Water's Edge Limited Partnership*:

A chapter 11 debtor in possession wears two hats. As observed by Judge Saris, it is a fiduciary of the bankruptcy estate, and as such owes fiduciary obligations to the unsecured creditors, the prime beneficiaries of the estate. . . . Subject to certain limitations not material here, the Code provides that “a debtor in possession shall have all the rights ... and powers, and shall perform all the functions and duties ... of a trustee serving in a case under this chapter.” 11 U.S.C.S. § 1107(a) (Law.Co-op.1987). The general powers and obligations of a debtor in possession are accordingly based upon sections of the Code which refer to the “trustee.”

A chapter 11 debtor's obligations are quite different as to the plan dividend it proposes. In describing the role of a debtor in possession as plan proponent the Code contains no reference to the debtor as a trustee. Instead, the Code calls the debtor in possession “debtor” or plan “proponent.” See 11 U.S.C.S. §§ 1121, 1127, 1129, 1142, 1144 (Law.Co-op.1987 & Supp.2000).

There is a basic reason for the Code's failure to describe a chapter 11 debtor in possession as a “trustee” when referring to its role in proposing and confirming a plan of reorganization. A consensual plan (one accepted by all impaired classes of claims or interests) is typically the result of hard bargaining between the debtor and a creditors' committee. To be confirmed, the plan must give creditors at least what they would get in a liquidation under chapter 7. See 11 U.S.C.S. § 1129(a)(7) (Law.Co-op. Supp.2000). If they have plan proposal rights, creditors can propose a plan of their own which converts their debt to equity. See 11 U.S.C.S. § 1129(b)(2)(C)(ii) (Law.Co-op.1987). As equity holders, they can then sell the business and obtain its going concern value. In the plan negotiations, therefore, liquidation value is the floor for any dividend and going concern value is the ceiling. The

²³ 11 U.S.C. § 1101(1) (2006) (“[D]ebtor in possession’ means debtor except when [a trustee is appointed].”); see *In re Water's Edge Ltd. P'ship*, 251 B.R. at 6–7 (describing “dichotomy in the obligations of a [DIP] and its counsel”); *In re Rancourt*, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (noting that attorney representing DIP in chapter 11 proceeding “always faces the prospect of some conflict between the ultimate interests of the individual debtor and those of the bankruptcy estate created by the reorganization proceeding”).

²⁴ 11 U.S.C. §§ 521, 1106, 1121, 1127, 1129, 1142, 1144 (2006) (referring to DIP as “plan proponent” or “debtor” and not as “trustee”), 1129(b) (cram-down provisions); see *In re Water's Edge Ltd. P'ship*, 251 B.R. at 7 (suggesting that Code's drafters chose terminology intentionally and discussing cram-down rights).

difference can be considerable. And of course value under any standard is a slippery concept.

So there is plenty of room for bargaining. Beyond the minimal disclosure requirements of section 1125, the Code imposes no fiduciary obligations upon a debtor in possession in this negotiation process. The debtor is not required, for example, to disclose the maximum dividend it is willing to pay. Moreover, not all plans are consensual. A debtor may, as here, confirm a plan over the objection of a class of creditors if the plan gains the acceptance of at least one class of impaired claims and satisfies the other requirements for a so-called “cramdown” plan. *See* 11 U.S.C.S. § 1129(b) (Law.Co-op.1987). The self-serving nature of these negotiating and cramdown rights has been noted. . . .

A debtor in possession is therefore permitted to place its own interests above those of the unsecured creditors with respect to what it proposes to pay under its plan. This is of course inconsistent with the concept that the debtor in possession is a fiduciary of the unsecured creditors owing them a duty of loyalty. The conclusion seems inescapable. As to its proposed plan dividend, a debtor in possession is not a fiduciary of the unsecured creditors owing them a duty of loyalty. Its bargaining and cramdown rights necessarily exclude such a fiduciary obligation.²⁵

In a sense, then, the DIP is more of a quasi-trustee than it is the pure equivalent of a state law trustee;²⁶ it has certain obligations that rise to the level of fiduciary duties, and it has obligations that relate to its status as a debtor in bankruptcy, in which its duty is to act within the confines of the Bankruptcy Code.

Generally, in Chapter 11, a single law firm will represent the client in its capacities as both debtor and DIP.²⁷ Representing the DIP/debtor client entails counseling the “debtor part” of the

²⁵ *In re Water’s Edge Ltd. P’ship*, 251 B.R. 1, 7-8 (Bankr. D. Mass. 2000) (footnotes and some citations omitted).

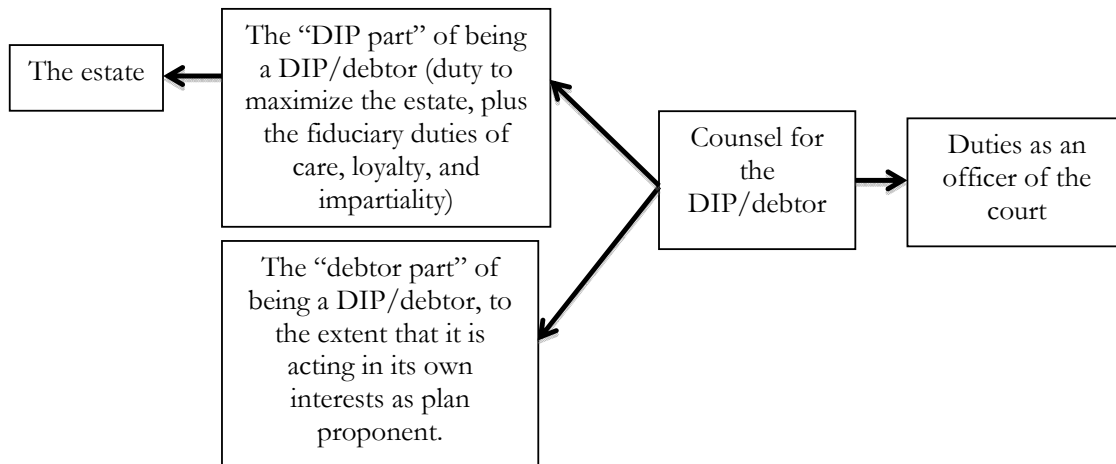
²⁶ As observed,

[A] DIP is not the same as a trustee. As the Supreme Court has recognized, there is a difference between a “strict trusteeship,” such as a bankruptcy trusteeship, and “one of those quasi-trusteeships in which self-interest and representative interests are combined.” A DIP is a quintessential example of such a quasi-trusteeship. The DIP is, first of all, the debtor with additional, rights, duties and powers. Not only are these comprised solely of the rights, duties and powers of a trustee, but the DIP also has the duties of the debtor, the rights of a party in interest and—most significantly, at the outset of a chapter 11 case—the exclusive right to file a plan. Consequently, there should at least be a distinction between the rights, duties and powers the DIP enjoys as a debtor, and those it enjoys as a trustee. For those it enjoys as a trustee, it has a fiduciary duty to the estate. For those it enjoys as debtor, it does not.

Alec P. Ostrow, *We Don’t Need the Case Law to Turn the DIP’s Attorney into a Court Informant*, 27-MAY AM. BANKR. INST. J. 14, 44, April 2008 (footnotes omitted).

²⁷ The debtor’s equity owner may be separately represented when the debtor is closely held or publicly held and there is an equity committee. In cases in which the equity owner of a closely held company or partnership is also a debtor, a number of courts have required separate representation. *See In re Straughn*, 428 B.R. 618, 623-24 (Bankr. W.D. Pa. 2010) and cases cited therein. In larger cases of affiliated debtors, requiring

client on exercising its rights and responsibilities as defined under the Bankruptcy Code. Advising the “DIP part” of the client entails understanding and facilitating the exercise of the DIP’s fiduciary duties of loyalty, care, and impartiality.²⁸ It also requires the lawyer’s refusal to participate in the client’s proposed violation of its statutory and fiduciary duties.²⁹ Therefore, a complete depiction of the relationships among the estate, the DIP, the debtor, DIP counsel, and the court looks like this:



separate counsel is often not done, but separate counsel may be required in circumstances in which there are significant conflicts. *In re Adelphia Communications Corp.*, 336 B.R. 610 (Bankr. S.D. N.Y. 2006), *judgment aff’d*, 342 B.R. 122 (S.D. N.Y. 2006) (single firm for affiliated debtors, approved on facts). A court may require separate representation of equity owners even when they are not debtors in their own bankruptcy case and may disqualify the DIP lawyer based on the lawyer’s connections with non-filing equity owners. *In re Freedom Solar Center, Inc.*, 776 F.2d 14 (1st Cir. 1985); *In re TMA Associates, Ltd.*, 129 B.R. 643 (Bankr. D. Colo. 1991).

²⁸ Advising the DIP (as with any client) involves the provision of competent legal advice and likely involves a discussion of the DIP’s business considerations in addition to any purely legal advice. The Task Force recognizes the difficulty of drawing a line of demarcation between legal advice and business advice. Although such a discussion is beyond the scope of this Report, the Task Force finds useful the guidance in MODEL RULE 2.1 (“In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.”).

²⁹ For a thorough discussion of the DIP’s fiduciary duties, as well as a discussion of the issue about what “not participating in the client in a proposed violation of its duties” means, 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, 333-36 (Winter 2009) [hereinafter Freeman, *DIP Counsel as Fiduciary*]; C.R. Bowles & Nancy B. Rapoport, *Debtor Counsel’s Fiduciary Duty: Is There a Duty to Rat in Chapter 11?*, 29 AM. BANKR. INST. JOURNAL 16 (2010); C.R. Bowles & Nancy B. Rapoport, *Has the DIP’s Attorney Become the Ultimate Creditors’ Lawyer in Bankruptcy Reorganization Proceedings?*, 5 AM. BANKR. INST. L. REV. 47 (1997). The attorney for the DIP/debtor must clearly explain to the equity owners and management that the lawyer represents the entity, not the individual owners, and that the entity has fiduciary duties. *In re Kendavis Industries International, Inc.*, 91 B.R. 742, 752 (Bankr. N.D. Tex. 1988).

To recap the complexity, then: As the lawyer for a fiduciary, DIP counsel must take proactive steps to ensure that the DIP client understands its responsibilities, informing the client of the need for preventative or corrective measures.³⁰ The DIP's counsel may not proceed with actions that violate legal requirements.³¹ Where the client's proposed action is a borderline judgment call, courts stress the importance of disclosure to enable all parties in interest to weigh in on the acceptability of the action.³² The DIP's counsel does not owe duties to individual creditors, except to the extent that the lawyer assumes particular responsibilities, such as holding bankruptcy estate

³⁰ *In re Count Liberty, LLC*, 370 B.R. 259, 281–82 (Bankr. C.D. Cal. 2007) (remarking that DIP counsel must proactively render candid advice and must not ignore matters that may adversely affect the estate); *In re Nilges*, 301 B.R. 321, 325 (Bankr. N.D. Iowa 2003) (“As a professional, an attorney must instruct the debtor on appropriate conduct and must develop client control.” (quoting *In re Berg*, 268 B.R. 250, 262 (Bankr. D. Mont. 2001)); *In re Whitney Place Partners*, 147 B.R. 619, 620–21 (Bankr. N.D. Ga. 1992) (“[D]ebtor’s attorney must take conceptual control of the case and provide guidance for management of the debtor, not only to discern what measures are necessary to achieve a successful reorganization, but to assure that, in so doing, compliance with the Bankruptcy Code and Rules is sought rather than avoided.”); *In re Consupak, Inc.*, 87 B.R. 529, 551 (Bankr. N.D. Ill. 1988) (finding violation of ethical obligations where lawyer failed to offer legal advice, client was unaware of adverse legal consequences, and advice would have been in client’s best interest). See MODEL RULES R. 2.1 (2009) (stating that lawyer shall exercise independent professional judgment and render candid advice); *id.* R. 2.1 cmt. [5] (2009) (“In general, a lawyer is not expected to give advice until asked by the client. However, *when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to a client*, duty to a client under Rule 1.4 may require that the lawyer act if the client’s course of action is related to the representation A lawyer ordinarily has no duty to initiate investigation of a client’s affairs or to give advice that the client has indicated is unwanted, but a lawyer may initiate advice to a client *when doing so appears to be in the client’s interest*.”) (emphasis added); *but see also id.* R. 2.2 (“In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.”)

³¹ *United Student Aid Funds v. Espinosa*, 130 S. Ct. 1367 (2010); *Everett v. Perez (In re Perez)*, 30 F.3d 1209, 1219 (9th Cir. 1994); *In re Jones*, 339 B.R. 903, 904 (Bankr. E.D. Mich. 2006) (indicating attorney cannot file chapter 13 case simply because client so instructs when feasibility is not reasonably arguable); *In re The Phoenix Group Corp.*, 305 B.R. 447, 450–52 (Bankr. N.D. Tex. 2003) (discussing situation where DIP counsel determined that DIP as fiduciary should not pursue action and moved to withdraw, citing demand to pursue strategies firm believed were legally and/or ethically improper).

³² See *In re Rancourt*, 207 B.R. 338, 358 (Bankr. D.N.H. 1997) (indicating that the natural desire of individual DIP to negotiate plan providing maximum value for equity does not represent conflict for DIP counsel “*provided that full disclosure is made as to any divergence of interests in that regard that may be appropriate for the creditors and the Court itself to consider in context*”); *see also* *Browning Mfg. v. Mims (In re Coastal Plains, Inc.)*, 179 F.3d 197, 208 (5th Cir. 1999) (stressing importance of disclosure generally).

funds.³³ Courts confronted with creditors' claims for damages from an alleged breach of fiduciary duty by a DIP counsel have denied such claims.³⁴

The DIP's attorney must, of course, comply with her professional responsibility duties to the DIP/debtor client³⁵ and to the court, notwithstanding the absence of direct liability to creditors.³⁶ Duties to the court include maintaining candor, providing the appropriate disclosures, complying with the court's rules and procedures, and not asserting frivolous positions.³⁷ Lawyers may not knowingly make a false statement of material fact or law to a court, or fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client.³⁸ And although all lawyers must avoid conflicts of interest, the Bankruptcy Code and Rules impose heightened duties on the DIP's attorney not to hold or represent any interest adverse to the estate and to be disinterested.³⁹ The duty to avoid a conflict of interest is particularly relevant when the DIP's lawyer acts in a manner that appears to favor the interests of insider individuals over those of the DIP fiduciary.⁴⁰

³³ ICM Notes, Ltd. v. Andrews & Kurth, L.L.P., 278 B.R. 117, 124 (Bankr. S.D. Tex. 2002) (DIP counsel does not owe fiduciary duties to any individual creditor and is not subject to creditor cause of action for breach of fiduciary duty); *In re Texasoil Enters.*, 296 B.R. at 435 (noting that, although DIP counsel may not owe duty directly to creditors, DIP counsel does have obligation to ensure that debtor properly maintains estate). One court proposed that a DIP's lawyer owes duties to non-clients, under RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(4) (2000) ("LGL RESTATEMENT"). *In re Food Mgmt. Group, LLC*, 380 B.R. 677, 708-10 (Bankr. S.D.N.Y. 2008). That section, though, does not apply to clients for whom fiduciary responsibilities are part of a larger role, such as management of a business, and the identified duties are not "fiduciary" duties. *See Freeman, DIP Counsel as Fiduciary*, *supra* n. 29.

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

³⁵ Restatement (Third) of the Law Governing Lawyers § 16 (2000).

³⁶ *Id.* § 120 (2000) (describing duties owed to court); *see In re The Phoenix Group Corp.*, 305 B.R. 447, 452-53 (Bankr. N.D. Tex. 2003) (finding that attorney properly refused to file documents requested by client that would violate client's and lawyer's ethical duties).

³⁷ MODEL RULES R. 3.3 (candor and disclosure), R. 1.1 (competence—demonstrated here by complying with the court's rules and procedures), and R. 3.1 (not asserting frivolous positions).

³⁸ *See* MODEL RULES R. 3.3 (2009); *see also In re Count Liberty, LLC*, 370 B.R. 259, 283-84 (Bankr. C.D. Cal. 2007) (lawyer represented that estate funds were in blocked bank account without confirming with bank).

³⁹ 11 U.S.C. § 327(c).

⁴⁰ *See Bezanson v. Thomas (In re R&R Assocs. of Hampton)*, 402 F.3d 257, 272 (1st Cir. 2005) (finding that lawyer helped partners transfer partnership estate assets to themselves, breaching duty of loyalty to partnership client DIP); *Fellheimer, Eichen & Braverman, PC v. Charter Techs., Inc.*, 57 F.3d 1215, 1228-29 (3d Cir. 1995) (determining that lawyer abandoned fiduciary obligation to debtor corporation by advocating for its president). As noted *infra* in n. 42, the DIP, as debtor, may pursue the rights of insiders, but only within the parameters of applicable law.

An attorney for the DIP, like the DIP itself, cannot engage in improper self-dealing or have unacceptable conflicts of interest. But, like the DIP, its attorney has personal interests and conflicts, including, most notably, the interest in being compensated for work performed and receiving that compensation on an administrative expense basis, ahead of other creditors. The lawyer may pursue a personal interest in obtaining a retainer, negotiate a DIP loan carve-out for professional fees, propound other methods for safeguarding fees (including getting collateral as security for the fees), and insist on fee payment as an administrative expense despite its effect on plan confirmation.⁴¹ The Bankruptcy Code and Rules provide the parameters for proper pursuit of such personal interests, with a mandate of full disclosure and court review and approval.

The DIP's attorney, likewise, must meet her obligations of full disclosure and actions within the confines of bankruptcy law, with court approval, when required, when advising and acting for the fiduciary DIP client.⁴²

When a lawyer's representation *will* violate the applicable rules of professional conduct or other law, the lawyer must withdraw.⁴³ Withdrawal requires court permission, and there is always a risk that a court will order continued representation.⁴⁴ In other circumstances, such as when the client insists on taking action that the lawyer considers repugnant or insists on taking action with which the lawyer fundamentally disagrees, withdrawal is optional.⁴⁵

⁴¹ See *In re Martin*, 817 F.2d 175, 180 (1st Cir. 1987) (acknowledging that any attorney retained for DIP "becomes a creditor of the estate just as soon as any compensable time is spent on account"); see 11 U.S.C. § 1129(a)(9)(A) (2006) (stating that debtor must pay administrative fees included in 11 U.S.C. § 507(a)(2) in order to have plan confirmed); see also *In re Capitol Hill Group*, 313 B.R. 344, 347 (D. D.C. 2004) (recognizing problem when debtor, in process of confirming plan, asked counsel to accept less than full amount agreed to, despite previously agreeing to pay entire amount); *In re Dale's Serv., Inc.*, No. 07-01255-JDP, 2008 Bankr. LEXIS 1652, at *10 (Bankr. D. Idaho May 27, 2008) (acknowledging attorney may object to confirmation of plan that did compensate attorney for services); Jay Lawrence Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287, 287 (1993) (stating there are "unavoidable conflicts that are inherent in the representation of DIPs").

⁴² Thus, the attorney can represent the "debtor part" of the DIP/debtor client and successfully avoid any conflict between the interest of the DIP as fiduciary by, e.g., openly negotiating with adverse counsel for the creditors' committee and secured creditors for a smaller "new value" plan contribution by equity owners, assuming that the facts of the case support such a negotiation within the boundaries of the Code. But if a transaction benefiting DIP insiders is hidden from adverse parties in interest and the court, and if it falls outside the parameters of the Code and Rules, the DIP's attorney may be charged with having taken on the representation of an additional party in interest adverse to the DIP—a conflict of interest. In such a situation, then, the lawyer would be perceived as serving two masters (the insider and the fiduciary entity). That "serving two masters" situation occurs outside of bankruptcy, too, if a lawyer is secretly advising a corporate president to embezzle. See *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742, 762 (Bankr. N.D. Tex. 1988); see also *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 464 (D. Utah 1998) (DIP counsel must exercise independent judgment in advising DIP client of its fiduciary duties to the estate and not favor the interests of management to the exclusion of creditors).

⁴³ MODEL RULES R. 1.16 (2009).

⁴⁴ MODEL RULES R. 1.16(c) (2009).

⁴⁵ MODEL RULES R. 1.16(b)(4) (2009).

A DIP's persistence in a course of action that the lawyer considers to breach fiduciary duties can trigger withdrawal. At that point, the DIP's lawyer must also determine whether there is an obligation to bring the DIP's breaches of fiduciary duty to the attention of the court in some way. Several courts have stated that disclosure is required.⁴⁶ Some courts have also stated that a breach of "any fiduciary duty" requires disclosure, but the facts of these cases concern such serious crimes or frauds as embezzlement, and the decisions generally do not explain how such disclosure is to be accomplished.⁴⁷

The DIP's attorney, like any other attorney, must comply with her applicable rules of professional responsibility when undertaking a "noisy withdrawal" (bringing misconduct to the attention of the court and creditor body by withdrawing "for professional reasons," accompanied by a filing stating that the lawyer withdraws particular documents for such reasons), while maintaining specific client confidences to the extent mandated by those rules.⁴⁸

⁴⁶ See *In re Ward*, 894 F.2d 771, 776 (5th Cir. 1990) (noting that, had attorney for debtor known of existence of unscheduled judgment against estate, "as an officer of the court, [the attorney] would certainly have had a duty to inform the court"); *In re JLM, Inc.*, 210 B.R. at 26 (holding that attorney for DIP must inform "the court in some manner of derogation by the debtor in possession"); *United States v. Thomas*, 342 B.R. 758, 761-62 (S.D. Tex. 2005) (indicating that once lawyer discovers omission in schedules, he has duty to court and opposing counsel to notify, amend, and formally correct effect of omission); *In re Gregory*, 214 B.R. 570, 576 (S.D. Tex. 1997) (noting duty to disclose client defalcation); *In re N. Star Mgmt., LP*, 305 B.R. 312, 320 (Bankr. D.N.D. 2003) (describing requirement of trustee to act affirmatively to investigate and halt misappropriation of funds, and report to court or U.S. Trustee), *rev'd on other grounds*, 308 B.R. 906 (B.A.P. 8th Cir. 2004) (finding professional took appropriate steps but was undermined by wrongdoer); *In re Granite Sheet Metal Works, Inc.*, 159 B.R. 840, 848 (Bankr. S.D. Ill. 1993) (determining that it was DIP counsel's duty to bring to court's attention that DIP was breaching fiduciary duties by refusing to investigate insider transfers); *In re Swansea Consol. Res., Inc.*, 155 B.R. 28, 38 n. 14 (Bankr. D.R.I. 1993) (noting as officer of court, attorney had "absolutely no choice but to disclose the fact of the missing \$64,000 [of DIP funds]"); *In re United Utensils Corp.*, 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) (noting that former DIP counsel hired by trustee was obliged to disclose to trustee his information about estate assets; "If the debtor is not fulfilling its fiduciary obligation to the estate, it is the responsibility and duty of Debtor's counsel to bring such matters to the attention of the court" (quoting *In re Wilde Horse Enters.*, 136 B.R. 830, 847 (Bankr. C.D. Cal. 1991)); *id.* at 847 (indicating that upon suspicion of dishonesty or neglect of fiduciary duty to estate, attorney must ask probing questions and demand fully and reasonably corroborated responses, and if still unsatisfied or ethically uncomfortable, immediately bring unresolved concerns to court's attention by way of motion to be relieved as counsel or in some other way); see also MODEL RULES R. 1.6 cmt. [4] (2009) (noting lawyer will sometimes be required to disclose confidential information); ABA Comm. on Ethics and Prof'l Responsibility, FORMAL OP. 92-366 (1992) (discussing duty of "noisy withdrawal" from representation).

⁴⁷ See cases cited *supra* n. 46.

⁴⁸ See MODEL RULE R. 1.6 cmt. [8] (2009) (explaining attorney may disclose information relating to representation to remedy fraud); *id.* R. 1.16 cmt. [3] (2009); *id.* R. 4.1 cmt. [3] (2009) ("Sometimes it may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like."); *id.* R. 2.1 cmt. 10 (discussing how lawyer may not assist client in conduct discovered to be criminal or fraudulent, but must instead withdraw from representation and how there may be instances where "withdrawal alone might be insufficient" and "[i]t may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like"); ABA Comm. on Ethics and Prof'l Responsibility, FORMAL OP. 92-366 *Withdrawal When a Lawyer's Services will Otherwise be Used to*

Although the DIP's attorney has no liability to individual creditors for breach of any fiduciary duties owed by the DIP to the bankruptcy estate,⁴⁹ the attorney may still be sanctioned by the court, especially through reductions of fee awards, for misrepresentations or non-disclosures about criminal behavior by the DIP client, such as concealing estate assets.⁵⁰ Outside of bankruptcy, a lawyer who knowingly participates in the client's breach of fiduciary duties may be liable to third parties on such grounds as conspiracy to breach or aiding and abetting the breach of a client's fiduciary duty, or for personally handling funds of a fiduciary contrary to the interest of the beneficiary.⁵¹ In the trust context, the mere knowledge of a breach of fiduciary duty is generally not enough for liability without the attorney's active involvement.⁵²

Perpetrate a Fraud (1992) (determining that, although "noisy" withdrawal could result in the impermissible disclosure of information otherwise protected as a client confidence, nothing "prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw, or disaffirm any opinion, document, affirmation, or the like"); see also *In re Matthews*, 154 B.R. 673, 680–81 (Bankr. W.D. Tex. 1993) (explaining duty to alert U.S. Trustee, court, or another interested party that schedules are incomplete or inaccurate; failure to withdraw contributed to debtor's dishonesty by not setting up early alarm that something was amiss); *In re Saturley*, 131 B.R. 509, 519 (Bankr. D. Me. 1991) (indicating attorney's prerogative to inform trustee that schedules are incomplete if concerned about client's candor, thus prompting trustee investigation); *In re Wilde Horse*, 136 B.R. at 847 (positing that upon suspicion of debtor's dishonesty or neglect of fiduciary duty to the estate, attorney has duty to ask probing questions, demand full and reasonably corroborated responses, and if "still unsatisfied or ethically uncomfortable, immediately bring the unresolved concerns to court's attention by way of a motion to be relieved as counsel or in some other way"); see also C.R. Bowles, Jr., *Noisy Withdrawals: Urban Bankruptcy Legend or Invaluable Ethical Tool?*, 20 AM. BANKR. INST. L. J. 26, 26–27 (Oct. 2001).

⁴⁹ See *ICM Notes, Ltd. v. Andrews & Kurth, L.L.P.*, 278 B.R. 117, 123–24 (Bankr. S.D. Tex. 2002) (discussing how, although DIP counsel may owe general fiduciary duties to bankruptcy estate, "this duty cannot be extended to justify the imposition of a fiduciary duty running from counsel for the debtor-in-possession directly to a particular creditor that would support a separate civil action for breach"), *aff'd without change*, 324 F.3d 768 (5th Cir. 2003); see also *In re Count Liberty, LLC*, 370 B.R. 259, 280 n. 54 (Bankr. C.D. Cal. 2007) ("Fiduciary duties of a debtor in possession's counsel to the estate do not extend to any particular creditor in a chapter 11 case."); *In re Texasoil Enters., Inc.*, 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (acknowledging that DIP counsel does not directly owe fiduciary duties to creditors).

⁵⁰ See, e.g., *In re Count Liberty, L.L.C.*, 370 B.R. 259, 281 (Bankr. C.D. Cal. 2007) (issuing civil contempt sanctions to DIP's attorney for not appropriately counseling DIP when DIP transferred money out of account against court orders and finding that DIP's attorney did not fulfill fiduciary duty to carry out responsibilities of estate); *In re Sky Valley*, 135 B.R. 925, 933, 936 (Bankr. N.D. Ga. 1992) (sanctioning DIP counsel for obtaining court approval of a broker's employment without disclosing the broker's connections and lack of disinterestedness, failing to disclose the role of an insider secretly being compensated through the broker's employment, and failing to instruct the broker on disposition of sale proceeds); *In re Wilde Horse Enters.*, 136 B.R. 830, 840, 846 (Bankr. C.D. Cal. 1991) (denying fees to attorney for improper conduct as officer of court for not reporting illegal sale of DIP's property and for improperly certifying application); MODEL RULES R. 1.16, 3.3, 1.6 cmt. [18] (2009).

⁵¹ See *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 461 (Bankr. D. Utah 1998) (rejecting any fiduciary duty owed by the DIP to creditors or shareholders, reasoning that "[i]f counsel owes the same fiduciary duty to creditors and shareholders and other parties in interest as does the debtor-in-possession, any breach of debtor's duties theoretically exposes counsel to liability to these nonclient beneficiaries, even if counsel's conduct was not fraudulent or criminal."); see also *In re Dieringer*, 132 B.R. 34, 37 (Bankr. N.D. Cal. 1991) (DIP counsel served as disbursing agent under confirmed plan; continued to assure creditors they

Best Practices Recommendations

- A. An attorney for a debtor-in-possession must be proactive in counseling her client with respect to its compliance with its fiduciary duties to the bankruptcy estate.
- B. An attorney for a debtor-in-possession must recognize and understand which hat (DIP or debtor) the client is wearing at a given time. The same lawyer may, and generally does, advise the DIP in its capacity as the debtor, including preparing and advocating for a reorganization plan that may include cram-down treatment of creditors. When doing so, the attorney must not advocate for personal debtor interests that violate the DIP's fiduciary duties.
- C. An attorney for a debtor-in-possession must, at all times, comply with the applicable rules of professional responsibility. She must also meet the applicable requirements of the Bankruptcy Code and Rules for disclosure, non-adversity and disinterestedness, and reasonableness of fees and expenses.
- D. An attorney must ensure that her client knows and understands its basic fiduciary duties to the estate. These consist of:
 - 1. Loyalty: All actions taken must be fair and reasonable. The DIP and its management and owners must not obtain an improper personal benefit, even when pursuing their "debtor" interests. This standard is met by compliance with applicable provisions of the Code and Rules, full and accurate disclosures, and ratification or approval by the court when required by law.
 - 2. Care: All actions must be taken in good faith, with the care of a prudent person.

would eventually be paid while allowing debtors to make withdrawals and incur liabilities; lawyer held liable to creditors for misrepresentations for damages suffered by his forbearance from action); *see* Klepak v. Dole, 490 U.S. 1089 (1989) (holding lawyer liable to pension plan for aiding trustee in breach of duties); *Morales v. Field*, 160 Cal. Rptr. 239, 243 (Cal. Ct. App. 1979) (acknowledging that lawyer for fiduciary is liable to beneficiary for active participation in breach of trust); *but see In re Dieringer*, 132 B.R. 34, 36 (Bankr. N.D. Cal. 1991) (holding no breach of fiduciary duty because lawyer had fiduciary duty to bankruptcy estate, not to plaintiffs, because plaintiffs were not beneficiaries of trust).

⁵² *See* *Newburger, Loeb & Co., v. Gross*, 563 F.2d 1057, 1074, 1080 (2d Cir. 1977) (lawyer found liable for inducing and participating in his clients' breach of fiduciary duty by affirmatively permitting transfer of funds to take place); *see also Albright v. Burns*, 503 A.2d 386 388–91 (N.J. Super. Ct. App. Div. 1986) (finding lawyer "participation" when lawyer received funds from trust and disbursed funds to fiduciary, knowing fiduciary intended to use them illegally); *see also* Robert W. Tuttle, *The Fiduciary's Fiduciary: Legal Ethics in Fiduciary Representation*, 1994 U. ILL. L. REV. 889, 945 ("[E]ven if the lawyer has notice of the breach, she only assumes liability if she 'participates' in the breach."); RESTATEMENT (SECOND) OF TORTS §§ 874, 876 (1965) (asserting attorney will be subject to liability if he knowingly gives "substantial assistance or encouragement" to personal representative's breach of fiduciary duty); Katerina P. Lewinbuk, *Let's Sue All the Lawyers: The Rise of Claims Against Lawyers for Aiding and Abetting a Client's Breach of Fiduciary Duty*, 40 ARIZ. ST. L.J. 135, 152–53 (2008).

3. Impartiality: All estate constituents must be treated fairly and within the structure of the Code, without unfairly favoring particular creditors to the detriment of others.
- E. The DIP's attorney cannot knowingly facilitate a DIP's violation of fiduciary duties. If the DIP client breaches any of its fiduciary duties, the DIP's attorney must explain the law and consequences and urge compliance. If the DIP still refuses to correct the violation after such counseling and the action rises to the level of violating applicable rules of professional conduct or other law, the DIP's attorney must seek court permission to withdraw from the representation and must make disclosures in the manner and to the extent allowed by the applicable rules of professional responsibility.
- F. An attorney must be aware of the exceptions to the "no individual liability to creditors" rule. The DIP's attorney has no liability to individual creditors for the DIP's violation of its fiduciary duties, *unless* the lawyer's actions are fraudulent or intentionally wrongful. Nonetheless, the DIP's attorney may be held liable for knowingly and actively participating in (and, in some jurisdictions, aiding and abetting), the DIP's breach of its fiduciary duties. The DIP's attorney may also be sanctioned in a variety of ways, including fee disallowance or referral to the appropriate disciplinary authorities, for violations of the Code, the Rules, or the applicable rules of professional responsibility.

A Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328

Introduction¹

Section 327 of the Bankruptcy Code sets forth the standards for the employment of professional persons by trustees and debtors-in-possession.² Section 327(a) indicates that a trustee or debtor-in-possession, with the court's approval, may employ various professional persons to represent and assist in carrying out the duties prescribed under the Bankruptcy Code. For the purposes of section 327(a), the definition of "professional person" is generally limited to attorneys, accountants, appraisers, auctioneers, financial advisors, and others who play a central role in the case.³

Section 327(a) establishes that a professional person can be retained only if such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person."⁴ The professional's duty to meet those requirements continues throughout the case.⁵ The retention process is designed to ensure public confidence in the bankruptcy system, prevent abuses, and achieve a degree of efficiency in the administration of a Chapter 11 case. The requirements of 11 U.S.C. § 327 "serve the important policy of ensuring that all professionals ... tender undivided

¹ The Reporters gratefully thank Andy Vara for his thorough and helpful report on this topic.

² 11 U.S.C. § 1107(a).

³ See, e.g., *In re Renaissance Residential of Countryside LLC*, 423 B.R. 848, 858 (Bankr. N.D. Ill. 2010); *Comm. of Asbestos-Related Litigants and/or Creditors v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 60 B.R. 612, 620 (Bankr. S.D.N.Y. 1986).

⁴ 11 U.S.C. § 327(a); see also *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park Helena Corp.)*, 63 F.3d 877 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049 (1996); *In re Granite Partners*, 219 B.R. 22 (Bankr. S.D.N.Y. 1998).

⁵ Section 328, titled "Limitation on compensation of professional persons," provides in part:

(c) Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is to be employed.

Section 328(c) applies to professionals retained under Section 327 or 1103. This section allows the bankruptcy court to deny compensation if a retained professional fails to be disinterested or represents or holds an interest adverse to the estate with respect to the matter on which such professional has been employed. Although focusing on the allowance of fees, as opposed to articulating a standard for retention, Section 328(c) appears to incorporate the disinterestedness and adverse interest standards under Section 327 into considerations governing the selection of professionals by Committees under Section 1103. *In re Caldor, Inc.*, 193 B.R. 165, 170-71 (Bankr. S.D.N.Y. 1996).

loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.”⁶ Court approval of a professional person’s employment is contingent upon the court’s finding that the applicant has met a two-pronged test. Under section 327(a), the professional (1) must be disinterested; and (2) must not hold or represent an interest adverse to the estate.⁷ Other parts of section 327 govern special counsel for the estate⁸ and the effect of a professional’s representation of a creditor on his or her eligibility for employment.⁹ The retention provisions embodied in the Bankruptcy Code “create an ongoing duty on the part of professionals hired by the estate to avoid conflicts of interest.”¹⁰

There are other provisions in the Bankruptcy Code beyond section 327 that address the issue of the employment, and specifically the compensation of professionals. As one commentator has explained,

The other statutory provision requiring court approval of employment is section 1103, which covers the employment of professionals working for committees. 11 U.S.C. § 1103 permits a committee that has been appointed under section 1102 to employ professionals for the benefit of the committee, provided that the professional may not concurrently “represent any other entity having an adverse interest in connection with the case.”¹¹

Some professionals have focused their attention on section 328,¹² which allows for a variety of creative compensation structures (“on any reasonable terms and conditions of

⁶ *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994).

