Ethical considerations governing attorney behavior are sometimes different for clients in or near bankruptcy. This outline addresses ethical considerations for solvent business clients, insolvent clients outside of bankruptcy, and bankruptcy clients, with emphasis on Alaska and Ninth Circuit cases.

I Solvent business clients

- Focus on business-oriented ethical issues (not criminal, personal injury, family law).

- Alaska Rules of Professional Responsibility are currently being revised. New rules will become effective April 15, 2009.

- See 14-page summary of rule changes. Most changes are stylistic, or elaborate on the former rules in an unsurprising way. There are some substantive changes.

- One significant difference for the business lawyer is Rule 1.7, which creates a new term, “concurrent conflict of interest,” to refer to situation where lawyer simultaneously represents two clients with adverse interests, and “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.”

- Concurrent conflicts of interest are permitted only if each client gives informed consent confirmed in writing.

- Comment 7 to Rule 1.7 gives an example - attorney represents Buyer in a sale transaction. Seller in that transaction wants the attorney to represent him, Seller, in an unrelated transaction. Attorney must obtain written consent of both Buyer and Seller to both transactions.

- Can clients consent in advance to a future conflict? Comment 21 to Rule 1.7 says it depends on “the extent to which the client reasonably understands the material risks that the waiver entails.” “If the consent is general and open-ended, then the consent ordinarily will be ineffective ... In the other hand, if the client is an experienced user of the legal services involved and is reasonably informed
regarding the risk that a conflict may arise, such consent is more likely to be effective ...

- Can a lawyer obtain a security interest in a client’s assets, for example to secure payment of a fee? Rule 1.8 says yes, if among other things the lawyer tells the client in writing to obtain separate counsel, and gives the client reasonable time to do so.

- “Who is client?” is frequently an issue in business context: e.g.:
  - Formation of corporation by shareholders with differing interests (the “money guy” and the “worker guy” want to get together and start a corporation).
  - Corporate attorney’s role in employment contracts (contract between corporation and worker guy), loans (contract between corporation and money guy).
  - Corporate attorney’s role where the corporation is owned 50-50 by an “office guy” and a “field guy.” Attorney probably usually deals with office guy.
  - Corporate attorney role in shareholder-shareholder dispute.
  - Corporate attorney vis-a-vis non-key corporate employees.
  - Many issues avoided by initial disclosures and consultation with corporate representative, and well thought out engagement letter.

- Greg Miller’s 17 points go a long way in avoiding fee disputes.

II Insolvent client NOT in bankruptcy

- Wilner’s Fuel v. Noreen, 882 P.2d 399 (Alaska 1994) - Attorney represented both a dissolved, insolvent corporation and its sole shareholder in a lawsuit. The case settled for a lump sum. Meanwhile, creditor sued both shareholder and corporation, obtained judgment against corporation and dismissed shareholder without prejudice. Essentially simultaneously, the attorney distributed the entire settlement, net of the attorney’s fee, to the shareholder. Alaska Supreme Court held “if the attorney controls corporate assets, then the attorney must protect the financial rights” of the corporation’s creditors, and the attorney himself could be liable for funds distributed to shareholder. Remedy was not that the one complaining creditor got paid - instead, funds were to be deposited into state court registry.
Many of Wilner’s themes are echoed in bankruptcy law - attorney’s duty to creditors of insolvent corporation trumps shareholder interests; duty is to creditors collectively.

Note that none of the Wilner’s dilemmas could have been avoided with an engagement letter - the problem was entirely due to the attorney not recognizing that “the client” had transformed before his eyes and that Thomas Rosson and Thomas Rosson, Inc. had conflicting interests.

In Nerox Power Systems v. M-B Contracting, Inc., 54 P.3d 791 (Alaska 2002), director of corporation, who was also an attorney, was found to have breached his fiduciary duty to insolvent corporation by giving himself deed of trust on corporate property.

Attorney drafting fraudulent conveyance documents: is there a problem?

- Professional Rule 8.4 states that it is professional misconduct for a lawyer to “engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.” Does this include an attorney drafting documents implementing fraudulent conveyances? (Upon client being served with lawsuit, client requests that attorney prepare deed conveying property to client’s infant son).

