Conflicts Check: Bankruptcy’s Ethic Rules in Practice

By Arthur Kimball-Stanley

For lawyers, conflicts of interest rules are critical. Such rules are essential in assuring the adequate representation of clients, the preservation of confidences and maintenance of the integrity of the adversary system. In bankruptcy cases, these rules are important as well, but, such proceedings require different ethical considerations than the typical two-party civil proceeding. Given the multiplicity of parties in bankruptcy proceedings and the differing interests in a bankruptcy case, Congress has imposed special rules governing the employment of bankruptcy professionals under the Bankruptcy Code (the “Code”).

In a large corporate Chapter 11 reorganization, interests in the debtor’s estate are at least as diverse as the corporation’s capital structure and parties can find themselves with varying alliances. As interests shift, so must the conflict concerns of the lawyers representing each party. The problems this maze of potential conflicts can create have been a topic of debate among bankruptcy scholars for years.

The nuances of bankruptcy’s conflict rules are not just academic. Attorneys at the highest level of the bankruptcy bar have found themselves running afoul of the Code’s conflict rules. In 1994, debtor’s counsel for the Leslie Fay Companies was forced to give up large portions of fees earned from its representation of the debtor for failing to properly disclose conflicts relating to an investigation of Leslie Fay’s management.

More recently, attorneys representing LyondellBasell in its Chapter 11 reorganization were accused of allowing conflicts to result in an unsatisfactorily low settlement that was presented to the court for approval. While the accusations made against counsel were forgotten when the settlement amount was increased, the episode remains a stark reminder for bankruptcy attorneys that conflict issues can be raised at any time during a case.

1 J.D. Candidate 2010, Boston College Law School.
3 Many cases that have cited the common fund nature of bankruptcy – the fact that all professional fees are paid by the estate - and past ill perception of corrupt practice in the insolvency bar as the rational for holding bankruptcy attorneys to a sometimes higher conflict of interest standards than in other areas of practice. See, e.g., In re EWC Inc., 138 B.R. 276, 279 (Bankr. W. D. Okl. 1992). For a general historical overview of the conflict issues that plagued the early bankruptcy bar and the efforts towards reform during the 20th century, see David A. Skeel, Debt’s Dominion: A History of Bankruptcy Law in America, 73-101 (2003).
This article seeks to provide an overview of the conflict requirements as they apply in the bankruptcy context. The brief tour of the issues involved is intended to give practitioners a sense of the complexity of bankruptcy conflict rules and, in particular, when an attorney has a conflict, when he or she doesn’t have a conflict and how to deal with the potential uncertainties surrounding the issue.


The Code contains specific rules governing the employment of attorneys. All professionals representing a debtor must obtain court approval. The Code does not specifically define “conflict of interest.” Courts, instead, are left to examine the various employment-related provisions of the Code to interpret when an attorney may or may not represent an estate in bankruptcy.

Section 327(a) of the Code provides the statutory language applied in determining whether a professional’s representation of a debtor is appropriate. The section has two requirements, the professional (1) may not “hold or represent an interest adverse to the estate” and (2) must be a “disinterested person” as that term is defined under Section 101 of the Code. Section 101(14)(E) provides, in part, that a “disinterested person” as a person who “does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders[.]” In addition, Section 328(c) of the Code, which provides for compensation of professionals, states that the court may deny compensation for services performed by an attorney if, during the attorney’s employment by the estate, the attorney “is not a disinterested person, or represents or holds an interest adverse to the interest of the estate [.]”