⁷ The question of whether a professional meets these tests is one for the court to adjudicate after full disclosure of the facts in accordance with FED. R. BANKR. P. 2014. *In re Filene’s Basement, Inc.*, 239 B.R. 850 (Bankr. D. Mass. 1999); *In re Leslie Fay Cos., Inc.*, 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

⁸ 11 U.S.C. § 327(e).

⁹ 11 U.S.C. § 327(c).

¹⁰ *In re Creative Desperation, Inc.*, 415 B.R. 882, 896 (Bankr. S.D. Fla. 2009).

¹¹ Section 1103(a) provides: “At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court’s approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.” There’s a bit of a gap between sections 327 and 1103: “It’s a little trickier for getting court approval for those professionals whom committees want to employ. Section 1103(a) gives committees the authority to seek court approval for the employment of professionals, but section 327 speaks only of employing professionals for the trustee (and, via section 1107, for the debtor in possession). That’s a drafting glitch that omits employment approval for committee professionals.” Nancy B. Rapoport, *The Case for Value Billing in Chapter 11*, 7 J. BUS. L. & TECH. LAW 117, 124 (2012) [hereinafter *Value Billing*]. Most courts solve this problem by using section 328(a) as the appointing authority for committee professionals; the other way is to use section 1103 itself as the authority. *See id.* at 122-23.

¹² 11 U.S.C. § 328(a) provides:

The trustee, or a committee appointed under section 1102 of this title, with the court’s approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a

employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis”). But—at least for professionals employed by the trustee or debtor in possession—section 328 is more properly read as elaborating the latitude that a court has in approving compensation arrangements, rather than as separate authority for appointment. Under section 328, the court may only “allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions”—a much more difficult standard for the court to meet. In other words, compensation arrangements made pursuant to section 328 protect the professional’s compensation structure far more aggressively than those made pursuant to section 327.¹³

Section 330(a)(3) provides the roadmap for reviewing compensation:

In determining the amount of reasonable compensation to be awarded to an examiner, trustee under Chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

- (A) the time spent on such services;
- (B) the rates charged for such services;
- (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
- (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
- (E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
- (F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.¹⁴

Traditionally, a court’s review of compensation for professionals appointed under section 327 focuses on the “lodestar” method (hours multiplied by hourly rate)¹⁵ as part of its determination

contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

¹³ *Value Billing*, *supra* n. 11, at 122-23 (footnotes omitted).

¹⁴ 11 U.S.C. § 330(a)(3).

¹⁵ In *Matter of Pilgrim’s Pride Corp.*, 690 F.3d 650, 655 (5th Cir. 2012), the Fifth Circuit defined the lodestar amount as “the number of hours reasonably expended multiplied by the prevailing hourly rate in the community for similar work.” *Id.* (quoting *In re Lawler*, 807 F.2d 1207, 1211 (5th Cir.1987)).

of the reasonableness of that compensation. Because the lodestar method does not, in itself, contemplate success fees or fee enhancements based on particular benchmarks, professionals, such as financial advisors and investment bankers, have sought the approval of non-lodestar types of compensation under section 328.¹⁶ Compensation formats approved pursuant to section 328 can only be reconsidered “if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.”¹⁷ Under section 328, the compensation method used to calculate professional fees receive up-front approval.¹⁸ Such pre-determination differs from the ordinary retrospective fee review and analysis performed when employment is approved under section 327.

On the theory that a discussion of “best practices” for compensation approved under section 328 would be useful for courts and those professionals seeking such approval, the Task Force suggests a particular framework for professionals seeking approval of their compensation methods under that section.¹⁹

¹⁶ Trustees, debtors-in-possession, and official committees sometimes use section 328 to obtain pre-approval of the terms through which the fees of certain professionals, such as special counsel, financial advisors or investment bankers, will be allowed and paid on an interim basis or at the conclusion of the engagement. “Absent approval of compensation under § 328, the court awards a professional employed under § 327 “reasonable compensation for actual, necessary services rendered by [the professional] . . . , based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title,” as well as “reimbursement for actual, necessary expenses.” *Nischwitz v. Miskovic (In re Airspect Air Inc.)*, 385 F.3d 915, 920 (6th Cir. 2004).

¹⁷ In *Pilgrim’s Pride*, the Fifth Circuit held that bankruptcy courts could award fee enhancements under certain circumstances, notwithstanding the Supreme Court’s ruling in another, non-bankruptcy, case limiting the ability of courts to award fee enhancements. *Id.* at 667. The professional in *Pilgrim’s Pride* sought a fee enhancement at the end of a very successful case. *Id.* at 653. That fee enhancement was later affirmed. In *Matter of Pilgrim’s Pride Corp.*, 690 F.3d 650, 667 (5th Cir. 2012) (affirming the bankruptcy court’s order of a \$1 million fee enhancement).

¹⁸ In most instances in which a professional seeks approval of a section 328 compensation formula, the United States Trustee will seek to preserve a “back-end” review and objection for its office and for the bankruptcy court despite the pre-approval that is binding on all other parties in interest (unless developments incapable of being anticipated ultimately show the improvidence of approving the form of compensation).

¹⁹ The Task Force is aware that some law firms are moving in the direction of alternative fee arrangements, such as flat-rate billing and success fee benchmarks. This Report is not intended to review the variety of creative compensation arrangements for which professionals can seek approval under section 328. Some of these alternative compensation arrangements are even referenced in the United States Trustee Program’s Updated Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases (“Proposed Guidelines”), available at

http://www.justice.gov/ust/eo/rules_regulations/guidelines/docs/proposed/AppendixB_Fee_Guidelines_Exhibits_Comments.pdf. See, e.g., Proposed Guidelines at 20.

**Framework for Pre-Approval of Terms for Retention and Compensation
Under 11 U.S.C. § 328**

- 1. Be clear about the Bankruptcy Code provision under which approval is being sought.**
- 2. A bankruptcy court has wide discretion to decide whether a proposed arrangement is or is not reasonable or appropriate.**

In reaching this decision, the court will carefully examine the circumstances of the particular case. To receive approval under section 328, the moving party must unambiguously specify that it is seeking such pre-approval. Unless the moving party meets all of section 328's conditions, as described in its employment application (and the court approves the professional's method of compensation), the court must review the professional's fee application under section 330 (the lodestar review).

The Fifth Circuit Court of Appeals has provided a clear articulation of the differences between fee review and approval under sections 328 and 330:

Sections 328 and 330 of the Bankruptcy Code govern attorneys' fees in representing bankruptcy estates. Under 11 U.S.C. § 330, attorneys' fees are reviewed for their reasonableness after representation has concluded. In contrast, section 328 of the Bankruptcy Code allows an attorney seeking to represent a bankruptcy estate to obtain prior court approval of her compensation plan. As this Court has noted, "able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done. That uncertainty continues under the present § 330" ²⁰

Therefore, unless a professional wishes to have his or her fees reviewed under section 330's reasonableness standard, the professional should specify—both in the employment application itself and in the draft order approving such employment—that he or she is seeking approval of the compensation structure under section 328.²¹

²⁰ Daniels v. Barron (*In re Barron*), 325 F.3d 690, 692-93 (5th Cir. 2003) (quoting *In re National Gypsum Co.*, 123 F.3d 861, 862 (5th Cir. 1997)).

²¹ In the Ninth Circuit, the applicant "must invoke . . . section [328] explicitly in the retention application" in order to ensure that that section will govern the review of the professional's fees. Circle K. Corp. v. Houlihan, Lokey, Howard & Zukin Inc. (*In re Circle K Corp.*), 279 F. 3d 669, 674 (9th Cir. 2002). The Sixth Circuit Court of Appeals has adopted a more lenient standard for evaluating whether a compensation structure has been pre-approved under section 328. In the case of Nischwitz v. Miskovic (*In re Airspect Air Inc.*), 385 F.3d 915 (6th Cir. 2004), the Sixth Circuit eschewed the standards of both the Third and Ninth Circuits, holding instead that the analysis rests on the totality of the circumstances, "looking at both the application and the bankruptcy court's order." *Id.* at 922. The Sixth Circuit indicated that relevant factors for courts to consider in their analysis include (1) the existence of a request for preapproval; (2) the reasonableness of the requested compensation; and (3) and an express reference to § 328. *Id.*

3. The party seeking approval of a professional's employment has the burden of proof in its employment application.

The party seeking approval of a professional's compensation arrangement under section 328 should be mindful that he has the burden of proof and must "ensure that the court notes explicitly the terms and conditions if the applicant expects them to be established at that early point."²² Therefore, professionals seeking retention and approval of a fee structure under either section 327 or 328 must be prepared to put forth specific evidence establishing the reasonableness of the employment agreement. Both the United States Trustee and the bankruptcy court will scrutinize the employment agreement to ensure that it meets the test for approval under the Bankruptcy Code.

Financial advisors and investment bankers should, in particular, take note of the opinion issued by the Bankruptcy Court for the Southern District of Texas in the Chapter 11 case of *Energy Partners* when preparing for their employment application hearings. In *Energy Partners*, the Court denied applications filed by both the equity holders' and note-holders' committees to engage separate investment banking firms in order to perform a valuation analysis of the debtor. The Court was highly critical of the proposed fee agreements and the lack of evidence offered by the applicants, beginning its analysis by noting that it does not "take § 328(a) applications lightly" and, in performing its duties as a gatekeeper, the Court "must have a sufficiently strong record when deciding whether to approve a professional under § 328(a)."²³ The Court relied on decisions from the District of Delaware and District of Massachusetts in setting forth a non-exhaustive list of five factors to consider when determining whether to approve employment terms under section 328(a). Such factors include:

(1) whether terms of an engagement agreement reflect normal business terms in the marketplace; (2) the relationship between the Debtor and the professionals, i.e., whether the parties involved are sophisticated business entities with equal bargaining power who engaged in an arms-length negotiation; (3) whether the retention, as proposed, is in the best interests of the estate; (4) whether there is creditor opposition to the retention and retainer provisions; and (5) whether, given the size, circumstances and posture of the case, the amount of the retainer is itself reasonable, including whether the retainer provides the appropriate level of "risk minimization," especially in light of the existence of any other "risk-minimizing" devices, such as an administrative order and/or a carve-out.²⁴

In the *High Voltage Energy Corp.* case, cited in *Energy Partners*, the court used blunt and straightforward language in denying the retention application and highlighting the debtor's failure to present sufficient evidence to warrant the engagement:

The Court has been given no information about the specific scope and complexity of the assignment or specialized skills needed for it. The Court has been given no information about the prevailing fees in the industry for comparable engagements, either in bankruptcy

²² *Zolfo, Copper & Co. v. Sunbeam-Oster Co.* (*In re Zolfo Cooper*), 50 F.3d 253, 262 (3d Cir. 1995).

²³ *In re Energy Partners, Ltd.*, 409 B.R. 211, 225 (Bankr. N.D. Tex. 2009).

²⁴ *In re Energy Partners, Ltd.*, 409 at 226 (citing *In re High Voltage Energy Corp.*, 311 B.R. 320, 333 (Bankr. D. Mass. 2004) (quoting *In re Insilco Techs., Inc.*, 291 B.R. 628, 633 (Bankr. D. Del. 2003)).

cases or other insolvency or workout situations. The Court has been given no information about how Evercore was selected. The Court has been given no information about the number and qualifications of the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the compensation being paid to the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the number of hours these employees have devoted to and intend to devote to assisting the Debtors in restructuring their financial affairs. The Court has merely been provided with vague descriptions of the tasks Evercore intends to perform. Accordingly, the Court simply is not in a position to gauge the reasonableness of the terms and conditions of Evercore's employment at this time and whether the monthly and contingent fees proposed reasonably corresponds to the value of the services which Evercore is being asked to perform.²⁵

Debtors, committees, and professionals alike should be aware of the analytical and evidentiary approaches used in section 328 applications in their district and circuit and should be prepared to satisfy the Bankruptcy Court's scrutiny into the propriety and reasonableness of the professional's fee agreement.

4. Lawyers must be mindful of the dictates of state ethics rules.

In addition to knowing and following the directives of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, attorneys retained in bankruptcy cases should not lose sight of the obligations imposed under applicable rules of professional conduct—in particular, the rules addressing the reasonableness of fees and candor to the court.

The standard for fees under state ethics rules is reasonableness.²⁶ If the reasonableness standard is not met, even a compensation arrangement approved under section 328 does not

²⁵ High Voltage Energy Corp., 311 B.R. at 335.

²⁶ See Model Rule of Professional Conduct R. 1.5 (Fees):

- (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:
 - (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
 - (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
 - (3) the fee customarily charged in the locality for similar legal services;
 - (4) the amount involved and the results obtained;
 - (5) the time limitations imposed by the client or by the circumstances;
 - (6) the nature and length of the professional relationship with the client;

preclude a court from reviewing those fees—unless the *amount* of the fees was specifically pre-approved.²⁷ Given that some professionals are beginning to request fee enhancements, the Task Force also recommends that any professional contemplating a fee enhancement based on defined “success” benchmarks should have the method for determining the fee enhancement (and, if possible, the amount of an enhancement itself) approved explicitly at the time that the professional is seeking approval of its employment application under section 328.

5. Employment applications under section 328 must contain truthful assertions supporting the compensation method.

In the same way that a professional should specify in the employment application that he or she is seeking approval of the compensation method under section 328, the professional should also make sure that the representations in support of the section 328 approval are accurate and truthful. An example of a faulty employment application was at issue in *In re Mirant Corp.*²⁸ In *Mirant*, the court specifically mentioned its frustration with the representations made by the financial advisors in their employment application: “The court erred seriously in entering orders which left it so little discretion in assessing the work of the financial advisors. Though the court was given to understand [that the] Debtors and the Committees could not obtain competent financial advisors without assurance that there would be substantial ‘success’ bonuses, whether or not each advisor could show it had earned such a fee, the court has since learned that some financial advisors, at least, will accept

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination. . . .

²⁷ See Committee of Equity Security Holders of Federal-Mogul Corp. v. Official Committee of Unsecured Creditors (*In re Federal-Mogul, Inc.*), 348 F.3d 390, 397-98 (3d Cir. 2003); see also Cadle Co. II, Inc. v. Fashion Shop of Kentucky, Inc. (*In re Fashion Shop of Kentucky*), 350 Fed. Appx. 24, 27-28 (6th Cir. 2009).

²⁸ 354 B.R. 113, 128 (Bankr. N.D. Tex. 2006).

more conventional arrangements in terms of compensation.”²⁹ Although the *Mirant* court determined that its hands were tied in terms of having to award the bonuses under section 328,³⁰ it was none too happy about the bonuses.

Lawyers seeking section 328 approval for their own employment or for the professionals whom they represent have another reason to be both accurate and truthful. The rules demanding candor toward the tribunal subject a lawyer to sanctions for knowingly making an untrue statement.³¹ The time to establish or reinforce a professional’s reputation with the court is when the employment application is submitted. Professionals should be mindful of the disclosure requirements set forth in Rule 2014 when preparing employment applications.³²

²⁹ *Id.* at 128 (footnote omitted).

³⁰ *Id.* at 127-31.

³¹ For veracity in a lawyer’s dealings with a court, see MODEL RULE OF PROFESSIONAL CONDUCT R. 3.3 (“(a) A lawyer shall not knowingly . . . (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false. . . .”). For veracity in representing one’s client, see MODEL RULE OF PROFESSIONAL CONDUCT R. 4.1 (“In the course of representing a client a lawyer shall not knowingly . . . make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.”). And, of course, MODEL RULE OF PROFESSIONAL CONDUCT R. 8.4 creates an independent ethics violation when dishonesty is involved (“It is professional misconduct for a lawyer to . . . (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer’s honesty, trustworthiness or fitness as a lawyer in other respects; [or] (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation. . . .”).

³² *Cf.* ABI Report of ABI Task Force on Proposed Amendment to Rule 2014 (April 2013).

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The Use of Conflicts Counsel in Business Reorganization Cases

Introduction¹

Before a court can approve the employment of counsel for the trustee or the DIP in bankruptcy cases, counsel must satisfy Section 327(a)'s² twin requirements of (1) disinterestedness³ and (2) not holding or representing an interest adverse to the bankruptcy estate.⁴ Section 327(c) states that counsel will not be disqualified solely because of representation of a creditor, but the court will disapprove employment if a creditor or the United States trustee objects and the court determines that there is a disabling conflict of interest.⁵ Counsel for a committee⁶ may not represent any other entity having an adverse interest in connection with the case, but representation of creditors of the committee's constituent class of creditors does not *per se* constitute representation of an adverse interest.⁷

For certain DIPs,⁸ the company may be so large and the issues involved in the bankruptcy case may be so complex that only a handful of law firms will have the staffing and expertise to represent the DIP. But with the case's heft may also come firm clients with interests potentially adverse to the estate. The preferred counsel—because of its enormous client base—may have some types of potentially disqualifying conflicts of interest. Smaller DIPs may also wish to employ counsel whose relationship with another party is potentially disabling—a choice to be honored if a means to address the conflict is available. In an attempt to respect the DIP's desire to employ its counsel of choice, courts can sometimes find a way to approve the proposed counsel without running afoul of either the Bankruptcy Code's restrictions or state ethics rules.⁹

¹ Susan Freeman should get credit for much of this background section—along with most of the drafting of the proposed rule. Al Togut should also get huge kudos for his work, as should Chip Bowles and Rob Charles.

² 11 U.S.C. § 327(a) provides: “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.”

³ See 11 U.S.C. § 101(14).

⁴ See, e.g., *Michel v. Eagle-Picher Industries, Inc.* (*In re Eagle-Picher Industries, Inc.*), 999 F.2d 969 (6th Cir. 1993) (§ 1107(b) exception narrow); *but see In re Talsma*, 436 B.R. 908 (Bankr. N.D. Tex. 2010) (construing §§ 1107(b) and 327(a) contrary to majority rule).

⁵ 11 U.S.C. § 327(c).

⁶ 11 U.S.C. § 1103(a).

⁷ 11 U.S.C. § 1103(b).

⁸ Because this issue of disqualifying conflicts also can appear when a trustee or committee wishes to employ counsel, these same considerations will apply to them.

⁹ Outside of bankruptcy, a waiver might fix the problem, but the Bankruptcy Code’s extra layer of “disinterestedness” makes the waiver inadequate, given the DIP’s role as a fiduciary.

Courts must balance the twin goals of giving the debtor an opportunity to reorganize with counsel of its choice and honoring applicable ethics rules. Sometimes, a proposed main counsel for a trustee, DIP, or committee may want to seek authorization to provide general bankruptcy representation but may have imputation issues that arise due to the firm's representation of a creditor or other party in interest on unrelated matters. To address the imputation problem, bankruptcy courts in numerous cases have approved the appointment of a second law firm ("conflicts counsel") to represent the client in matters that main counsel cannot undertake.

Some courts view certain client representations as too "small" to trigger a problem. In fact, some courts have recognized a 1% rule: if a law firm's client represents less than 1% of that firm's billings, those courts have considered such a representation to be too inconsequential to warrant disqualification.¹⁰ That 1% rule, though, has its limitations. In 1985,¹¹ shortly after the Bankruptcy Code began, the largest law firm's revenues were \$129 million.¹² Today, that same largest firm's annual revenues are \$2.1 billion.¹³ One percent of that amount means annual billings of \$21 million, a significant client by any measure, calling into question the continued use of the 1% rule. The Reporters point this out for consideration without reaching any conclusion about what threshold should apply.

Although it is more appropriate for bankruptcy courts to rely on Code §§ 327(a) and (c) as authority in DIP conflicts counsel cases,¹⁴ sometimes courts will authorize the employment of

¹⁰ See NORTON ANNUAL SURVEY OF BANKRUPTCY LAW, Volume 2004, Issue 2004 at 3; see also *In re Clark Retail Enterprises, Inc.*, 308 B.R. 869 (Bankr. N.D. Ill. 2004) (finding no actual conflict of interest where a firm represented debtor and its post-petition lender where the lender accounted for only 1.03% of the firm's annual revenue); *In re Filene's Basement, Inc.*, 239 B.R. 850, 853 (Bankr. D. Mass. 1999).

¹¹ The first *American Lawyer* survey on bankruptcy firm revenues that could be found was for 1985, six years after the Code became effective but close enough in time to be relevant. See *ALM's Survey of Law Firm Economics Shows Firm Revenues Took Hit in 2011*, ALM (Aug. 6, 2012) <http://www.alm.com/about/pr/releases/alm-s-survey-law-firm-economics-shows-firm-revenues-took-hit-2011>.

¹² Technically, that figure may have been for the previous fiscal year.

¹³ See Andrea Murphy, *Skadden Not The Only Law Firm on the 2012 Private Companies List*, Forbes (Apr. 30, 2012, 10:25 am) <http://www.forbes.com/sites/andreamurphy/2012/04/30/skadden-not-the-only-law-firm-on-the-2012-private-companies-list/>.

¹⁴ 11 U.S.C. § 327(a); see *Tri-State Fin., LLC v. Lovald*, 525 F.3d 649, 655-56 & n.5 (8th Cir. 2008) (recognizing propriety of using conflicts counsel); *In re Blinder, Robinson & Co.*, 131 B.R. 872, 879-81 (D. Colo. 1991) (affirming with reservations bankruptcy court ruling that independent counsel to consider a claim by creditor client rendered SIPA counsel disinterested); see also *In re cToys, Inc.*, 331 B.R. 176, 192 (Bankr. D. Del. 2005) (DIP counsel should have promptly filed disclosure affidavit and let another, disinterested professional handle matter involving creditor client); but see *In re Cook*, 223 B.R. 782, 791-92 (B.A.P. 10th Cir. 1998) (special counsel too limited and too late). Attorneys cannot purport to serve as special counsel to bypass disinterested requirements while actually acting as general bankruptcy counsel. See, e.g., *In re Congoleum Corp.*, 426 F.3d 675 (3d Cir. 2005) (special insurance counsel's role in plan process was too expansive for Code §327(e), and conflicts disqualified lawyer from Code §327(a) appointment); *In re Running Horse, L.L.C.*, 371 B.R. 446 (Bankr. E.D. Cal. 2007) (real estate and transactional services would be central to case and plan); *In re Argus Group 1700, Inc.*, 199 B.R. 525, (Bankr. E.D. Pa. 1996) (bankruptcy case was two-party dispute so litigation counsel was primary legal advisor). Because, under certain circumstances, main counsel would be entirely "conflicted out" without the ability to turn certain issues in a case over to conflicts counsel, one way to view the relationship of main counsel and conflicts counsel is that it is the *combination* of the two firms—

counsel to handle conflicts by using Code §§ 327(e) or 327(b).¹⁵ To a lesser degree, courts have used committee counsel to take responsibility for DIP counsel's conflicted work in limited instances.¹⁶ Committee counsel may also employ conflicts counsel, under appropriate circumstances, under § 1103.

These work-arounds are not without their problems. Congress intended section 327(e) to allow *pre-petition* counsel that has been representing the debtor, particularly in litigation pending at the time of the commencement of the bankruptcy case, to continue its work post-petition on discrete matters (*i.e.*, the same litigation) as special counsel for that purpose;¹⁷ and there are cases interpreting section 327(e) that limit such special counsel from counseling the debtor on plan

main counsel and conflicts counsel—that is necessary to satisfy Section 327(a)'s disinterestedness requirement, with both main and conflicts counsel appointed under Section 327(a).

¹⁵ In virtually all circumstances, Section 327(a) will be the appropriate section; occasionally, counsel appointed under Section 327(e) for other purposes may also be asked to handle conflicts issues upon court approval. Should the court wish to expand Section 327(e) counsel to include certain conflicts counsel work, provided that such work is within the scope of Section 327(e) and not advising on plan issues, the order approving the employment of the Section 327(e) counsel should clarify just what conflicts work the Section 327(e) counsel is appointed to do. The same clarification is necessary should the court use Section 327(b).

¹⁶ 11 U.S.C. § 327(e) (“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(b) (“...if the debtor has regularly employed attorneys, accountants or other professional persons on salary, the trustee may retain...such professional persons if necessary in the operation of such business”); *See In re Git-N-Go, Inc.*, 321 B.R. 54, 61 (Bankr. N.D. Okla. 2004) (representation request denied). Section 327(a) is more applicable than Section 327(e) in cases where aspects of general bankruptcy representation are needed, rather than limited litigation with a few clients. If proposed counsel has a conflict arising from representation of a creditor rather than prior representation of the debtor (as referenced in Code §327(e)), courts are divided on whether the attorney will be disqualified, with most cases authorizing such representation under Code §§327(a) and (c) and citing by analogy Section 327(e). *See, e.g., In re AroChem Corp.*, 176 F.3d 610, 622 (2d Cir. 1999) (creditor’s counsel not disqualified; applying §327(a) by analogy to §327(e) to limited scope of representation and finding lack of actual conflict of interest under § 327(e) where creditor’s and estate’s interests aligned on limited representation); *Stoumbos v. Kilimnik*, 988 F.2d 949, 964 (9th Cir. 1993) (creditor’s counsel not disqualified as special counsel, reasoning by analogy to § 327(e)); *In re Age Ref., Inc.*, 447 B.R. 786 (Bankr. W.D. Tex. 2011) (creditors’ committee counsel may represent chapter 11 trustee as special counsel to pursue avoidance actions); *contra, In re M & M Marketing, L.L.C.*, 426 B.R. 796 (B.A.P. 8th Cir. 2010), *aff’d*, 397 F. App’x 258 (8th Cir. 2010) (§ 327(e) inapplicable; whether to follow *AroChem* not decided since lawyer represented an interest adverse to the estate with respect to the matter for which his employment was proposed); *Meespierson Inc. v. Strategic Telecom Inc.*, 202 B.R. 845 (D. Del. 1996) (attorney representing creditor disqualified; § 327(e) only applies to prior representation of debtor); *In re Abrass*, 250 B.R. 432 (Bankr. M.D. Fla. 2000) (attorney representing creditor disqualified from service as special counsel).

¹⁷ The legislative history of Section 327(e) states that Section 327(e) “... will most likely be used when the Debtor is involved in complex litigation, and changing attorneys in the middle of the case after the bankruptcy case has commenced would be detrimental to the progress of that other litigation.” H.R. REP. NO. 595, 95TH CONG., 1ST SESS. 328 (1977), U.S. CODE CONG. & ADMIN. NEWS 1977, p. 5963; S. REP. NO. 989, 95TH CONG., 2D SESS. 38–39 (1978), U.S. CODE CONG. & ADMIN. NEWS 1978, p. 5787.

issues.¹⁸ Unless the particular conflict is discrete, the better (and majority) view is that both main counsel¹⁹ and conflicts counsel²⁰ should be retained as co-counsel for a DIP or trustee under Section 327(a), which provides that a trustee may employ “one or more attorneys” as *general* bankruptcy counsel.²¹ Courts have also authorized conflicts counsel to work with a committee’s general bankruptcy counsel when the unrelated client representation would otherwise be disqualifying, although often courts do so without pointing to statutory authority that permits such a creative solution.²²

Use of conflicts counsel is especially important in mega-debtor cases of multinational corporations with complex capital structures, extremely diverse operations, and many subsidiaries that require the services of large multi-disciplinary firms. Almost without exception, these law firms for the DIP and committee have conflicts due to their massive size and diversity of clients. Disqualifying one such firm does not solve the problem because another firm of equal size and experience likely will have the same sort of conflict issues.²³ In smaller cases, courts may approve the employment of conflicts counsel when the main bankruptcy counsel’s firm represents a few parties in interest on unrelated matters and those parties’ claims and issues can be discretely addressed by a separate lawyer, assuming of course that those parties’ claims or issues are not key to the bankruptcy case as a whole.²⁴ In large and small cases, counsel must ensure that all applicable ethics rules are satisfied and that it makes full disclosures of connections. Conflicts of interest, however, cannot always be solved through the employment of conflicts counsel.

¹⁸ COLLIER ON BANKRUPTCY is of the view that the “specified special purpose” referred to in §327(e) must be unrelated to the reorganization of the Debtor. For example, counsel previously retained by the Debtor to handle specific legal action for which that attorney is particularly suited. 3 COLLIER ON BANKRUPTCY (16th ed.) 327.04 [9][d] (2012).

¹⁹ The term “main counsel,” then, might be a misnomer, but for purposes of this Report, “main counsel” means the Section 327(a) general counsel handling issues other than those that the conflicts counsel is handling.

²⁰ “Conflicts counsel” may be a misnomer as well, but we are using the term “conflicts counsel” to indicate the law firm hired to eliminate main counsel’s disqualifying conflicts problem or to take on some matters that are more cost-effectively handled by the conflicts counsel’s firm. In any event, conflicts counsel actually serves as co-counsel with the “main” counsel, albeit with a subset of main counsel’s duties.

²¹ *In re Git-N-Go, Inc.*, 321 B.R. 54, 61 (Bankr. N.D. Okla. 2004) (“The Court finds that it is not appropriate or in the best interests of the estate to allocate to what might otherwise be ‘special counsel’ under Section 327(e) the duties described in Section 327(a)—that is, ‘to represent or assist the trustee in carrying out the trustee’s duties under this title.’”).

²² Just as Section 327(a) authorizes the retention of more than one general counsel, Section 1103(a) [Powers and duties of committees] authorizes the committee to employ “one or more attorneys” to perform services for the committee. 11 U.S.C. § 1103 (2006). *E.g.*, *In re Enron Corp.*, 2003 WL 223455, at *7-8 (S.D.N.Y. 2003), *aff’d* 2002 WL 32034346 (Bankr. S.D.N.Y. 2002) (special conflicts counsel important to approval of committee counsel); *In re National Century Financial Enterprises, Inc.*, 298 B.R. 112, 118 (Bankr. S.D. Ohio 2003).

²³ In some large cases, co-counsel is used to perform routine services that do not require the breadth and depth of main counsel efficiently and cost-effectively. This report focuses on ethical issues, but conflicts counsel may be retained to perform other services as well. A clear division of duties should be made at the beginning of every case and coordinated, thereafter, to avoid duplication of effort and provide for economical estate administration.

²⁴ *See In re Project Orange Assocs., Inc.*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010).

Although some otherwise disqualifying conflicts can be resolved with conflicts counsel, not all can. The more pervasive a disqualifying conflict is, the less appropriate appointment of the “conflicted out” law firm is. Those conflicts that (1) are unlikely to occur throughout the case, (2) involve just a few parties in interest, (3) do not involve the main issues in the case, and (4) are capable of being handed over to a non-conflicted law firm are more likely to be suitable for the appointment of “conflicts counsel.”

Conflicts counsel differs from full-fledged co-counsel in one respect: it is designed to have jurisdiction over the “conflicted-out” issues that hinder the main bankruptcy counsel’s appointment, meaning that the main counsel may not handle those issues. Courts are rightly concerned, when considering the appointment of law firms with disqualifying conflicts, about unnecessarily multiplying the magnitude of fees incurred during the case and about leaving the debtor with less than the full range of talent that it might need. Therefore, the best design for conflicts counsel involves separate spheres of issues, with only minimal overlap for coordination and communication purposes. (See Figure 1, which represents the overlap between the purviews of main counsel and conflicts counsel. Some overlap is unavoidable, at least for communication purposes, but the main and conflicts counsel should try to keep the overlap to a minimum.)

As mentioned in footnotes 23 and 26 below,²⁵ an effective means of avoiding duplication of services between the two firms is to task conflicts counsel with additional (non-conflicts) work that it can perform more economically. Rather than be main counsel’s “shadow,” standing behind the main counsel and billing with limited benefit to the estate, conflicts counsel can perform services that do not require the breadth and depth of main counsel but that nonetheless need to be performed as part of a Chapter 11 case.²⁶ Indeed, the United States Trustee Program recognizes the desirability of this approach in its megacase fee guidelines: in paragraph 5 of the “Summary of Significant Changes” Section, the Proposed Guidelines suggest that “[d]ebtors and official

²⁵ See also note 20 *supra*.

²⁶ Conflicts counsel’s services may also involve bankruptcy projects, such as working on claims objections and executory contract rejections, that may be handled more cost-effectively through conflicts counsel. Some courts use conflicts counsel for this purpose; others do not. In addition to solving the problem of the disqualifying conflicts, conflicts counsel’s services on each special project have the added benefit of educating conflicts counsel about the case in ways that should help it to resolve other disputes efficiently. Conflicts counsel must know enough about the case to “hit the ground running.” The advantage of a clear division of responsibility is that, rather than shadow main counsel’s work, conflicts counsel does its *own* work. Because it is involved in the case, conflicts counsel knows what is going on in the case without duplicating the work of main counsel. Done right—aside from necessary coordinating communications—there is minimal duplication of effort. The Task Force recommends that, for clarity’s sake, the orders authorizing the employment of counsel specify a clear division of responsibility between conflicts counsel and main counsel. The Updated Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases; Summary of Revisions; and Analysis of Comments, USDOJ: U.S. TRUSTEE PROGRAM (Nov. 2, 2012), *available at* http://www.justice.gov/ust/eo/rules_regulations/guidelines/docs/proposed/AppendixB_Fee_Guidelines_Exhibits_Comments.pdf [hereinafter *Proposed Guidelines*], recognize the potential cost savings of such a division of labor. See Proposed Guidelines at 23-24.

committees are encouraged to use co-counsel arrangements to achieve better staffing and fee efficiencies.”²⁷

Before a law firm can even seek approval of its employment from a bankruptcy court, though, it must also satisfy its state’s own ethics rules. We will refer generally to the Model Rules of Professional Conduct throughout, rather than referring to specific state provisions.

MODEL RULE OF PROFESSIONAL CONDUCT 1.7 provides that a lawyer has a conflict of interest and shall not represent a client if (a) the representation will be directly adverse to another client or (b) there is a significant risk that the representation will be materially limited by the lawyer’s responsibilities to another client, former client, third person, or the lawyer’s own interests, unless (1) the lawyer reasonably believes that the representation will not adversely affect the relationship, (2) the representation is not prohibited by law, (3) the representation does not involve assertion of a claim by one client against the other represented by the same firm in the same proceeding, and (4) each client consents after consultation. That consultation must include an explanation of the implications of common representation and the advantages and risks involved.²⁸ Either (a) or (b) will disqualify a lawyer.²⁹

The first component of the MODEL RULE 1.7 test for ethical representation of two clients, *i.e.*, direct adversity, is objective. It turns on whether such action will have a substantial effect on the other firm client, *e.g.*, by staying pending litigation or preventing contract termination or a suit that would otherwise be brought, given the amount involved. In most single-asset bankruptcy cases, the mere filing of a petition will be “directly adverse” to the secured lender. In a Chapter 11 of an operating business, simply filing the case is likely not directly adverse to small creditors and other parties in interest. However, litigating a claim objection or avoidance action against the client would be “directly adverse” and would be “asserting or defending a claim” in the words of the RESTATEMENT.

²⁷ The Guidelines go on to explain that the cost-saving “arrangements include using less expensive co-counsel for certain routine, commoditized, or discrete matters to avoid duplication, overlap, and [achieve] efficiencies.” That duplication is more likely when the orders appointing counsel and co-counsel do not specify the appropriate division of labor. *Cf. In re S.T.N. Enterprises, Inc.*, 70 B.R. 823, 840-41 (Bankr. D. Vt. 1987) (judge warned both counsel and co-counsel against duplicating services and court subsequently denied attorney’s request for fees).

²⁸ Model Rules of Prof’l Conduct R. 1.7 (2012); *see also* Restatement (Third) of the Law Governing Lawyers § 128 (2000):

Unless all affected clients consent to the representation under the limitations and conditions provided in § 122, a lawyer in civil litigation may not:

- (1) represent two or more clients in a matter if there is a substantial *risk* that the lawyer’s *representation* of one client would be *materially and adversely affected* by the lawyer’s duties to another client in the matter; *or*
- (2) represent one client to *assert or defend a claim* against or brought by another client currently represented by the lawyer, even if the matters are not related.

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 128 (2000).

²⁹ MODEL RULE OF PROFESSIONAL CONDUCT R. 1.9 concerns conflicts on account of duties to former clients. A relationship with a former client may also constitute a disqualifying adverse interest.

