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Creditor and Creditor Committee Conflicts in Representation

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This article comprises the second part in a two-part series setting forth the law pertaining to conflicts in representation in the bankruptcy arena. Part One, *An Analysis on Conflict Issues in Debtor Representation*, focused primarily on debtor representation. Part Two focuses on creditors and creditors' committees.

GOVERNING LAW

Representation as committee counsel in bankruptcy proceedings is primarily governed by Section 1103 of the Bankruptcy Code (the "Code"), which prohibits committee counsel from holding an interest adverse to the committee. The section reads in relevant part:

> An attorney or accountant employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

11 U.S.C. § 1103 (2008).[i]

REPRESENTATIVE CONFLICTS

A. An Attorney Likely May Represent Multiple Creditors Simultaneously

An attorney likely may represent multiple creditors simultaneously, as there is no inherent ethical conflict in a lawyer representing more than one creditor in a bankruptcy case.[ii] So long as the dual representation is disclosed and each client gives its informed consent, then dual representation may be permitted. See Model Rule of Professional Conduct 1.7.

However, representation of creditors of different classes is generally ill-advised.[iii] For example, representation of unsecured and secured creditors simultaneously is generally not recommended as "[i]n the ordinary case, unsecured creditors regard it as their function in life to defeat secured claims." John D. Ayer, How to Think About Bankruptcy Ethics, 60 Am. Bankr. L.J. 355, 391 (Fall 1986). See also In re Whitman, 101 B.R. 37, 39 (Bankr. N.D. Ind. 1989) (attorney could not represent secured creditor and unsecured creditors' committee simultaneously even if secured creditor had unsecured portion of debt which allowed it to sit on the unsecured creditors' committee; such mutuality did not eliminate the irreconcilable conflict between secured and unsecured creditors). Similarly, representation of two secured lienholders is ill-advised if lien priority must be determined. In re Oklahoma P.A.C. First Ltd. P'ship, 122 B.R. 387, 392 (Bankr. D. Ariz. 1990) (holding that one law firm could not represent two secured creditors in the same bankruptcy proceeding because "if the priority of the liens does become an issue, one law firm cannot vigorously defend the rights of both creditors").

B. An Attorney Likely May Not Represent An Individual Creditor And A Creditors' Committee Simultaneously

Simultaneous representation of an individual creditor and an unsecured creditors' committee is generally not permitted as an attorney must represent all members of the committee on an equal basis. The potential preference for one or a few creditors over others to the detriment of the committee as a whole is a governing factor when evaluating such representations. For example, in In re Grant Broad., Inc., 71 B.R. 655, 663 (Bankr. E.D. Pa. 1987), a group of television broadcasting stations filed for bankruptcy. One law firm organized a group of creditors which consisted of entities which sold programming content to the debtors (the "Programming Creditors"). Another law firm organized a group of trade creditors (the "Trade Creditors"). The court determined that there could only be one unsecured creditors' committee and the firms vied for representation of such committee. The court disqualified the Programming Creditors' firm from representation, as the firm had previously filed a motion on behalf of some of the Programming Creditors requesting payment of all post-petition charges as they came due. The court held that this representation of individual creditors clearly prejudiced other members of the potential committee and thus disqualified the firm from committee representation. Id. at 663. The Trade Creditors' firm was appointed committee counsel instead. Id.; see also In re Electro-Optix, U.S.A., Inc., 130 B.R. 621, 622 (Bankr. S.D. Fla. 1991) (disqualifying committee counsel because it also represented the largest unsecured creditor in the bankruptcy which representation created "an appearance of impropriety"); In re

Universal Bldg. Prod., Inc., No. 10-12453 (MFW) (Bankr. D. Del. Aug. 4, 2010) (debtors objected to the retention of a particular law firm as committee counsel because the law firm had previously advised individual creditors in the case which interests were adverse to those of the committee; law firm was disqualified on different grounds). Thus, simultaneous representation of an individual creditor and a creditors' committee is generally discouraged.

C. An Attorney May Represent A Debtor in Possession (Or Trustee) And A Creditor In The Same Case Simultaneously But Likely Only In A Limited Manner

Case law demonstrates that dual representation of a debtor and a creditor in the same case is generally permitted only when the attorney represents the debtor in a limited fashion. In In re Midway Motor Sales, Inc., 355 B.R. 26 (N.D. Ohio 2006), an attorney represented two general unsecured creditors. The Trustee appointed to the case stated that he would be forced to abandon some accounts receivables and the pursuit of various claims against third parties as there was no longer enough cash in the estate to pursue such claims. The attorney for the creditors announced that he was willing to take on such limited representation of the Trustee on a contingency basis. The court held that such representation was permissible, as the attorney's scope of duties was circumscribed to the investigation of these claims, thereby potentially increasing the size of the Debtor's estate. Because this was also in the interest of the creditors, no conflict existed and the representation was permitted. See also Tri-State Fin., LLC v. Lovald, 525 F.3d 649, 656 (8th Cir. 2008) (firm permitted to represent trustee and creditor simultaneously where trustee employed conflicts counsel to represent the estate in challenging any claim by the creditor).

However, representation of a debtor and a creditor in the same case simultaneously is risky. Under Model Rule of Professional Conduct 1.7, if at any time a controversy were to arise and one of the two clients were to withdraw their consent to the dual representation, the lawyer would be required to withdraw from representation of that client. However, even if counsel withdraws from representation of one party, counsel may still be disqualified from representation of the other. See Model Rule of Professional Conduct 1.7, cmt. 21 (2009) ("Whether revoking consent to the client's own representation precludes the lawyer from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of the other client and whether material detriment to the other clients or the lawyer would result."); In re Philadelphia Athletic Club, Inc., 20 B.R. 328, 338 (Bankr. E.D. Pa. 1982) (firm had withdrawn from representation of principals of debtor; however, the court did not permit the Trustee to subsequently retain such firm because of the appearance of impropriety and because the firm might unconsciously cater to its former clients). Given the potential that a lawyer might have to withdraw from representation altogether because of a creditor's change of heart, it is generally ill-advised to represent a debtor and creditor in the same case simultaneously.