As a number of courts have noted, the Code’s definition of disinterested repeats the reference to adverse interests included separately under section 327(a), albeit with a materiality qualifier. Consequently, the two requirements “telescope into a single hallmark.” Unfortunately, the Code does not define “an interest adverse to the estate.” Understanding the conflicts rules as they apply in the bankruptcy context requires understanding the judicial interpretation of this provision.

a) Defining an Interest Adverse to the Estate

Judicial application of the Code’s “interest adverse to the estate” language has taken a variety of paths. Courts agree that the relevant underlying question is “whether an attorney has meaningful incentive to act contrary to the best interests of the estate.” The reasoning, stated simply, is: “if it is plausible that the representation of another interest may cause the debtor’s attorneys to act any differently than they would without the other representation, then they have a conflict and an interest adverse to the estate.” Courts differ on the extent to which the incentive to act contrary to the debtor’s interests is meaningful. As one court noted, the “difficult area is when a live conflict of

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8 See 11 U.S.C. § 327 (a). Section 327 (a) of the Code discusses the employment of professionals by the debtor. Specifically, the section states: “the trustee, with the court’s approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons...”
12 In re Martin, 817 F.2d 175, 181 (1st Cir. 1987).
13 Id.
14 In re Leslie Fay Companies, Inc., 175 B.R. at 532.
15 Id.
interest has not quite emerged, yet the factual scenario is sufficiently susceptible to that possibility so as to make the conflict more than merely "hypothetical or theoretical."  

Some courts draw a line between the appearance of potential conflict and actual conflict, holding that only actual conflicts prevent representation. These courts define a conflict as actual when "the professional serves two presently competing and adverse interests." A potential conflict, on the other hand, arises "when the competition does not presently exist, but may become active if certain contingencies arise." These courts recognize that potential conflict may be enough to bar an attorney from serving as debtor’s counsel, but leave this decision up to the discretion of the bankruptcy judge supervising the estate. These courts rely on the fact that historically bankruptcy courts have been given wide latitude to balance "efficiency and economy" with the "protection of the integrity of the bankruptcy process."

The consideration of actual conflicts reigns, however, and courts often examine the extent to which a relationship between an attorney and another party rises to a level that a court would consider it adverse to the interest of the estate. In applying this "adverse interest test," these courts inquire whether the attorney (1) has any economic interest that would lessen the value of the bankruptcy estate of create a dispute in which the estate is a rival; (2) possesses a predisposition that would bias the attorney against the estate. Other variations on this test include, as noted above, asking whether the attorney’s employment creates a meaningful incentive to act contrary to the debtor’s best interest. These cases also emphasize a balancing approach that takes into account all the relevant facts to determine whether a conflict is sufficiently significant to bar the court’s approval of an attorney’s retention. Courts that have opted for this less structured application of the Section 327(a) have argued that debate in other courts about the proper approach has "been more semantic than substantive" and that results "were largely driven by the facts of each case."

The fact driven results of bankruptcy conflict rules are particularly evident in large, complex debtor cases. In the largest bankruptcy cases - Enron, General Motors, Lehman Brothers - the ability of a debtor or other interested parties to retain competent, conflict free counsel is limited. In such cases, use of co-counsel for special litigation when conflicts do arise, and law firm screening systems to ferret out and disclose newly arising conflicts over the course of representation, are usually considered sufficient to appoint counsel even though the possibility of an adverse interest exists.

b) Particular Kinds of Conflicts and Exceptions to 327(a)

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16 Id. at 532.
17 In re Marvel Entertainment Group, Inc., 140 F.3d 463, 476 (3d Cir. 1998).
19 Id.
20 See In re Marvel Entertainment Group, Inc., 140 F.3d at 476 (Citing In re BH & P, Inc., 949 F.2d 1300, 1317 (3d Cir. 1991). This approach has been recognized by a variety of courts. See, e.g., In re Penny, 334 B.R. 517, 520 (Bankr. D. Mass. 2005).
21 In re BH & P, Inc., 949 F.2d 1300, 1317 (3d Cir. 1991) (Citing In re Martin, 817 F.2d at 175).
23 See In re Enron Corp., 2002 WL 32054346 at *8 (Citing In re AroChem Corp., 176 F.3d 610, 623 (2d Cir. 1999)).
24 In re Martin, 817 F.2d 175 at 647.
25 In re Leslie Fay Companies, Inc., 175 B.R. at 532.
26 Id.
27 See Marcia L. Goldstein, Retention of Professionals in Bankruptcy Cases: Ethical Issues & Special Considerations, 1172 ALI-ABI Course of Study: Commercial Real Estate Defaults, Workouts & Reorganizations (2006).
28 Id.
Every interest in a bankruptcy case represents a potential conflict, but there are two kinds of relationships that come up most often for attorneys seeking to represent a bankruptcy estate: i) concurrent representation of a debtor and its creditors; ii) former representation of creditors or the debtor.