The second component of the MODEL RULE 1.7 test—determining whether there is a significant risk that representation of the DIP, trustee, or committee will be materially limited by responsibilities to another client—is subjective. It focuses on the effect of the conflict on counsel’s decision-making - *e.g.*, will it affect counsel’s evaluation of whether to switch to another contract supplier, or whether to file preference litigation? Part of the determination of the materiality of any limitation will be the pervasiveness of the party in interest’s role in the case and how important a client that party is to the law firm.³⁰

Conflicts counsel can enable general bankruptcy counsel for a DIP, trustee, or committee to avoid the “direct adversity” disqualification of MODEL RULE 1.7, and thereby avoid the obligation to obtain client consent. However, counsel must still consider the subjective test of whether there is a significant risk of a material limitation on counsel’s other responsibilities. The law firm and, eventually (if counsel is seeking approval of employment), the court must analyze the importance of the adverse party client’s position in the case and the extent of that party’s relationship with the proposed general bankruptcy counsel’s firm. If the party’s role in the bankruptcy case is so large and central to the debtor’s very existence,³¹ such a carve-out of general bankruptcy representation may be infeasible and would impermissibly force conflicts counsel to effectively take on the role of main bankruptcy counsel.³² As an ethical matter, the lawyer’s responsibilities to the adverse party client not to take action adverse to it in such circumstances will likely also materially limit her responsibilities to the DIP, trustee, or committee, thereby violating her state’s version of MODEL RULE 1.7(b). If the party is a significant client of the proposed general bankruptcy counsel’s firm, the lawyer may also be inclined to “pull her punches” on any issue that indirectly adversely affects the client party, again precluding the lawyer from meeting the subjective test of MODEL RULE 1.7(b).³³ Conflicts counsel cannot “sanitize” such overwhelming conflicts. At that point, even the employment of conflicts counsel cannot salvage the proposed main counsel’s ability to satisfy the disinterestedness requirements of the Code or the subjective test of Rule 1.7. In such instances, the proposed main counsel cannot qualify to serve at all other than *perhaps* as special counsel under section 327(e). Even as special counsel, the professional could not advise the debtor on plan issues.

³⁰ See, *e.g.*, *In re Project Orange Assoc.*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010); *In re Amdura*, 121 B.R. 862, 866-67, 871 (Bankr. D. Colo. 1990) (largest creditor in the case was a significant client of the firm: “the hand that feeds the firm”).

³¹ *In re Project Orange Assoc.* 431 B.R. 363, 366 (Bankr. S.D.N.Y. 2010).

³² See, *e.g.*, *Project Orange*, 431 B.R. at 375 (representation on other matters of largest creditor, central to reorganization, and whose waiver still forbids bringing or threatening any actions, disqualified DIP counsel); *Amdura*, 121 B.R. at 866-67, 871 and 139 B.R. at 979 (creditor’s role in case too extensive to solve disinterestedness through local counsel handling creditor disputes).

³³ *Project Orange*, 431 B.R. at 375 (court found that conflict waiver agreement with creditor severely limited the law firm’s ability to fully, adequately and vigorously represent the debtor; “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 EZ Links Golf, LLC*, 317 B.R. 858, 864 (Bankr. D. Colo. 2004) (declaration that firm would not sue creditor raises inferences that potential claims against creditor have not been raised); *In re Premier Farms, L.C.*, 305 B.R. 717, 720-21 (Bankr. N.D. Iowa 2003) (bank was one of most significant creditors and lawyer had “predisposition to bias in favor of Bank”); *In re Envirodyne Indus., Inc.*, 150 B.R. 1008, 1016-18 (Bankr. N.D. Ill. 1993) (debtor, as fiduciary, may not waive conflicts on behalf of estate).

The point is to preclude adversity to the DIP, trustee, or committee by having conflicts counsel handle all matters considered directly adverse to that client. The RESTATEMENT OF THE LAW GOVERNING LAWYERS states that conflicts can be eliminated by an agreement limiting the scope of the lawyer's representation.³⁴ Eliminating adversity could also be accomplished through permissible provisions in a conflict waiver letter.³⁵ Thus, the client that would be the adverse party in interest (on unrelated matters) and the DIP, trustee, or committee could agree (ethically) that the firm would not represent the DIP, trustee, or committee on matters directly adverse to that party, and that objecting to the adverse party client's proof of claim, or filing any adversary proceeding against it, would be deemed direct adversity, while plan treatment of the claim would not be directly adverse. They could agree that negotiating the terms for and seeking to assume a creditor client's contract would not be considered direct adversity, while a motion to reject that contract would be deemed directly adverse.³⁶

Any waiver of a conflict of interest by the DIP or trustee is, of course, subject to the bankruptcy court's approval of the employment of both the proposed general counsel and the proposed conflicts counsel under Section 327(a).³⁷ The bankruptcy court will also have to consider a conflict waiver for committee counsel of a client creditor when it considers the approval of employment for the committee's proposed general bankruptcy counsel and conflicts counsel. Conflict waivers must comply with applicable state professional rule requirements.³⁸ The bankruptcy

³⁴ RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 121 cmt. c(iii) (2000). The limitation must not render the remaining representation by the lawyer objectively inadequate. *Id.*; see also MODEL RULE 1.2(c) ("A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.").

³⁵ MODEL RULE R. 1.7(b) (lawyer must reasonably believe he can provide competent and diligent representation to each client, and each client must consent in writing); MODEL RULE R. 1.7, Comment 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."). See RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 122, cmt. e (2000) ("A client's informed consent to a conflict can be qualified or conditional... [T]he *client might condition consent* on particular action being taken by the lawyer or law firm... Such a partial or conditional consent can be valid even if an unconditional consent in the same situation would be invalid. For example, a *client might give informed consent to a lawyer serving only in the role of mediator between clients, but not to the lawyer representing those clients opposing each other in litigation* if mediation is unavailing.") (citations omitted and emphasis added).

³⁶ Any such limitations must be spelled out, and disclosed to the court. See *In re Amdura Corp.*, 139 B.R. 963, 976-77 (Bankr. D. Colo. 1992) (discussing whether DIP counsel's agreement not to sue creditor client precluded DIP representation in cash collateral dispute, and explaining importance of disclosure). In the *Jore* case, DIP counsel agreed with the DIP lender, a client on unrelated matters, not to litigate against the lender, without disclosing the no-litigation carve-out from the waiver to the court. When a dispute over ability to impose a Section 506(c) surcharge arose, the lender considered that to be litigation within the scope of the waiver carve-out. *In re Jore Corp.*, 298 B.R. 703 (Bankr. D. Mont. 2003).

³⁷ See *In re Congoleum Corp.*, 426 F.3d 675, 690-91 (3d Cir. 2005) (court determines that waivers inadequate due to lack of informed consent); *In re JMK Construction Group, Ltd.*, 441 B.R. 222, 237 (Bankr. S.D.N.Y. 2010) (court held conflict waiver did not satisfy the adverse interest requirement of 327(a)); *Premier Farms*, 305 B.R. at 720-21 (court found while firm had a waiver from debtor and firm's client creditor bank, firm not disinterested); *In re Git-N-Go, Inc.*, 321 B.R. 54, 60 (Bankr. N.D. Okla. 2004) (waiver needed for RPC compliance was given without independent advice and did not eliminate adversity).

³⁸ See MODEL RULE 1.0(e) ("informed consent"); MODEL RULE R. 1.2 (agreements on scope of representation); see Task Force's Report on Proposed Amendments to Rule 2014.

court and/or the United States trustee may request a copy of any conflict waivers, subject to redaction for privileged information of the waiving client.

In order to inform the court regarding the necessity of conflicts counsel, main counsel seeking the approval of employment of conflicts counsel should ensure that the Rule 2014 disclosures address the following components:

- the need for the appointment of conflicts counsel in the first place;
- the nature of the conflict that the main counsel is facing;
- how pervasive the conflict is with respect to the entire case;
- the identity of the client with whom the main counsel's conflict exists;
- the magnitude of the conflict and its importance to the case; and
- any discussions regarding any waivers of potential or actual conflicts.

Additional disclosures may be necessary in order to provide the court with sufficient information to judge whether the approval of conflicts counsel is an appropriate way to deal with the conflict that the main counsel is facing.

Note: This Report does not address the issue of when a court should appoint local counsel in general or when it should approve the appointment of both local counsel for the main counsel and conflicts counsel.³⁹

Guidelines for Use of Conflicts Counsel

If general bankruptcy counsel for a DIP, trustee, or committee proposes the use of conflicts counsel, the court should examine the nature of the disqualifying conflicts to determine their magnitude and potential duration. Significant conflicts that are expected to last throughout the case will be more problematic than will be those smaller conflicts of limited duration (or that are only potential conflicts).⁴⁰ Should a court find that a combined appointment of main 327(a) counsel and conflicts counsel would solve the problem of main counsel's disqualifying conflicts, then the court should craft employment orders for both the main and conflicts counsel. Note that, sometimes, local counsel can serve as conflicts counsel. Those employment orders should delineate the purviews of main counsel and conflicts counsel in order to avoid any unnecessary duplication of effort and any unnecessary fees and expenses. If the DIP⁴¹ seeks approval of the employment of conflicts

³⁹ The proposals contained in this Report are designed to deal only with the issues of appointment and scope of duties of conflicts counsel. The issues inherent in the appointment and scope of duties of local counsel implicate similar issues but are different in kind from the issues involving conflicts counsel and are not addressed here.

⁴⁰ See, e.g., Nancy B. Rapoport, *Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy*, 26 CONN. L. REV. 913 (1994), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=936337; see also Nancy B. Rapoport, *The Intractable Problem of Bankruptcy Ethics: Square Peg, Round Hole*, 30 HOFSTRA L. REV. 977 (2002) (solicited essay for ethics symposium), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=936235.

⁴¹ Or the trustee, or the committee.

counsel not at the beginning of the case but later, when the necessity for conflicts counsel is first discovered, then the court should—as part of the order appointing conflicts counsel—simultaneously amend the main counsel's employment order to clarify the delineation of responsibility.⁴²

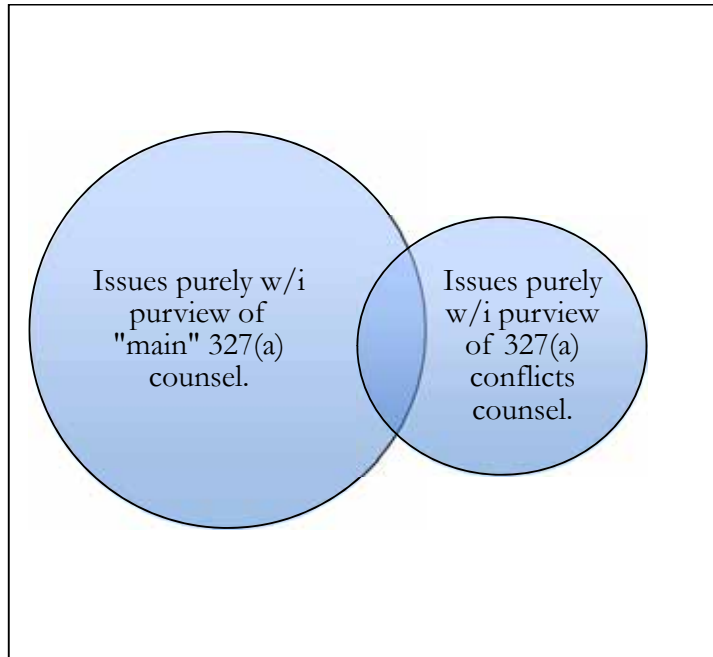
Main general bankruptcy counsel unable to meet the requirements of Section 327(a) or 1103(b) because of representation of another party in interest or third parties on unrelated matters (the “conflicting entity”) may be retained, in the court’s discretion, after appropriate waivers that comply with applicable non-bankruptcy ethics rules—even if the waivers do not permit estate-paid counsel to take positions adverse to the conflicting entity—if the court approves employment of conflicts co-counsel to assert or defend any claim against or brought by the conflicting party, provided that:

- (1) the role of the conflicting party in the case is not so central to the outcome, extensive, and significant that such co-counsel would have to take over the primary duties of main general bankruptcy counsel, or would render division of responsibilities between co-counsel infeasible;
- (2) the scope of duties is defined in the retention orders of main counsel and conflicts counsel, and the work is allocated to minimize costs and reduce duplication; and
- (3) the relationship of the conflicting party with main counsel is not so extensive or significant that there is a significant risk that the representation will be materially limited by the counsel’s responsibilities to that conflicting client.

This standard does not alter conflict of interest waiver requirements for any counsel under non-Bankruptcy Code professional responsibility rules in the applicable jurisdiction. Notwithstanding such waiver, the court must approve counsel’s employment. All relevant details of all conflict of interest waivers, including any limitations on representation, must be fully disclosed to the court.

⁴² Courts should encourage main counsel, at the time that the DIP, trustee, or committee is seeking approval of that employment, to anticipate those potential conflicts that a reasonable main counsel should have anticipated, in order for the court to consider the early appointment of conflicts counsel.

Figure 1: Intersections of the purviews of “main” counsel and conflicts counsel.



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Best Practices for Limited Services Representation in Consumer Bankruptcy Cases¹

Introduction²

The ABI Bankruptcy Ethics Task Force has considered the issue of Limited Scope Representation (“LSR”), also known as “unbundling legal services” and “discrete task representation.” We have also briefly examined the issue of “ghostwriting,” a form of LSR.³ These practices have developed as a means to serve the ever-increasing number of self-represented debtors (also known as *pro se* debtors).

LSR on behalf of a consumer debtor typically consists of the provision by an attorney of a subset of legal services in connection with the filing of a consumer bankruptcy case. LSR is in contrast to the plenary representation of a debtor, where the lawyer is paid a full fee to represent a debtor with respect to all aspects of his bankruptcy case—from pre-filing counseling to post-discharge proceedings. LSR is undertaken to achieve a lower overall cost, and typically in lieu of filing *pro se* or filing with the assistance of a petition preparer. This arrangement allows for legal representation by an attorney for cost containment purposes.⁴

The problem of the high cost of consumer bankruptcy representation is well documented.⁵ The recent Consumer Bankruptcy Fee Study revealed a 24% increase in attorney fees post-BAPCPA for Chapter 13 cases, with mean fees in some jurisdictions approaching \$5,000.⁶ For no-asset cases filed under Chapter 7, mean attorney fees have increased 48%—as high as \$1,500 at the mean in some jurisdictions.⁷

Although in most jurisdictions there is a mechanism for attorney fees in Chapter 13 cases to be paid through the plan (thus limiting the amount of cash a financially distressed debtor must have

¹ This proposed rule is restricted to consumer practice. LSR in the business context has a very different justification and implicates very different issues.

² The Reporters’ Notes liberally draw on the excellent WHITE PAPER ON LIMITED SCOPE REPRESENTATION IN BANKRUPTCY, prepared by LSR Subcommittee member Theresa V. Brown-Edwards (ABI Ethics Task Force Multijurisdictional Practice/Limited Service Representation Subcommittee) 2012.

³ Due to the time and resource constraints, the Task Force decided to defer a thorough discussion ghostwriting. It is expected that a future ABI working group will address this important issue.

⁴ The Task Force discussed at length the issue of consumers’ access to the bankruptcy system, and the tension between the time and skill it takes to responsibly and ethically represent a consumer debtor, and the legal fee the consumer can afford and the market will support. Ultimately the Task Force decided to limit the scope of its report addressing access to the consumer bankruptcy system to a discussion of the issue of Limited Services Representation.

⁵ Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 AM. BANKR. INST. L. REV. 17 (2012) [hereinafter Lupica].

⁶ *Id.* at 30.

⁷ *Id.*

in hand to pay an attorney prior to filing),⁸ high attorney fees remain a concern. In many instances, at least a portion of the fee must be paid to the attorney up front, and providing for the fee balance to be paid through the plan may adversely affect the plan's feasibility. Thus, high fees in Chapter 13 cases *may* be pricing some debtors out of filing for bankruptcy under Chapter 13.⁹ Although it is difficult to measure how many consumers in financial distress do *not* file for bankruptcy protection, the Consumer Bankruptcy Fee Study did reveal that zero cases filed *pro se* under Chapter 13 ended with the debtor receiving a discharge.¹⁰ This is a result of the myriad new obligations imposed on debtors by BAPCPA, and the difficulty many debtors have had (and continue to have) in meeting these obligations.¹¹

The problem of *pro se* representation is even more compelling in Chapter 7, where it is far more common. The Consumer Bankruptcy Fee Study found that 5.8% of all Chapter 7 cases are filed *pro se*.¹² This descriptive statistic is reflective of a national random sample of cases filed post-BAPCPA. We recognize, however, that the incidence of *pro se* filings is considerably higher in many jurisdictions. In the ten courts with the greatest number of *pro se* cases, 9.5% to 27.1% of all cases are filed without attorney representation.¹³

The burden that *pro se* debtors place on the court system has been widely recognized.¹⁴ Judges, trustees, and court staff have detailed the extra time and system resources eaten up by aiding

⁸ *Id.* at 116.

⁹ *Id.* at 104.

¹⁰ *Id.* at 33-34.

¹¹ As observed:

BAPCPA's enactment changed the consumer bankruptcy system in a myriad of small and not-so-small ways. For example, there is now an income and expense standard consumer debtors must meet in order to qualify for Chapter 7. The most critiqued of all new requirements, the means test, mandates that all debtors calculate their income and expenses using a system of complex calculations. It requires the application of various local and IRS expense standards to the debtor's financial information, adjusted by geographic location and household size.

The list of necessary documents and records required by a consumer debtor filing under Chapter 7 or Chapter 13 has also notably increased. In addition to a schedule of assets and liabilities, a schedule of current income and expenditures, and a statement of financial affairs, a debtor must now produce: (i) evidence of payment from employers, if any, received within 60 days of filing; (ii) a statement of monthly net income and any anticipated increase in income or expenses after filing; (iii) a record of any interest the debtor has in a federal or state qualified education or tuition account; and (iv) a copy of his or her tax return for the most recent tax year.

Two educational courses are now also required of debtors—a debtor must complete a credit counseling course prior to filing, and a debtor education course must be completed prior to discharge.

Id. at 33-34 (footnotes omitted).

¹² *Id.* at 31.

¹³ See Administrative Office of the United States Courts, By the Numbers—Pro Se Filers in the Bankruptcy Courts (2011) (*available at* http://www.uscourts.gov/News/TheThirdBranch/11-10-01/By_the_Numbers--Pro_Se_Filers_in_the_Bankruptcy_Courts.aspx).

¹⁴ Lupica, *supra* note 5, at 102.

pro se debtors who are attempting to navigate the complexities of the bankruptcy process.¹⁵ Moreover, these efforts and resource expenditures are often for naught. The chance a *pro se* debtor's case will be dismissed because of a failure to comply with the dictates of the Bankruptcy Code and Rules is considerably higher than if the debtor were represented.¹⁶

In considering the issue of Limited Services Representation, the Task Force recognizes the necessity of reconciling the need to protect debtors from receiving inadequate and ineffective representation, even for a limited fee, and the interest of providing debtors with the option of limited legal representation in lieu of self-help resources or non-legal assistance. With the goal of addressing each of these concerns, the Task Force has examined the elements of debtor representation in consumer bankruptcy cases and has developed a framework for engagement of counsel for limited services. After due discussion and consideration, the Task Force is recommending a framework for LSR representation in Chapter 7 consumer cases *only* because of Chapter 13's complexity and the difficulty of distinguishing between the "basic" and the "full service" elements of representation of a Chapter 13 debtor.¹⁷ In addition, the ability to pay legal fees paid through a plan and the historically low incidence of *pro se* Chapter 13 cases has led the Task Force to conclude that the concerns motivating the LSR Proposal are best met by the development of a proposal for best practices for limited services representation only in Chapter 7 consumer cases.

LSR and Model Rules, Local Rules, Bar Association Opinions and Judicial Pronouncements

Limited Scope Representation has been gaining attention among the federal and state judiciary. Typically, states and bar associations have been more receptive to "unbundled" legal services than federal courts. The Model Rules of Professional Conduct, largely adopted in some form in most states, permit Limited Scope Representation under certain, defined circumstances. Rule 1.2(c) reads, "[a] lawyer may limit the scope of representation if the limitation is reasonable under the circumstances and the client gives informed consent."¹⁸ The Official Comments to Rule 1.2(c) provide:

The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer's services are made available to the client A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client's objectives. Such limitations may exclude actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent.¹⁹

¹⁵ *Id.*

¹⁶ *Id.* at 103.

¹⁷ Note, however, that nothing in this Best Practices Statement obviates the need for attorneys for consumer debtors to comply with, *e.g.*, the Bankruptcy Code provisions involving debt relief agencies. *See* 11 U.S.C. §§ 101(8), 101(12A), 526-258.

¹⁸ MODEL RULES OF PROF'L CONDUCT R. 1.2(c) (2011).

¹⁹ *Id.* at R. 1.2 cmt. 5.

The comments to Rule 1.2 further state that lawyers and clients may enjoy “substantial latitude to limit the representation,” so long as the proposed limitations are “reasonable under the circumstances.” The Official Comment [7] offers the following illustration.

If, for example, a client’s objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer’s services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if the time allotted was not sufficient to yield advice upon which the client could rely.²⁰

Model Rule 1.0(h) defines “reasonable” as being consistent with the “conduct of a reasonably prudent and competent lawyer.”²¹ In determining the reasonableness of a proposed representation, the legal knowledge, skill, thoroughness and preparation required is informed by the nature of the unbundled representation.²²

Currently, dozens of federal judicial districts have adopted a local rule of bankruptcy procedure or written an opinion addressing LSR. The degree of enthusiasm for LSR by courts, who have examined this issue, ranges from high to very low. Some courts have embraced LSR as a tool to address the growing problem of *pro se* debtors.²³ As reported above, legal fees have increased in almost every jurisdiction, pricing some debtors out of legal representation. Moreover, diminished funding for legal services organizations has decreased the availability of low- or no-cost legal representation for low-income debtors. Although the incidence of *pro se* debtors varies from jurisdiction to jurisdiction, at all levels *pro se* cases are reported to add to the already considerably administrative burdens on the courts and the trustees.²⁴

Other courts, however, have viewed the practice of unbundling more skeptically.²⁵ Those

²⁰ *Id.* at R. 1.2 cmt. 7; *see also In re Minardi*, 399 B.R. 841, 851-52 (Bankr. N.D. Okla. 2009) (examining the reasonableness requirement based on the nature of the case and the financial circumstances facing a chapter 7 debtor).

²¹ MODEL RULES OF PROF’L CONDUCT R. 1.0(h) (2011).

²² *Id.* at R. 1.2 cmt. 7.

²³ *See Hale v. United States Trustee*, 509 F.3d 1139, 1148 (9th Cir. 2007) (agreeing with the bankruptcy court’s determination that bankruptcy counsel may not exclude from representation of the debtor “critical and necessary services”); *In re Johnson*, 291 B.R. 462, 469 (Bankr. D. Minn. 2003) (attorneys representing individual debtors in chapter 7 cases may not “unbundle the core package of ordinary legal representation reasonably anticipated in every case”); *In re DeSantis*, 395 B.R. 162, 169 (Bankr. M.D. Fla. 2008) (counsel for an individual chapter 7 debtor in a consumer case may not exclude from the scope of representation certain essential services; debtor’s counsel “must advise and assist their client in complying with their responsibilities assigned by Section 520 of the Bankruptcy Code, including helping their clients decide whether to surrender collateral or instead reaffirm or to redeem secured debts.”); *In re Burton*, 442 B.R. 421, 452-53 (Bankr. W.D. N.C. 2009) (disapproving of an attempt to limit representation to file lien avoidances or defend against stay relief motions on the basis that these constitute “key services” to the bankruptcy case).

²⁴ Lupica, *supra* note 5, at 102.

²⁵ *See In re Egwim*, 291 B.R. 559, 578 (Bankr. N.D. Ga. 2003); *In re Carvajal*, 365 B.R. 631, 631 (Bankr. E.D. Va. 2007); *In re Hodges*, 342 B.R. 616, 619-20 (Bankr. E.D. Wa. 2006). Despite differing views as to the

courts that have viewed limited scope representation less favorably have expressed concern that LSR leaves debtors without guidance in the thick of the bankruptcy case, when they are most vulnerable.²⁶ Moreover, some judges see full service representation as necessary to meet the minimum standards of a lawyer's professional responsibility. Yet others have noted that what falls under the umbrella of "basic services" is fact-intensive and varies from case to case.

Although both sides of the argument have merit, the Task Force is viewing the LSR Proposal as a needed alternative to a debtor's *pro se* representation. The Proposed Rule should be used as a guide for measuring the reasonableness of a particular Chapter 7 bankruptcy representation arrangement.

In recognizing that the concept of reasonableness is both fact-intensive and situation-specific, the Restatement (Third) of Law Governing Lawyers offers the following guidelines: (i) a client must be informed of and consent to any "problems that might arise related to the limitation," (ii) a contract limiting the representation is construed "from the standpoint of a reasonable client," (iii) if any fee is charged, it must be reasonable in light of the scope of the representation, (iv) changes to representation made after an unreasonably long time after beginning representation must "meet the more stringent tests...for post inception contracts or modifications," and (v) the limitation's terms must be reasonable in light of the client's sophistication level and circumstances.²⁷

Informed Client Consent

The reasonableness of a representation cannot be evaluated without the client's informed consent. Informed consent requires that the client knows of and understands the risks and benefits of the limited representation. The Model Rules define informed consent as "the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks and reasonably available alternatives to the proposed course of conduct."²⁸

In the context of consumer bankruptcy, any attempt to limit the scope of representation

degree to which unbundling is permissible, no court appears to have allowed the exclusion of all post-petition services altogether. See *In re Wagers*, 340 B.R. 391, 398 (Bankr. D. Kan. 2006).

²⁶ *In re Bulen*, 375 B.R. 858, 866 (Bankr. D. Minn. 2007) (observing that unbundled legal representation is akin to putting a "Band-aid on a gun shot" and leads to an "unraveled legal process, no increased access to justice."); see also *In re Cuddy*, 322 B.R. 12, 17 018 (Bankr. D. Mass. 2005).

²⁷ Restatement (Third) of Law Governing Lawyers § 19 cmt. c. (2000).

²⁸ MODEL RULES OF PROF'L CONDUCT R. 1.0(e) (2011). The Official Comments to Rule 1.0(e) further explain: "The communication necessary to obtain such consent will vary according to the Rule involved and circumstances giving rise to the need to obtain informed consent. The lawyer must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client's or other person's options and alternatives." *Id.* at cmt. 6.

must be fully disclosed and clearly understood by the debtor before proceeding with the engagement.²⁹ This means that for a debtor to provide valid, fully informed consent to limited services representation, the lawyer must fully explain the services that are omitted from the representation, including the materiality of these services and the potential ramifications of their omission. As a matter of “best practices,” the Task Force recommends that any informed consent be in writing. A “Model Agreement and Consent to Limited Representation in Consumer Bankruptcy” is found below.

In addition to executing the “Agreement and Consent to Limited Representation in Consumer Bankruptcy,” the Task Force further recommends that an affidavit be signed by the attorney and filed with the Bankruptcy Court attesting that the “Agreement and Consent to Limited Representation in Consumer Bankruptcy” was signed by the debtor and the attorney and that the debtor understood its substance.

Despite well-founded concerns for protecting the interests of consumer debtors, the trend in bankruptcy cases (and non-bankruptcy cases) generally favors allowing limited representation in some form. The target of this proposed rule is the debtor who falls in the liminal space between not qualifying for legal aid but with limited funds to pay for full-service representation.

Best Practices for Limited Scope Representation

Given the fact-specific nature of limited scope representation in the context of consumer bankruptcy, it is difficult to design the contours of a limited scope representation that fully addresses the client’s needs for affordable counsel and that also meets the standard of competent representation.³⁰ Best practices, at a minimum, require the following:

²⁹ See *Hale v. U.S. Trustee*, 509 F.3d 1139, 1147 (9th Cir. 2007); *In re Castorena*, 270 B.R. 504, 529 (Bankr. D. Idaho 2001) (“Unless debtors truly understand what they are bargaining away, the bargain is a sham.”)(citing *In re Basham*, 208 B.R. 926, 932-33 (B.A.P. 9th Cir. 1997), *aff’d*, 152 F.3d 924 (1998)).

³⁰ *In re Castorena*, 270 B.R. at 530 (noting the difficulty of predicting which services would be deemed to “part and parcel” of any debtor-engagement, but that “the closer to heart of the matter—the debtors’ desire to obtain bankruptcy relief and the process necessary to do so—the less likely exclusion is appropriate.” The court identified the following services as core: (i) proper filing of required schedules, statements, and disclosures, including any required amendments thereto; (ii) attendance at the section 341 meeting; (iii) turnover of assets and cooperation with the trustee; (iv) compliance with tax turnover and other orders of the bankruptcy court; (v) performance of the duties imposed by section 521(1), (3) and (4); (v) counseling in regard to and the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors, and assisting the debtor in accomplishing these aims; (vi) responding to issues that arise in the basic milieu of the bankruptcy case, such as violations of stay and stay relief requests, objections to exemptions and avoidance of liens impairing exemptions.). See also *In re Kieffer*, 306 B.R. 197, 207 (Bankr. N.D. Ohio 2004) (characterizing the following matters as “routine”: (i) motion for turnover of tax refund, (ii) Rule 2004 examination, (iii) objection to exemption, (iv) objection to motion for relief from stay, and (v) simple notice of sale); *In re Wagers*, 340 B.R. at 398–99 (observing that objections to exemptions, objections to discharge based on the schedules and statements and motion to dismiss for substantial abuse under section 707(b) likely “are so closely related to the advice the attorney gave the pre-petition preparation for filing that the attorney would at least be morally bound, and might be legally bound, to defend the debtor’s position against such attacks.”).

1. The initial client interview and counseling should make clear the expected scope of representation and the expected limited fee.
2. Attorneys counseling unsophisticated consumer debtors must be mindful, when gathering initial information to assess a case, to avoid the formation of the debtor's perception that a full-scale attorney-client relationship is being formed.
3. An engagement letter and informed consent should be prepared in plain language and carefully reviewed with the debtor. This letter must clearly and conspicuously set forth the services being provided, the services *not* being provided, and the potential consequences of the limited services arrangement.
4. The engagement letter must also clearly describe the fee arrangement, including a statement of how fees for additional services will be charged.³¹
5. All documents and disclosures filed with the bankruptcy court should be done with full candor consistent with the attorney's duty of confidentiality, disclosing the exact nature of the representation and the calculation of fees for services being provided.
6. In the event that withdrawal from the unbundled representation becomes warranted, attorneys must be mindful of protecting their client's interests to the fullest extent practical when exiting the case.
7. As is the case with all legal representation, if the attorney becomes aware of a legal remedy, problem, or alternative outside of the scope of his or her representation, the client must be promptly informed. The attorney has the further obligation to provide his or her client with a thorough explanation of the potential benefits and harms implicated, in order for the client to make an informed decision as to how to proceed.

In considering the range of tasks and services an attorney typically provides to consumer debtors, the Task Force recognized a distinction between the representation of Chapter 7 individual debtors with secured consumer debts, and those Chapter 7 debtors with only unsecured consumer debt.

³¹ There are always risks with asking the client to pay, post-petition, for fees incurred pre-petition as part of the engagement. If the Proposed Rule suggested in this Best Practices Statement is not enacted, then perhaps a better approach would be that taken by a case in the Middle District of Florida. In that case, the court approved a payment system in which "the client execute[d] separate fee agreements for prepetition and postpetition services." *See* *Walton v. Clark & Washington*, 469 B.R. 383, 384 (Bankr. M.D. Fla. 2012).

Even in the context of providing limited services representation, a lawyer representing a Chapter 7 debtor must comply with all of the relevant governing Rules of Professional Conduct. These rules include the requirements of (i) competency (Rule 1.1),³² (ii) diligence (Rule 1.3),³³ (iii) communication (Rule 1.4),³⁴ (iv) confidentiality (Rule 1.6)³⁵, and (v) conflicts of interest (Rules 1.7,³⁶ 1.8,³⁷ 1.9,³⁸ 1.10,³⁹ and 1.11⁴⁰).⁴¹

³² “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” Model Rules of Professional Conduct R. 1.1 (2011). The issue of attorney competency in the bankruptcy context will be further addressed elsewhere in the Task Force’s Reports.

³³ “A lawyer shall act with reasonable diligence and promptness in representing a client.” *Id.* at R. 1.3.

³⁴ (a) A lawyer shall:

- (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
- (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
- (3) keep the client reasonably informed about the status of the matter;
- (4) promptly comply with reasonable requests for information; and
- (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Id. at R. 1.4.

³⁵ “(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).” *Id.* at R. 1.6.

³⁶ *Id.* at 1.7 (prohibiting representation of current clients whose interests conflict with other current clients).

³⁷ *Id.* at 1.8 (prohibiting the representation of clients whose interests conflict with the lawyer’s personal or business interests).

³⁸ *Id.* at 1.9 (prohibiting the representation of current clients’ whose interests conflict with former clients).

³⁹ *Id.* at 1.10 (imputing certain conflicts of interest to other members of a lawyer’s law firm).

⁴⁰ *Id.* at 1.11 (addressing conflicts of interest when an attorney leaves government service and enters private sector practice).

⁴¹ For example, it is a breach of the obligations of competence and diligence to have non-lawyer staff to counsel a debtor. *See generally In re Sledge*, 353 B.R. 742, 749 (Bankr. E.D.N.C. 2006); *In re Pinkins*, 213 B.R. 818, 820-21 (Bankr. E.D. Mich. 1997).

**Proposed Rule Providing for Limited Scope Representation in Consumer
Bankruptcy Cases**

- (1) If permitted by the governing Rules of Professional Conduct, a lawyer may limit the scope of the representation of an individual debtor (or debtors in a joint case),⁴² whose debts are primarily consumer debts, if the limitation is reasonable under the circumstances and the client gives informed consent in writing.
- (2) Limited Services Representation for Individual Chapter 7 Debtors with No Secured Debts.
 - A. With respect to a Chapter 7 case filed by an individual debtor, whose debts are primarily consumer debts, where such debtor has no secured debt listed on the bankruptcy schedules or statements, reasonable limited representation includes all of the following:
 1. An initial meeting with the debtor to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
 2. Advice to the debtor concerning the debtor's obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
 3. Preparation and filing of the documents and disclosures required by the Bankruptcy Code, including performance of the duties imposed by Section 521 of the Code.
 4. Provision of assistance with the debtor's compliance with Section 707(b)(4) of the Bankruptcy Code.
 5. Preparation and filing of the petition, the Statement of Financial Affairs, and the necessary schedules.
 6. Attendance at the Section 341(a) meeting.
 7. Communication with the debtor after the Section 341(a) meeting.
 8. Monitoring the docket for issues related to discharge.
 - B. In addition to the limited service representation in a Chapter 7 case, as it is defined above, the representation may also include the following services, to be indicated with a check on the Model Agreement:
 - Representation of the debtor in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
 - Representation of the debtor in connection with a challenge to the debtor's discharge and/or the dischargeability of certain debts.

⁴² As used herein, the term "debtor" shall include an individual debtor, as well as debtors in a joint case. Counsel should be particularly careful in joint debtor cases to ensure that both debtors are fully cognizant of the limitations of LSR. Counsel should also be mindful of the danger of joint debtors implicating conflict of interest concerns.

- Preparation and filing of all motions required to protect the debtor's interests.
- Representation of the debtor with respect to defending objections to exemptions.
- Preparation and filing of responses to all motions filed against the debtor.
- Representation of the debtor in connection with a motion for relief from stay.
- Representation of the debtor in connection with a motion for relief from stay that is resolved by agreement.
- Representation of the debtor in connection with a motion seeking dismissal of the case.
- Other _____

(3) Limited Services Representation for Chapter 7 Debtors with Listed Secured Debts.

A. With respect to a Chapter 7 case filed by an individual debtor, whose debts are primarily consumer debts, where such debtor has listed secured debt on the bankruptcy schedules or statements, reasonable limited representation includes all of the following:

1. An initial meeting with the debtor to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to the debtor concerning debtor's obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.
4. Provision of assistance with the debtor's compliance with Section 707(b)(4) of the Bankruptcy Code.
5. Preparation and filing of the petition, the Statement of Financial Affairs, and the necessary schedules.
6. Representation of the debtor (including counseling) with respect to the reaffirmation, redemption, surrender, or retention of consumer goods securing obligations to creditors.
7. Attendance at the Section 341(a) meeting.
8. Communication with the debtor after the Section 341(a) meeting.
9. Monitoring the docket for issues related to discharge.

B. In addition to the limited service representation in a Chapter 7 case, as it is defined above, the representation may also include the following services, to be indicated with a check on the Model Agreement:

- Representation of the debtor in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
- Representation of the debtor in connection with a challenge to debtor's discharge and/or the dischargeability of certain debts.

