

## **An Analysis on Conflict Issues in Debtor Representation**

By Edward L. Schnitzer & Anting J. Wang

As opposed to the standard two-party plaintiff-defendant model which is commonly encountered in commercial litigation, bankruptcy cases involve a wide array of parties with diverse interests that may coincide and yet diverge in the same matter. If an attorney should be so fortunate as to be selected for representation by multiple parties in a bankruptcy proceeding, then that practitioner might face difficult questions when evaluating potential conflicts of interests or ethical issues that arise. In some cases, the representation may be challenged in a longitudinal manner, in which the attorney's past representations may conflict with the issues at hand. In other cases, representation may be challenged in a latitudinal manner, in which current conflicts may or may not bar a potential representation.

In general, courts utilize a totality of circumstances approach when evaluating potential simultaneous representations. Factors which may be considered include the relationship between the parties; the extent of the parties' interactions; the size of the debt at issue; and the appearance of impropriety as considered within the context of the Model Rules of Professional Conduct and relevant provisions of the Bankruptcy Code (the "Code"). Part One of this article provides an analysis of the law governing debtor representation and sets forth two representative scenarios. Part Two focuses primarily on issues pertaining to creditor and creditors' committee representation.

### **GOVERNING LAW**

Representation as debtors' counsel in bankruptcy proceedings is chiefly governed by Section 327(a) of the Code. The section provides in relevant part:

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

11 U.S.C. § 327(a) (2008). The requirements of the section apply equally to a debtor in possession by virtue of section 1107 of the Code. See 3 Collier on Bankruptcy § 327.02 (15th ed. 1994).

Section 327(a) appears to impose two requirements on a trustee or debtor in possession seeking to employ counsel: (i) that the attorney does not hold or represent an interest adverse to the estate, and (ii) that the attorney is disinterested. The word "disinterested" is a term of art, defined in section 101(14) of the Code as, among other things, not having "an interest materially adverse to the interest of the estate . . ." 11 U.S.C. § 101(14) (2008). Thus, the First Circuit has noted that "the twin requirements of disinterestedness and lack of adversity telescope into a single hallmark." In re Martin, 817 F.2d 175, 181 (1st Cir. 1987); see also In re BH & P, Inc., 949 F.2d 1300, 1314 (3d Cir. 1991).

However, neither of the aforementioned two prongs are well-defined nor does there appear to be any golden rule to determine whether an impermissible conflict exists. Instead, courts may focus on the individual facts of each case when faced with a conflict.

#### **A. The Totality Of The Circumstances**

Courts generally evaluate each circumstance on a case-by-case basis, adopting a wide-screen view of the facts underlying a hypothetical conflict. Considerations include the nature of disclosure of the conflict made at the time of appointment; whether the interests of the related estates are parallel or conflicting; and the nature of the inter-debtor claims made. In re BH & P Inc., 949 F.2d 1300, 1316 (3d Cir. 1991). Other factors may include the existence of interlocking interests between the parties; the size of the debt at issue; the existence of inter-party guarantees; and whether assets are collateralized discretely or across various asset categories. In re Amdura Corp., 121 B.R. 862, 867 (Bankr. D. Colo. 1990).

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In general, courts favor the totality approach over an alternative method which distinguishes between actual and potential conflicts. This is because the difference between present and hypothetical conflicts may be semantic as well as problematic to apply in real-time. See In re Angelika Films 57th, 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1998) (“The distinction between ‘potential’ and ‘hypothetical’ conflicts merely confuses the analysis, and several courts have rejected it as artificial.”); In re Kendavis Indus. Int’l, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988) (finding that the concept of potential conflicts is a contradiction; once there is a conflict, it is actual, not potential). These courts instead focus on the facts of each case to determine whether an attorney has an adverse interest without limiting labels. See, e.g., In re Leslie Fay Cos., 175 B.R. 525, 532-33 (Bankr. S.D.N.Y. 1994) (rejecting the actual/potential dichotomy and observing that courts should focus on the facts of a case when reviewing retention applications).

However, some courts still utilize the actual/potential paradigm and it may be necessary to frame your argument in these terms. See In re Jade Mgmt. Serv., No. 09-2800, 2010 U.S. App. LEXIS 14125 (3d Cir. May 4, 2010) (focus of inquiry is whether there is an actual conflict of interest); In re McKinney Ranch Assocs., 62 B.R. 249, 255 (Bankr. C.D. Cal. 1986) (remote potential conflict should not result in disqualification). Additionally, other opinions appear to discuss both models in their opinions and/or to conflate the two standards. See In re Hoffman, 53 B.R. 564, 566 (Bankr. W.D. Ark. 1985) (“Whether ... an actual disqualifying conflict exists must be considered in light of the particular facts of each case.”). Accordingly, it is prudent to research the individual holdings of your judge and potentially present arguments under both paradigms when making a case for simultaneous representation.