   i. Concurrent Representation of Creditors by Debtor’s Counsel

Courts have generally held that current representation of a creditor by an attorney applying to represent the debtor is not by itself sufficient grounds for disqualification. In fact, Code section 327(c) specifically allows for such a possibility. Disqualification on other grounds, however, is still possible. As discussed above, the courts focus specifically on whether the attorney’s representation of the creditor is adverse to the interest of the estate. The courts will examine whether it is plausible that the representation of another interest will lead the attorney to act differently than it would without the representation.

In most cases, concurrent representation of a debtor and a creditor by an attorney will be found unacceptable. Courts have generally found it clear that when an attorney “seeking employment by a bankruptcy trustee is concurrently representing other parties, his or her duties of loyalty and confidentiality will combine to make it very difficult for the attorney to overcome the requirement that he or she must not hold or represent an interest adverse to the estate.”

Still, there are situations in which such concurrent representation is allowed. In recently decided In re Kobra Properties, an Eastern District of California Bankruptcy Court allowed temporary concurrent representation of a debtor and creditor because the parties’ interests were sufficiently aligned so as to negate the plausibility of an adverse interest existing. In another case, this time in the Southern District of California, a court allowed a firm to represent both a debtor and the largest secured creditor in the case because the representation of the secured creditor concerned a matter unrelated to the bankruptcy.

In large complex debtor’s cases, it is nearly impossible to find debtor’s counsel with the resources to handle such cases that does not have a conflict. Courts, therefore, have taken a pragmatic approach to such cases. Specifically, courts will usually allow for conflicts counsel to handle matters where an adverse interest arises, while allowing the conflicted attorney to provide overall representation to the estate. These cases are highly fact specific, but it is hard to imagine

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29 The rules differ depending on whether the attorney seeks to be appointed creditors’ committee counsel or counsel for the trustee or debtor. Attorneys may be appointed committee counsel even though they represent interests adverse to the estate if those interests concern matters that are: (1) unrelated to the bankruptcy case; (2) not adverse to the committee’s interest in the bankruptcy case; or (3) pre-date the professional’s employment by the committee. See 11 U.S.C. § 1103(b); Daido Steel Co. v. Official Comm. of Unsecured Creditors, 178 B.R. 129, 132 (N. D. Ohio 1995); In re Firstmark Corp., 132 F.3d 1179, 1181-83 (7th Cir. 1997).

32 In re Development Corp. of Plymouth, Inc., 283 B.R. at 468.
34 See In re Enron Corp., 2002 at *8 (Citing In re Leslie Fay, 175 B.R. at 533).
36 See Id.
37 See Id.
39 See Goldstein, supra note 26.
40 Id.
41 See e.g. In re Enron Corp., et al., Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy, 2003 WL 223455 (S.D.N.Y).
alternative outcomes for large debtor cases, given the current structure of the insolvency bar and the extent of the relationships of many large debtors.