- Preparation and filing of all motions required to protect the debtor's interests.
- Representation of the debtor with respect to defending objections to exemptions.
- Preparation and filing of responses to all motions filed against the debtor.
- Representation of the debtor in connection with a motion for relief from stay.
- Representation of the debtor in connection with a motion for relief from stay that is resolved by agreement.
- Representation of the debtor in connection with a motion seeking dismissal of the case.
- Other _____

**Model Agreement and Consent to Limited Representation in Consumer
Bankruptcy Cases**

In order to provide you with reasonable and affordable representation in connection with your consumer bankruptcy case, I, _____, attorney-at-law, licensed in the State of _____, Bar No. _____, agree to provide you, for a limited fee (as described in **Section III** below, hereinafter referred to as the “Fee”), with some, but not all, of the services and advice you may need in connection with your bankruptcy case.

You agree that I am being hired to provide you limited bankruptcy-related representation and recognize that at any time between now and when your case is concluded (either because you receive a discharge, your case is converted to a case under another chapter, or because your case is dismissed), circumstances may arise that require additional legal advice and/or legal services. In such event, you have the option of engaging my services for an additional fee, hiring another attorney, or representing yourself.

You understand that you are seeking legal representation under Section ____ (I OR II) below.

Within the scope of my representation, I agree to act in your best interest at all times, and agree to provide you with competent legal services.

I. For Chapter 7 Debtors Who Have No Secured Debts.

If you have no secured debts and are filing for bankruptcy under Chapter 7, the Fee includes all of the following services:

1. An initial meeting with you to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to you concerning your obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.
4. Provision of assistance with respect to your compliance with Section 707(b)(4) of the Bankruptcy Code.
5. Preparation and filing of the petition, Statement of Financial Affairs, and the necessary schedules.
6. Attendance at the Section 341(a) meeting.
7. Communication with you after the Section 341(a) meeting.
8. Monitoring the docket for issues related to discharge.

If you have no secured debts and are filing for bankruptcy under Chapter 7, the Fee *does not* include any of the following services unless the box next to the service is checked. If a box next to a service is checked, that service will be included in the Fee.

- ☐ Representation of your interests in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
- ☐ Representation of your interests in connection with a challenge to your discharge and/or the dischargeability of certain debts.
- ☐ Preparation and filing of all motions required to protect your interests.
- ☐ Representation of your interests with respect to defending objections to exemptions.
- ☐ Preparation and filing of responses to all motions filed against you.
- ☐ Representation of your interests in connection with a motion for relief from stay.
- ☐ Representation of your interests in connection with a motion for relief from stay that is resolved by agreement.
- ☐ Representation of you in connection with a motion seeking dismissal of the case.
- ☐ Other _____

II. For Chapter 7 Debtors Who Have Secured Debts.

If you have secured debts and are filing for bankruptcy under Chapter 7, the Fee includes all of the following services:

1. An initial meeting with you to explain the bankruptcy process and discuss pre-bankruptcy planning (including exemptions) as well as non-bankruptcy alternatives.
2. Advice to you concerning your obligations and duties under the Bankruptcy Code and Rules and applicable court orders.
3. Preparation and filing of the documents and disclosures required by and performance of the duties imposed by Section 521 of the Bankruptcy Code.
4. Provision of assistance with respect to your compliance with Section 707(b)(4) of the Bankruptcy Code.
5. Preparation and filing of the petition, Statement of Financial Affairs, and the necessary schedules.
6. Representation of your interests (including counseling) with respect to the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors.
7. Attendance at the Section 341(a) meeting.
8. Communication with you after the Section 341(a) meeting.
9. Monitoring the docket for issues related to discharge.

If you have secured debts and are filing for bankruptcy under Chapter 7, the Fee *does not* include any of the following services unless the box next to the service is checked. If a box next to a service is checked, that service will be included in the Fee.

- ☐ Representation of your interests in connection with a motion by the Chapter 7 Trustee to reopen the case for the inclusion of newly discovered assets.
- ☐ Representation of your interests in connection with a challenge to your discharge and/or the dischargeability of certain debts.
- ☐ Preparation and filing of all motions required to protect your interests.
- ☐ Representation of your interests with respect to defending objections to exemptions.
- ☐ Preparation and filing of responses to all motions filed against you.
- ☐ Representation of your interests in connection with a motion for relief from stay.
- ☐ Representation of your interests in connection with a motion for relief from stay that is resolved by agreement.
- ☐ Representation of your interests in connection with a motion seeking dismissal of the case.
- ☐ Other _____

III. The Fee

Because you have agreed to a limited services representation arrangement, I have agreed to a limited fee (the “Fee”). You shall pay for the services described and indicated in **Section ____ (I or II)** above as follows:

☐ **A flat fee of \$ _____**, plus \$____ for out of pocket expenses,⁴³ **OR**

☐ **An hourly fee.** The current hourly fee that I charge is \$____. The current hourly fee that my legal assistant charges is \$____. I expect your case will take about ____ hours. The total Fee you will be charged will be capped at \$ _____, plus \$____ for expenses.

In the event that you ask me to provide additional services (in addition to those services set forth in Section ____ (I or II) above) after I have begun representing you, there shall be an additional fee paid to me to be calculated as follows: _____

You acknowledge that the fee for additional services (on top of those services set forth in _____)

⁴³ These expenses may include long-distance telephone and fax costs, photocopy expenses, and postage. Costs such as filing fees, if any, and debtor counseling and debtor education fees shall be paid directly by you.

Section ____ (I or II) above) requested after your bankruptcy petition is filed must be paid from funds that are not part of your bankruptcy estate (such as your post-petition earnings).

You understand that I will exercise my best judgment while performing the limited legal services described in **Section ____ (I or II)** above, and you also understand:

- a. that I am not promising any particular outcome;
- b. that you entered into this agreement for limited services because I am charging you a Fee that is less than a fee would be for full-service legal representation in connection with your bankruptcy case;
- c. that issues may arise in your case that are not covered by the list of core tasks. If that happens, you have the option of (i) representing yourself with respect to the new issues, (ii) entering into another agreement with me, whereby I will continue to represent you for an additional fee, or (iii) hiring another lawyer to represent you; and
- d. that I have no further obligation to you after completing the above-described limited legal services unless and until we enter into another written representation agreement.

Except as required by law, I have not made any independent investigation of the facts and I am relying entirely on your limited disclosure of the facts necessary to provide you with the services described in **Section ____ (I or II)** above. .

If any dispute arises under this agreement concerning the payment of the Fee, we shall submit the dispute for fee arbitration in accordance with [_____]. This arbitration shall be binding upon both parties to this agreement.

YOU ACKNOWLEDGE THAT YOU HAVE READ THE ABOVE AGREEMENT BEFORE SIGNING IT. YOU FURTHER ACKNOWLEDGE THAT I HAVE ANSWERED ANY QUESTIONS YOU HAVE ABOUT THE LIMITED SERVICE REPRESENTATION ARRANGEMENT INTO WHICH WE ARE ABOUT TO ENTER.

Signature of client/s 1. _____
2. _____

Signature of attorney _____

Date: _____

Competency for Debtors' Counsel

Introduction¹

Rule 1.1 of the MODEL RULES OF PROFESSIONAL CONDUCT, adopted by most states and the District of Columbia, sets forth the standard for lawyer competency: “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”² Comment 5 to MODEL RULE 1.1 states that “[c]ompetent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners.” In addition to the standard set forth in Rule 1.1, most federal courts, including some bankruptcy courts, have adopted a court-specific competency standard.³ These standards typically include the requirement that lawyers are familiar with the applicable rules of procedure, evidence, and in some cases, substantive law.

The generalized pronouncement that a lawyer must be “competent,” however, does not provide specific needed guidance to lawyers, clients, or judges about what precise skill sets a lawyer must have in order for him or her to provide competent client representation. As such, this Report describes, with some specificity, the substantive information that a bankruptcy lawyer must understand, as well as some of the specific skills that the lawyer must possess, to provide competent representation to a debtor in bankruptcy.

The Bankruptcy Context

Bankruptcy is a complex area of law, practiced in myriad contexts, with very different types of debtors accessing the bankruptcy system. For example, the bankruptcy reorganizations of public companies such as General Motors and American Airlines implicate very different issues and require different sets of skills for debtors’ lawyers than the liquidation of small privately-held business enterprises. Further, the representation of a consumer debtor in a Chapter 13 case requires a body of knowledge and strategy significantly different from that required to represent, for instance, a liquidating nursing home.

Because the context and type of client can be so varied across the spectrum of potential debtors, bankruptcy lawyers typically specialize. They usually restrict their practice to consumer bankruptcy *or* business bankruptcy cases.⁴ Lawyers within the two broadest bankruptcy categories

¹ The Reporters would like to thank Task Force members Richard P. Carmody, James H. Cossitt, Steven A. Schwaber, and Andy Vara for their excellent background research that formed the basis of this Report.

² Model Rule of Professional Conduct R. 1.1.

³S.D. Cal. Civ. Local R. (2011), *available at* <http://www.casd.uscourts.gov/uploads/Rules/Local%20Rules/LocalRules.pdf>; ARIZ. BANKR. L. R., *available at* <http://www.azb.uscourts.gov/default.aspx?PID=16> (last visited Aug. 3, 2012).

⁴ Although it is not unusual for lawyers to represent both consumers and small businesses, including sole proprietors (and in fact, there are lawyers with dual certifications as specialists in business and consumer

may further specialize: some attorneys may primarily represent Chapter 13 debtors, while others may primarily represent debtors who file under Chapter 7; yet others may focus on the representation of sole proprietors and small family businesses or individual Chapter 11 reorganizations. Business bankruptcy lawyers may develop a specialization by the type of debtor, using such categories as market capitalization or industry sector. A lawyer must recognize the extent to which each of these individual types of bankruptcy practices requires different bodies of knowledge and skill sets. As noted below, to the extent that the lawyer's client or the type of case implicates issues about which the lawyer has little or no knowledge or with which he has little or no experience, the lawyer should either seek to educate himself (time and resources permitting) or seek counsel or assistance from a professional with experience and expertise in the particular issue or matter.⁵

Although the objective of this Report is to list the core competencies and skills required to represent both consumer and business *debtors* competently, the Task Force is mindful that many, if not all, of these same competencies and skills are required to represent the other parties in interest in bankruptcy cases. Some of these parties include trustees, examiners, ombudsmen, secured and unsecured creditors, various official and *ad hoc* committees, indenture trustees, lenders, asset purchasers and brokers, liquidators, landlords, trade suppliers, franchisers and franchisees, licensors and licensees, and equity owners. The representation of these parties will require lawyers to have similarly specialized skills and knowledge, tailored to their clients' role in the bankruptcy process, in order to provide competent representation to their clients.⁶

The Task Force's primary goal is to ensure that debtors receive the competent representation to which they are entitled. Although this Report detailing "best practices" for bankruptcy lawyers is not seeking to restrict entry into bankruptcy practice, the Report recognizes that bankruptcy practice is complex and specialized and demands a substantial investment of time in the form of education and practical experience over a career. There is no lack of reasonably-priced educational resources available to aspiring bankruptcy lawyers. Lawyers for all parties in a bankruptcy proceeding or case also should realize that there are significant risks in providing less

bankruptcy law), it is less typical for lawyers to represent consumers and large business debtors in complex reorganizations or liquidations. See Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 AM. BANKR. INST. L. REV. 17, 93 (2012). Even if a lawyer typically represents a particular type of debtor or files most of his or her cases under one chapter or category (e.g., chapter 13 and consumer chapter 7 cases), the competency standard requires that the lawyer be able to recognize a range of bankruptcy-related issues that may arise in individual cases, as well as the circumstances when a client may benefit from relief under another chapter.

⁵ See MODEL RULE 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.

⁶ The focus of the discussion in this proposal is on counsel for the debtors in consumer and business bankruptcy cases. Similar capacities, skill sets, and competencies are necessary for counsel for other participants in the bankruptcy process (e.g., counsel for creditors, counsel for a standing, panel, or case trustee, and committee counsel), albeit in a somewhat different context. A thorough discussion of specific best practices for counsel for parties other than the debtor in bankruptcy is outside of the scope of this Report. We recognize that competency is not solely an issue with respect to debtors' counsel, but with the debtor's fresh start on the line, competent representation through the bankruptcy process is an 'all or nothing' event for debtors. For this and a variety of other reasons, including time and resource issues, the Task Force chose to focus on the issue of competency of counsel in this one role. Other ABI working groups may choose to pursue competency issues of counsel serving in other roles.

than competent representation, such as being subject to fee reductions, sanctions, civil liability and, in rare instances, criminal liability.

Consumer Practice

Consumer debtors, according to the Bankruptcy Code's definition, are individuals who have incurred debts primarily for personal, family, or household purposes.⁷ The vast majority of consumer bankruptcy filers are represented by counsel.⁸ Because there are numerous complex legal and strategic decisions to be made in even in the simplest no- or low-asset consumer case, competent counsel serves as a valuable guide through the bankruptcy labyrinth. If a consumer client in financial distress presents a more complicated scenario, such as wanting to retain a home or car by paying the debt over time, then the need for legal advice from a knowledgeable attorney becomes even more compelling.⁹ The absence of professional counsel can adversely affect both seemingly simple and complex consumer bankruptcy case outcomes, as well as the long-term value of the remedy of bankruptcy.¹⁰

A lawyer seeking to represent a consumer debtor must possess certain core competencies and skills.¹¹ These include an awareness of alternatives to the bankruptcy system, an understanding of bankruptcy as a substantive and procedural remedy, knowledge of the bankruptcy process, the skill to provide counseling to a client in financial and emotional distress, proficiency in the courtroom, the ability to negotiate with multiple parties with adverse interests, the judgment to aid a client to make decisions in his or her best interest, and the diligence to see what can be an arduous process through to its resolution. By agreeing to represent a consumer bankruptcy debtor, a lawyer is certifying that he or she possesses the requisite legal knowledge and skills. Further, the lawyer accepts the trust and reliance of his or her client to provide competent representation in response to the client's oft-changing needs.

⁷ 11 U.S.C. § 101(8). Many individual debtors, however, file for bankruptcy seeking to discharge business debts. The debtor typically incurs these business debts in the course of operating a small business.

⁸ In most jurisdictions, a small percentage of consumers file for bankruptcy *pro se*. Lupica, *supra* note 4, at 139. In some jurisdictions, however, the percentage of *pro se* cases is considerably higher than the national mean. See e.g., *In re Castorena*, 270 B.R. 504, 524-26 (Bankr. D. Idaho, 2001) ("...fully 90% of the debtors filing in this District [retains] ... a licensed lawyer to assist them in successfully navigating the statutory channels of bankruptcy law.")

⁹ A recent empirical study of thousands of randomly selected consumer bankruptcy cases found that no *pro se* Chapter 13 debtors received a discharge. Lupica, *supra* note 4, at 81.

¹⁰ "The counseling of a client in financial matters, particularly about his or her choice of remedies under the Bankruptcy Code or whether a bankruptcy proceeding can be avoided, is a serious matter that deserves the attention of a qualified attorney." *Columbus B. Ass'n v. Flanagan*, 77 Ohio St. 3d 381, 383, 674 N.E.2d 681, 683 (Ohio 1997).

¹¹ This section addresses primarily representation of consumers under chapter 13 and chapter 7. Individual Chapter 11 cases are a hybrid between Chapter 11 business reorganization and Chapter 13 cases. If individuals want or need to reorganize their finances, and they exceed Chapter 13 debt limits, Chapter 11 offers an option. The process of representing an individual under Chapter 11 is considerably different than representing a debtor under Chapter 7 or 13, but there are similarities in the general skills required of an attorney.

The core capacities and skills possessed by a competent lawyer representing consumer bankruptcy debtors include, but are not limited to, the following:

1. **A lawyer should understand and be able to communicate to his or her client the advantages and disadvantages of bankruptcy as a debt relief remedy.**

Comment: At the first client meeting, prior to any bankruptcy filing, the lawyer should be able to evaluate whether bankruptcy is the appropriate remedy for the particular consumer's problems.¹² As a "debt relief agency" under the Bankruptcy Code,¹³ the lawyer must be able to assess the particular facts and circumstances presented by the client in order to weigh them against the advantages and disadvantages of filing a bankruptcy case. If the lawyer and client conclude that bankruptcy is an appropriate remedy, the lawyer's next concern is the appropriate chapter under which to file and the proper timing for filing. The timing consideration requires the lawyer to understand the consequences of a decision to file now in order to address exigent issues (such as a pending foreclosure sale or an eviction proceeding), or to wait in order to engage in acceptable pre-bankruptcy planning.

Pre-bankruptcy planning requires the identification of applicable and available exemptions, a discussion of tax liabilities, and the identification of any pre-petition financial transactions, to name a few. A review of the consumer's eligibility for relief under each chapter includes a consideration of any prior cases filed, the constraint imposed by statutory debt limits, and the balance between the debtor's consumer and non-consumer debts, as well as an appraisal of the benefits, burdens, and intended and unintended consequences offered by each chapter.

2. **A lawyer should be familiar with the information necessary to prepare a bankruptcy case. In addition, the lawyer must have developed efficient and effective systems and procedures to obtain from the client the information and documentation required by the Bankruptcy Code.**

Comment: Before a bankruptcy case is filed, a lawyer representing a consumer debtor must recognize the need to assemble and evaluate accurate and complete information and documentation from his or her client. This information and documentation should include copies of (a) pay advices; (b) tax returns; (c) bank statements; (d) inventories of all property owned by the debtor; (e) itemizations of all debts owed by the client, with appropriate back-up documentation; (f) itemizations of real estate owned and mortgages obligated on with appropriate back-up documentation; (g) financial statements and other financial information necessary to complete

¹² See *In re Pereira Santiago*, 457 B.R. 172, 176 (Bankr. D.P.R. 2011) (citing 9 WILLIAM L. NORTON JR., BANKR. L. & PRAC. 3D § 172.25) ("Attorneys must explain the benefits, burdens, and consequences of bankruptcy to their clients to the extent reasonably necessary to permit informed decisions about the case."); *In re DeSantis*, 395 B.R. 162, 169 (Bankr. M.D. Fla. 2008) ("Attorneys must explain the rules and assist debtors in making good decisions.").

¹³ See 11 U.S.C. § 101 (12A) ("The term 'debt relief agency' means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include [certain exceptions]"). Under 11 U.S.C. § 101(3), "[t]he term 'assisted person' means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than \$150,000.").

required schedules; (h) itemizations of all expenses in appropriate detail; and (i) a credit report. This list is not exhaustive, and the lawyer should be mindful of any additional information necessitated by the facts of a particular case.

In addition, the lawyer must be aware of the dictates and prohibitions set forth in the governing state rules of professional conduct on criminal or fraudulent behavior, including engaging in criminal, fraudulent, or prohibited transactions.¹⁴ The lawyer must further be familiar with the evolving case law relating to pre-bankruptcy and exemption planning, including the line between permissible and impermissible conduct. It is the responsibility of the lawyer to apply the relevant rules to his or her client's goals and advise the client as to whether the proposed conduct is clearly proper, clearly improper, or falls within the gray area between the two ends of the spectrum. If the proposed conduct falls in the gray area, the lawyer must provide appropriate guidance and an informed opinion sufficient to allow the client to make an informed decision. The lawyer must make reasonable inquiry to ensure information supplied by the consumer debtor is accurate and complete. The scope of the reasonable inquiry to be performed by debtor's counsel may vary depending upon the type of client, the size of the case and the scope of the issues presented.¹⁵

3. A lawyer should be aware of the Bankruptcy Code provisions mandating certain disclosures by the lawyer. A lawyer should also know what types of information he or she is required to communicate to consumer debtor clients.

Comment: The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) requires attorneys to make certain disclosures and provide specific information to their consumer debtor clients. A lawyer should know that each of the following should be provided to his or her client: (i) a form notice under 11 U.S.C. § 342(b) and § 527(a)(2) describing bankruptcy's requirements and consequences, (ii) general information about legal services and rights of an assisted person, (iii) a form notice setting forth general information on how to arrive at certain values and information mandated by the official schedules, statements and forms, and (iv) a fully executed written contract (a retention letter) that identifies the services to be provided and the fees or charges for such services.¹⁶

¹⁴ MODEL RULES OF PROFESSIONAL CONDUCT R. 1.2(d) prohibits a lawyer from "counseling a client to engage, or assist a client in conduct that the lawyer knows is criminal or fraudulent" Official Comments 9, 10, and 12 offer lawyers further guidance.

¹⁵ See, e.g., Task Force on Att'y Discipline Best Practices Working Grp., Ad Hoc et. al., *Working Paper: Best Practices for Debtors' Attorneys*, 64 BUS. LAW. 79, 82 (2008).

¹⁶ *Id.*; see also Ad Hoc Comm. on Bankr. Ct. Structure and Insolvency Processes, & Task Force on Att'y Discipline, ABA Section of Bus. Law, *Attorney Liability Under Section 707(b)(4) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 61 BUS. LAW. 697, 717 (2006). If the scope of the representation is limited, the specific services to be provided should be explicitly described. See ABI Task Force on National Ethics Standards Report on Best Practices for Limited Services Representation in Consumer Bankruptcy Cases (April 2013); H. SLAYTON DABNEY, JR., STEFANIE BIRBROWER GREER, RICHELLE KALNIT & DANIEL G. EGAN, *RETENTION AND PAYMENT: ESSENTIALS OF BEING RETAINED AND PAID AS DEBTOR'S COUNSEL IN CHAPTER 11* (2008).

In addition, the lawyer should facilitate the client's enrollment in the credit counseling course required of all consumer debtors as a predicate to filing a petition.¹⁷

4. A lawyer should know how to efficiently and effectively prepare and file a bankruptcy petition and the related schedules, statements and other necessary documents.

Comment: Once a lawyer has conducted his or her initial client counseling, gathered the necessary information and documentation, made the required disclosures, and provided advice with respect to the appropriate case, the lawyer must then prepare the necessary petition, schedules, statements, and forms. Preparation of these documents requires the lawyer to know how to analyze the available and applicable exemptions, determine the appropriate treatment of collateralized debts, (e.g., surrender, redemption, reaffirmation, or retention), evaluate priority debts and administrative claims, and assess the debtor's ability to repay creditors from income or assets. If the debtor is filing a case under Chapter 13, the lawyer must also prepare the Chapter 13 plan.¹⁸

As noted above, the lawyer must make reasonable inquiry to ensure information supplied by the consumer debtor is accurate and complete and must conduct an inquiry sufficient to satisfy his or her obligation to sign the petition pursuant to Section 707(b)(4)(D) of the Bankruptcy Code.¹⁹ As recently observed, “[w]here a lawyer systematically fails to take any responsibility for seeking adequate information from her client, makes representations without any factual basis because they are included in a “form pleading” she has been trained to fill out, and ignores obvious indications

¹⁷ The debtor in a Chapter 7 “asset” case was deemed to have satisfied the Bankruptcy Code’s credit counseling requirement without filing his credit counseling certificate; debtor had stated under oath that he had completed the credit counseling required by the BAPCPA and would file his credit counseling certificate, debtor later failed to file the certificate. When debtor later failed to file the certificate and to appear at the first meeting of creditors, the debtor was found to be judicially estopped from denying that he completed the requisite credit counseling. Robin Miller, *Validity, Construction, and Application of Credit Counseling Requirement Under Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)*, 11 U.S.C.A. § 109(h), 11 A.L.R. FED. 2D 43 (originally published in 2006); see also Lindsay Sherp, *To Strike or To Dismiss, That Is the Question: How Courts Should Dispose of Bankruptcy Cases Filed by Debtors Who Failed to Obtain Credit Counseling*, 60 BAYLOR L. REV. 317, 320 (2008) (“By requiring individual debtors to undergo credit counseling before filing for bankruptcy, Congress ‘intended to give consumers in financial distress an opportunity to learn about the consequences of bankruptcy—such as the potentially devastating effect it can have on their credit rating—before they decide to file for bankruptcy relief.’ In other words, Congress has determined that bankruptcy should be a last resort instead of ‘the first place where an individual consumer debtor turns for help.’”).

¹⁸ If the debtor is not eligible for chapter 7 and has debts that exceed the chapter 13 debt limits, an individual chapter 11 case may be appropriate. In such instance, the lawyer for the debtor must be aware of the host of specific issues that arise in such cases. See, e.g., Eduardo V. Rodriguez, *Bankruptcy and Individual Chapter 11s: The Newest Battleground for the Absolute Priority Rule*, 60-FEB Fed. Law. 49 (Jan./Feb. 2013); Hon. Alan R. Jaroslovsky, United States Bankruptcy Court for the Northern District of California, Notice to Bar Regarding *Individual Chapter 11 Cases*, www.canb.uscourts.gov/.../notice%20re%20chapter%2011.pdf (“A Chapter 11 is not just a big Chapter 13.”)

¹⁹ In addition, an attorney is subject to Federal Rule of Bankruptcy Procedure 9011, which requires that an attorney represent to a court that the document being filed is not being presented for an improper purpose, that the claims and defenses are warranted by existing law, and that the factual contentions and denials contained in the filings have evidentiary support.

that her information may be incorrect, she cannot be said to have made reasonable inquiry.”²⁰ A lawyer must also be familiar with the privacy protections afforded debtors pursuant to Federal Rule of Bankruptcy Procedure 9037. These protections include filings with redacted information and filings made under seal. A lawyer should understand the circumstances under which it is advisable for a client to take advantage of the privacy protections afforded by this Rule (including, for example, where a debtor has been subject to domestic violence, or where a minor is listed).

In addition, a lawyer must be familiar with the Electronic Case Filing (“ECF”) system, and have hardware, software, and operating systems that allow for efficient access to the ECF system.²¹ In addition, consistent with the ABA amendment to Comment 6 to MODEL RULE OF PROFESSIONAL CONDUCT R. 1.1, a lawyer must “keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology... .”²² The recent ABA Commission on Ethics 20/20 further recognized and detailed the responsibility of lawyers with respect to technological advances and issues relating to communication and confidentiality.²³ The responsibility to acquire and maintain appropriate technological competency is relevant to lawyers practicing bankruptcy law.²⁴

Because of the nature of consumer bankruptcy practices, lawyers often use subordinate lawyers and non-lawyer assistants to perform routine case-related services. Typically, in high-volume consumer bankruptcy practices, non-lawyer assistants are integral to a law firm’s efficient functioning. In such cases, the senior lawyer must recognize the high level of responsibility he or she has for thoroughly training and properly supervising such subordinate lawyers and non-lawyer assistants.²⁵ Attention to detail is imperative in connection with debtor representation in consumer bankruptcy cases, and a lawyer’s effort to keep legal fees in individual cases low by engaging in a high volume practice does not diminish a lawyer’s professional responsibility to his or her client.

²⁰ *In re Taylor*, 655 F. 3d 274, 286 (3d Cir. 2011). Although this case involved the behavior of creditor’s counsel, the court was clear to observe that all attorneys in a bankruptcy case have a duty to review information provided by clients and evaluate its reasonability. Moreover, once additional information brings its reasonableness into question, attorneys has an affirmative duty to determine which facts can be reasonably supported.

²¹ For a cautionary tale about the misuse of the ECF system, see *In re Smith*, 462 B.R. 783 (Bankr. D. Nev. 2011) (misuse of ECF credentials).

²² American Bar Association, Commission on Ethics 20/20, Resolution adopted August 2012.

²³ *Id.*

²⁴ See *In re Taylor*, 655 F.3d 274 (3d Cir. 2011). (“This case is an unfortunate example of the ways in which overreliance on computerized processes in a high-volume practice, as well as a failure on the part of clients and lawyers alike to take responsibility for accurate knowledge of a case, can lead to attorney misconduct before a court.”) *Id.* at 277.

²⁵ See MODEL RULE OF PROFESSIONAL CONDUCT R. 5.1 (Responsibilities of a Partner or Supervisory Lawyer).

5. A lawyer should understand the consumer bankruptcy case process and system and have the skills to represent the debtor's interests diligently in connection with the case proceedings, keep his or her client informed, provide ongoing advice and responses to the debtor's inquiries, and be responsive to inquiries and requests made by the court and by other professionals in the case.²⁶

Comment: The lawyer must be familiar with both the relevant facts of his or her client's case as well as with the applicable law. Typically, debtor representation requires a working knowledge of the Bankruptcy Code and the relevant parts of the U.S. Code addressing bankruptcy jurisdiction (Title 28) and bankruptcy crimes (Title 18); the jurisdiction's Local Rules; practice customs in the relevant jurisdiction;²⁷ the Federal Rules of Bankruptcy Procedure; the Federal Rules of Evidence; state law property rules, such as Article 9 of the U.C.C. and the law regarding real property title and transfer; and state law governing domestic relations. To the extent an issue or matter arises that is outside of the bankruptcy lawyer's area of expertise (*e.g.*, a tax or ERISA matter, or a domestic relations issue), the lawyer must seek counsel from another professional with expertise in that area.²⁸

After the bankruptcy petition is filed, the case trustee sets a date for the Section 341 meeting of creditors. The lawyer should explain the process of that meeting to his or her client in order to raise issues in defense of the debtor's interests and to answer questions as they arise. Counseling at this stage in the process includes advice to debtors on the consequences of the incurring of post-petition debt.

In addition, a lawyer should be able to represent his or her client's interest in all proceedings before the bankruptcy court that are within the scope of his or her representation of the client. When appropriate in a particular case, a lawyer should have the knowledge and skills to (i) investigate and defend any avoidance actions initiated by the case trustee against the debtor, (ii) facilitate the turnover of property and documents upon the request of the trustee, (iii) appear at and represent a client's interest during a Rule 2004 examination, (iv) take steps necessary to enforce the automatic stay, including providing advice to debtors on actions for relief from stay, and (v) review reaffirmation requests and provide counsel and advice as to their advisability. A lawyer must also understand and be able to advise debtors on the extent and limits of the bankruptcy discharge, represent the debtor's interest in response to any objections contesting the discharge or the dischargeability of a particular debt, and provide counsel in the event of a violation of the discharge injunction.²⁹ Prior to discharge, the lawyer should facilitate the client's enrollment in the Personal Financial Management course required of all consumer debtors. Throughout the case, the lawyer should respond to calls and requests for information about the case from his or her client, from

²⁶ See ABI Task Force on National Ethics Standards Report on Best Practices for Limited Services Representation in Consumer Bankruptcy Cases (April 2013).

²⁷ If a lawyer practices in a district in which more than one judge sits, a lawyer is well advised to become familiar with each judge's specific style and temperament, as well as the particular requirements each judge imposes upon counsel.

²⁸ See MODEL RULE R. 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.

²⁹ See 18 U.S.C. §§ 152-156.

other professionals in the case, including bankruptcy trustees and the United States Trustee's Office, and respond to any and all requests made by the court.³⁰

Business Practice

As is true with representing consumers in bankruptcy, lawyers for business debtors must also possess certain core competencies and skills.³¹ Though, on the surface, there is considerable overlap in the skills needed to represent debtors in consumer and business cases, the context in which these competencies are required and are applied can be quite different. In both types of cases, a lawyer must have an awareness of alternatives to the bankruptcy system, an understanding of bankruptcy as a substantive and procedural remedy, knowledge of the bankruptcy process, the skills to provide advice to clients in financial distress, the ability to negotiate with multiple parties with adverse interests, the organizational skills to manage an administratively complex process, the judgment to aid a client to make decisions in his best interest, and the diligence to see what can be an arduous process through to its resolution.

In addition, by agreeing to represent a business bankruptcy debtor, a lawyer is representing that he or she possesses the requisite legal knowledge and skills required to navigate a business client through a reorganization or liquidation proceeding.³² In many cases, this includes a working knowledge of finance, accounting, and asset valuation procedures. Moreover, in some types of cases, a lawyer is also representing that he or she is familiar with (or will become familiar with) the rules and practices that uniquely apply to a debtor's particular industry, market niche, or type of case (*e.g.*, a health care industry debtor, a single-asset real estate case, or an oil and gas producer debtor). To the extent that a lawyer is not competent to provide advice and counsel with respect to an issue in connection with a business bankruptcy case (*e.g.*, a tax matter, a stockbroker debtor, a Chapter 15 debtor's case), the lawyer must seek counsel and advice from another professional with expertise in that area.³³

By agreeing to represent a business in connection with its bankruptcy case, the lawyer is safeguarding the trust and reliance of his or her client to provide competent representation in response to the client's oft-changing needs. The core capacities and skills possessed by a competent lawyer representing business bankruptcy clients include, but are not limited to, the following:

³⁰ "[W]hen a person hires an attorney, he or she is entitled to a certain level of professional services and those services are to be rendered in a competent manner. An attorney should regularly communicate with his clients to insure that the clients understand the impact and scope of their case and the consequences of certain actions that may be taken in the case." *In re Sledge*, 352 B.R. 742, 748 (Bankr. E.D. N.C. 2006).

³¹ As noted above, a lawyer representing an individual in a chapter 11 cases must have knowledge of the issues need to represent debtors under both chapter 13 and chapter 11. Competent representation in an individual chapter 11 case also requires an understanding of the issues that are uniquely implicated in these cases. See Sally S. Neely, *How BAPCPA Changed Chapter 11 for Individuals, or No, This is Not Your Mother's Chapter 11* (2012).

³² See MODEL RULE R. 1.1 cmt. 2 and MODEL RULE 1.2 cmt. 6.

³³ Alternatively, the lawyer can ask the client to authorize the lawyer to affiliate with another professional with the needed expertise. At the outset of an engagement, the lawyer should describe in the engagement letter the protocol to be used if it is discovered that the representation involves an issue that is outside of the lawyer's expertise. See MODEL RULE 1.1 cmt 2 and MODEL RULE 1.2 cmt. 6.

1. A lawyer must have the knowledge and skill to provide pre-petition operational and exit strategy counseling and information to a client or prospective client in financial distress.

Comment: Competent handling of a business bankruptcy case begins with one or more pre-petition strategy and information sessions with a bankruptcy client (or prospective bankruptcy client).³⁴ A lawyer must have the depth of knowledge and experience to offer operational strategies and a sound exit plan. The lawyer should explain the myriad options and remedies available, including non-bankruptcy remedies. This discussion typically involves disclosures by the client or prospective client of financial, management and market information. The lawyer must have the skills to understand the company information, including the financial information, in order to provide useful advice as to the possible courses of action, and each course's potential consequences.

A lawyer must also make clear to the principals contemplating bankruptcy early on that the lawyer will be engaged by and will represent the debtor-in-possession and not any individual members of management.³⁵ The lawyer should describe the fiduciary duties of the DIP, provide examples of how the interests of the principals and the DIP may diverge, and explain what the lawyer's professional responsibilities are in such situations.³⁶ Finally, the lawyer should advise the principals that it might be in their best interest to engage their own counsel. The lawyer must recognize the need for a written retention letter, setting forth the scope of the representation and executed by both parties. In addition, the lawyer must be familiar with the required procedures for the retention of professionals under the Bankruptcy Code.

The lawyer must also have the requisite knowledge and skills to negotiate with some or all the client's creditors at this stage in an effort to either avert a bankruptcy filing or, in certain circumstances, to evaluate if a pre-packaged or pre-negotiated bankruptcy is feasible and advisable. In addition, the lawyer should be aware of, and communicate to his or her client, the advantages and disadvantages of: (i) liquidation, (ii) reorganization through a plan, (iii) the sale of assets under § 363 of the Bankruptcy Code, or (iv) an asset sale pursuant to a plan.

2. A lawyer should understand and be able to explain the myriad legal and business issues implicated by the prospect of a client's business bankruptcy filing. A lawyer should also be aware of the pre-petition steps required to be taken to prepare a case for filing. In addition to this substantive knowledge, a lawyer should have systems and procedures to execute the case filing efficiently and effectively.

³⁴ See generally, Thomas J. Salerno, et. al, *Pre-Bankruptcy Planning for the Commercial Reorganization: A Guide for the CEO, CFO/COO, General Counsel and Tax Advisor* (2008).

³⁵ This of course assumes that this is the case. In the event it is not clear who the client will be prior to the lawyer's engagement, the lawyer should be mindful of any communication that may implicate issues relating to attorney-client privilege, conflicts of interest and Model Rule 1.18 governing communications with prospective clients.

³⁶ See ABI Task Force on National Ethics Standards Report on Duties of Counsel for a DIP as Fiduciary and Responsibilities to the Estate (April 2013).