## **REPRESENTATIVE CONFLICTS**

### **A. An Attorney Likely May Represent Multiple Debtors Simultaneously**

With the increasing size and complexity of reorganization cases, the most efficient and effective way of administering multiple-debtor cases may be the use of a single law firm, professional or coordinated group of professionals. In re BH & P Inc., 949 F.2d 1300, 1310 (3d Cir. 1991). Thus, to conserve estate assets, courts will permit multiple-debtor representation but also evaluate the facts surrounding the representation to protect the integrity of the bankruptcy process. In re Global Marine, Inc., 108 B.R. 998 (Bankr. D. Tex. 1987) (counsel permitted to represent debtor and its subsidiaries in consolidated chapter 11 case where debtors functioned as one enterprise that operated for the benefit of the whole, and where, during the course of counsel’s representation of debtors, there existed a unity of interest and singleness of purpose on debtors’ part).

Even when there are inter-company debts, it is standard practice to allow multi-debtor representation such that estate assets may be conserved. See, e.g., In re Int’l Oil Co., 427 F.2d 186, 187 (2d Cir. 1970) (the existence of intercompany claims by itself was not a basis “to saddle these estates with the expense of separate trustees and trustees’ attorneys”); In re O.P.M. Leasing Serv., Inc., 16 B.R. 932 (Bankr. S.D.N.Y. 1982) (declining to remove trustee from stewardship of consolidated bankruptcy proceedings of debtors despite existence of an inter-debtor claim as the case was a well-progressed, complex bankruptcy proceeding where disclosure of potential conflicts had been made at the time of appointment without objection, and it appeared that defendants’ later removal motion was a litigation tactic). Instead, in order to deal with cross-debtor claims, a bankruptcy plan may consolidate a parent and its subsidiaries either legally or administratively such that any inter-debtor claims are equalized. Further, an inter-debtor claim is not necessarily a conflict. “Even the presence of an inter-company claim is not likely to rise to the level of an actual conflict, without more.” 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). Instead, a court may use its discretion to determine whether counsel should be disqualified. See In re Interwest Bus. Equip., Inc., 23 F.3d 311, 316 (10<sup>th</sup> Cir. 1994) (denying simultaneous representation of three interrelated debtors when intercompany debts existed as well as a management contract between two of the entities; “The jaundiced eye and scowling mien of counsel for the debtor should fall upon all who have done business with the debtor recently enough to be potential targets for the recovery of assets of the estate.”); Quarles & Brady, LLP v. Maxfield (In re Jennings), 199 Fed. Appx. 845 (11<sup>th</sup> Cir. 2006) (law firm disqualified from representing eleven related debtors when one debtor depleted its assets although another debtor held a secured claim against those assets).

**B. An Attorney Likely May Not Represent A Debtor And The Principals Of Such Debtor Simultaneously**

Because officers and directors of debtors may be defendants in actions brought by a trustee, simultaneous representation of a debtor and the principals of such debtor is often prohibited. For example, in In re Genco, Inc., 105 B.R. 620 (D. Colo. 1988), the trustee filed an application for approval of the appointment of special counsel to the trustee in prosecuting claims against a lender, as well as for appointment of that same counsel on behalf of the debtor's principal shareholder. The bankruptcy court authorized such an appointment because it viewed the trustee and the shareholder as sharing a common interest in prosecuting litigation against the debtor's lender. However, the district court overturned such appointment, noting that "an attorney may not hold or represent an interest adverse to the estate in any matter" in accordance with section 327(a) of the Code. Id. at 621 (emphasis in original). The fact that the shareholder could be a potential target for claims of corporate mismanagement in the future precluded the dual representation of the shareholder and the trustee. See also In re Occidental Fin. Group, Inc., 40 F. 3d 1059 (9<sup>th</sup> Cir. 1994) (attorney cannot represent debtor and principals of debtor (who were also creditors of debtor) simultaneously); In re Johore Inv. Co., Inc., 41 B.R. 318 (Bankr. D. Haw. 1984) (special counsel not allowed to represent both the debtor corporation and its principal owner); Roger J. Au & Son, Inc. v. Aetna Ins. Co., 64 B.R. 600 (Bankr. N.D. Ohio 1986) (attorney simultaneously representing debtor corporation and its sole shareholder disqualified under Code of Professional Responsibility for creating appearance of impropriety). But see In re Jade Mgmt. Serv., No. 09-2800, 2010 U.S. App. LEXIS 14125 (3d Cir. May 4, 2010) (counsel permitted to simultaneously represent debtor and debtor's sole shareholder who had guaranteed the debtor's secured debt where it appeared substantially certain that all secured claims would be satisfied in full).

**Conclusion**

There are no *per se* rules as to when simultaneous representation is forbidden. Instead, courts generally consider the totality of the circumstances, including the relationship between the parties, the extent of any interactions and the size of any debts at issue. In addition, practitioners would be wise to avoid the appearance of impropriety when considering any potential representation.

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