There are not, however, very many cases that find concurrent representation of a debtor and a creditor does not constitute an interest adverse to the estate. There is a thoroughly gray area where concurrent representation is allowed. One possible reason for this absence of cases is that Section 327(c) of the Code states that an attorney is not disqualified solely because of the attorney's employment by or representation of a creditor, unless there is an objection by another creditor or the U.S. Trustee. Courts have viewed Section 327(c) as providing a limited exception to the general rule in 327(a).

ii. Former Representation of Pre-Petition Debtor

Pre-petition representation of the debtor is not usually a bar to employment by the debtor in possession. The Code specifically provides an exception for attorneys of the pre-petition debtor to provide services to the debtor post-petition. Code section 1107(b) states “a person is not disqualified for employment under Section 327 of this title by a debtor in possession solely because of such person’s employment by or representation of the debtor before the commencement of the case.” Courts have been careful to construe this provision narrowly, finding that Section 1107(b) does not “alleviate the requirement that professionals to be employed must be disinterested [for purposes of Section 327(a)], but simply provides that pre-petition employment of professionals by a debtor does not automatically disqualify the person.” The result is that the adverse interest test is still applied by courts in evaluating representation of a debtor in possession. As with any evaluation of an attorney with a potentially problematic relationship, the court will look at all the facts and assess the likelihood of the relationship changing the attorney’s behavior in representing the estate.

The rule for a trustee or debtor in possession to employ counsel for a special purpose is governed by Section 327(e), which allows, with the court’s approval, employment of an attorney who has represented the debtor for a specific purpose, other than conducting the bankruptcy case. Courts have interpreted this provision to allow for the use of a more lenient standard in appointing counsel who had represented the debtor to represent the trustee or debtor in possession in specific matters. In effect, the provision allows attorneys seeking to represent a trustee or debtor in possession under Section 327(e) to only disclose its potentially conflicting relationships pertaining to the special matter for which it has been hired. General representation of a trustee for the purposes of the bankruptcy case remains governed by Section 327(a). Under this provision, an attorney with a relationship with the debtor that might prove adverse to the estate administered by the trustee will be barred from providing representation.

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42 See 11 U.S.C. 327 (c).
44 See 11 U.S.C. 1107(b)
47 Id. at 504.
48 Id. at 505.
49 See 11 U.S.C. 327(e).
51 Id.
52 Id.
Law firms that have represented debtors pre-petition have found themselves conflicted because they themselves are creditors of the debtor.\textsuperscript{54} In one case, a prominent bankruptcy firm was found to be conflicted out of representing a debtor because it had received pre-petition payments for legal work in preparation of the filing of the petition.\textsuperscript{55} The Court found that such payments were potentially avoidable as preferences and the case was considered by some as a prime example of the overly burdensome provisions of Section 327(a).\textsuperscript{56}

c) Conflicts and Disclosure Requirements

Conflict disclosure obligations in the bankruptcy courts are governed by Bankruptcy Rule 2014, which requires attorneys seeking to be employed by the debtor to submit an application stating “to the best of the applicant’s knowledge, all of the person’s connections with the debtor’s creditors” and “any other party in interest[].”\textsuperscript{57} These disclosure rules present a challenge to attorneys independent of the Code’s provisions, since failing to provide what the courts deem sufficient disclosure has been found to be cause for sanction.\textsuperscript{58} Such sanction can include disqualification as counsel or the disallowance of fees.\textsuperscript{59}

In interpreting Rule 2014 requirements, courts have generally found that the burden is on the attorney to provide the court with the fullest possible picture of the attorney’s position with regard to the interest in the bankruptcy estate it seeks to counsel.\textsuperscript{60} The courts have often found that the disclosure requirements of Rule 2014 are more severe than the conflict requirements in the Code.\textsuperscript{61} While Code Section 327 generally requires that a conflict be in some sense material to bar an attorney’s employment, Rule 2014 requires all connections that are not de minimis to be disclosed.\textsuperscript{62}

The difference between what is material and de minimis has been relatively well delineated by the courts. Rule 2014 applicants are not expected to disclose “every past or remote connection with every party in interest.”\textsuperscript{63} Attorneys are, however, expected to disclose all connections “presently or recently existing, whether they are of business or professional nature, which could reasonably have an effect on the attorney’s judgment in the case.”\textsuperscript{64} Boilerplate disclosure is sufficient to free the applicant from conflicts that are unknown at the time the disclosure is submitted.\textsuperscript{65} But boilerplate is not sufficient to free the applicant from the responsibility of disclosing representation of “known and significant parties” that might raise questions about conflicts.\textsuperscript{66}