Comment: The lawyer must have the knowledge and skills to understand and explain the issues of chapter choice and its consequences, as well as the matter of the appropriate venue and the proper timing of the filing.³⁷ Chapter choice requires an assessment of the client's objectives, its eligibility under each chapter, whether reorganization is desirable and feasible, and whether, if liquidation is the course of action, the case should be filed under Chapter 7, 11, 9, 12, or 15.

In addition, if the substantive and/or procedural bankruptcy law differs in the courts or jurisdictions in which a case may potentially be filed, the lawyer should be aware of these differences and make a determination, in consultation with his or her client, as to which courts or jurisdiction's laws are more in accord with his or her client's interests. Further, the lawyer should have the knowledge and skills to prepare a substantive analysis of the case, based on the available venue options, and taking into consideration the differences, if any, in applicable non-bankruptcy law.

The lawyer should understand the pre-bankruptcy planning steps that may need to be taken, including the identification of pre-petition financial transactions (which in turn affects the timing of the filing), a review of the firm's capital structure, and an assessment of the business's assets and liabilities. The lawyer should also be aware of the need for, and consult with his or her client about, the engagement of a claims and noticing agent, as well as the engagement of other professionals, including financial advisors and accountants. The lawyer should understand the structure of his or her entity client and obtain proper authorization to file the bankruptcy case from the appropriate client body (*e.g.*, a corporation client's board of directors).

Moreover, the lawyer should be aware of and analyze how numerous issues may affect or be affected by the filing of the bankruptcy case. This non-exhaustive list includes:

- The necessity and availability of cash collateral;
- The necessity and availability of post-petition financing;
- The necessity and feasibility of hiring non-lawyer professionals, including financial advisors and accountants;
- The debtor's executory contracts and unexpired leases and their proposed treatment under § 365; and
- Potential avoidance actions and the likelihood, costs and benefits of their being brought.

The number and types of issues to be considered pre-filing will vary from case to case.

In addition, the lawyer must be aware of the nature and type of information and documentation necessary to be collected prior to preparing a case for filing. This information and documentation may include (depending upon the chapter selected) (a) financial statements; (b) insurance policies; (c) tax returns; (d) bank statements; (e) an inventory of all property owned by the debtor, with appropriate documentation; (f) an itemization of all debts owed by the client, with appropriate documentation; (g) real estate and mortgage information; (h) other descriptive information necessary to complete required schedules, plan and disclosure statement; and (i)

³⁷ A lawyer should be aware that the timing of the case must be in the best interest of the debtor and not in the best interest of the principals or other insiders. *See* Wallach v. Bucheit (*In re* Northstar Dev. Corp.), 465 B.R. 6 (Bankr. W.D.N.Y. 2012).

identification of all going-forward expenses with appropriate detail. The lawyer must make reasonable inquiries to ensure information supplied by his or her client is accurate and complete. In the event that the lawyer recognizes an irregularity or other “red flag,” he or she should be aware of the necessity of bringing the matter to the attention of his or her client, or taking other appropriate steps.³⁸

Finally, the lawyer must have developed administrative systems to keep the client’s information organized and accessible throughout the case. In addition, the lawyer must confirm that the client has the administrative and substantive capacity to prepare periodic financial reports, pay all interim expenses, including attorney’s fees, and perform all other necessary administrative duties.

3. A lawyer should know how to prepare and file a bankruptcy petition and the related schedules and statements efficiently and effectively.

Comment: Once the initial client counseling has been conducted, information and documentation gathered, and disclosures made, the lawyer must then prepare the necessary petition, schedules, statements, and forms. The lawyer must have the knowledge and skills to prepare the filing and its related schedules and statements and to conduct a reasonable inquiry into the validity and accuracy of the financial information on the Schedules and Statement of Financial Affairs provided by the client. The lawyer must understand the consequences of the timing of the case filing.

The lawyer must also be familiar with the Electronic Case Filing (“ECF”) system and have hardware, software and operating systems that allow for efficient access to the ECF system.³⁹ Furthermore, a lawyer must “keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology...”⁴⁰ The recent ABA Commission on Ethics 20/20 further recognized and detailed the responsibility of lawyers with respect to technological advances and issues relating to communication and confidentiality.⁴¹ The responsibility to acquire and maintain appropriate technological competency is relevant to lawyers practicing business bankruptcy law. In addition, if a lawyer is aided in his or her practice by subordinate lawyers and non-lawyer assistants, the senior lawyer is responsible for thoroughly training and properly supervising such subordinate lawyers and/or non-lawyer assistants.⁴²

³⁸ C.R. Bowles, Jr. & Nancy B. Rapoport, *Debtor Counsel’s Fiduciary Duty: Is There a Duty to Rat in Chapter 11?*, 29-FEB AM. BANKR. INST. J. 16 (2010).

³⁹ For a discussion of the ramifications of abusing ECF credentials, see note 21 *supra*.

⁴⁰ American Bar Association, Commission on Ethics 20/20, Resolution Adopted August 2012. For information on the Ethics 20/20 revisions involving technology, *see* http://www.americanbar.org/groups/professional_responsibility/aba_commission_on_ethics_20_20/house_of_delegates_filings.html.

⁴¹ *See* American Bar Association, Commission on Ethics 20/20, Resolution Adopted August 2012.

⁴² *See* MODEL RULE OF PROFESSIONAL CONDUCT R. 5.1 (Responsibilities of a Partner or Supervisory Lawyer).

- 4. Lawyers must be aware of and comply with the provisions of the Bankruptcy Code and related rules relevant during the immediate post-filing time period. A lawyer should have the knowledge and skills to argue first-day motions and otherwise take steps to address the substantive and procedural issues that arise at the beginning of a case.**

Comment: The business bankruptcy lawyer must be familiar with both the relevant facts of his or her client's case as well as with the applicable law. Typically, debtor representation requires a working knowledge of the Bankruptcy Code and the relevant parts of the U.S. Code addressing bankruptcy jurisdiction (Title 28) and bankruptcy crimes (Title 18); the jurisdiction's Local Rules; practice customs in the relevant jurisdiction;⁴³ the Federal Rules of Bankruptcy Procedure; the Federal Rules of Evidence; state law property rules, such as Article 9 of the U.C.C. and the law regarding real property title and transfer; and state law governing domestic relations. To the extent an issue or matter arises that is outside of the bankruptcy lawyer's area of expertise or implicates issues that are less commonly encountered, (such as stockbroker debtors, railroads, health care facilities, Chapter 15 cases, Chapter 12 cases, tax and ERISA matters, to name a few), the lawyer should gain an understanding of the relevant issues, or seek counsel from a professional with experience and expertise in the issue or matter.

In addition to being a skilled advisor, negotiator and drafter, in many cases lawyers for debtors in possession must also have the ability to advocate for their clients in bankruptcy court. In a Chapter 11 case, the lawyer typically addresses his or her client's exigent issues by arguing "first-day motions."⁴⁴ By way of illustration, these motions may include:

- A motion to employ counsel and other professionals (this process involves the disclosure of connections, as set forth in Rule 2014);
- A motion to extend time to file schedules and statements;
- A motion to retain "ordinary course professionals";
- A motion to authorize procedures for notice;
- A motion to approve investment guidelines;
- A motion to apply cash management procedures;
- A motion to obtain post-petition financing;
- A motion to establish interim professional fees procedures;
- A motion to use cash collateral;
- A motion to pay pre-petition employee wages; and
- A motion to honor pre-petition obligations to vendors and taxing authorities.

A lawyer must be aware of and communicate the numerous issues necessary to be addressed on an exigent basis in each individual case and have the skill to argue in support of his or her client's interests. Moreover, the lawyer must be aware of and comply with the applicable operational provisions in the Bankruptcy Code and related Rules, such as certain required notices, disclosures,

⁴³ If a lawyer practices in a district in which more than one judge sits, a lawyer is well advised to become familiar with each judge's specific style and temperament, as well as the particular requirements each judge imposes upon counsel.

⁴⁴ American Bankruptcy Institute, *FIRST DAY MOTIONS* (2010).

and filings. These include the noticing rules for motions that must be sent to appropriate parties. The applicability of many of these requirements turns on the nature, size, and type of business case.

In addition, a lawyer for a business DIP must have the knowledge and skills to:

- Facilitate the turnover of property and documents upon request of parties in interest;
- Take steps necessary to enforce the automatic stay, including providing advice to the client on actions for relief from stay;
- Represent his or her client's interests in connection with objections to claims;
- Represent the debtor in possession at the Section 341 meeting; and
- Appear and represent his or her client's interests at Rule 2004 examinations.

A lawyer must provide continuing disclosures to the court, as necessary (*e.g.*, Rule 2014 disclosures).⁴⁵ A lawyer must also respond to calls and requests from his or her client, the court, and creditors and other parties in interest, including bankruptcy trustees and the United States Trustee.

5. The lawyer representing a reorganizing DIP must have the knowledge and skills to draft an effective and confirmable plan of reorganization and disclosure statement in compliance with the relevant Bankruptcy Code provisions.

Comment: If a plan is to be drafted, it must satisfy the requirements of Chapter 11 and, more specifically, the plan confirmation requirements of Section 1129(a). This requires the lawyer's familiarity with the nuances for structuring a plan, including the classification of claims, and the satisfaction of the "best interests" test (which in turn requires a liquidation and feasibility analysis). The lawyer must further understand the various methods used to value assets, and be able to assess any such valuations. In addition, the lawyer for the DIP must be familiar with bankruptcy procedure, including the timing of key events in the case, such as the exclusivity period, the deadline for filing a disclosure statement and plan, the timing of vote solicitation, and the confirmation hearing.

The lawyer must also have the knowledge and skills to draft a disclosure statement, which must include thorough and complete information about the proposed plan and its consequences. A lawyer must understand the required standards for disclosure in order to solicit plan votes effectively. In the case of a publicly held DIP, the lawyer should also follow the applicable securities laws.

6. A lawyer should have the substantive and procedural knowledge and skills to manage the bankruptcy case and to effectively represent his or her client in all case proceedings.

Comment: The business bankruptcy lawyer must be aware of the range of matters that may need to be addressed throughout the pendency of the case and must possess the skills and experience to address them. An illustrative list includes:

- The consideration of whether to accept or reject executory contracts and the relevant rules with respect to the timing of such actions;

⁴⁵ See ABI Report of ABI Task Force on Proposed Amendment to Rule 2014 (April 2013).

- Ongoing assessments of cash collateral availability and need;
- Ongoing assessments of post-petition financing availability and need;
- The providing of advice concerning retaining non-lawyer professionals;
- The pursuit of any avoidance actions determined to be in the client's interest; and
- The monitoring of the DIP's ongoing financial performance.

7. A lawyer must be aware of the need to offer his or her client ongoing advice and provide the court with relevant disclosures throughout the duration of the bankruptcy case.

Comment: During the pendency of the case, the lawyer should continue to confer with and respond to inquiries from his or her client and provide proactive assistance with respect to the DIP's fulfillment of its fiduciary duties to the estate. In addition, a lawyer must be aware of his or her duty to comply proactively with any reporting requirements imposed by the court and by the Office of the United States Trustee.

8. The lawyer should have knowledge and understanding of the process of getting retained by the client, as well as the procedures required to be followed in order to receive professional fees. In addition, the lawyer must ensure that other professionals in the case understand the retention and payment requirements imposed by the Bankruptcy Code.

Comment: As an estate professional, the lawyer for the DIP must understand the process of retention, how time is to be billed, and the procedure necessary to be followed in order to have fees approved by the court. This includes the proper structure and use of pre-petition retainers and payments of pre-petition fees (or waiver of claims for such fees) to preserve continued employability and disinterestedness. In addition, a DIP's lawyer must ensure that any non-bankruptcy professionals, such as securities or corporate counsel, financial advisors, accountants and real estate agents, and fellow professionals within the lawyer's own firm understand the particulars of the bankruptcy retention and fee application process.

9. A lawyer must have the knowledge and skill to provide his or her client with advice concerning plan confirmation and the post-confirmation injunction.

Comment: A lawyer must understand and advise debtors on the extent and limits of the bankruptcy discharge and represent the debtor's interest in response to any objections contesting the discharge.⁴⁶ In addition, the lawyer must counsel the debtor about the scope of, and if necessary, respond to actions in violation of the post-confirmation injunction.

⁴⁶ See 11 U.S.C. § 523; see also 18 U.S.C. §§ 152-156.

Maintaining Competence

As Comment 6 to ABA Model Rule 1.1 observes, “[t]o maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risk associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject.”

- In the field of bankruptcy, lawyers must be aware of new developments in both statutory and case law. Lawyers should remain cognizant of any changes to the Official Forms and be aware of changes to federal and local rules of procedure and evidence. Lawyers should also be familiar with changes and developments in relevant technology.⁴⁷
- A lawyer representing debtors in both consumer and business cases should adhere to the requirements for admission and continued practice established by local bankruptcy courts.
- A lawyer representing consumer debtors, business debtors, or DIPs should participate in relevant continuing education courses.
- A lawyer desiring to begin a practice representing consumer debtors should participate in education courses, mentoring, and/or individual instruction prior to preparing cases for filing.
- A lawyer desiring to begin practice representing business debtors should similarly participate in education courses and, preferably, gain experience working under the supervision of more experienced attorneys.

⁴⁷ American Bar Association, COMMISSION ON ETHICS 20/20, Resolution adopted August 2012.

Proposed Rule

PROPOSED BANKRUPTCY RULE [ADMINISTRATIVE ORDER]
GOVERNING THE ADMISSION AND PRACTICE
OF PRIMARY ATTORNEYS IN BANKRUPTCY
COURT PROCEEDINGS

- 1.1 An attorney is qualified for admission to and practice in this Court as primary bankruptcy attorney for a party in interest if the attorney:
- (a) is currently a member in good standing of the State Bar of _____ and the Bar of the United States District Court for the _____ District of _____; and
 - (b) certifies that he/she has, and will maintain, a working knowledge of this Court's local rules and administrative orders, the relevant provisions of Title 28 (bankruptcy jurisdiction), the Bankruptcy Code, all of the applicable federal rules of procedure and evidence, Title 18 (bankruptcy crimes), and the Rules of Professional Conduct of the State Bar and any other state bar of which the attorney is a member, and will reasonably supervise the work of others working for with him/her in the representation.
- 1.2 By appearing in matters before this Court, a primary bankruptcy attorney is continually certifying that, during the past two years, he/she has completed at least ten hours of continuing legal education in the areas of Federal Bankruptcy Law and relevant federal and state law and at least two hours of continuing legal education in bankruptcy-related ethics or has associated with an attorney who makes such a certification.
- 1.3 In order to represent debtors in bankruptcy cases, the attorney's working knowledge should demonstrate competence requisite to the nature of the case being filed. It may be necessary for an attorney to associate with an attorney who has demonstrated such appropriate working knowledge.
- 1.4 This rule is not intended to preclude an attorney who is not qualified as a primary bankruptcy attorney from giving emergency representation to a party in interest as long as such representation is limited to that which is reasonably necessary under the circumstances.
- 1.5 Attorneys residing in other jurisdictions who do not meet the requirements of 1.1(a) may be admitted *pro hac vice* pursuant to Local Rule/Order _____.

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Report on Best Practices for Creditors' Committee Solicitation

Introduction: The Problem of Improper Solicitation¹

Pursuant to § 1102 of the Bankruptcy Code, in a Chapter 11 case, the United States Trustee is empowered to appoint an official committee of unsecured creditors.² Creditors' committees serve a very real and significant purpose in Chapter 11 bankruptcy reorganizations. They represent and protect the interests of unsecured creditors throughout the entire bankruptcy case and have a right to be heard on any issue that arises.³ Creditors' committees protect their constituents' interests by monitoring the case's progress and keeping abreast of important developments. They are also empowered to evaluate the case's viability, as well as the feasibility of any proposed plan.⁴ In short, creditors' committees are the watchdogs of the interests of unsecured creditors in the reorganization.⁵

The important role of the creditors' committee is facilitated by a committee's employment of various professionals to help it fulfill its fiduciary duties to the unsecured creditors.⁶ Those professionals can include lawyers and non-lawyers. Pursuant to § 1103(a) of the Bankruptcy Code and Bankruptcy Rule 2014, the bankruptcy court must first approve their employment applications.⁷ If the committee chooses to employ counsel, the Bankruptcy Code provides that counsel be selected at or after a scheduled meeting attended by a majority of the committee members⁸ or at any time after the committee is formed.

Obtaining employment for committee work necessarily requires that a committee be aware of a professional's skills and experience and the degree to which that professional may satisfy the committee's professional needs. Some committee members are repeat players across a variety of

¹ The Reporters are particularly grateful to Susan Freeman, Ted Gavin, Richard Meth, Michael P. Richman, and Andy Vara for their significant contributions to this Report.

² 11 U.S.C. § 1102 by the use of its word "shall" mandates that the Office of the United States Trustee appoint a committee of unsecured creditors when sufficient creditor interest is shown. See 7 Collier on Bankruptcy (16th rev. ed.), ¶ 1102.02[1] at 1102.6.

³ 11 U.S.C. § 1109(b).

⁴ 11 U.S.C. § 1103(c) defines the duties of the committee. *See also* H.R. Rep. No. 595, 95th Cong., 1st Sess. 235, 401 (1978) (creditors' committees will be the "primary negotiating bodies for the formulation of a plan of reorganization," will represent the class of creditors from which selected, will provide "supervision of the debtor in possession and of the trustee, and will protect their constituents' interests."); *see also In re Arkansas Company, Inc.* 798 F.2d 645, 649 (3rd Cir. 1986). *See generally* Greg M. Zipes & Lisa L. Lambert, *Creditors' Committee Formation Dynamics: Issues in the Real World*, 77 Am. Bankr. L. J. 229 (2003). *See also In re Caldor, Inc.* NY, 193 B.R. 165, 169-70 (Bankr. S.D.N.Y. 1996) ("A creditors' committee stands as a fiduciary to the class of creditors it represents. Its principal function "is to advise the creditors of their rights and the proper course of action in the bankruptcy proceedings."").

⁵ Although this Report deals with the issue of creditors' committee solicitation, many of its observations would apply equally to *ad hoc* committees and equity committees.

⁶ 11 U.S.C. § 1103(a).

⁷ *Id.*; 11 U.S.C. §§ 1103(a) and 328(a).

⁸ *Id.* at § 1103(a).

bankruptcy cases, and thus, may have existing relationships and experience with certain attorney and non-attorney bankruptcy professionals. Other committee members, however, are first-time participants in the bankruptcy process and may not know professionals with the skills to counsel and advise them. Both single-case and repeat player committee members may lack familiarity with many bankruptcy professionals who might seek employment by a committee in a new bankruptcy case.

This variation in committee member experience raises the question of how a committee can find appropriate professional representation. Committees need a procedure to identify and consider qualified firms to represent them. Likewise, attorneys desiring to undertake such representation need to be able to inform committee members of their expertise and availability. Given the importance of providing committee input on actions taken and decisions made early in the case, committee counsel is often chosen at the initial committee meeting. Thus, the choice of committee counsel is often made almost immediately after committee members, themselves, are selected. If committee members are to make reasoned choices among options for counsel, they need information—while they are still *prospective* committee members—that they can discuss during their initial committee meeting, and, potentially, determine which attorney(s) to interview as a committee. Those committee members who have worked with, and thus know, skilled and experienced professionals can suggest these professionals to the committee as a whole. Unless the committee is going to defer to such recommendations, however, prospective committee members will want to hear from potential counsel, and those lawyers will need to have some contact with the prospective committee members. The contact between the lawyer and a prospective committee member may be considered solicitation—permissible or otherwise—under applicable professional ethics rules.⁹

Issues surrounding solicitation of committee members include (1) whether professionals who are not known to a committee member or potential committee member may solicit potential employment (and *whom* they may permissibly solicit); (2) whether it is possible or permissible¹⁰ for a professional to solicit a committee member before the committee has been formed; and (3) when solicitation is permissible, what specific actions, in particular contexts, a professional may take before those actions become “prohibited solicitation.”

Unfortunately, although there are clear rules in every state regulating cold, live client solicitation by attorneys, many attorneys and non-attorney professionals have expressed concern that the rules, as they are applied to professionals seeking retention as counsel for an official committee of unsecured creditors (or other committees), leave several questions unanswered. Moreover, there is no single or consistent code of ethics for non-attorney professionals that appears to cover the issue of solicitation. This Report, therefore, is designed to provide guidance as to the parameters for permissible solicitation by all such professionals.

⁹ See MODEL R. PROF'L CONDUCT R. 7.3, discussed herein. A copy of the ABA's Model Rules of Professional Conduct (and links to state professional conduct rules) may be obtained at http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents.html

¹⁰ There is a school of thought among the legal profession that the committee is the prospective client and, therefore, that the solicitation of individual creditors who might ultimately be appointed to the committee does not constitute solicitation of a prospective client under the applicable rules. Under this theory, the prospective client is the committee itself, not any individual creditors. This theory has been effectively negated with the *Universal Building Products* decision, which will be discussed below.

To provide background and context, the Committee Solicitation Subcommittee (the "Subcommittee") first assessed the current landscape of ethics rules applicable to parties seeking employment by an official committee. The Subcommittee then assessed the current state of practice through a two-pronged analysis. First, the Subcommittee and Reporter Lois R. Lupica created a survey (the "Survey Instrument") to solicit anonymous input from the ABI membership as to their observations of behavior by professionals seeking employment by a committee. Second, Reporter Lupica convened a focus group of sitting bankruptcy judges (the "Focus Group") at the 2012 National Conference of Bankruptcy Judges to discuss committee solicitation issues. By comparing the present statutory landscape, the current state of practice by observation from those in the profession, and the current state of practice from the judiciary's perspective, the Task Force was able to understand more fully current practice and how that practice aligns with the present rules. This information "from the trenches" enabled the Task Force to propose how best to address the topic of committee solicitation.

Governing Rules

Bankruptcy lawyers must not only comply with the dictates of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, but they must also ensure that their behavior conforms to the state ethics rules governing professional conduct. When an attorney is seeking engagement as committee counsel, the principal relevant state rules are those similar to Model Rules 7.3¹¹ and 8.4.¹²

¹¹ Rule 7.3 Solicitation of Clients

(a) A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted:

- (1) is a lawyer; or
- (2) has a family, close personal, or prior professional relationship with the lawyer.

...

Official Comment:

[1] A solicitation is a targeted communication initiated by the lawyer that is directed to a specific person and that offers to provide, or can reasonably be understood as offering to provide, legal services. In contrast, a lawyer's communication typically does not constitute a solicitation if it is directed to the general public, such as through a billboard, an internet banner advertisement, a website or a television commercial, or if it is in response to a request for information or is automatically generated in response to internet searches.

[2] There is a potential for abuse when a solicitation involves direct in-person, live telephone or real-time electronic contact by a lawyer with someone known to need legal services. These forms of contact subject a person to the private importuning of the trained advocate in a direct interpersonal encounter. The person, who may already feel overwhelmed by the circumstances giving rise to the need for legal services, may find it difficult fully to evaluate all available alternatives with reasoned judgment and appropriate self-interest in the face of the lawyer's presence and insistence upon being retained immediately. The situation is fraught with the possibility of undue influence, intimidation, and over-reaching.

[3] This potential for abuse inherent in direct in-person, live telephone or real-time electronic solicitation justifies its prohibition, particularly since lawyers have alternative means of conveying necessary information to those who may be in need of legal services. In particular, communications can be mailed or transmitted by email or other electronic means that do not involve real-time contact and do not violate other laws governing solicitations. These forms of communications and solicitations make it possible for the public to be informed about the need for legal services, and about the qualifications of available lawyers and law firms, without

Model Rule 7.3 proscribes in-person, live telephonic, or real-time electronic solicitation of potential clients, when the motive for doing so is “pecuniary gain” and where the target of the solicitation (i) is not a lawyer, (ii) does not have a close family or personal relationship with the lawyer or (iii) does not have a prior professional relationship with the lawyer.”¹³ Model Rule 7.3 was recently amended to clarify the types of communications that constitute a “solicitation.”¹⁴ Official Comment [1] explains that a lawyer is engaged in a solicitation when he or she “offers to provide, or can be reasonably understood to be offering to provide, legal services to a specific potential client.”¹⁵ Recognizing that “technology has enabled various kinds of online interactions between

subjecting the public to direct in-person, telephone or real-time electronic persuasion that may overwhelm a person’s judgment.

¹² The ABA Model Rules of Professional Conduct were adopted by the ABA House of Delegates in 1983. The most recent major revision to the Model Rules was in 2000, but the various rules have also been revised more recently. The Model Rules serve as models for the ethics rules of most states. As of the first quarter of 2013, 49 states and the District of Columbia and the Virgin Islands have all adopted a version of the Model Rules of Professional Conduct.

¹³ The Supreme Court has been clear that direct live solicitation of potential clients can be categorically prohibited, and that other forms of direct solicitation of potential clients can be regulated without implicating First Amendment concerns. *Ohralik v. Ohio State Bar Ass’n*, 436 U.S. 447 (1978) (the state may ban all in-person lawyer solicitation for profit); *Shapero v. Ky. Bar Ass’n*, 486 U.S. 466 (1988) (state may categorically ban in-person solicitation by lawyers for profit, but may only regulate and not ban written communications that the prospective client can read without pressure and can discard; the Supreme Court expressly approved the type of regulation set forth in current Model Rule 7.3, revised after *Shapero*). As the Court has observed, the state’s interest in preventing “those aspects of solicitation that involve fraud, undue influence, intimidation, overreaching, and other forms of vexatious conduct” overrides the lawyer’s interest in communication. *See also* *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626 (1985) (“possibilities for overreaching, invasion of privacy, the exercise of undue influence[,] outright fraud” and other “unique features of in-person solicitation by lawyers ... justify a prophylactic rule prohibiting lawyers from engaging in solicitation for pecuniary gain”); *Edenfeld v. Fane*, 507 U.S. 761, 774-75 (1993) (where the Supreme Court struck down a statute prohibiting all solicitation by certified public accountants, in part based upon reasoning relevant to solicitation of most potential committee members, i.e. that business clients are different from the “unsophisticated, injured or distressed lay person.”). *Edenfeld* cited and did not overrule *Shapero* or limit state regulation of attorney solicitation.

¹⁴ Revised Model Rule 7.3 also addresses the distinction between “potential” and “prospective” clients. As noted, “[w]ith the creation of Rule 1.18 in 2002, the phrase “prospective client” refers to a potential client who has actually shared information with a lawyer. Model Rule 7.3 clearly intends to cover contacts with all possible future clients, not just those who have had some contact with lawyers and have become “prospective clients” under Rule 1.18. ... Accordingly, the Commission proposes to replace the word “prospective” with the word “potential” throughout Rule 7.3 and its Comments. *See* <http://www.legalethicsforum.com/blog/2012/02/ethics-2020-proposal-on-rule-73-direct-contact-with-prospective-clients.html>.

¹⁵ The phrase “reasonably understood to be offering to provide” is intended to ensure that lawyers are governed by the Rule even if their communications do not contain a formal offer of representation, but are nevertheless clearly intended for that purpose. For example, if a lawyer approaches potential clients at their homes and describes various legal services, the lawyer’s communications constitute a “solicitation” even if the lawyer does not formally offer to provide those services, as long as a reasonable person would interpret the lawyer’s communications as an offer to provide those services. *See* <http://www.legalethicsforum.com/blog/2012/02/ethics-2020-proposal-on-rule-73-direct-contact-with-prospective-clients.html>.

lawyers and potential clients,” the revised rule and clarifications in the Official Comments are designed to more clearly identify the contours of the types of prohibited lawyer solicitation. If a real-time contact with a potential client exerts pressure and demands an immediate response, “without providing an opportunity for comparison or reflection,” such a contact falls within the rationale that Model Rule 7.3 is designed to address, *i.e.*, “undue influence, intimidation, and overreaching” when seeking to obtain new clients.¹⁶ State regulation is justified by the potential for such pressure and its effects.

Moreover, pursuant to Model Rule 8.4, a lawyer may not engage a third party to do something that he or she is prohibited from doing directly.¹⁷ Thus, in the context of real-time committee solicitation of potential clients, lawyers may not direct an agent to contact members of the committee or to solicit proxies in order to gain employment as counsel.¹⁸

Other relevant Model Rules include Model Rule 7.2(b), which prohibits a lawyer from giving anything of value to a person for recommending the lawyer's services, except for the reasonable costs of permitted advertisements and communications and for certain lawyer referral services. This Model Rule is relevant to, for example, offers of meals and transportation to meetings to discuss counsel's capabilities and to the committee formation meeting.¹⁹ Also, Model Rule 7.1 provides that solicitations cannot contain false or misleading statements of fact or law or omissions that cause

¹⁶ Model Rule 7.3, Comment [1]. Some jurisdictions, however, have addressed this evil short of an absolute prohibition on “live” solicitation. *See, e.g.*, Maine Rule of Professional Conduct 7.3 (prohibiting in-person, live telephone, or real-time electronic professional employment solicitation from a *non-commercial client* if “such solicitation involves or has substantial potential of harassing conduct, coercion, duress, compulsion, intimidation or unwarranted promises of benefits.” The Rule continues by making clear, “The prospective client's sophistication regarding legal matters; the physical, emotional state of the prospective non-commercial client; and the circumstances in which the solicitation is made are factors to be considered when evaluating the solicitation.” The Reporter's Notes explain “[t]he Model Rule's original formulation ... categorically prohibits “in-person, live telephone or real-time electronic contact” with prospective clients. The Task Force discussed the concerns underlying this categorical prohibition: lawyer overreaching or harassing vulnerable prospective clients through direct solicitations. The Task Force ultimately concluded that such concerns were adequately addressed by limiting solicitation to circumstances in which a lawyer could overreach or harass non-commercial clients. Non-commercial prospective clients are those individual clients in need of legal services in non-commercial or personal matters or circumstances.

¹⁷ Rule 8.4 states that “[i]t is professional misconduct for a lawyer to: (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another.” Comment [1] provides that “[l]awyers are subject to discipline when they violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so or do so through the acts of another, as when they request or instruct an agent to do so on the lawyer's behalf.”

¹⁸ *See, e.g., In re O'Keefe*, 877 So. 2d 79 (La. 2004) (where an attorney was disbarred for paying “runners” to solicit personal injury cases); *Miss. Bar v. Turnage*, 919 So. 2d 36 (Miss. 2005) (where an attorney was suspended for hiring an agent to solicit clients for potential class suit); *Md. Ethics Op. 98-30* (1998) (where a lawyer was prohibited from having a bail bondsman distribute his business cards with the attorney's contact information printed on back); *see also Cincinnati Bar Ass'n v. Rinderknecht*, 679 N.E.2d 669 (Ohio 1997) (where an attorney was indefinitely suspended for establishing a direct marketing service to solicit accident victims as clients for himself and a chiropractor).

¹⁹ Comment 5 to Model Rule 7.2 explains the rationale: “Lawyers are not permitted to pay others for channeling professional work. Giving or receiving a de minimis gift that is not a quid pro quo for referring a particular client is permissible.”

statements to be misleading. Attorneys should beware of touting their prior work in a way that would mislead committee members about what will happen in a case for which the professional is seeking employment. Model Rule 8.4(e) says solicitation may not state or imply an ability to improperly influence the court, the United States Trustee, or other official, or to achieve results by means that violate professional conduct rules or other laws; therefore, statements about familiarity and good relations should be made with care. Model Rule 7.4 provides that a lawyer may communicate his or her practice in a particular field, but it limits what can be said about whether the lawyer is a “specialist,” which bears on the wording of communications to potential committee members. Model Rule 1.18 sets forth various duties to “prospective clients” and mandates care in obtaining information about prospective committee members’ positions, in case the attorney is not chosen as committee counsel.

Notably, in addition to the applicable Model Rules, Bankruptcy Rule 2014 requires the disclosure of all “connections” with the debtor, creditors, any other party in interest, and their respective attorneys and accountants (interpreted to include non-attorney financial advisory professionals of all types, including accountants, financial advisors, investment bankers, and the like) and the United States Trustee.²⁰ As explained by the bankruptcy court in the *Universal Building Products* case discussed below, solicitation of prospective committee members, including through other professionals, constitutes disclosable “connections.”

Recent Creditor Committee Solicitation Case Law

A. *Creditor Contacts and Solicitation*

The court in *Universal Building Products*²¹ squarely addressed the proscription in Delaware Lawyers Rule of Professional Conduct 7.3 against real-time direct client contact in the context of creditor committee solicitation.²² In that case, several law firms were seeking engagement as counsel to the creditors’ committee. At least two of the interested law firms sent Mr. Liu, an individual who had provided translation services to official creditors’ committees in the past, the list of the twenty largest unsecured creditors. Liu, who had not had prior dealings with any of the creditors on the list, contacted a number of overseas creditors to discuss the case, including discussing the engagement of at least two of these law firms as committee counsel. He also asked the creditors if he could act as proxy for them on the committee. One creditor granted Liu its proxy,²³ allowing him to attend the committee formation meeting and vote for the engagement of the soliciting law firms. Liu was subsequently engaged by the committee to provide translation services. At the time that the

²⁰ See ABI Ethics Task Force, *Proposed Amendments to Rule 2014* (2013).

²¹ 486 B.R. 650 (Bankr. D. Del. 2010).

²² The relevant language in the Delaware Rule of Professional Conduct Rule 7.3 (which is identical to Model Rule 7.3), reads: “A lawyer shall not, by in-person, live telephone, or real-time electronic contact solicit professional employment from a prospective client when a significant motive for the lawyer’s doing so is the lawyer’s pecuniary gain”

²³ Another proxy was granted to a “friendly” professional, with the understanding that he would also vote in favor of engaging the soliciting law firms.

committee voted for the appointment of counsel, there had been no disclosure of Liu's relationship with the soliciting lawyers.

In considering these behaviors, Judge Walrath found that the solicitation behaviors by the attorneys seeking appointment as creditors' committee counsel violated Delaware Rule 7.3. Their active encouragement of Liu's cold communications with creditors, even after learning that Liu had no prior relationship with any creditor on the list, was a clear violation of the proscription against solicitation.²⁴ The opinion points out that Delaware's version of Rule 8.4 states that an attorney may not use an intermediary to solicit prospective clients when the attorney is prohibited by Rule 7.3 from doing so directly.²⁵ Accordingly, the court found sufficient reason to disqualify the law firms from serving as counsel to the committee.²⁶

Judge Walrath also addressed the issue of required disclosures under Bankruptcy Rule 2014(a). Rule 2014(a) requires that "the application [of any professional person seeking retention by the debtor or committee] shall be accompanied by a verified statement setting forth the person's connections with the debtor, creditors, any other party of interest, etc. ..." Delaware Local Rule 2014-1 further requires that additional disclosures be made promptly after learning any additional material information.²⁷ The court explained that the solicitation communications were relevant "connections" and noted that the lawyers' failure to disclose such connections was enough to require disqualification of counsel from committee employment. The evidence supported disqualification of both soliciting law firms because their initial disclosures were inadequate and, notwithstanding the ongoing duty to disclose, subsequent disclosures were insufficient to cure the original deficiencies.²⁸

Judge Walrath concluded her opinion in the *Universal Building Products* case by stressing the importance of disclosure of the practice of using others to solicit proxies to act at committee formation meetings and by further urging the Office of the United States Trustee to consider implementing additional procedures in connection with its procedures concerning committee formation and solicitation. These recommended procedures included amending the prospective committee member questionnaire and separating creditors from prospective professionals in order to reduce the possibility of undue influence of the committee in connection with its decision to hire counsel.²⁹

²⁴ The court found nothing wrong with the law firms' transmission of the list of creditors and its analysis of the debtor's case to their existing clients and contacts. *Id.* at 659.

²⁵ The court stated that making cold contacts between soliciting counsel and creditors is particularly improper when creditors are foreign and unfamiliar with committee formation procedures. *Id.* at 660. The court also took pains to note that the practices employed by these law firms had been criticized in the past. The current disclosure rules surrounding proxy solicitation grew out of creditors' lawyers' past behaviors of actively participating in the selection of committee members in order to then be selected as counsel for the committee.

²⁶ *Id.*

²⁷ Fed. R. Bankr. P. Rule 2014(a).

²⁸ 2010 WL 4642046, at 11 ("[T]he law firms should have fully disclosed at the outset their efforts in support of Dr. Liu's attempt to obtain proxies from creditors to attend the Committee formation meeting.").