D. An Attorney Likely May Represent a Debtor and a Creditor in an Unrelated Case Simultaneously So Long as There is No On-going Litigation Between the Parties

In evaluating whether an attorney may simultaneously represent a debtor and a creditor in unrelated matters, many factors may be considered such as the size of the creditor's claim and whether conflicts counsel would be effective. However, the key determinant is whether there is any on-going litigation between the parties. In In re Rockaway Bedding, Inc., No. 07-14890, 2007 WL 1461319 (Bankr. D.N.J. May 14, 2007), the court held that a law firm that represented a debtor's biggest secured creditor in unrelated matters could also represent the debtors. Central to the court's decision was the fact that there was no on-going litigation between the parties nor was any envisioned. Id. at *3; see also In re Dynamast, Ltd., 137 B.R. 380 (Bankr. C.D. Cal. 1991) (court approved the retention of an attorney as debtor's counsel who also represented the estate's largest secured creditor in unrelated matters, finding no outstanding litigation between the parties). Accordingly, courts will evaluate a totality of circumstances when evaluating the simultaneous representation of a debtor and creditor in different matters, but the element which likely bears the greatest weight is the existence of on-going litigation between the parties.

E. An Attorney Likely May Simultaneously Represent The Unsecured Creditors' Committees Of Debtors Who Are Economic Competitors

As only a few firms are noted for their committee experience, often these same firms and/or individuals are repeatedly invited to serve as committee counsel. However, attorneys must consider other committee representations when taking on such an assignment. Simultaneous representation may be permitted or disallowed depending on the level of interconnectedness between the debtors. In In re Caldor, Inc., 193 B.R. 165 (Bankr. S.D.N.Y. 1996), the unsecured creditors' committee sought to retain counsel which was already representing the unsecured creditors' committee of a competitor. The two debtors were unrelated except for the fact that they competed in the same market niche. The debtors were not affiliated entities, did not hold claims against one another, and were not creditors of each other in their respective bankruptcy cases. Id. at 175.

The Trustee objected, hypothesizing that a conflict could occur, *e.g.*, in the event of a potential merger between the two debtors, or if both debtors simultaneously decided to purchase the assets of a third party. Id. at 171. However, the court rejected the Trustee's contentions as "too speculative." Id. at 172-173. Even though a hypothetical set of facts could be devised to create a conflict, "horrible imaginings alone cannot be allowed to carry the day." Id. at 172. Instead, the court set forth a test to determine whether a disqualifying conflict existed: whether the simultaneous representation will create "either a meaningful incentive to act contrary to the best interest of [one committee] – an incentive sufficient to place those parties at more than acceptable risk – or the reasonable perception of one." Id. at 171. In other words, if it is possible that the representation of one committee would cause the professionals to act any differently than they would without that representation, then a conflict exists. Id. The court held that there was no such conflict in Caldor, as neither the committees nor the debtors were likely to become "rival claimants." Id. at 172. Thus, counsel was permitted to represent the unsecured creditors' committees of both competitors simultaneously as there was no relation between the debtors other than the fact that they operated in the same market niche.[iv]

F. Conclusion

Committee representation is fraught with caveats and there appear to be no absolute rules controlling such representation. However, practitioners should likely review the case law governing each potential conflict scenario and also avoid the simultaneous representation of different classes of creditors and/or lienholders.

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The views expressed in this paper are those of the authors and do not reflect the views of the firm.

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[i] *It is unsettled whether committee counsel must meet the "disinterested" standard (under section 328(c) of the Bankruptcy Code) in addition to the "adverse interest" standard. Under section 328(c), the court "may deny allowance of compensation for services and reimbursement of expenses of a professional person … if, at any time during such professional person's employment … such professional person is not a disinterested person ….." In a recent decision out of Delaware, Judge Mary Walrath held that only the adverse interest standard of section 1103 controls. See In re Universal Building Prod., Inc., No. 10-12453 (MFW) (Bankr. D. Del. Aug. 4, 2010). Further, Judge Walrath held that potential conflicts "do[] not mandate disqualification of counsel for the Committee" and the time to evaluate whether committee counsel is disqualified is at the time of the retention; prior representations do not necessarily disqualify counsel. Id. at *25-26.*

[ii] *While simultaneous representation of multiple creditors may not present an ethical conflict, it may require certain disclosures to the court. Under the proposed amendments to Federal Rule of Bankruptcy Procedure 2019 (anticipated effective date December 1, 2011), ad hoc committees and unofficial committees must disclose the identities of their members as well as the timing and amount of each member's holdings in a debtor. To the extent that these creditors may have conflicting interests, simultaneous representation may be barred.*

[iii] *Note that even two creditors in the same class arguably have an inherent conflict – each one wishes its claim to be allowed and to recover the maximum possible amount on such claim, but unless there are enough assets in the estate for every creditor to be paid in full, the allowance of one claim necessarily means a reduction in recovery for the other. Robert D. Albergotti, Leif M. Clark & Thomas S. Henderson, The Current State of Retention of Professionals, presented at the University of Texas Jay L. Westbrook Bankruptcy Conference (Nov. 13, 2008).*

[iv] *The Caldor court found that the law firm's implementation of an information barrier between the bankruptcy teams for the two committees augmented the propriety of the simultaneous representation. The information barrier appears to have consisted of designating two separate and distinct teams of professionals to service the two committees. Id. at 177.*