Courts have generally found that in addition to the initial disclosure requirements of Rule 2014 when a representation begins, Section 327(a) creates a continuing obligation to disclose conflicts

\textsuperscript{55} See In re Pillowtex, 304 F.3d 246 (2002).
\textsuperscript{56} Bruce H. White and William L. Medford, Disinterestedness and Preferential Transfers: Can’t We Talk About This Later, 21-JAN Am. Bankr. Inst. J. 38 (December 2002)
\textsuperscript{58} See In re Enron Corp., 2002 32034346 at *5.
\textsuperscript{60} See In re EWC, Inc.,138 B.R. at 280 (explaining that the court “has neither the obligation nor the resources to investigate the truthfulness of information supplied, or to seek out conflicts of interest not disclosed.”).
\textsuperscript{61} See In re Leslie Fay, 175 B.R. at 536.
\textsuperscript{62} Id.
\textsuperscript{63} In re El San Juan Hotel Corp., 239 B.R. at 647.
\textsuperscript{64} Id.
\textsuperscript{65} In re Leslie Fay, 175 B.R. at 537.
\textsuperscript{66} Id.
that are subsequently discovered or that arise prior to the Rule 2014 application.\textsuperscript{67} Attorneys must provide prompt notice to the court if a potential conflict arises.\textsuperscript{68}

A court’s view on the extent to which Rule 2014 disclosure is sufficient when it comes to conflicts is determined based on the facts of a given case.\textsuperscript{69} As with a Section 327 analysis, the best approach for practitioners is to reflect on what connections might be or become relevant to the debtor’s bankruptcy proceeding in general. In other words, disclose everything.

d) \textit{Curative Measures}

There are some situations in which a court will allow a firm holding an interest adverse to the bankruptcy estate to take curative measures in order to represent the debtor. In such cases, after full disclosure has been provided, courts have allowed attorneys to cease representing a former client in order to eliminate the adverse interest and meet Section 327(a) standards.\textsuperscript{70} In other cases, courts have allowed debtor’s attorneys to appoint special counsel to deal with issues in which a conflict arises, while maintaining overall management of the debtor’s bankruptcy case.\textsuperscript{71} The courts closely monitor such appointments and the attorney found to have an adverse interest is under a continuing duty to monitor the situation and disclose any changes that would require the court to reconsider the conflict issues.\textsuperscript{72}

The special counsel approach has been particularly useful in large debtor cases, where qualified counsel that is non-conflicted as to every issue that might arise in the bankruptcy court is unlikely to be found.\textsuperscript{73} During the Enron bankruptcy, the use of special counsel was allowed for Milbank, a prominent New York law firm, to be employed as debtor’s counsel.\textsuperscript{74} One of Enron’s creditors had moved to have Milbank disqualified as counsel for the Committee of Unsecured Creditors because of its prior relationship with two of those creditors - JP Morgan and Citigroup - that allegedly aided in misleading investors about Enron’s pre-petition financial position.\textsuperscript{75} The creditors alleged that Milbank would work with those creditors to cover up any evidence that might lead to the equitable subordination of the creditors.\textsuperscript{76} Rejecting these arguments, the bankruptcy judge ruled that the establishment of ethical walls within Milbank and the use of special counsel to investigate potential equitable subordination of specific creditors would be sufficient to cleanse Milbank of the conflict.\textsuperscript{77} In ruling on the issue, the judge cited that such arrangements had been used in numerous large bankruptcies.\textsuperscript{78}

Some courts are wary, however, about the extent to which curative measures are appropriate. In some cases, courts have found that an attorney’s adverse relationship was too severe to be cured by appointment of special counsel.\textsuperscript{79} For example, in \textit{In re Amdura Group}, a court was asked to approve an attorney’s representation of multiple debtors who also acted as creditors to each other.