²⁹ *Id.* at 12. In another case addressing the issue of committee solicitation by attorneys, *In re Diva Jewelry Design, Inc.*, 367 B.R. 463 (Bankr. S.D.N.Y. 2007), the court deferred to the trustee's choice of counsel over the objection of the United States Trustee. The United States Trustee argued that, because of a prior

The court in *In re ABC Automotive Products Corp.* similarly examined the contours of permitted behaviors in the context of creditor committee solicitation.³⁰ The debtor in this case, an auto parts distributor, filed for Chapter 11 and the United States Trustee appointed a four member creditors' committee. The committee then selected committee counsel. Simultaneously, another attorney was seeking appointment as committee counsel. The debtor's president identified this new attorney as the person whom creditors should contact if they had a question. The attorney sent these creditors proxy forms authorizing his firm to vote on the creditors' behalf on all matters, including the retention of professionals. The new attorney then contacted the United States Trustee, who amended the creditors' committee list to include the new members. The new attorney ultimately held proxies for four of the seven committee members and convened a committee meeting. At this meeting the new attorney informed the committee of his intention to use their proxies to appoint his firm as counsel for the committee.

The United States Trustee and a firm both objected, arguing that the law firm could not act both as a member of the committee by virtue of its proxies, and also as its counsel. The court denied the law firm's committee retention application, holding that the law firm's self interest impermissibly motivated the process by which it was selected. In its role as committee counsel, the firm would not be taking direction from actual creditors, but rather it would effectively control the committee's decision-making. Thus, the actual creditors would be deprived of any meaningful role in the decisions regarding the committee's governance. It was not the *per se* use of proxies to elect committee counsel to which the court objected, but rather how the proxies were used in this case. The court had "no confidence that [the committee's choice of counsel] reflect[ed] the will of the Committee, if indeed it ha[d] one."³¹ The court further observed:

. . . It is not uncommon at an in person organizational meeting of creditors conducted by the United States [T]rustee for creditors who are unable to be physically present to send counsel with their proxy. That is far different than a lawyer securing the proxies and then calling and conducting a "meeting" not calculated to secure any participation other than his own to elect himself. The approach utilized here smacks of the much maligned attorney activism criticized by the Third Circuit in *Arkansas* and intended to be replaced under the current Code. . . . [I]t is not the fact that proxies were used, but how they were used that dictates the resolution of this contested matter.³²

engagement by creditors in the case, the counsel represented interests adverse to the estate, was not disinterested, and had an actual conflict of interest. Moreover, the United States Trustee argued that "the pattern of . . . [counsel's] clients electing a trustee and then having that same trustee retain the Applicant indirectly fosters the problems that the election procedure was intended to proscribe." In finding for the trustee, Judge Gerber observed, "an attorney is not barred from assisting the solicitation efforts of a creditor or committee, so long as it is clear that the attorney is not the solicitor and that the solicitation is not on behalf of the attorney. *Id.* at 475.

³⁰ 210 B.R. 437 (Bankr. E.D. Pa. 1997).

³¹ *Id.*

³² *Id.* at 445.

Members of the Task Force have reported, in at least one district, several post-*Universal Building Products* committee organizational meetings in which the prospective committee members were kept apart from the professionals attending the meetings at which they were seeking employment. Whether this practice is, or will be, consistently applied across the United States Trustee Program's regions and offices, remains to be seen.³³

B. *Proxies and Avoiding the Appearance of Impropriety*³⁴

In the predecessor to the Model Rules of Professional Conduct, the American Bar Association codified in Canon 9 of the Model Code of Professional Responsibility that attorneys should avoid even the appearance of impropriety.³⁵ Comments that judges in the Focus Group made regarding unseemly behavior—whether or not it rose to the “appearance of impropriety” standard—indicated the judges’ sensitivity to the issue of misbehavior. Some of the participants in the Focus Group specifically noted that an attorney’s or firm’s reputation in other cases or other districts would be a factor in evaluating their retention applications—some going so far as to raise specific examples.

In the *Universal Building Products* litigation, for example, much ado was made of proposed committee counsel’s history with two cases in other districts, referred to here as the “Texas cases.” The court itself did not mention Texas cases, but instead was raised by debtors’ counsel in their objection to the motion to employ committee counsel. Debtors’ counsel argued that, because of its involvement in the Texas cases, proposed committee counsel should have been “on notice” that its actions would be subject to scrutiny. The court’s position, as stated on the record, was that it could take judicial notice of the Texas cases because, having faced accusations of improper solicitation before, counsel in the Texas cases was “on notice of the issue regarding solicitation of clients through another.”³⁶

³³ In many districts outside of New York and Delaware, committees are appointed by the Office of the United States Trustee without any formal organizational meeting and, thereafter, advised, by a United States Trustee representative overseeing a particular chapter 11 case, generally about their duties, including a recommendation to seek out and select professionals.

³⁴ This section borrows heavily from Richard M. Meth & Jessica D. Gabel, *An Icy Reception to Cold Calls: Committee Solicitation After Universal Building Products*, 2011 American Bankruptcy Institute Southwest Bankruptcy Conference (2011).

³⁵ Under the Model Code, Canon 9’s “avoid the appearance of impropriety” principle was set forth in DR 9-101:

(A) A lawyer shall not accept private employment in a matter upon the merits of which he has acted in a judicial capacity.

(B) A lawyer shall not accept private employment in a matter in which he had substantial responsibility while he was a public employee.

(C) A lawyer shall not state or imply that he is able to influence improperly or upon irrelevant grounds any tribunal, legislative body, or public official.

Courts over the years, however, have construed the avoidance of impropriety principle far more broadly than DR 9-101 ever suggested, using “appearance of impropriety” as a catch-all for behavior that a court believed to be unseemly. *See, e.g., In re Marvel Entertainment Group, Inc.*, 140 F.3d 1463 (3d Cir. 1998) (rejecting use of “appearance of impropriety” standard as a discredited concept).

³⁶ Transcript of October 7, 2010 hearing, p. 107 at 4.

The case of *In re TKO Sports Group USA*³⁷ highlighted the difficulties associated with “connections” and their disclosure pursuant to Bankruptcy Rule 2014. The case also addressed the issue of with whom the duty to disclose rests. In *TKO*, the controversy arose in the context of a long-standing professional relationship between the committee’s counsel and a non-attorney professional who appeared at the committee formation meeting holding a proxy for a foreign creditor. This representative then went on to serve on the committee on the creditor’s behalf, ultimately seeking appointment as the liquidating trustee in the case. Neither the non-attorney professional, nor his counsel, disclosed the relationship and the matter subsequently arose, in the heat of a contentious Chapter 11 case, in the form of an objection to committee counsel’s fees.

Discovery in the litigation showed the relationship between the non-attorney and counsel to be extensive, generating millions of dollars in fees to the law firm as the result of their engagement on the non-attorney’s behalf in his role as liquidating trustee in other cases. In fact, the law firm represented the non-attorney in at least seventy-five adversary proceedings. When, after the fact, the law firm disclosed the relationship with the non-attorney, the disclosure was limited to the bare mention of having represented the individual in other cases. The law firm, in its defense, argued that representing a creditor committee’s representative in the past was not a connection requiring disclosure under Bankruptcy Rule 2014 and that such disclosure would have been necessary only had the individual been appointed the liquidating trustee in the present case. As in many such cases, the matter was eventually consensually resolved and the pleadings in the case were ordered sealed and then unsealed, as noted below.

More recently, in *In re North Bay General Hospital*³⁸, another dispute arose involving the same firm and the same non-attorney in the same district as the *TKO* case. In this case, the parties again failed to disclose their other business connections. Once the failure to disclose was brought before the court, the debtor filed adversary proceedings against the law firm seeking disgorgement of fees and findings of, among other things, fraud, conspiracy, a civil RICO, breach of fiduciary duty and negligence. The debtor also moved to unseal the *TKO* pleadings. In ruling to unseal the records, the court noted that, even though the unsealing of the records might harm the law firm’s reputation, in the absence of the law firm showing that the information in the record was untrue, there was no sufficient basis to keep the records sealed.

Both of these cases were referenced heavily in the *Universal Building Products* debtor’s objections to the employment application of the same law firm and were mentioned specifically by several judges in the Focus Group. That these cases could well have been meritless and were not adjudicated to completion is immaterial: the bell, once rung, is heard. And in the sphere of professional conduct, a question as to one’s reputation, once raised, can follow a professional far beyond a single case.

Much of the complexity in the issue of disclosures of connections by retained committee professionals derives from the use of proxies: agency relationships between a party in interest in a case (typically, an unsecured creditor) and an agent appointed to be present on the creditor’s behalf

³⁷ Bankr. S. D. Texas, Case No. 05-48509, available on PACER.

³⁸ 404 B.R. (Bankr. S. D. Tex. 2009)

at the organizational meeting of the committee. Proxies are both a useful and necessary way for the United States Trustee to form a committee that is representative of the estate's diverse creditor interests without individual creditors, often small business owners, incurring the cost and inconvenience of traveling—sometimes cross-country, sometimes internationally—to attend the committee organizational meeting. Proxies, in and of themselves, are not problematic. The manner in which they are obtained and for what purpose, however, can raise significant issues, especially in light of thirty-eight percent (38%) of survey respondents having reported observing proxy-seeking behavior by attorneys and the vast majority of these respondents (eighty-seven percent (87%)) observing such behavior “sometimes or “often.” The Task Force suggests that:

- a) misuse of proxies raises questions of compliance with the rules;
- b) professionals' failure to disclose their participation in proxy relationships or connections to proxy holders is a potential violation of Rule 2014; and
- c) the proxyholder owes a duty to the creditor whom the proxyholder represents.

Information on Current Practices

A. Survey Instrument

One purpose of a survey is to gather generalized and subjective information from and about a cohort of people in an effort to elicit information about a practice, an event, or a program. In its consideration of the issue of best practices in connection with committee solicitation, the Task Force wanted further insight into current committee solicitation practices. It used an anonymous survey that asked respondents to report on their own practices and behaviors, as well as observed practices and behaviors, in order to develop a clear picture of current practices.

The Survey Instrument was designed to gather descriptive and impressionistic data from a broad group of stakeholders so that patterns, themes, and trends would come to light. The Survey Instrument was sent to 8,861 ABI members (attorney and non-attorney professionals, including financial advisors and accountants) who are identified in the ABI membership database as having a business bankruptcy practice. 496 members responded to the survey – a 5.6% response rate.³⁹ Of all respondents, 66.7% identified themselves as attorneys, and 33.3% identified themselves as non-attorney professionals. 85.7% of attorney respondents reported having been in practice for ten years or more. The state bars with the largest number of Survey respondents were California, Delaware, Illinois, Massachusetts, New York, Pennsylvania and Texas.

1. Pre-Meeting Conduct of Business Bankruptcy Professionals

³⁹ This response rate is typically considered reasonable in order for the responding group to be considered a “representative sample” of the ABI membership. It should not be inferred, however, that this sample is representative of the national bankruptcy bar.

The Survey Instrument asked respondents about their personal knowledge of certain pre-committee meeting contacts between lawyers and creditors. Fifty-three percent (53.3%) of respondents reported having knowledge of an attorney who made one or more telephone calls to one or more prospective committee members without that professional having a prior relationship with the phone call recipient. Of the respondents who reported this observation, over ninety percent (90%) of them reported observing this practice “sometimes” or “often.” A similar number of respondents reported having knowledge of “cold” telephone contacts by non-attorney professionals.

When asked about e-mail “cold contacts” with prospective committee members, forty-five percent (45%) of respondents reported having personal knowledge of pre-meeting e-mail contacts. Eighty-seven percent (87%) of respondents who had knowledge of “cold” e-mail solicitation observed this behavior “sometimes” or “often.” Thirty-three percent (33%) of respondents observed non-attorney professionals engaging in “cold” e-mail contacts. Thirty-three percent (33%) of respondents reported having personal knowledge of arranged “cold” meetings with one or more prospective committee members. Of these respondents, over eighty percent (80%) reported observing these behaviors “sometimes” or “often.” Moreover, forty-six percent (46%) of these respondents reported observing the exchange of value (including food, drinks or gifts) at these meetings. Twenty-eight percent (28%) of respondents observed these behaviors with similar frequency in non-lawyer professionals.

When asked about the use of proxies, thirty-eight percent (38%) of respondents reported observing the request by an attorney that a prospective committee member give a voting proxy to an agent for use at the organizational meeting, with an advance understanding of how the proxy would be voted for purposes of hiring counsel for the creditors’ committee. Of these respondents, eighty-six percent (86%) reported seeing such behaviors “sometimes” or “often.” Sixty-two percent (62%) of respondents reported personal knowledge of an existing client and creditor in a case calling one or more prospective committee members during which the non-lawyer professional recommended counsel for the committee. Of these respondents eighty-seven percent (87%) reported seeing these behaviors “sometimes” or “often.”

2. Committee Meeting Conduct of Bankruptcy Professionals

Survey respondents were initially asked about attendance at official or *ad hoc* committee organizational meetings. Thirty-one percent (31%) of respondents reported attending an organizational meeting without having received an invitation. Two percent (2%) of respondents reported trying to attend a committee organizational meeting without having received an invitation but being turned away. Of those who attended and tried to attend a committee meeting, a strong majority reported learning about the meeting from either the United States Trustee, a creditor or an attorney connected to the case.

Of those respondents who have attended an organizational committee meeting, eighty-four percent (84%) reported being having been invited to do so by an unsecured creditor. Only eighteen percent (18%) reported having been required to fill out a form or obtain some type of authorization or permission to attend the meeting and only ten percent (10%) were given an unsecured creditors’ proxy and directed how to vote. Of those given a proxy, a strong majority obtained the proxy form

directly from the unsecured creditor or from a lawyer for the unsecured creditor. Seventy-three percent (73%) of those who attended an organizational meeting reported being permitted to be in the same room as the various persons representing the debtors' unsecured creditors.

Those who appeared at a committee organizational meeting reported a variety of pre-meeting communications. These pre-meeting communications included communications with (i) a law firm (about representing or co-representing the committee); (ii) any other professional (about representing or co-representing the committee); (iii) any other professional (about *that* professional representing the committee); (iv) the United States Trustee; or (v) another party in interest in the case. Other parties in interest included creditors, debtor's counsel, secured lenders' counsel, purchasers, landlords, and unsecured creditors. Illustrative reasons cited for the pre-meeting communications included, (i) to respond to a client asking for representation in the case or to pitch the committee or support another law firm at the organizational meeting; (ii) to determine the level of interest and the degree of competition, and to gain facts about the case; (iii) to ascertain the nature of the case and to ascertain any likely recovery for unsecured creditors; (iv) to advise the party contacted regarding any likely issues in the case and the professional's expertise; (v) to determine the potential availability of funding for professional fees; (vi) to discuss the committee meeting with his or her client who is or will be on the committee; (vii) to introduce himself or herself and talk about his or her qualifications and experience in order to represent the committee; (viii) to plan strategy; (ix) to show interest in and knowledge of the case; (x) to provide comfort and ideas to creditors; (xi) to gain support from potential committee members and to gain information about the case and the debtor; and (xii) to try to get an invitation to pitch to be counsel. As highlighted previously, the types of communications and the parties with whom the pre-meeting communications took place are neither all permissible, nor all impermissible. For example, a lawyer contacting debtor's counsel to inquire about funds available to pay professionals violates no Model Rule; however, a lawyer contacting unsecured creditors in a manner regulated by Model Rule 7.3 to gauge their interest in serving, or to try and gain an invitation to pitch to be counsel, either approaches or entirely crosses the line demarcating a violation of Model Rule 7.3.

This distinction is, again, entirely contextual based on who the parties to the communication are, and the intent behind the communication. Although this difference may be of some comfort to those attorneys inclined to make contacts with creditors, it bears noting that the controversy in *Universal Building Products* arose originally out of a dispute between the parties' counsel over the terms of proposed debtor-in-possession financing. From this, the lesson to be learned is that, once an attorney acts, that attorney can no longer control the context or light in which others view the action.

3. Conflicts Checks and Questions About Behaviors

Ninety-five percent (95%) of respondents reported performing a conflicts check prior to any official committee or *ad hoc* committee solicitation. Only four percent (4%) of respondents reported seeking advice from their state bar ethics hotline.

The need for attorneys to perform a conflicts check prior to soliciting a committee client is key. Unfortunately, it is not uncommon for counsel to be hired by a committee, only to later inform the committee that a conflict exists between the lawyer and some party in interest in the bankruptcy

case, and asking that the committee engage conflicts counsel to perform necessary work in fulfillment of the committee's fiduciary duties. But there are minor conflicts and disqualifying conflicts, and the Report addressing the use of conflicts counsel elaborates on this important difference. Conflicts can run to the mundane, such as an individual creditor being the target of an avoidance action where the lawyer representing the post-confirmation trust has represented that party previously or presently (raising conflict issues pursuant to Model Rules 1.9 or 1.7, respectively); or they can run to the heart of the Chapter 11 case, where committee counsel is precluded from taking any action potentially adverse to the secured lender in that case, including such tasks as lien investigation or loan document review.⁴⁰

The gravity of these two conflicts is fundamentally distinct, and each has a different economic effect on the bankruptcy case. In the former example, selecting another firm that can bring an avoidance action, as conflicts counsel, likely presents little to no economic effect or impairment. Conversely, when committee counsel is unable to perform basic tasks at the heart of the committee's function, then engaging conflicts counsel will not cure the problem. Although it is possible that a conflict will arise during the case, *e.g.*, when a firm's client becomes a bidder for estate assets, the information about the debtor, significant secured and unsecured creditors, equity owners, and advisors is available in the initial filing documents. Attorneys should perform a conflicts check using at least that information before communicating with any potential committee members about serving as committee counsel.

B. *Focus Group Interview*

Focus groups provide an effective and efficient way to gather qualitative data from study subjects, the goal being to produce "concentrated amounts of data on precisely the topic of interest."⁴¹ Focus groups can offer the opportunity for participants to respond to questions provided by the researcher, as well as to engage in and interact with other members of the group.⁴² "The hallmark of focus groups is their explicit use of group interaction to produce data and insights that would be less accessible without the interaction found in the group."⁴³

⁴⁰ See, *e.g.*, *In re Project Orange Assoc.*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010); *In re Amdura*, 121 B.R. 862, 866-67, 871 (Bankr. D. Colo. 1990). The issue of conflicts of interest is discussed more thoroughly in, *The Use of Conflicts Counsel in Business Reorganization Cases* (2013), *supra*.

⁴¹ There are clearly weaknesses associated with focus group interviews as a data-gathering tool. As observed, "[t]he fact that focus groups are driven by the researcher's interests can . . . be a source of weakness The fact that the researcher creates and directs the group makes them distinctly less naturalistic than participant observation so there is always some residual uncertainty about the accuracy of what the participants say. In particular, there is a very real concern that the moderator, in the name of maintaining the interview's focus, will influence the group's interactions." DAVID L. MORGAN, *FOCUS GROUPS AS QUALITATIVE RESEARCH* 14 (2nd ed. 1997). There is also the concern that "the presence of the group will affect what [participants] say, and how they say it." *Id.*

⁴² *Id.* at 2.

⁴³ *Id.*

The bankruptcy judge participants in the Focus Group were selected by a method known as “purposive” or “theoretical” sampling.⁴⁴ The participants were not randomly identified, but were invited because they were “information rich,” and offered useful, yet varied experiences of working within the system being studied.⁴⁵ The Focus Group was homogenous, comprised of bankruptcy judges with experience in cases in which committees were formed. The homogeneity allowed for unrestrained conversations among participants.⁴⁶

1. Committee Formation and Solicitation

The Focus Group was asked a series of open-ended questions, beginning with a general query about how committees were formed and committee counsel was selected. The answers revealed a great deal of variation in process from jurisdiction to jurisdiction. This variation was identified as a problem with the system in that it makes it difficult “to think through ... the right way do this.” Local culture, as that may vary from jurisdiction to jurisdiction, plays a significant role in whether and how committees are formed and, ultimately, how counsel comes to be interviewed and/or hired.

The Focus Group consistently asserted that nationally uniform standards for committee formation (by the United States Trustee Program) and standards addressing committee solicitation (by prospective counsel) would improve the process and address existing uncertainties and inconsistencies with respect to the best practices and preferred processes. The participants suggested that, if the Executive Office of the United States Trustee announced a uniform policy, United States Trustee regions and offices would follow it.

Focus Group judges discussed the importance of committees as overseers of the Chapter 11 process, describing committees as playing a “broker role” between the secured creditor and the debtor, often serving as a debtor’s ally in the process of negotiations with the secured creditor. The judges further observed, in describing committee formation practice and the hiring of committee counsel, that it was important to distinguish between “large” cases and medium or “middle market” cases.⁴⁷ In some jurisdictions, it was reported that the bulk of cases with committees are middle

⁴⁴ Morgan, *supra* note 40, at 35.

⁴⁵ Marshall, *supra* note 40, at 523 (“Qualitative researchers recognize that some informants are ‘richer’ than others and that these people are more likely to provide insight and understanding for the researcher. Choosing someone at random to answer a qualitative question would be analogous to randomly asking a passer-by how to repair a broken down car, rather than asking a garage mechanic—the former might have a good stab, but asking the latter is likely to be more productive.”)

⁴⁶ Morgan, *supra* note 40, at 35.

⁴⁷ A respondent observed, “Defining big and small has lots of facets to it. It seems to me it might mean a total number of assets. It might mean any potential for reorganization. It might mean simply a case of where the assets are going to get sold and so there is going to be some negotiations there about something as opposed to something that is dead on arrival and has filed for 11 for reasons that I never really understood so there’s – it’s going to be – it would be difficult. What I’m trying to say is if you are looking at the cases that are New York and Delaware those are different worlds from everywhere else. I think that Chicago is probably the third leg of that stool.”

market. In other jurisdictions, committees are formed only occasionally in anything other than large cases, because of the difficulty in getting creditors interested in serving.⁴⁸

2. Proxies

The Focus Group further noted that when proxies are used, they take a wide variety of forms. As observed, “[proxies are] sometimes firm-specific. It’s very unclear what powers someone holding a proxy actually has. I have seen proxies that say ‘well you have my proxy to go and be my representative with a formation of the Committee but not for the voting on counsel’.”

When asked about committee formation and counsel engagement, Focus Group judges reported that lawyer-to-lawyer relationships play a significant role in the selection of committee counsel. As observed, “a lot of the large creditors just don’t come because they’re in every case and they send their lawyer. They just call up their lawyer and say “go,” and some of those lawyers are actually are barred by their client from pitching the Committee. They say ‘you are my lawyer, you represent me, [and] I don’t want you representing the Committee.’ So those lawyers are actually highly sought-after relationship wise, lawyer to lawyer ... because everyone knows that they will vote for [their] buddy who has the office across the hall.”

Another solicitation scenario described in the Focus Group was where a lawyer calls his or her client’s credit manager to “hear [about who] the six other credit managers [are], and the lawyer calls them” in order to solicit committee employment. It was further observed, that this behavior is not “limited to lawyers. I think that there are other professionals that are involved in that chase as well. Not in part for their own engagements, but I think more engagement of professionals who are friendly to them seeking lead counsel who would be friendly to hiring the right accounting firm, turn around advisory firm or investment banking firm”

Focus Group judges observed that a lot of business gets done via video conferencing or via telecom conferencing and that’s how committees operate anyway. Rarely do you have that monthly face-to-face meeting that you used to have.

3. Disclosure

With respect to the issue of disclosure of connections, Focus Group judges asserted that, from the bench, “it’s hard to know what adequate disclosure is, [but] what you can tell pretty clearly is what is inadequate disclosure. And then you will get someone who files something and [the filing] says, “I have had contacts with creditors in this case, period, full stop, moving on and you look at that and that’s not enough.” It was clear, however, that the bench relies on the Office of the United

⁴⁸ One respondent noted that they often observed the “U.S. Trustee ... fil[ing] a record saying that they had solicited creditors in a Chapter 11, for participation in Creditors’ Committee and they couldn’t get anybody who’s interested ...[in] participat[ing] so they were not going to appoint a Committee.”

States Trustee to monitor retention applications and disclosures. The Focus Group judges consistently observed that “they are much more involved in the case, they knew who the players are and they’ve looked at the affidavits and the attachments and they . . . ask the right questions.”

Observations & Conclusions

1. *Solicitation of Prospective Committee Members*

The Survey Instrument observations span a number of different patterns of behavior, any of which on their own may or may not indicate violations or potential violations of Model Rules 7.3 and 8.4. For example, although a significant portion of respondents observed non-attorney professionals engaging in certain behavior—twenty-eight percent (28%) of such professionals participating in “cold” meetings with creditors where something of value was exchanged, and thirty-three percent (33%) observing “cold” email contact between non-attorney professionals and creditors—this behavior does not, in and of itself, appear to violate any ethics rules. As mentioned above, non-attorney professionals generally do not have ethics rules prohibiting solicitation in the same manner as do attorneys. The practice, however, becomes a violation of Model Rule 8.4 (and, by extension, Model Rule 7.3) if the non-attorney professional undertakes the behavior on behalf of an attorney who cannot him or herself engage in such practices.

For attorneys engaging in the observed behavior, the situation is more complicated. The practices described in the responses to the Survey Instrument all predicate the hallmarks of improper solicitation: no existing or past professional association between lawyer and creditor; the creditors contacted were neither family members nor did they have close personal relationships with the lawyer; and, the goal was the lawyer’s pecuniary gain. The Survey Instrument did not ask if the persons contacted were themselves lawyers, though. If they were, then Model Rule 7.3 would not apply. All of the behaviors observed—cold calls, cold emails, and attendance by lawyers at meetings with creditors—are potential violations of Model Rule 7.3. Assuming that the cold emails did not include language that the communication was “attorney advertising,” those emails could also be interpreted as a violation of a state’s version of Model Rule 7.2.

The challenge posed by these ethics rules is the difficulty of meeting a committee’s needs to learn about qualified and available prospective counsel and avoid limiting the choice of counsel to a favored few firms, all while meeting the ethics rules’ regulatory requirements for lawyers who want to be considered for employment. The Task Force found no reported decisions finding a violation of Model Rule 7.3 (solicitation) or Model Rule 7.2 (advertising) on recommending a lawyer’s services in exchange for value when a lawyer goes to dinner with an existing business client and that client’s friend (who also owns a business) for the purpose of having the existing client introduce the lawyer to the prospective client. The prospective client has consented to the contact and was invited by his friend. If the lawyer asked his client to arrange the dinner in the hope of getting new business, he likely did so to gain the benefit of his client’s support and recommendation rather than to circumvent Model Rule 7.3. And a normal business dinner is not likely to be deemed a *quid pro quo* to the existing client for the referral. If Mr. Liu had known the prospective committee members in the *Universal Building Products* case and had called them to recommend lawyers based on his personal knowledge, offering to arrange a meeting, then the court likely would have reacted very differently.

Uncertainty as to how Model Rule 7.3 applies in differing circumstances leaves attorneys with an obligation (if only for their own self-interest) to presume that, given the chance, the ethics rules on solicitation will be interpreted in the manner least favorable to whatever activity they happen to be undertaking. Inviting creditors who have no past business relationship with the attorney to a pre-committee-formation breakfast, where the attorney pays for the meal and thereby “give[s] anything of value to a person for recommending the lawyer’s services,” might violate both Model Rules 7.3 and 7.2(b). An email sent to a non-client with whom the attorney has no past association, if the email does not bear the words “attorney advertising,” could, in most states, be construed as solicitation. However, not all states require the notation of “attorney advertising,” and some states, including Florida,⁴⁹ require the pre-approval of solicitation materials.

A safer practice, in those instances where the nature of the creditor allows the practice, is to determine the identity of inside counsel for the company or outside counsel who has represented it in other cases and then contact the prospective committee member through that lawyer. The attorney should also check her firm’s conflicts database and circulate an email within the firm to ascertain if there are any past client or social relationships that would excuse the applicability of Model Rule 7.3. That would level the playing field with lawyers whose firms have previously represented prospective committee members in other cases. Telephone calls after business hours to non-lawyers in order to leave voice mail messages *appear* to be permissible under Model Rule 7.3. And if a lawyer teams up with lawyer or non-lawyer professionals who know persons at a prospective committee member’s company, and these professionals submit materials jointly, this also does not violate Model Rule 7.3, provided that care is taken to avoid (i) *quid pro quo* referrals and (ii) the non-lawyer professional engaging in activities on the lawyer’s behalf as to which the lawyer would be prohibited by the Model Rules.⁵⁰

As with most ethics issues that bear upon a lawyer’s conduct, the most pragmatic rule is that which cautions the attorney against engaging in any activity that he or she would not want to explain to a court or a jury, or have published in detail on the front page of a newspaper. In short:

- If an attorney contacts a creditor who is not a present or past client and who is not a family member or close personal friend, where the contact is not made through inside counsel or another lawyer of that creditor, and where the reason for the contact is ultimately rooted in the attorney’s desire to be hired by a committee on which that creditor might serve, that contact can easily be viewed as a violation of Model Rule 7.3.
- If a non-lawyer creditor is contacted by a non-lawyer who does not already know the creditor, but the contact is intended to benefit, through hiring, any attorney or attorneys,

⁴⁹ See Florida Rule 4-7.2, available at <http://www.floridabar.org/divexe/rrtfb.nsf/FV/805933D56732F188852573C6006D4167>, and Rule 4-7.4, available at <http://www.floridabar.org/divexe/rrtfb.nsf/FV/99855EBF1EDE4BF0852574F6005AC724>.

⁵⁰ “Comment 5 to Model Rule 7.3 also provides that “[i]f after sending a letter or other communication to a client, as permitted by paragraph (c), the lawyer receives no response, any further effort to communicate with the prospective client may violate Rule 7.3(b).”

then both Model Rules 7.3 and 8.4 are likely being violated, either intentionally or inadvertently.

- If an attorney attends a meeting of non-client, non-lawyer creditors with whom the attorney does not have a client relationship or close personal relationship, and anything of more than *de-minimis* value is provided to the non-client, non-lawyer creditors by the attorney (either actively, in the form of gifts, or passively, in the form of meals, drinks and the like beyond what professional courtesy warrants), then Model Rules 7.3 and 7.2(b) are likely being violated.

Given the prevalence with which the Survey Instrument's population observed these behaviors, it is reasonable to surmise that the variety of questionable (or sanctionable) practices is widespread enough to be recognizable and, therefore, widespread enough to capture the attention of the United States Trustee Program and the courts. Attorneys engaging in such conduct should be forewarned; the penalties for violating the Model Rules extend far beyond a single case. The reputational effect of violations not only spreads from judge to judge, as was confirmed by the Focus Group participants, but lasts years beyond a single court's opinion in a given case.

Based on data from the Survey Instrument, the review of relevant cases, and observation from the Focus Group judges, the Task Force notes that there have been, and currently are, observable practices that violate both the spirit and the language of Model Rules 7.3 and 8.4. These violations exist in the forms of cold-calling non-lawyer creditors, the exchange of value in the hopes of securing business, the use of proxies, and the use of non-attorney professionals to do that which attorneys are prohibited from doing.

The challenge, then, comes from the fact that the problem is not so much an *ethics rules* problem as it is an *enforcement* problem, although the differences in state-by-state implementation of their own versions of Model Rules 7.3 and 8.4 move the goal of universal compliance even further from the realm of possibility. There are few, if any, mechanisms for a process by which parties in interest in a case will learn that lawyers have solicited committee engagements if committee counsel does not make full disclosure of all connections, as required by Bankruptcy Rule 2014, and there are no follow-up questions by the United States Trustee or other parties. As a result, the solicitation rules have sometimes been violated with impunity. Further, lawyers who observe the rules may, with some justification, view themselves as being placed at a competitive disadvantage to those lawyers who violate the rules.⁵¹ ⁵² Therefore, insistence by the courts, the United States Trustees, and parties in interest on the full compliance with applicable ethics rules and with Bankruptcy Rule 2014 is important.

An additional problem is the variability of the solicitation rules among the States and the difficulty of applying choice-of-law principles to determine which State's solicitation rules ought to apply. The choice of which jurisdiction's ethics rules to apply can involve the state where the bankruptcy case is filed, the state or states in which the soliciting lawyer is licensed, and the state or

⁵¹ The Task Force in no way endorses the concept of violating ethics rules as a way of evening out any perceived competitive advantage.

⁵² To say nothing of an officer of the court's duty to report known ethical violations to the appropriate State Bar.

states in which the solicited parties reside.⁵³ The Task Force has determined that, given the problems, generally, with breaches of the solicitation rules, and due to the federal nature of bankruptcy practice, the bar and the judiciary would be better served by bringing uniformity to this area. However, the Task Force is equally cognizant that the ethics rules are creations of state law and, as such, vary from state to state, thereby making uniformity problematic and unrealistic. Nevertheless, as a matter of best practices, therefore, the Task Force recommends that, in situations in which more than one jurisdiction's ethics rule might apply, the attorney should assure that his or her solicitation activities are permitted under the most restrictive of the potentially applicable rules.⁵⁴

The Task Force considered the disparity between the language of the ethics rules, on the one hand, and the reports of significant instances of observable conduct that appeared to violate the Model Rules and Bankruptcy Rule 2014, on the other. Given this intersection of reported (and proscribed) practice, attorneys may be well-served by their respective state bar association's ethics hotlines. At the very least, such hotlines may confirm acceptable behavior in the state law context and, at the very most, they may provide guidance to attorneys considering engaging in conduct that might violate an ethics rule. If the middle ground is that an ethics hotline provides clarity to a set of Model Rules that can be construed to favor many differing types of viewpoints regarding solicitation, then the effort of calling the hotline is worth it.

2. *Checking for Conflicts*

As is the case when any new client engagement is undertaken, a law firm must undertake a conflicts check before committing to the representation and, to the extent practicable, prior to seeking employment in the case. It is misleading to a prospective client to solicit an engagement, only to later advise the client that the attorney has a conflict and cannot undertake the work after all. In some instances in which a conflict is discrete and not central to the representation, "conflicts counsel" can be engaged to supplement the services of primary counsel.⁵⁵ In a committee context, a conflict with a secured creditor whose lien is to be investigated by the committee may be disqualifying, for example, when that analysis is likely to be the heart of the committee's role in the case. Or that dispute may be a minor issue where another firm can bring an avoidance action, on behalf of the estate, as conflicts counsel.

If counsel were to seek engagement by a committee without first disclosing any *potential* conflict, the behavior would be tantamount to deception. The committee client is entitled to know about the conflicts and their implications before consenting to the representation. It is certainly a violation of Bankruptcy Rule 2014 to seek court approval of engagement by the committee and not disclose any such conflicts.

⁵³ This problem is discussed and reviewed generally in Michael Richman & Anthony Nguyen, *Whose Rules Apply In Multi-Jurisdictional Cold-Calling?*, 30-JAN AM. BANKR. INST. J. 18 (2012).

⁵⁴ See article cited in note 44 *supra*.

⁵⁵ See, e.g., *In re Project Orange Assoc.*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010); *In re Amdura*, 121 B.R. 862, 866-67, 871 (Bankr. D. Colo. 1990). See, *The Use of Conflicts Counsel in Business Reorganization Cases* (2013), *supra*.

3. Proxies

With respect to proxies, the Task Force finds no basis for regulation of the form or content of proxies by the United States Trustee Program, but notes that it is the United States Trustees who are ultimately responsible for the formation of committees and, therefore, are the parties most likely to have to deal with proxies. When determining the acceptability of proxies, the interests of creditors and the committee formation process are best served by clear and transparent standards from the United States Trustee Program, with those standards applied consistently across regions and offices. This consistency from the United States Trustee Program is more easily achieved when there is a predictable level of integrity in the process by which a proxy relationship is established. Therefore, some consistency regarding a proxyholder's relationship with its principal is desired, as it maintains an avenue for creditors to participate in the Chapter 11 committee process.

To that end, the Task Force offers these recommendations to provide some degree of transparency and independence in the use of proxies in order to maintain the use of proxies for creditors to participate in the committee formation process without the need to incur the time and expense of in-person participation:

1. A party holding a proxy for a creditor must communicate with the creditor prior to the organizational meeting and should have a clear understanding of:
 - a. the creditor's relationship with the debtor(s);
 - b. the nature of the creditor's claim;
 - c. the creditor's plans for a future relationship with the debtor(s); and
 - d. any potential conflicts that the creditor might have (*e.g.*, a 503(b)(9) claim; a pending sale of its claim; an interest in acquiring the debtor(s)' business(es), and the like).⁵⁶
2. The party holding the proxy should discuss with the creditor the creditor's preference or instructions as to the interviewing or selection of professionals to represent the committee.
 - a. The creditor should be given the opportunity to voice:
 - i. a desire that the proxyholder advocate for the retention of specific committee professionals in the creditor's absence;
 - ii. a desire to defer selection of professionals until the creditor can participate personally; or
 - iii. a decision to defer to the proxyholder's discretion as to selection of professionals.
 - b. If the proxyholder has a pre-existing relationship with any of the professionals that it knows or believes will be seeking employment by the committee, including any professionals who contacted the proxyholder with the intent of asking the proxyholder to serve in that capacity, the proxyholder should disclose these facts and any pre-existing relationship to the creditor.