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\item\textsuperscript{67} Rome v. Braunstein, 19 F.3d at 57-58.
\item\textsuperscript{68} \textit{In re} Granite Partners, L.P., 219 B.R. at 22.
\item\textsuperscript{69} Rome v. Braunstein, 19 F.3d at 58.
\item\textsuperscript{70} See \textit{TWI, Intern., Inc. v. Vanguard Oil and Service Co.}, 162 B.R. 672 (S.D.N.Y 1994).
\item\textsuperscript{71} \textit{See In re eToys, Inc.}, 331 B.R. 176 (Bankr. D. Del. 2005).
\item\textsuperscript{72} \textit{See In re Leslie Fay}, 175 B.R. at 536.
\item\textsuperscript{73} \textit{See Goldstein, supra note 26.}
\item\textsuperscript{74} \textit{See In re Enron Corp.}, 2002 WL 32034346 (Bankr. S.D.N.Y 2002).
\item\textsuperscript{75} Id.
\item\textsuperscript{76} Id.
\item\textsuperscript{77} Id. at 11.
\item\textsuperscript{78} Id.
\item\textsuperscript{79} \textit{See In re Amdura Corp.}, 121 B.R. 862, 869 (Bankr. D. Colo. 1990).
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in the debtors’ jointly administrated bankruptcy case.80 These debtors had operated as a single business pre-petition and the firm had been their legal counsel.81 Anticipating the conflict inherent in representing a group of debtors whose interests were adverse to one another, the law firm proposed appointing special counsel to oversee issues related to specific debts between the petitioners.82 The judge in Amdura held that the inter-debtor issues were too integral to the overall case to allow special counsel to remedy the conflict.83 The debtors were required to find individual counsel.84

II. The Rules in Practice

Knowing what the rules are is the first step. Knowing how to meet their requirements is the second. And it’s not always easy. As this section will describe, the level of conflict review and disclosure in larger cases can be somewhat daunting. And, as recently occurred in Lyondell, you don’t necessarily have to run afoul of the rules at all to have the issue become a problem.

a) The Conflicts Affidavit

For big bankruptcy cases, 2009 was a boom year. Companies with assets that numbered in the tens of billions filed one after the other. And any such enterprise will necessarily have a large number of relationships. The firms that seek to represent these debtors in bankruptcy are forced to analyze each one of the relationships to determine whether a potential conflict exists. The resulting disclosure can be voluminous.

Take General Motors, which had $91 billion in reported assets when it filed for bankruptcy protection. In preparing its conflict disclosure affidavit, General Motor’s Counsel, Weil Gotshal & Manges, compiled a list of all the entities that were likely to have a relationship with the debtor.85 It then crosschecked this list of creditors, suppliers, dealers, insurers, professional service providers and insiders with its own current client and past client database.86 The firm also reached out to all employees to inquire whether any personal relationships between Weil Gotshal staff and General Motors employees existed.87 Any matches that came up were disclosed in detail to the court.88 Weil Gotshal detailed not only current and former client matches, but also provided a list of potential matches between General Motors relationships and firm relationships.89 The list of potential conflicts numbered 246 relationships.90

Potential conflicts in big cases that run into the hundreds are common. In the Chrysler bankruptcy, Jones Day submitted an affidavit that disclosed 196 potential conflicts.91 In the Tribune
Company bankruptcy, Sidley Austin disclosed 259 potential conflicts. In Lehman Brothers, Weil Gotshal disclosed 158 potential conflicts, including five current clients that each represented between 1.04% and 3.3% of the firm’s revenue. In the same case, Milbank, which sought to represent the Unsecured Creditor’s Committee, disclosed 153 potential conflicts. Bankruptcy courts evaluated all of these relationships. Each of these firms was permitted to represent their client despite the large number of potentially problematic associations. Clearly, the number of potential conflicts is not necessarily the problem.

b) Application of the Rules

One of the most controversial issues surrounding the Code’s conflict rules is the extent to which the application of these rules differs between judicial districts. This discussion is part of an overall debate regarding debtor friendly districts and the obvious concentration of major bankruptcy cases in New York and Delaware. While there are certainly local cultures in every judicial district (an in every courtroom), the extent to which some jurisdictions treat attorneys seeking to take part in a bankruptcy case more harshly when it comes to conflicts is unclear.

Take the case of John Gellene, the New York bankruptcy lawyer who went to prison because he couldn’t meet the standards of conflict rules in a Wisconsin bankruptcy court. The famous quote from that episode came from the Wisconsin bankruptcy judge dressing down lawyers who had just flown in from Manhattan: “New York is different from Milwaukee... Professional things like conflicts are taken very, very seriously. And for better or worse, you’re stuck in Wisconsin.” What is discussed less often is the extent to which Gellene misled the court in attempting to cover up his failure to disclose a conflict. Arguably, Gellene would have faced the same penalty for repeatedly lying to a judge had he been in the Southern District of New York, Delaware or anywhere else. Therefore, while there are certainly good stories out there, the actual differences between districts are harder to pin down.

A general review of the cases regarding the Code’s conflict provisions, one could argue, reveals that there is certainly a diversity of opinion regarding the application of the Section 327. But, at the same time, there does not seem to be distinct divides between circuits or districts regarding that

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92 Application for an Order Authorizing the Employment and Retention of Sidley Austin LLP as Attorneys for the Debtors and Debtors in Possession Pursuant to 11 U.S.C. §327(a) and 1107, Nunc Pro Tunc to the Petition Date, (Dec. 26, 2009), D. Del. (08-13141(KJC)).

93 Notice of Debtor’s Application Pursuant to Section 327(a) and 328(a) of the Bankruptcy Code for Authorization to Employ and Retain Weil Gotshal & Manges LLP as Attorneys for the Debtors, Nunc Pro Tunc to the Commencement Date, (Oct. 8, 2008), S.D.N.Y. (08-13555(JMP)).


99 Id.

100 Id.

101 Unlike information regarding fees and plan confirmation, the data regarding different approaches to Code conflict doesn’t seem to exist. For data on fees and plan confirmation, see Lopucki & Kain, supra note 95.
application given that bankruptcy courts often take into account the totality of the circumstances involving each potential conflict.

c) Thinking About Lyondell?

The recent accusations made against debtor’s counsel in the Lyondell case provide an interesting example of the issues that bankruptcy’s conflicts rules can create. In Lyondell, debtor’s counsel filed a conflicts affidavit that disclosed 123 potential problematic relationships. Among these relationships, the firm singled out nine banks as representing between 1.14% and 5.9% of its revenue. Among these clients was Merrill Lynch. The judge approved reviewed this disclosure and affirmed debtor’s counsel’s retention as debtor’s counsel.

In December 2009, debtor’s counsel attorneys negotiated a settlement between Lyondell and several banks that had helped finance the merger of Lyondell and Basel AF in 2007. The merger had allegedly left Lyondell with an unmanageable amount of debt and had ultimately forced the company into bankruptcy. Debtor’s counsel had organized an agreement whereby the banks would pay the debtor’s estate $300 million in exchange for dropping the suit. Creditor’s committee counsel, who represented Lyondell’s Unsecured Creditor’s Committee, thought the settlement too little. Creditor’s counsel claimed that debtor’s counsel’s relationship with Merrill Lynch, one of the banks agreeing to settle with Lyondell’s bankruptcy estate, prevented the firm from properly representing the interests of Lyondell’s creditors.

Creditor’s counsel asserted that debtor’s counsel had failed to fully disclose its conflicts with Merrill Lynch. Creditor’s counsel claimed, among other allegations, that debtor’s counsel had failed to disclose to the Creditor’s Committee that it was presiding over the litigation with the banks. Creditor’s counsel stated that the Creditors Committee had been led to believe that special counsel had been appointed to oversee the litigation, when in fact debtor’s counsel was handling the matter alone. Creditor’s counsel asserted that debtor’s counsel had failed to fully disclose its conflicts with Merrill Lynch.