⁵⁶ When communicating with the creditor about the proxy and the claim, the conversation can easily slip into a discussion of legal rights, *e.g.* to priority treatment that might disqualify the creditor from service on the committee. Legal advice in such situations is within the scope of the attorney-client privilege despite lack of a formal engagement as counsel. Counsel should be cognizant of the restrictions on subsequent disclosures of privileged information in Model Rule 1.18, and on the disclosure obligations described in *Universal Building Products*, 486 B.R. 650, 658-65 (Bankr. D. Del. 2010).

3. If a professional seeking employment by the committee has arranged for a party to hold a proxy for a creditor later named to the committee or has a past connection to a party who held a proxy for a creditor named to the committee, that professional should disclose this information at the time of the initial disclosures required by Rule 2014.

The Task Force's recommendations for modifications to Rule 2014 has added language to that Rule that, if adopted, will require professionals to disclose such circumstantial connections. This language is reported elsewhere in our Final Report.

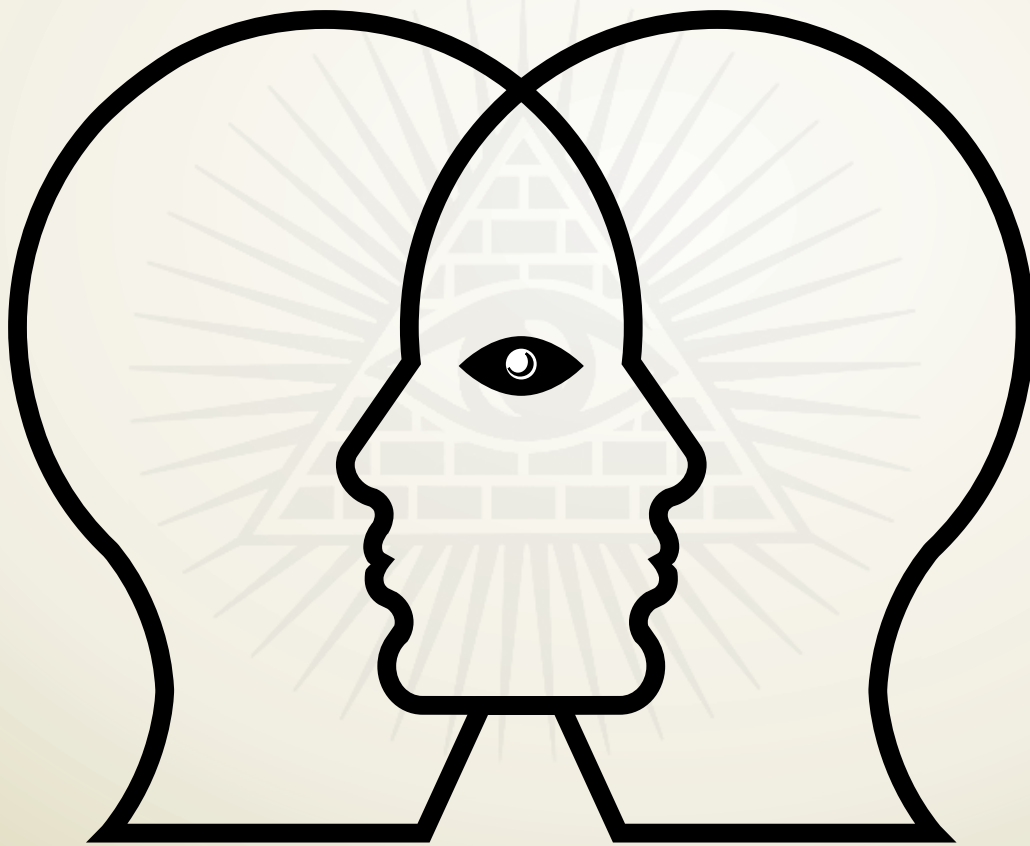
4. *Disclosure*

Bankruptcy Rule 2014 requires disclosure of all connections of the professional seeking approval of employment with, *inter alia*, creditors and their other professionals. The court in *Universal Building Products* found that solicitation relationships constitute disclosable connections, and counsel is advised to follow that precedent. The one catch-all observation that the Task Force offers is this: as in most cases involving disclosure, if the idea of disclosing an activity is undesirable to a professional, then the activity is probably questionable on its face. In disclosing any of these actions, one might argue about whether or not the activity constituted improper solicitation, but the idea that the professional sought to conceal the activity—with deliberate non-disclosure typically being viewed as the more damning act and being clearly impermissible—is removed from the debate.



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**REPORT ON STANDARDS OF PROFESSIONAL
COURTESY and CONDUCT**



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Report on Standards of Professional Courtesy and Conduct

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Report on Standards of Professional Courtesy and Conduct

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Reporter's Notes:¹

The need to promote civility is not a new topic. After all, Abraham Lincoln said, “There is a vague and popular belief that lawyers are necessarily dishonest.”² In 1992, the Seventh Circuit adopted its official civility code,³ a turning point that inspired hundreds of jurisdictions to codify their own understandings of professionalism and civility.⁴ This widespread codification is due in large measure to a perceived increase in incivility among business and legal professionals. What was once a watershed moment has now reached a tipping point. Indeed, over the past 30 years, the “biggest negative change [in the legal profession] has probably been the decreased emphasis on professionalism.”⁵ Yet despite this universal concern about incivility, there has been little discussion or study regarding unprofessional or uncivil behavior among insolvency professionals.⁶

I. Duties of civility and professionalism.

In striving to fulfill their duties and responsibilities to the public, insolvency professionals⁷ must remain conscious of the broader duty owed to their profession. The bankruptcy process is part of a larger legal system that is adversarial by design, and insolvency professionals must ardently represent their respective positions to ensure that the system is effective and trusted. But also rooted in bankruptcy, perhaps more so than in other areas of litigation, are the concepts of cooperation and

¹ James Patrick Shea (Civility Task Force Chair), David Houston, IV (Vice Chair), Emily Taube (Vice Chair), Nancy B. Rapoport, Deborah L. Thorne, and Bill P. Weintraub put together an excellent first draft of this topic, and I thank them. Additionally, I thank Civility Task Force members Rudy J. Cerone, Hon. Daniel P. Collins, Hon. Mary Grace Diehl, Edward T. Gavin, Hon. Bruce A. Harwood, Nina M. Parker, Andrea B. Schwartz, Hon. Elizabeth S. Stong, Hon. Howard R. Tallman, Hon. Gregg W. Zive, and James T. Markus. Finally, I thank Ashley D. Champion, Phillip Parham III, and Kimberly B. Reeves, graduates and students at Georgia State University College of Law, for their hard work in assisting our Task Force.

² Abraham Lincoln, July 1, 1850.

³ STANDARDS FOR PROFESSIONAL CONDUCT, U.S.C.S. Ct. App. 7th Cir., Appx. (LexisNexis 2013).

⁴ Howard Merten, *The Case for Self-Interested Civility*, F.D.C.C. Q., Jan. 1, 2012 at 214; *see also*, Ctr. for Prof'l Resp., *Professionalism Codes*, A.B.A., http://www.americanbar.org/groups/professional_responsibility/resources/professionalism/professionalism_codes.html (last updated August 2012) (listing more than 100 jurisdictional professionalism codes).

⁵ Jim Maiwurm, *Above the Law Interrogatories: 10 Questions with Jim Maiwurm of Squire Sanders*, ATL INTERROGATORIES (MAY 22, 2013, 2:55 PM), <http://abovethelaw.com/2013/05/the-atl-interrogatories-10-questions-with-jim-maiwurm-of-squire-sanders/>; *see, e.g.*, Howard Merten, *The Case for Self-Interested Civility*, *supra* note 4.

⁶ Despite the lack of empirical evidence related to the insolvency world, it is undeniable that, in recent years, there has been an increase in unprofessional and uncivil behavior among insolvency professionals; yet no civility code relates strictly to the bankruptcy profession.

⁷ The American Bankruptcy Institute “includes more than 13,000 attorneys, auctioneers, bankers, judges, lenders, professors, turnaround specialists, accountants and others bankruptcy professionals.” *About ABI*, AM. BANKR. INST., http://www.abiworld.org/AM/Template.cfm?Section=About_ABI (last visited July 5, 2013).

negotiation, and those components seem to have become misplaced in an increasingly uncivil legal climate.

While some headlines may make us snicker, others leave us disappointed. The collection of attorney misconduct stories reiterate that the system's integrity must be fortified by ensuring that members' conduct adheres to fundamental concepts of civility.⁸ Undoubtedly, a professional owes his colleagues a certain level of candor, courtesy, fairness, and cooperation. Indeed, the bankruptcy system is a "civilized mechanism for resolving disputes, but only if the [professionals] themselves behave with dignity."⁹ In disagreement, we must not be disagreeable.

II. Addressing civility among bankruptcy professionals.

Despite the apparently heavy-handed focus on changing the character of professionals' interactions, the lack of civil behavior continues to plague professional communities.¹⁰ Incivility comes with a high price. As Judge Gene E.K. Pratter (addressing opposing litigators' incivility) commented, "[U]ncivil, abrasive, abusive, hostile or obstructive conduct . . . impedes the fundamental goal of resolving disputes rationally, peacefully and efficiently."¹¹

For over two decades, the legal community has attempted to quash incivility among members, but the problem seems more deeply entrenched in professional culture despite efforts to excise the growth. While the causes and effects of this troubling trend are numerous, growing

⁸ See Jennifer Smith, *Lawyers Behaving Badly Get a Dressing Down from Civility Cops*, WALL ST. J. (U.S.), Jan. 27, 2013 (the prevalence of in-court shouting and vulgar emails and phone calls to judges and clients further damages the already poor reputations of "Rambo" litigators), available at <http://online.wsj.com/article/SB10001424127887323539804578263733099255320.html>; e.g., *Goldberg v. Mt. Sinai Med. Ctr. of Greater Miami, Inc.*, 2007 Bankr. LEXIS 2780, *6 (ordering bankruptcy attorney William P. Smith (appearing *pro hac vice*) to attend professionalism course for telling U.S. Bankruptcy Judge Laurell Isicoff, "[Y]ou're a few French fries short of a Happy Meal," because "there is no jurisdiction in the United States . . . [where Smith's comments] would fall within the bounds of professional behavior."); Debra Cassens Weiss, *11th Circuit OKs Sanction for Brief Calling Judge's Findings 'Half Baked' and Wine Peace Offering*, A.B.A. J., Oct. 17, 2012, available at http://www.abajournal.com/news/article/11th_circuit_oks_sanction_for_brief_calling_judges_findings_half_baked_wine (reporting that the Eleventh Circuit Court of Appeals upheld bankruptcy attorney Kevin Gleason's 60-day suspension for calling U.S. Bankruptcy Judge John Olson's rulings "half-baked," then sending a bottle of wine to the judge's chambers with a note inviting him to resolve the issue "privately"); G.M. Filisko, *Be Nice: More States Are Treating Incivility as a Possible Ethics Violation*, A.B.A. J., Apr. 2012, available at http://www.abajournal.com/magazine/article/be_nice_more_states_are_treating_incivility_as_a_possible_ethics_violation (reporting that famed Jack Kevorkian attorney Geoffrey Fieger compared three Michigan Court of Appeals judges to Hitler and other Nazis on his radio program after the three-judge panel overturned a \$15M jury verdict for his client); Kyle Munzenrieder, *Lawyers Thrown Off Case for Drawing D*** Pics, Playing Angry Birds During Deposition*, Miami New Times Blog (May, 17 2012, 12:26 PM), available at http://blogs.miamiherald.com/2012/05/lawyers_drew_dick_pictures_and.php (reporting that two attorneys, Richard Cellar and Stacey Schulman, and the Morgan & Morgan firm were disqualified from a case because one lawyer drew pictures of male genitalia and played the video game Angry Birds during depositions); Debra Cassens Weiss, *Courtroom 'Shoutfest' over Scheduling Conflict Results in \$200 Fine for Lawyer*, A.B.A. J., Apr. 3, 2012, available at http://www.abajournal.com/news/article/lawyer_is_fined_200_after_scheduling_conflict_spurs_courtroom_shouting.

⁹ Melvin F. Right, Jr., *I'll See You in Court!*, N.C. CH. J.'S COMM'N ON PROF'LISM, (Feb. 2012), available at <http://www.nccourts.org/Courts/CRS/Councils/Professionalism/Documents/seeyouincourt-feb2012.pdf>.

¹⁰ See, e.g., Julie Kay, *Got Civility? Litigation Is Getting Uglier than Ever*, DAILY BUS. REV., Jan. 28, 2013, available at <http://dailybusinessreview.com/PubArticleDBR.jsp?id=1202585857660&slreturn=20130607200553>.

¹¹ Michael J. Newman, *Being the Lawyer You Want to Be*, THE LEGAL INTELLIGENCER, March 22, 2013 (citing *Huggins v. Coatesville Area Sch. Dist.*, CIV A. 07-4917 (E.D. Pa. Sept. 16, 2009)), available at <http://law.com/jsp/pa/PubArticlePA.jsp?id=1202593170481>.

incivility is likely attributable in large part to the business (and legal) world's rapidly changing landscape. Popular culture continually embraces over-the-top portrayals of hard-nosed lawyers, judges, and businessmen.¹² Factor in technological advances,¹³ a globalized business market,¹⁴ decreased mentorship within the legal community,¹⁵ and vague professionalism policies,¹⁶ and it creates a perfect storm that may affect young professionals' misguided understanding of professionalism.¹⁷ Reversing the trend will require changing the culture. The task of clearly defining acceptable standards of conduct lies with each profession's governing body, but personal responsibility for one's actions must also be at the forefront of civility consideration.

During his tenure as president of the American Bankruptcy Institute, Geoffrey L. Berman created the Civility Task Force¹⁸ to promulgate principles of civility within the context of the insolvency profession. Under the leadership of ABI's immediate past-president, Jim Markus, and current president Patricia A. Redmond, the Task Force drafted the proposed Principles of Civility, a professionalism initiative intended to be a framework on which to build civility among bankruptcy professionals and fortify ABI's leadership role in policymaking and education.

The bankruptcy profession largely is self-regulating. Thus, re-emphasizing professionalism must begin with each member's commitment to carry out his or her duties to colleagues, clients, and the public in a manner that instills trust and confidence in the profession. The Principles are designed to guide ABI's member community of more than 13,000 by codifying fundamental concepts of civility. Accordingly, the proposed Principles are not intended to supplement professional ethical codes, nor are they to be enforced by a disciplinary committee.¹⁹ Rather, these Principles of Civility are aspirational — meant to encourage members to rise above the fray to promote the profession's integrity and instill in the public a trust in the bankruptcy system. Accordingly, the Principles' effectiveness relies on individuals maintaining accountability to themselves and their peers.

III. Standards of civility and professionalism across jurisdictions.

¹²G.M. Filisko, *You're Out of Order! Dealing with the costs of incivility in the legal profession*, A.B.A. J., Jan. 2013, at 37.

¹³Gone are the days when written communications were carefully crafted with time to reflect on the content of letters before putting them in the mailbox. Today, typing a strongly worded email and hitting send is often a source of strife among colleagues. See G.M. Filisko, *You're Out of Order!*, supra note 12 ("By far, technology is cited most often as the foundation for boorish behavior."); David Bernstein, *A New Civility Standard*, VOLOKH CONSPIRACY (Mar. 4, 2013, 4:36 PM), <http://volokh.com/2013/03/04/a-new-civility-standard>.

¹⁴Generally, today's business environment requires interacting with colleagues from different towns, states, or even countries. See, e.g., Julie Kay, *Got Civility?*, supra note 10 ("Now [professionals] frequently parachute in[] . . . from out of town and may not know or ever see the same [people] again.").

¹⁵G.M. Filisko, *You're Out of Order!*, supra note 12, at 37.

¹⁶See, e.g., Kay, *Got Civility?*, supra note 10; Phillip Bantz, *All fun and games until free speech rights in S.C. get violated*, S.C. Law. Wkly., Feb. 1, 2013 (listing reasons judges and Florida bar associations have given for the rise of incivility in Florida's legal profession), available at <http://sclawyersweekly.com/news/2013/02/01/all-fun-and-games-until-free-speech-rights-get-violated>.

¹⁷G.M. Filisko, *You're Out of Order!*, supra note 12.

¹⁸The Civility Task Force is a stand-alone committee created to work with ABI's Ethics and Professional Compensation Committee in order to address standards of conduct within the bankruptcy profession.

¹⁹In this sense, the Principles fit within the "Professionalism as Focus of Aspiration" definition from Robert Atkinson: "voluntary conformity with legally unenforceable standards." Robert Atkinson, *A Dissenter's Commentary on the Professionalism Crusade*, 74 Tex. L. Rev. 259, 275 (1995).

As a starting point, the American Bar Association's House of Delegates adopted Resolution 108, which, at a general policy level, encourages attorneys to promote public discourse. The Resolution also calls for lawyers to personally take notice and take charge of the degree to which they engage in civil discourse, and to exercise self-management of communicative etiquette in all of their professional dealings. The Resolution also puts the onus on bar associations to take "meaningful steps" toward fostering civil discourse and promoting the lawyer's role in its realization. This purposefully vague call to action is intended to encourage creative pursuits — no matter how big or small — provided that the step is taken to promote and embody civil public discourse in the law profession.

IV. The American Bankruptcy Institute's Principles of Civility

"Every action done in company ought to be with some sign of respect to those that are present." – George Washington, ca. 1744.

A. Goal(s) and purpose(s) of the Principles.

Purpose(s). In furtherance of the fundamental concepts of civility, these Principles are designed to define the expected degree of courtesy and professionalism among insolvency professionals and to provide specific guidance to those new to bankruptcy practice as to how to maintain an acceptable standard of professional conduct. The Principles are intended to educate and guide professionals who are representatives of — or practicing in — American bankruptcy courts.

Although professionals are encouraged to comply with the Principles, this civility code does not establish enforceable minimum standards of professional care or competence. Rather, the Principles should be considered against the context of the professional's duty to represent clients competently, diligently, and ethically, and to promote the ideals of professional courtesy, conduct, and cooperation.

The Principles are not a basis for litigation, sanctions, or penalties. Nothing in the Principles supersedes existing ethics rules or alters existing standards of conduct against which professional negligence may be determined. Instead, ABI intends that its members voluntarily agree to adhere to these Principles so as to improve the bankruptcy profession and the administration of justice for all of its participants.

Goal(s). Consider ethics and professionalism issues in bankruptcy practice and make recommendations for uniform standards.

B. Principles of Civility²⁰

Preamble

Professionals should be mindful of the need to protect the integrity of the bankruptcy process in the eyes of the public and in the eyes of the legal community around us.

General Duties of Professionals

- 1. Professionals should be courteous and civil in all professional dealings with other persons.**
 - a. Professionals should act in a civil manner regardless of the feelings that they or their clients may have toward others.
 - b. Professionals can disagree without being disagreeable. Effective representation does not require antagonistic or acrimonious behavior. In all communications, professionals should avoid vulgar language, disparaging personal remarks, or other indications of acrimony toward counsel, parties, witnesses, and court personnel.
 - c. Professionals should require that persons under their supervision conduct themselves with courtesy and civility.
- 2. When not inconsistent with their clients' interests, professionals should cooperate with other professionals in an effort to avoid litigation and to resolve litigation that already has commenced.**
 - a. Professionals should avoid unnecessary motion practice or other judicial intervention whenever it is practicable to do so.
 - b. Professionals should allow themselves sufficient time to resolve any dispute or disagreement by communicating with one another directly (in person or by telephone) and imposing reasonable and meaningful deadlines in light of the nature and status of the case.
- 3. Professionals should respect the schedule and commitments of others, consistent with the protection of the client's interests.**
 - a. On receipt of any inquiry concerning a proposed time for a hearing, deposition, meeting, or other proceeding, a professional should — if not inconsistent with the legitimate interests of the client — agree to the proposal or offer a counter-suggestion that is as close in time to the original proposal as is reasonably possible.

²⁰ Many of the concepts incorporated into the Principles of Civility began with the Administrative Order issued by the Bankruptcy Court for the Eastern District of New York that adopted the New York State Standards of Civility. *See* Ch. J. Judith S. Kaye, *Standards of Civility*, NEW YORK STATE UNIFIED CT. SYSTEM, (Oct. 1997), *available at* http://www.americanbar.org/content/dam/aba/administrative/labor_law/meetings/2009/2009_ethics_h.authcheckdam.pdf.

- b. A professional should agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of the client will not be adversely affected. Ordinarily, the first request for an extension of time should be granted as a matter of courtesy.
 - c. A professional should consult with others regarding scheduling matters in a good-faith effort to avoid scheduling conflicts. Likewise, a professional should cooperate with others when scheduling changes are requested, provided that the legitimate interests of his or her client will not be jeopardized.
 - d. A professional should not attach unreasonable conditions to any extensions of time. A professional is entitled to impose conditions appropriate to preserve rights that an extension otherwise might jeopardize.
 - e. A professional should not request a calendar change or misrepresent a conflict in order to obtain an undue advantage or delay.
 - f. A professional should advise clients against the strategy of refusing to accede to time extensions for the sake of appearing “tough.”
4. **A professional should not initiate communications with the intention of gaining undue advantage from the recipient’s lack of immediate availability.**
5. **A professional should return telephone calls promptly and respond to communications that reasonably require a response, with due consideration of time zone differences and other known circumstances affecting availability.**
6. **The timing and manner of the servicing of papers should not be designed to cause disadvantage or embarrassment to the party receiving the papers.**
7. **A professional should not use any aspect of the litigation process, including discovery and motion practice, as a means of harassment or for the purpose of unnecessarily prolonging litigation or increasing litigation expenses.**
- a. A professional should avoid discovery that is not necessary to obtain facts or perpetuate testimony or that is designed to place an undue burden or expense on a party.
 - b. A professional should respond to discovery requests reasonably and not strain to interpret the request so as to avoid disclosure of relevant and non-privileged information.
 - c. A professional should base discovery objections on a good-faith belief in their merit and should not object solely for the purpose of withholding or delaying the disclosure of relevant information.

- 8. In out-of-court proceedings, professionals should not engage in any conduct that would not be appropriate in the presence of a judge.**
- 9. A professional should keep his or her word.**
- 10. A professional should not mislead others involved in the bankruptcy process.**
 - a. A professional should not falsely hold out the possibility of settlement as a means for adjourning discovery or delaying trial.
 - b. A professional exchanging drafts with others should identify any changes in the drafts or otherwise explicitly bring those changes to the attention of the recipient.

General Duties of Lawyers

- 1. Lawyers should be respectful of the schedules and commitments of others.**
 - a. When scheduling hearings and other adjudicative proceedings, a lawyer should request an amount of time that is calculated to permit full and fair representation of the matter to be adjudicated and to permit an appropriate time for the lawyer's adversary to prepare a full response.
 - b. A lawyer should notify other counsel and, if appropriate, the court and other persons foreseeably affected at the earliest possible time when hearings, depositions, meetings, or conferences are to be canceled or postponed, and should inform the court as soon as possible as to whether the parties will seek to have the matter continued or whether the matter has been resolved.
 - c. A lawyer should serve papers to other counsel with the understanding that all parties should have adequate time to consider their contents.
- 2. In examinations and other proceedings, as well as in meetings and negotiations, professionals should conduct themselves with dignity and refrain from displaying rudeness and disrespect.**
 - a. Lawyers should advise their clients and witnesses of the proper conduct expected of them in court, at examinations, and at conferences.
 - b. A lawyer should not obstruct questioning during a deposition or object to deposition questions unless necessary to protect the legitimate interests of the client.
 - c. Lawyers should ask only those questions they reasonably believe are necessary for the prosecution or defense of an action. Lawyers should refrain from asking repetitive or argumentative questions and from making self-serving statements.

3. Lawyers should not mislead others involved in the bankruptcy process.

- a. A lawyer should not ascribe a position to another professional that he or she has not taken or otherwise seek to create an unjustified inference based on the professional's statements or conduct.
- b. In preparing written versions of agreements and court orders, a lawyer should attempt to correctly reflect the agreement of the parties or the direction of the court.

Lawyers' Duties to the Court and Court Personnel

1. A lawyer is both an officer of the court and an advocate. As such, a lawyer should always strive to uphold the honor and dignity of the profession, avoid disorder and disruption in the courtroom, and maintain a respectful attitude toward the court and its personnel.

- a. A lawyer should speak and write civilly and respectfully in all communications with the court and court personnel, avoiding histrionics and innuendo.
- b. A lawyer should stipulate to relevant matters if they are undisputed and if no good-faith advocacy basis exists for a refusal to so stipulate.
- c. A lawyer should use his or her best efforts to dissuade clients and witnesses from causing disorder or disruption in the courtroom.
- d. A lawyer should not engage in conduct intended primarily to harass or humiliate witnesses, parties, or professionals.
- e. During court proceedings, a lawyer shall maintain neutral behavior and refrain from making inappropriate gestures, facial expressions, audible comments, or similar attitudes. A lawyer shall also advise clients to conduct themselves similarly.

2. Court personnel are an integral part of the justice system and should be treated with courtesy and respect at all times.

- a. A lawyer should be considerate of the time constraints and pressures on the court and court staff inherent in their efforts to administer justice.
- b. A lawyer should be punctual and prepared for all court appearances; if delayed, the lawyer should notify the court and counsel whenever possible. Parties should notify the court of requested continuances or resolutions as soon as practicable.
- c. A lawyer should use his or her best efforts to ensure that persons under their direction act civilly toward court personnel.

Duties of Judges and Court Personnel to Lawyers, Parties, and Witnesses

- 1. A judge should be patient, courteous, and civil to lawyers, parties, and witnesses.**
 - a. A judge should maintain control over the proceedings and ensure that the proceedings are conducted in a civil manner.
 - b. Judges should not employ hostile, demeaning, or humiliating words in opinions or in written or oral communications with lawyers, parties, or witnesses.
 - c. To the extent consistent with the efficient conduct of litigation and other demands on the court, judges should be considerate of the schedules of lawyers, parties, and witnesses when scheduling hearings, meetings, or conferences.
 - d. Judges should be punctual in convening all trials, hearings, meetings, and conferences; if delayed, they should notify counsel when practicable.
 - e. Judges should make all reasonable efforts to promptly decide all matters presented to them for decision.
 - f. Judges should use their best efforts to ensure that court personnel under their direction act civilly toward lawyers, parties, and witnesses and be mindful of the far-reaching consequences of sanctions before imposing them.
- 2. Court personnel should be courteous, patient, and respectful while providing prompt, efficient, and helpful service to all persons having business with the courts.**
 - a. Court employees should respond promptly and helpfully to requests for assistance or information; if the requests are for information that a court employee is not permitted to provide, then the court employee should refuse that request with an explanation of the reason for the refusal.
 - b. Court employees should respect the judge's directions concerning the procedures and atmosphere that the judge wishes to maintain in his or her courtroom.
 - c. Court employees should avoid unfounded and unreasonable attacks on lawyers and the judiciary.
 - d. When circulating documents, a court employee should explicitly highlight all proposed changes.

1 IN THE UNITED STATES BANKRUPTCY COURT

2 FOR THE DISTRICT OF DELAWARE

3

4 _____ X

5 In Re: Chapter 11

6 Case No. 09-10138 (KG)

7 NORTEL NETWORKS INC., et al.,

8 Jointly Administered
Debtors.

9 _____ X

10

11 TRANSCRIPT OF PROCEEDINGS

12 BEFORE THE HONORABLE JUDGE KEVIN GROSS

13 UNITED STATES BANKRUPTCY JUDGE

14

15 Courtroom 3

16 824 Market Street

17 Wilmington, Delaware

18 10:07 a.m.

19 Tuesday, January 24, 2017

20 Lisa Forlano, CCR, CRR, RMR

21 Reliable Court Reporting

22 302-654-8080

23

24

25

1 everybody about exculpation is, I was at the
2 table and therefore I want to be exculpated.
3 I gave up something on claims, I want to be
4 exculpated.

5 Your Honor, Chapter 11 is people on the
6 table banging the hell out of each other.
7 It's about people fighting for their claims,
8 about people resolving their claims, giving up
9 something on their claims.

10 Out of six judges in this district,
11 Your Honor, you're the only one who still
12 allows exculpation to non-estate fiduciaries.
13 Let me first point out that they pointed out a
14 couple of cases by Judge Silverstein and Judge
15 Sontchi where exculpation was allowed.
16 Subsequently Judge Silverstein in ATLS
17 acquisition said no more exculpation. In
18 Allied System Holdings, Judge Sontchi in
19 Hercules said no exculpation you don't get it.
20 The reason is the estate fiduciaries are
21 there. They have a job to do. They're
22 representing more than just their own
23 interest. They're usually representing some
24 very large constituency. An indentured
25 trustee for bondholders, as a member of

1 committee is representing general unsecured
2 creditors, I have no objection for them being
3 exculpated for that.

4 JUDGE GROSS: Right.

5 MR. KINNEY: Anything else they're
6 doing, they're doing on behalf of the
7 bondholders. They have a contractual
8 obligation. They have a fiduciary to the
9 bondholder. It does not run to the state. It
10 does not run to any other question other than
11 the bondholders.

12 Essentially what they're saying is, we
13 were at the table, we want exculpation for
14 that reason. I know Your Honor has said you
15 disagree as everybody else's interpretation of
16 PWS. Your Honor, I have to say, I disagree
17 with your interpretation.

18 In PWS somebody had argued that
19 committee counsel was getting a release and
20 the Court looked at it and said it's an
21 exculpation is that they're getting and it's
22 appropriate because they're fiduciaries. They
23 didn't say anything about being appropriate
24 for anybody who is a nonfiduciary. You're
25 essentially looking at if it's really an

1 exculpation, it's a release, Your Honor, and
2 what are they doing to get this additional
3 release that basically even people who didn't
4 consent to it, even the people who didn't plan
5 are still bound not to sue them. I have
6 indentured trustees who acted. What if an
7 indentured trustee did something horribly
8 wrong and was in breach of the trust. It
9 seems to me one of the bondholders can sue the
10 indentured trustee, regardless of what the
11 indentured trust provides. It might have some
12 caveat that allowed that suit. I think this
13 exculpation, unless it was gross misconduct or
14 willful in -- willful in conduct or gross
15 negligence, pardon me, unless it's one of
16 those things the bondholders are going to be
17 told, nope, not right here. You're done, you
18 can't sue.

19 The concept of exculpation has been
20 treated by the other judges in this district
21 as a narrow one. Your Honor, what I also
22 noted is they cite a lot of cases where you're
23 the judge. So they're citing you to you.

24 JUDGE GROSS: Right.

25 MR. KINNEY: We had a judge in Eastern

1 District of Pennsylvania, Judge Shaw, who was
2 famous for citing himself. I don't think he
3 fared too well historically, Your Honor.

4 JUDGE GROSS: That's kind of insulting.
5 But that's all right. You can insult me.

6 MR. KINNEY: I'm not trying to be
7 insulting.

8 JUDGE GROSS: I've heard enough on this
9 point.

10 MR. KINNEY: You're saying nobody is
11 smarter than you.

12 JUDGE GROSS: Mr. Kinney, I've heard
13 enough from you. Sit down. You may sit down
14 now.

15 MR. KINNEY: I may, but I won't, Your
16 Honor.

17 JUDGE GROSS: You may sit down, I said,
18 or I'll call in the guards to sit you down.
19 Is that what you want me to do?

20 MR. KINNEY: No, Your Honor, that's not
21 what I want to do.

22 JUDGE GROSS: Then sit down.

23 MR. KINNEY: I have a right to finish,
24 Your Honor.

25 JUDGE GROSS: No, you're finished your

1 argument. Sit down.

2 MR. KINNEY: Thank you.

3 JUDGE GROSS: You're a wise guy,
4 Mr. Kinney.

5 MR. KINNEY: I'm a wise man, but not a
6 wise guy.

7 JUDGE GROSS: Now, I will take this
8 under consideration.

9 Mr. Cantwell.

10 MR. CANTWELL: What's the next
11 objection?

12 JUDGE GROSS: The next objection.

13 MR. CANTWELL: It's just more of a
14 notice just to draw Your Honor's attention to.

15 JUDGE GROSS: Yes.

16 MR. CANTWELL: As we've discussed at
17 the disclosure statement hearing, and today is
18 not the day to argue the merits of the SPSA
19 research claims, but we wanted to make Your
20 Honor aware of the notice and agreement that
21 we entered into with them to avoid a
22 confirmation objection today and it sets us up
23 to move that case forward as quickly as
24 possible. The parties did agree to and did
25 work consensually through the plan



Department of Justice

FOR IMMEDIATE RELEASE
TUESDAY, MARCH 3, 2015
WWW.JUSTICE.GOV/UST

UST
CONTACT: JANE LIMPRECHT
(202) 305-7411

U.S. TRUSTEE PROGRAM REACHES \$50 MILLION SETTLEMENT WITH JPMORGAN CHASE TO PROTECT HOMEOWNERS IN BANKRUPTCY

Settlement Addresses Robo-Signing and Other Improper Practices in Bankruptcy Cases

WASHINGTON – The Department of Justice's U.S. Trustee Program (USTP) has entered into a national settlement agreement with JPMorgan Chase Bank N.A. (Chase) requiring Chase to pay more than \$50 million, including cash payments, mortgage loan credits and loan forgiveness, to over 25,000 homeowners who are or were in bankruptcy. Chase will also change internal operations and submit to oversight by an independent compliance reviewer. The proposed settlement has been filed in the U.S. Bankruptcy Court for the Eastern District of Michigan, where it is subject to court approval.

In the proposed settlement, Chase acknowledges that it filed in bankruptcy courts around the country more than 50,000 payment change notices that were improperly signed, under penalty of perjury, by persons who had not reviewed the accuracy of the notices. More than 25,000 notices were signed in the names of former employees or of employees who had nothing to do with reviewing the accuracy of the filings. The rest of the notices were signed by individuals employed by a third party vendor on matters unrelated to checking the accuracy of the filings.

Chase also acknowledges that it failed to file timely, accurate notices of mortgage payment changes and failed to provide timely, accurate escrow statements.

"It is shocking that the conduct admitted to by Chase in this settlement, including the filing of tens of thousands of documents in court that never had been reviewed by the people who attested to their accuracy, continued as long as it did," said Acting Associate Attorney General Stuart F. Delery. "Such unlawful and abusive banking practices can deprive American homeowners of a fair chance in the bankruptcy system, and we will not tolerate them."

"This settlement should signal once again to banks and mortgage servicers that they cannot continue to flout legal requirements, compromise the integrity of the bankruptcy system and abuse their customers in financial distress," said Director Cliff White of the U.S. Trustee Program. "It should be acknowledged that Chase responded to the U.S. Trustee's court actions by conducting an internal investigation and taking steps to mitigate harm to homeowners. But years after uncovering improper mortgage servicing practices and entering into court-ordered settlements to fix flawed systems, it is deeply disturbing that a major bank would still make

improper court filings and fail to provide adequate and timely notices to homeowners about payments due. Other servicers should take note that the U.S. Trustee Program will continue to police their practices and will work to ensure that those who do not comply with bankruptcy law protections for homeowners will pay a price, just as Chase has done in this matter.”

Payments, Credits and Contributions of More Than \$50 Million.

In the proposed settlement, Chase agrees to provide payments, credits and contributions totaling more than \$50 million:

- Chase will provide \$22.4 million in credits and second lien forgiveness to about 400 homeowners who received inaccurate payment increase notices during their bankruptcy cases.
- Chase will pay \$10.8 million to more than 12,000 homeowners in bankruptcy through credits or refunds for payment increases or decreases that were not timely filed in bankruptcy court and noticed to the homeowners.
- Chase will pay \$4.8 million to more than 18,000 homeowners who did not receive accurate and timely escrow statements. This includes credits for taxes and insurance owed by the homeowners and paid by Chase during periods covered by escrow statements that were not timely filed and transmitted to homeowners.
- Chase will pay \$4.9 million, through payment of approximately \$600 per loan, to more than 8,000 homeowners whose escrow payments Chase may have applied in a manner inconsistent with escrow statements it provided to the homeowners.
- Chase will contribute \$7.5 million to the American Bankruptcy Institute’s endowment for financial education and support for the Credit Abuse Resistance Education Program.

Changes to Internal Operations: In the proposed settlement Chase also agrees to make necessary changes to its technology, policies, procedures, internal controls and other oversight systems to ensure that the problems identified in the settlement do not recur.

Oversight by Independent Reviewer: Amy Walsh, a partner with the law firm Morvillo LLP, has been selected to serve as independent reviewer to verify that Chase complies with the settlement order. The independent reviewer will file public reports with the bankruptcy court.

No Effect on Additional Relief by Homeowners: This settlement does not affect the rights of any homeowners to seek any relief against Chase that they may deem appropriate.

Chase Contact Information: Homeowners with questions about the settlement may contact Chase at 866-451-2327.

The settlement is the culmination of actions taken by the U.S. Trustee Program in districts around the country concerning Chase’s improper practices in bankruptcy cases, including robo-signing. Director White commended the U.S. Trustee Program team in the field and headquarters who expertly identified, investigated, litigated and settled this matter, including Deputy Director and General Counsel Ramona Elliott, National Creditor Enforcement Coordinator Gail Geiger and Trial Attorneys Diarmuid Gorham and Kelley Callard.

The U.S. Trustee Program is the component of the Justice Department that protects the integrity of the bankruptcy system by overseeing case administration and litigating to enforce the bankruptcy laws. The U.S. Trustee Program has 21 regions and 93 field office locations.

Contact: Jane Limprecht, Public Information Officer
Executive Office for U.S. Trustees
(202) 305-7411

#

15-256

DO NOT REPLY TO THIS MESSAGE. IF YOU HAVE QUESTIONS, PLEASE USE THE CONTACTS IN THE MESSAGE OR CALL THE OFFICE OF PUBLIC AFFAIRS AT 202-514-2007.

2017 SOUTHWEST BANKRUPTCY CONFERENCE

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION-BAY CITY

In re:

**DAVID S. BELZAK,
LYNDA J. BELZAK,**

Debtors.

Case No. 10-23963-dob

Chapter 13

Hon. Daniel S. Opperman

**STIPULATION FOR ENTRY OF ORDER APPROVING SETTLEMENT BETWEEN
THE UNITED STATES TRUSTEE PROGRAM AND JPMORGAN CHASE BANK, N.A.**

Daniel M. McDermott, the United States Trustee for Region 9, the Executive Office for United States Trustees (EOUST), the United States Trustees and Acting United States Trustees for Regions 1 through 21, and JPMorgan Chase Bank, N.A., by their respective counsel, respectfully request that this Court enter the Order Approving Settlement between the United States Trustee Program and JPMorgan Chase Bank, N.A. A copy of the proposed Order is attached.

DANIEL M. McDERMOTT
UNITED STATES TRUSTEE
Region 9

DYKEMA GOSSETT PLLC

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Dated: February 27, 2015

Dated: February 27, 2015

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AMERICAN BANKRUPTCY INSTITUTE

EXECUTIVE OFFICE FOR
UNITED STATES TRUSTEES

By: 
Ramona D. Elliott
Deputy Director/General Counsel


Dated: February 27th, 2015

JPMORGAN CHASE BANK, N.A.,
On behalf of itself and its affiliates

By: 
Kevin P. Watters
Chief Executive Officer, Mortgage Banking

Dated: February 26, 2015

K&L GATES LLP

By: 
phoebe.winder@klates.com
Attorneys for JPMorgan Chase Bank, N.A.
State Street Financial Center
One Lincoln Street
Boston, MA 02111
(617) 261-3100
Admitted in the Eastern District of Michigan as of August 2014

Dated: February 27, 2015

AMERICAN BANKRUPTCY INSTITUTE

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION-BAY CITY

In re:

DAVID S. BELZAK,
LYNDA J. BELZAK,

Debtors.

Case No. 10-23963-dob

Chapter 13

Hon. Daniel S. Opperman

ORDER APPROVING SETTLEMENT BETWEEN THE UNITED STATES TRUSTEE
PROGRAM AND JPMORGAN CHASE BANK, N.A.

RECITALS

Whereas, on October 26, 2010, David S. Belzak and Lynda J. Belzak (the "Belzaks") filed a chapter 13 Bankruptcy Petition in the United States Bankruptcy Court for the Eastern District of Michigan, captioned *In re David S. Belzak and Lynda J. Belzak*, Case No. 10-23963 (the "Belzaks' Case").

Whereas, on January 19, 2011, JPMorgan Chase Bank, N.A. ("Chase") filed a Proof of Claim in the Belzaks' Case asserting a secured claim arising out of a Home Equity Line of Credit Agreement dated September 7, 1999, executed by the Belzaks (the "Loan"). (Claims Register for Case No. 10-23963, Claim 15).

Whereas, on July 30, 2013, pursuant to Bankruptcy Rule 3002.1, Chase filed a payment change notice ("PCN") for the Loan. (Dkt. No. 57).

Whereas, on August 7, 2013, the Belzaks objected to the PCN, and the Court sustained the objection by Order entered on September 4, 2013. (Dkt. Nos. 59 & 63).

Whereas, on November 8, 2013, the United States Trustee for Region 9 (the "United States Trustee") filed an *ex-parte* motion requesting, among other things, that the Court enter an order requiring Chase to appear for an examination under Bankruptcy Rule 2004 and to produce certain documents (the "2004 Motion"). (Dkt. No. 71).

Whereas, on November 8, 2013, the Court entered an Order granting the 2004 Motion. (Dkt. No. 72).

Whereas, on November 25, 2013, Chase filed a motion for protective order seeking to modify the discovery ordered by the Court. (Dkt. No. 82).

Whereas, thereafter Chase engaged the United States Trustee in discussions to resolve the discovery disputes, and on January 10, 2014, the Court entered an Order Staying all UST-Related Proceedings. (Dkt. No. 101).

Whereas, Chase engaged K&L Gates LLP to conduct a review of its policies and practices related to PCNs and escrow matters as described further below.

Whereas, Chase has since engaged the Executive Office for United States Trustees (the "EOUST") in discussions concerning its policies and practices relating to PCNs and the administration of escrow accounts for residential mortgage loans in chapter 13 bankruptcy cases as described below.

Whereas, as a result of their discussions, the Parties have reached an agreement as set forth in this Order Approving Settlement Between the United States Trustee Program and JPMorgan Chase Bank, N.A.

Whereas, in consideration of the foregoing, and of the mutual promises and compromises between them, the EOUST and the United States Trustees and Acting United States Trustees for Regions 1 through 21 (collectively "the United States Trustee Program" or "USTP"), and Chase (Chase and USTP are collectively referred to here as the "Parties") do hereby agree, stipulate and consent to the Court's entry of this Order Approving Settlement Between the United States Trustee Program and J.P. Morgan Chase Bank, N.A. (this "Order"), and the Court otherwise being fully advised of the premises. Accordingly,

IT IS ORDERED AS FOLLOWS:

ARTICLE I

JURISDICTION AND VENUE

This Court has subject matter jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). This is a core proceeding under 28 U.S.C. § 157(b)(2). Venue in the United States Bankruptcy Court for the Eastern District of Michigan is proper pursuant to 28 U.S.C. § 1409(a).

ARTICLE II

DEFINITIONS

Capitalized terms used in this Order but not defined in this Article are defined elsewhere in the Order.

"Bankruptcy Case" shall mean or refer to a case filed under chapter 13 of the United States Bankruptcy Code.

"CM/ECF" means the bankruptcy courts' Case Management/Electronic Case Filing system.

"Covered Conduct" shall mean and include:

(1) With respect to PCNs:

(a) the accuracy of the payment change date or payment change amount in PCNs during the PCN Relevant Period;

(b) the review, preparation, signing and filing of PCNs or the lack of filing of PCNs during the PCN Relevant Period and the Moratorium;

(c) the adequacy of Chase's policies and procedures concerning PCNs during the PCN Relevant Period and the Moratorium;

(d) the timeliness of PCNs filed during the PCN Relevant Period; and

(e) the timeliness of PCNs that should have been filed during the Moratorium and will be filed late due to the Moratorium and the time needed to prepare, execute and file PCNs delayed by the Moratorium; and

(2) With respect to the administration of escrow accounts for mortgage loans during the Escrow Relevant Period:

(a) the timeliness of post-petition annual escrow analyses during the Escrow Relevant Period or as a consequence of the Moratorium for borrowers in the Pre-Moratorium Delayed Escrow Population and Moratorium Delayed Escrow Population; and

(b) the Escrow Remediation Project and any incorrect application of payments resulting from the Escrow Overlay Issue for borrowers in the Escrow Remediation Population.

"Escrow Relevant Period" shall mean the time period between February 9, 2012 and November 19, 2013.

"Escrow Shortage" shall mean and include both escrow shortages and deficiencies as those terms are defined under the Real Estate Settlement Procedures Act of 1974.

"HELOC loan" shall mean a home equity line of credit mortgage loan, and includes those loans serviced on the VLS system (and any successor servicing system).

"Incorrectly Signed PCNs" are PCNs filed with bankruptcy courts during the PCN Relevant Period in which the signature of the person executing and filing the PCN on Chase's

behalf is that of the individual whose CM/ECF credentials were used to file the PCN with the relevant bankruptcy court although that individual did not review and verify the contents of the PCN.

“Identified PCNs” are the 462 Substantively Inaccurate PCNs identified by Chase as having been filed with bankruptcy courts during the PCN Relevant Period.

“MSP” shall mean the mortgage servicing platform Chase used and uses to service its first lien mortgage loan portfolio during the time period relevant to the subject matter of this Order.

“Moratorium” shall mean the time period beginning November 19, 2013, when Chase generally stopped filing PCNs in Bankruptcy Cases and stopped running annual escrow analyses for loans in Bankruptcy and ending on a date on which Chase gives notice to the EOUST and the Court that it has resumed filing PCNs and running annual escrow analyses for loans in Bankruptcy in the ordinary course. Chase began filing MSP PCNs on July 24, 2014, steadily increased its PCN filing capacity and the MSP Moratorium ended on October 31, 2014. Chase will begin filing VLS PCNs prior to December 31, 2014, and the VLS Moratorium shall end no later than May 31, 2015, unless a later date is agreed to by the Parties in writing (“VLS Moratorium”).

“PCN Relevant Period” shall mean the time period between December 1, 2011 and November 19, 2013.

“Properly Filed PCN” shall mean a PCN: (i) timely filed with the bankruptcy court that provides the borrower with the correct payment change amount and the correct date that the new payment change will go into effect; (ii) that has been reviewed and verified by the person who signs the PCN, and (iii) that is otherwise in compliance with the requirements of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.

“Substantively Inaccurate PCNs” are PCNs filed with bankruptcy courts during the PCN Relevant Period that did not provide the borrower with (1) the correct payment change amount, or (2) the correct date that the new payment change would go into effect.

“Superseding PCN” shall mean a PCN that is filed as an affirmative obligation under the corrective action provisions of this Order that otherwise satisfies the requirements of a Properly Filed PCN except for the timeliness requirement under Bankruptcy Rule 3002.1.

“Untimely PCNs” are PCNs filed with bankruptcy courts (1) during the PCN Relevant Period, and (2) less than twenty-one (21) days before a payment in the new amount was due or after the effective date of the new payment amount.

“VLS” shall mean the mortgage servicing platform Chase used and uses to service its HELOC loan portfolio during the time period relevant to the subject matter of this Order.

ARTICLE III

THE REVIEW

Chase represents to the Court as follows:

1. Upon review of the PCN that was the subject of the objection in the *Belzak* case, Chase determined that the amount of the monthly payment in the PCN was erroneous and that the PCN had been filed using the CM/ECF credentials of a former Chase employee and contained the electronic signature of that former Chase employee.

2. On November 19, 2013, as a result of the issues found with the PCN in the *Belzak* case, Chase instituted a Moratorium on filing PCNs and commenced a review of the manner in which PCNs were prepared, reviewed, signed and filed, as described further below.

3. On or about December 5, 2013, as a result of the issues found with the PCN in the *Belzak* case, Chase retained K&L Gates, a law firm, to conduct a review of the Covered Conduct related to PCNs in order to determine how PCNs were prepared, reviewed, signed and filed and whether PCNs were accurate and timely; to assist with changes to Chase's PCN policies and procedures in order to accomplish the enhancements referenced in Article V, and to assist with establishing appropriate borrower corrective action and remediation. In late February 2014, the scope of the review was expanded to include the escrow matters described in the Covered Conduct (hereafter collectively the "Review").

4. K&L Gates was assisted in the Review by attorneys in Chase's Cross Consumer Investigations Legal team ("CCIL"). K&L Gates and CCIL determined the persons to be interviewed and the documents to be reviewed.

5. During the course of the Review, over 60 Chase employees, former employees, and third-parties involved in or with knowledge relating to the Covered Conduct were interviewed.

6. The Review also included the review of thousands of documents concerning the Covered Conduct, including but not limited to policies and procedures, internal quality assurance test results, training materials, results and validation of the review of PCNs for accuracy, timeliness and signatures, internal communications, communications with 4S Technologies ("4S"), documents concerning the Escrow Remediation Project (described below) and loan level account records, loan documents and escrow statements for a number of individual loans.

7. The Review conducted by K&L Gates and Chase is privileged. In addition, K&L Gates and CCIL reviewed privileged documents and other privileged communications as part of the Review. Privileged information is not disclosed in this Order. Chase has not waived and does not intend to waive the attorney-client privilege, the work product doctrine or any other applicable privilege.

8. K&L Gates has prepared and provided to the EOUST a report concerning the Review that contains its non-privileged findings and conclusions.

ARTICLE IV
FACTS AS THEY RELATE TO PCNS

Without waiving any privilege, Chase represents that the following facts are accurate to the best of its knowledge and belief:

9. During the PCN Relevant Period (which began on December 1, 2011, when Bankruptcy Rule 3002.1 became effective), Chase, through its outside vendor 4S, filed approximately 53,000 PCNs with the bankruptcy courts.

Review and Accuracy of PCNs

10. During the PCN Relevant Period, Chase filed approximately 462 Substantively Inaccurate PCNs (which is less than 1% of PCNs filed by Chase during the PCN Relevant Time Period).

11. Chase believes the inaccuracies that occurred were caused primarily by human error in the manual entry of data and the lack of quality control (meaning a second review) before filing the PCNs with the bankruptcy courts.

12. During the PCN Relevant Period, Chase had policies and procedures in place that required Chase employees to, among other things, verify the contents of a PCN by reviewing the data in the PCN and comparing it to the account information contained in the system of record (either MSP or VLS). For loans on VLS in particular, the Chase reviewer often had to subtract out fees from the monthly amount due that Chase does not charge to customers in bankruptcy.

13. For both MSP loans and VLS loans, the PCN could not be sent to 4S for filing unless a Chase employee clicked an "approve" button after reviewing the PCN data.

14. A sample of MSP PCNs underwent a post-filing quality assurance check to verify the accuracy of the data in the PCNs.

Signature and Filing of PCNs

15. During the PCN Relevant Period, Chase filed Incorrectly Signed PCNs. These Incorrectly Signed PCNs were signed electronically. The electronic signature reflected the name of the individual whose CM/ECF credentials were used to file the PCN with the relevant bankruptcy court even if that individual was not the same individual who reviewed and verified the contents of the PCN. As described above, it is Chase's belief that its PCNs were substantively reviewed before they were filed even if an Incorrectly Signed PCN was not reviewed by the person who signed it.

16. Chase did not have enough PCN reviewers with CM/ECF credentials so that those reviewers' CM/ECF credentials could be used to file the PCNs that they reviewed. Rather, only some of the Chase employees who reviewed PCNs had CM/ECF credentials in some jurisdictions.

17. As of the time that Bankruptcy Rule 3002.1 became effective, a former Chase employee who was then the manager for the bankruptcy group was aware that PCNs were filed and would continue to be filed using the electronic signature of and under the CM/ECF credentials of persons who did not review the contents of the PCNs being filed under their electronic signature. The bankruptcy group manager's superiors in the mortgage default servicing group did not know that PCNs were being filed with the signatures of persons who did not review the contents of the PCNs.

18. In light of the rule change, in 2012, Chase took steps to obtain additional CM/ECF credentials for its reviewers. In the interim, it continued to file PCNs using the limited CM/ECF credentials it had. Where Chase lacked CM/ECF credentials in a bankruptcy jurisdiction, PCNs were filed with the signature of and using the CM/ECF credentials of 4S employees. The "I am the Creditor" box on the PCN was checked. Chase also changed its process, however, to identify the PCN reviewer on the PCN. In general, Incorrectly Signed PCNs either: (1) contained the Chase employee identification number of the Chase employee who verified the contents of the PCN at the bottom of the signature page, or (2) beginning in approximately August, 2012, for escrow changes on MSP loans, contained a disclosure on the signature page that read "Approved by:" followed by the name of the Chase employee who reviewed and verified the contents of the PCN.

19. Chase's efforts to secure additional CM/ECF credentials for its reviewers stalled in 2012 and were not effectuated. Instead, the process described in paragraph 18 for signing and filing PCNs continued until the PCN Moratorium.

20. The names of two former Chase bankruptcy employees and of four bankruptcy employees who transferred to another group within Chase appeared as the signatories on PCNs after those employees had left Chase or transferred to another group within Chase because Chase did not have a formal process for deactivating employees' CM/ECF credentials.

21. When an employee left Chase or the bankruptcy group, the employee's supervisor was supposed to remove the former employee's access to the 4S system. There was a written procedure for this, but it did not include the deactivation of an individual's CM/ECF credentials. A former Chase employee who was a supervisor in the bankruptcy group was aware of the continued use of at least one of the departed employee's CM/ECF credentials but did not deactivate the credentials.

22. Other factors that may have contributed to the continuation of the practices that led to Incorrectly Signed PCNs include: (i) MSP and VLS technology limitations; (ii) a lack of clarity in the PCN procedures; (iii) lack of pre-filing quality control; (iv) insufficient quality assurance processes; and (v) inadequate training.

- a. MSP and VLS Technology Limitations. Neither MSP nor VLS permitted a reviewer to see a complete PCN form before it was signed and filed. Because the reviewer either did not see a PCN form or only saw a portion of the form, Chase believes that the reviewers did not see that they were verifying the content of a sworn document that was to be signed.
- b. PCN Procedures. The step-by-step procedures for processing PCNs did not explain how PCNs were to be electronically signed and filed.
- c. Quality Control. During the PCN Relevant Period, although the data in the PCNs were reviewed substantively, Chase employees did not review the fully completed and signed PCNs prior to filing.
- d. Quality Assurance. During the PCN Relevant Period, Chase had quality assurance processes in place to check a sample of filed PCNs. The quality assurance sample review of filed MSP PCNs did not include a review of PCN signatures or whether the person whose electronic signature appeared on the PCN reviewed the document. There was no quality assurance review of VLS PCNs.
- e. Training. PCN reviewers received general training on sworn documents but the training could have been more targeted to PCNs and their electronic signing and filing.

23. In early 2013, a former Chase Bankruptcy employee filed a wrongful employment termination lawsuit against Chase. The former employee's complaint contained various allegations regarding her employment (which had ended in mid-2012), including that her electronic signature was used on legal documents without her full knowledge or consent.

Untimely PCNs

24. Fewer than 5% of the PCNs filed during the PCN Relevant Time Period were Untimely. Chase's bankruptcy employees who reviewed PCNs had difficulty handling the volume of PCNs in a timely manner, particularly HELOC loan PCNs, which took longer to process because of additional steps needed prior to filing. In addition, HELOC loans for which interest is calculated on a daily simple interest basis ("DSI Loans") change monthly payment amounts frequently, and this volume of PCNs (caused by the DSI feature) was difficult to process in a timely manner. 4S had a failsafe mechanism that could automatically reject the late filing of PCNs. However, that failsafe mechanism was turned off during the PCN Relevant Period.

Testing of PCNs Pursuant to the Review

25. As part of the Review, Chase conducted tests to determine the numbers of Substantively Inaccurate PCNs and Untimely PCNs and to determine the identities of the persons whose electronic signatures appeared on PCNs filed during the PCN Relevant Period as well as

those persons' affiliation with Chase at the time of each PCN filing. The tests were validated by two levels of review as described below.

26. Chase's bankruptcy group conducted the initial testing of the PCN population by:
 - a. identifying the population of PCNs filed during the PCN Relevant Period;
 - b. identifying the Untimely PCNs by comparing the PCN filing date with the PCN effective date;
 - c. identifying the Substantively Inaccurate PCNs by reviewing the filed PCN population for the PCN Relevant Period and comparing the data in the filed PCNs with the data appearing in Chase's systems of record (MSP for non-HELOC loans and VLS for HELOC loans); and
 - d. then individually reviewing the PCNs for loans on the VLS system where the two data sets differed to identify Substantively Inaccurate PCNs for VLS loans. For loans on the MSP system, the bankruptcy group determined that the data in some filed PCNs differed from data on MSP due to the Escrow Overlay Issue but that when correct historical escrow data (as reflected in the Escrow Remediation Statements) was reviewed, this subpopulation of MSP PCNs had accurate payment amount information. The bankruptcy group then reviewed the remainder of MSP PCNs where the data in the PCN differed from the data on MSP to identify Substantively Inaccurate PCNs. The bankruptcy group compared the names on the signature line of the PCNs with Chase employment records to determine whether the signatory was employed by Chase at the time of filing, and if so, whether the person was assigned to the bankruptcy group at the time of the filing.

27. Chase's Control Team then confirmed the validity of the bankruptcy group's methodology and test results. The Control Team is independent of the bankruptcy group but is part of the Mortgage Banking business. The Control Team's review included an independent statistically valid sample of filed PCNs. Based on the results of that sample, the Control Team concluded that the findings of the bankruptcy group's review for numbers of Substantively Inaccurate PCNs and Untimely PCNs were consistent with the rates of those same findings in Control Team's independent testing.

28. The Control Team confirmed instances identified by the bankruptcy group where PCN payment effective dates were misstated. The Control Team also confirmed instances identified by the bankruptcy group where the payment change amount was misstated on the PCN. Finally, the Control Team confirmed instances where the PCN file date was less than 21 days prior to the PCN effective date.

29. Operational Risk Oversight then validated the Control Team's review. Operational Risk Oversight is an arm of the Independent Risk Management Function and resides completely outside of Chase's Consumer and Community Banking Line of Business (of which

Mortgage Banking is a part). Operational Risk Oversight concluded that the Control Team's approach to testing and validation was adequate. In conducting its review, Operational Risk Oversight examined the Control Team's methodology in sampling and reviewing the bankruptcy group's testing. As part of its independent review, Operational Risk Oversight also confirmed that the Control Team followed its stated procedures for the PCN review.

30. The bankruptcy group's testing, as reviewed and validated by the Control Team, found the following numbers of Inaccurate PCNs, Untimely PCNs and the various subpopulations of Incorrectly Signed PCNs filed during the PCN Relevant Period described below:

- a. Approximately 53,000 PCNs were filed during the PCN Relevant Period.
- b. Approximately 4,380 of the Incorrectly Signed PCNs were filed with the signature and using the CM/ECF credentials of an individual who no longer worked for Chase at the time that the PCNs were filed.
- c. Approximately 2,285 of the Incorrectly Signed PCNs were filed with the signature of and using the CM/ECF credentials of a Chase employee who no longer worked in Chase's bankruptcy department at the time that the PCNs were filed.
- d. Approximately 26,225 of the Incorrectly Signed PCNs were filed with the signature of and using the CM/ECF credentials of an employee of 4S.
- e. Approximately 20,301 of the Incorrectly Signed PCNs were filed with the signature of and using the CM/ECF Credentials of a current Chase bankruptcy employee, but in most instances this employee was not the same employee who reviewed and verified the contents of the PCNs pursuant to the policies and procedures described in paragraph 12.
- f. Chase filed approximately 462 Substantively Inaccurate PCNs for approximately 325 HELOC loans and 106 non-HELOC loans (which is less than 1% of PCNs filed by Chase during the PCN Relevant Time Period).
- g. Chase filed approximately 2,554 Untimely PCNs for 1,892 HELOC loans and 606 non-HELOC loans (which is less than 5% of PCNs filed by Chase during the PCN Relevant Time Period).

31. There were instances during the PCN Relevant Period in which borrowers' payments changed under the terms of their mortgage documents and monthly account statements, ARM letters or escrow analysis statements were mailed to the borrowers, but PCNs were not filed with the bankruptcy court. Chase has not quantified the number of times that a PCN should have been but was not filed during the PCN Relevant Period.

ARTICLE V

PCN SYSTEM AND OPERATIONAL ENHANCEMENTS

32. Chase has implemented, or will implement, a number of operational enhancements to ensure that all PCNs filed in Bankruptcy Cases going forward are Properly Filed PCNs. Chase has or will:

- a. enhance policies and procedures for the preparation, signing and filing of PCNs so that they make clear that, at minimum: (i) a PCN is filed in bankruptcy court not less than 21 days before a payment in the new amount is due; (ii) the person who signs a PCN is the same person who verifies and reviews the PCN (the "PCN Signer"); (iii) the PCN is accurate and (iv) there is a process for escalating questions about a proposed PCN to management as necessary;
- b. revise policies and procedures so that there are two levels of substantive, pre-filing PCN review, including a Quality Control ("QC") review;
- c. enhance its training for PCN Signers and QC reviewers of PCNs;
- d. train and certify current and additional Chase employees to become PCN Signers;
- e. obtain CM/ECF credentials for all PCN Signers so that each PCN Signer has credentials to file PCNs that she/he reviewed and signed provided that the Parties understand and agree that there are certain jurisdictions that grant credentials to Chase and not individual signers and there are jurisdictions that provide means other than CM/ECF for filing PCNs. In all jurisdictions the person who signs a PCN will be the person who verified and reviewed the PCN;
- f. discontinue using its current third-party vendor, 4S, to file PCNs in Bankruptcy Cases (although non-law firm third party vendors, including 4S, may still provide technological assistance (e.g., creating the blank template for PCNs) and provide a mailing service (e.g., certificates of service for PCNs)); and,
- g. implement additional post-filing quality assurance ("QA") review processes for PCNs to ensure that systems and operational enhancements are functioning as intended.

33. Chase's operational enhancements described in Paragraph 32 shall be implemented on or before September 30, 2014 for the MSP system (the "MSP Operational Implementation Date"), unless a later date is agreed to by the Parties in writing.

34. Chase's operational enhancements described in Paragraph 32 shall be implemented on or before December 31, 2014 for the VLS system (the "VLS Operational Implementation Date"), unless a later date is agreed to by the Parties in writing.

35. Chase is implementing a temporary reduction in the annual interest rate to 0.00% for certain DSI Loans on VLS. The temporary reduction will only be implemented for HELOCs as to which PCNs are required to be filed and that are DSI Loans that do not already have a fixed monthly payment amount. The reduction will be applied to: (I) all active Bankruptcy Cases for borrowers with DSI Loans when the next PCN is filed for such loan and (II) newly filed Bankruptcy Cases when the applicable proof of claim is filed. In each Bankruptcy Case, this reduced rate will remain in effect until the earlier to occur of the following: (a) the debtor's bankruptcy proceeding is dismissed, (b) the debtor successfully completes his or her Chapter 13 plan and is discharged by the Bankruptcy Court, (c) the debtor's discharge, if the debtor's bankruptcy proceeding is converted to a Chapter 7. Upon the occurrence of any of these events, the debtor's interest rate and related payment will revert back to the higher rate and the payment determined in accordance with the HELOC agreement. If during the term of the bankruptcy proceeding, the HELOC agreement requires the debtor to begin making principal payments, Chase will expect the debtor to make principal payments in accordance with the terms of the HELOC agreement. Chase has the option to terminate the voluntary interest rate reduction for Chapter 13 DSI Loans if Chase migrates any applicable DSI loans from VLS to MSP.

36. Chase is planning to implement additional technological enhancements to its MSP and VLS systems to further improve the PCN preparation and filing process. Once the system enhancements are completed, Chase will modify its PCN policies and procedures to conform to the new systems technology while maintaining the enhancements described in Paragraph 32. These additional technological enhancements shall be implemented on or before July 31, 2016, unless a later date is agreed to by the Parties in writing.

ARTICLE VI

PCN CORRECTIVE ACTION

37. Chase will undertake corrective action as described below to address the Substantively Inaccurate PCNs.

38. In those cases in which a Substantively Inaccurate PCN pertaining to a HELOC loan was filed during the PCN Relevant Period, regardless of whether the case is still pending, Chase will forgive the outstanding principal balance of the HELOC loan and any other due and unpaid amounts relating thereto in its entirety. HELOC loan borrowers shall receive 30 days' notice and a right to opt out of this offer. In the event, however, that a HELOC loan as to which a Substantively Inaccurate PCN was filed during the PCN Relevant Period has already been foreclosed upon or subject to a short sale as of the effective date of this Order, Chase will confirm that any deficiency has been waived or will waive any remaining deficiency and the borrower or former borrower shall not be entitled to any additional relief under this Order.

Chase is offering this relief because of the difficulty in implementing account-by-account retroactive changes for HELOC loans for this particular issue on the VLS system.

39. In the event that a HELOC borrower opts out of the forgiveness offer set forth in paragraph 38 or in the event that the HELOC loan has been closed or has a zero (\$0) principal balance as a result of payment in full of the loan balance by the borrower at the time of the offer, Chase will:

- a. take corrective action for borrowers who: (i) reached the post-petition payment effective date of a Substantively Inaccurate PCN that overstated the actual monthly payment amount due and (ii) paid more than the actual monthly amount due for one or more months while the Substantively Inaccurate PCN was effective, by paying to the borrower or the borrower's Bankruptcy trustee the amount of the relevant aggregate overpayment;
- b. take corrective action for borrowers who: (i) reached the post-petition payment effective date of a Substantively Inaccurate PCN that understated the actual monthly payment amount due and (ii) paid less than the actual monthly amount due for one or more months while the Substantively Inaccurate PCN was effective, by crediting the borrower's mortgage loan account with the aggregate difference between the amount paid by the borrower and the amount due for those months that the Substantively Inaccurate PCN was effective; or
- c. take corrective action for borrowers (i) as to whom Chase filed a Substantively Inaccurate PCN with an inaccurate effective date that sought to change the borrower's monthly amount, and (ii) who, as a result of the inaccurate effective date, paid an incorrect monthly amount for one or more months while the Substantively Inaccurate PCN was effective, by either crediting the borrower's mortgage loan account or refunding to the borrower or the borrower's Bankruptcy trustee, the aggregate difference between the previous monthly payment amount and the new monthly payment amount in the Substantively Inaccurate PCN for the time period between (i) the inaccurate effective date of the payment change set forth in the Substantively Inaccurate PCN and (ii) the correct effective date;
- d. file a notice of withdrawal, withdrawing Substantively Inaccurate PCNs that are still effective, overstate the monthly payment amount and have not been otherwise superseded by an accurate PCN. If a new PCN is required, Chase will file a Properly Filed PCN simultaneously with the withdrawal; and
- e. as to any cases with Substantively Inaccurate PCNs that are still effective, understate the monthly payment amount and have not been otherwise superseded by an accurate PCN, will file a Properly Filed PCN.

40. For those debtors whose mortgage loan is a DSI Loan without a fixed monthly payment amount and whose Bankruptcy case was pending as of October 31, 2013, Chase will

mail a check to the borrower in the amount of \$20.00 (payment on a per loan and not per borrower basis) by no later than July 31, 2015; unless Chase has already forgiven the DSI Loan as of May 31, 2015.

41. In those cases in which Substantively Inaccurate PCNs pertaining to non-HELOC loans were filed during the PCN Relevant Period, regardless of whether the case is still pending, Chase will:

- a. if the Substantively Inaccurate PCN misstated the monthly payment amount due, either credit the borrower's mortgage loan account or refund to the borrower or the borrower's Bankruptcy trustee, the aggregate difference between the correct contractually due amount (or in the case of a cram down the payment amount required by the confirmed bankruptcy plan) and the payment amount set forth in the Substantively Inaccurate PCN for those months that the Substantively Inaccurate PCN was effective; or
- b. if the Substantively Inaccurate PCN had an inaccurate effective date and sought to change the borrower's monthly amount then the credit or refund shall be in the amount of the aggregate difference between the previous monthly payment amount and the new monthly payment amount for the time period between (i) the inaccurate effective date of the payment change set forth in the Substantively Inaccurate PCN and (ii) the correct effective date; and
- c. file a notice of withdrawal, withdrawing Substantively Inaccurate PCNs that are still effective, overstate the monthly payment amount and have not been otherwise superseded by an accurate PCN. If a new PCN is required, Chase will file a Properly Filed PCN simultaneously with the withdrawal; and
- d. as to any cases with Substantively Inaccurate PCNs that are still effective, understate the monthly payment amount and have not been otherwise superseded by an accurate PCN, file a Properly Filed PCN;
- e. provided, however, that if the borrower had already filed an intention to surrender the property that served as collateral for the loan at the time that the Substantively Inaccurate PCN was filed and has in fact surrendered the property then Chase need not take any action.

42. In those cases in which a Substantively Inaccurate PCN or an Untimely PCN was filed or where no PCN was filed for a Non-HELOC payment change during the PCN Relevant Period, the Bankruptcy Case is still pending and the borrower or Bankruptcy trustee has disputed a payment increase or fees, charges, and costs imposed in connection therewith at the time of execution of this Order, and the overall result is thereafter successful, Chase will reimburse the borrower for his or her reasonable attorneys' fees. Provided however that in order to identify such instances, Chase shall only be required to review any internally maintained list of escalated bankruptcy matters and to request its outside bankruptcy counsel to bring any such cases to

Chase's attention. If a case that meets the criteria described in the first sentence of this paragraph is brought to Chase's attention by a borrower, trustee, the Independent Reviewer or the USTP, then Chase will also reimburse such borrower for his or her reasonable attorneys' fees.

43. Chase confirms that, as a matter of practice, it does not impose post-petition late fees on borrowers in the course of a Bankruptcy Case (the "Late Fee Policy").

44. Chase confirms that it has adhered, and will continue to adhere, to the Late Fee Policy in any Bankruptcy Case in which Chase filed a Substantively Inaccurate PCN or Untimely PCN, or did not file a PCN for a payment change during the PCN Relevant Period or Moratorium (hereafter an "Un-Noticed Payment Change"). Chase further confirms that it has a policy not to impose additional fees, penalties, or charges on a borrower in a Bankruptcy Case as a result of a Substantively Inaccurate PCN, Untimely PCN or because there was an Un-Noticed Payment Change (collectively with the Late Fee Policy, the "PCN Policies"). Chase confirms that it has adhered during the PCN Relevant Time Period, and will continue to adhere, to the PCN Policies in Bankruptcy Cases. If it is determined that Chase did not adhere to the PCN Policies in any Bankruptcy Case, Chase will take appropriate corrective action and remediation, including crediting the borrower's mortgage loan account with all amounts assessed or imposed against the borrower in contravention of the PCN Policies or refunding all amounts improperly collected in contravention of the PCN Policies.

45. In the event Chase previously resolved any objection to or adversary proceeding regarding a PCN filed during the PCN Relevant Period, and the dispute was related to the accuracy, timeliness or proper execution of the PCN, Chase shall have no further obligation under this Order to pay any borrower or Bankruptcy trustee on account of such PCN except as set forth in Paragraph 42.

46. Chase shall complete all affirmative obligations in paragraphs 38, 39, 41 and 42 on or before May 31, 2015, (the "PCN Corrective Action Date"), unless a later date is agreed to by the Parties in writing.

47. As of the effective date of this Order, Chase shall not seek relief from the automatic stay in any Bankruptcy Case in which a payment increase was not noticed via a filed PCN during the PCN Relevant Period until:

- a. Chase has undertaken a full account reconciliation of all payments received post-petition (whether from the borrower or the Bankruptcy trustee) to determine that all amounts claimed due and owing are properly collectible; and
- b. based upon the account reconciliation performed pursuant to subparagraph 47(a), in the event that the Un-Noticed Payment Change increased the payment amount due, Chase has credited the borrower's account for the aggregate difference between (i) the payment amount noticed in the last-filed PCN and (ii)