In its defense, debtor’s counsel claimed that the creditor’s committee was using the conflict claim as a mere litigation tactic. The debtor’s attorneys argued that they had fully disclosed their relationship with the banks, as well as their role in the negotiating the settlement. Finally, debtor’s counsel stated that no objection to its potential conflicts had been raised when it sought retention as debtor’s counsel or when it began to prosecute the Debtor’s claim against the banks.

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102 Application for an Order Authorizing the Employment and Retention of Cadwalader Wickersham & Taft LLP as Attorneys for the Debtors (Feb. 5, 2009), In re Lyondell Chemical Co., S.D.N.Y (No. 09 – 10023).
103 Id. at 18.
104 Baxter, supra note 6.
105 Id.
106 Id.
107 Id.
108 Id.
109 Corrected Objection of the Official Committee of Unsecured Creditors to Debtors’ Motion to Approve Settlement Agreement with Financing Party Defendants in Committee Litigation (Jan. 29, 2010), In re Lyondell Chemical Co., S.D.N.Y (No. 09 – 10023).
110 Id. at 79-79.
111 Id.
112 Id.
113 Debtor’s Omnibus Reply to Objections to the Debtor’s Motion to Approve Settlement with Financing Party Defendants in Committee Litigation (Feb. 10, 2010), In re Lyondell Chemical Co., S.D.N.Y (No. 09 – 10023).
114 Id. at 18.
115 Id.
The conflicts claim, debtor’s counsel argued, represented nothing more than an attempt by the creditor’s committee to control the debtor’s actions.116

Days later, the banks agreed to increase the settlement amount to $450 million and the Creditor’s Committee withdrew its objection.117 Reuters quoted one Creditor’s Committee attorney as stating that he hoped the settlement would usher in a new era of cooperation among previously warring parties.118

While we will never know which side of this argument was right, it is clear that allegation of an attorney’s conflict of interest is an effective litigation tool in bankruptcy. Moreover, it seems that robust disclosure may not necessarily insulate a firm from accusations of being conflicted. It seems a firm must rely on its good judgment and the certainty that comes with knowing that it has disclosed every relationship that could conceivably give rise to an adverse interest. Arguably debtor’s counsel’s best defense was that there was no relationship that it had not disclosed to the court. However, the extent of the interweaving relationships among the major law firms in the United States should provide an additional source of comfort to counsel on any side of a bankruptcy case. After all, debtor’s counsel disclosed 123 potentially problematic relationships. Creditor’s counsel disclosed 317.119 Much of the difference comes down to how each firm classified its potentially problematic relationship. Still, it is clear that the problem with insolvency practice is everyone has relationships with everyone.

III. Conclusion

There is bramble of case law interpreting the Code’s language as it pertains to conflicts. Courts have taken different approaches in applying the requirements of Section 327 and oftentimes a pragmatic application is taken in light of the multiplicity of parties in bankruptcy proceedings. The requirements exist to make sure all attorneys “tender undivided loyalty and provide untainted advice and assistance in furtherance of their responsibilities.”120 They screen for “even the appearance of impropriety.”121 Asking whether an attorney’s relationship creates a conflict is not sufficient to determine whether that relationship will later cause a problem. The question to ask is whether the relationship looks as if it might create a conflict. Attorneys that remember to disclose everything, and that are able to look at their representation from the point of view of a third party’s smell test, should be fine – most of the time.

116 Id.
118 Id.
119 Application for Order Authorizing the Retention of Brown Rudnick LLP as Retention as Counsel for the Official Committee of Unsecured Creditors (Feb. 6, 2009), In re Lyondell Chemical Co., S.D.N.Y (No. 09 – 10023).
120 Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).
121 In re El San Juan Hotel Corp., 239 B.R. 635, 647 (1st Cir. BAP 1999).