- Conspiracy to defraud - an unusual and important slice of Alaska fraudulent conveyance law. In Summers v. Hagen, 852 P.2d 1165 (Alaska 1993), Hagen sued Briske for debt. Briske fraudulently conveyed property to Summers, his business partner. Briske filed bankruptcy, and Hagen sued Summers directly. Summers offered to reconvey the property, but the property had lost value (a fact implied in the decision but not stated), and in any event the property would have gone back to the bankruptcy estate, not to Hagen. Alaska Supreme Court adopted a “conspiracy to fraudulently convey property, a novel theory of liability in Alaska” and a minority view in other jurisdictions. This remedy is available if voiding the transfer is an inadequate remedy, and entitles the plaintiff to a money judgement against the defendant equal to the lesser of the value of the property at the time of conveyance, or the debt owed plaintiff. Elements of the theory are (1) an unlawful agreement, (2) actual intent to hinder delay or defraud a creditor, (3) acts committed pursuant to the unlawful agreement, and (4) damages caused by the acts.

- U. S. v. Roti 484 F.3d 934 (7th Cir., 2007). Bankruptcy debtor parked his assets in family members name, and was convicted of bankruptcy fraud, 18 USC §152 and concealing assets, 18 USC §157. Debtor blamed his lawyer.
Court scoffed at this defense, but stated, “One observation before we close. Roti is in prison, but Andrew Dean Werth remains licensed to practice law. According to the Attorney Registration and Disciplinary Commission of Illinois, he is in good standing and no disciplinary inquiry has ever been conducted. If Roti’s testimony at trial is correct, however, then Werth planned and executed a federal crime for which Roti has taken the fall. If Roti was lying at trial about Werth’s role (as the district judge concluded when holding that Roti obstructed justice by his perjury), there remains the possibility that Werth turned a blind eye to his client’s fraud and facilitated misuse of the bankruptcy process. … Neither knaves nor fools should be representing debtors who need legal assistance. We will send copies of this opinion (and of the briefs, which provide additional factual detail) to the ARDC and the disciplinary committee of the federal district court so that appropriate inquiries can be made into Werth’s fitness. In asking these bodies to conduct an inquiry, we do not express any opinion about whether Werth has engaged in sanctionable conduct.”

III Bankruptcy clients: trustees, debtors and committees

In the bankruptcy context, different rules apply, depending on who the attorney represents. For attorneys representing individual secured and unsecured creditors, there are no special bankruptcy rules, subject to caveat that different creditors may be treated differently.

- **Attorneys representing trustees, debtors, committees:**
  - Trustees, debtors and committees are all fiduciaries. So the attorney is a fiduciary to a fiduciary. This fact underlies many of the bankruptcy rules applicable to attorneys for these entities.
  - Court order is required in order to be employed, and in order to be paid.
    - Application to be paid NOT subject to notice requirement. Fed. R. Bankr. P. 2002(a). But application must be accompanied by attorney disclosure information discussed below.
    - Motion to be paid DOES require notice to creditors. Section 330(a), rule 2016(a).
    - Most “ethics” bankruptcy cases are decided in the contexts of fee applications.
    - Getting paid also requires detailed billings being filed with court and thereby disclosed to the world. Fed. R. Bankr. P. 2016(a). Theory is that money comes from creditor’s pockets and attorney is
supposed to benefit creditors as part of estate as a whole. Submission of detailed billings requires some judgment in entering time when work is performed, and also requires review (many) months later when fee application is filed.

- Since fees orders are entered only after notice and hearing, this means that NON-CLIENTS - creditors and the U.S. Trustee - have input into whether attorney is entitled to be paid.

- Being court-approved is not a guarantee that the court will approve fees at all. *Ferrara & Hantman v Alvarez*, 124 F.3d 567 (3rd Cir. 1997). 1994 amendments to Section 330 added a “benefit to estate” condition of being paid, codifying prior case law.

- Order approving appointment as attorney for estate is not a final order for purposes of appeal. *In re S. S. Retail Stores Corp.*, 162 F.3d 1230 (9th Cir. 1998). This can be bad news for the lawyer in the sense that it is not until an appeal from the final fee application that the matter is ruled upon, although in this case the Ninth Circuit affirmed the lawyer’s final fee application in part because objecting U. S. Trustee did not obtain a stay of the appointment order, and the lawyer therefore did the work. *In re S. S. Retail Stores Corp.*, 216 F.3d 882 (9th Cir. 2000).

- Engagement letter is less important inside bankruptcy context than it would be outside bankruptcy context. Engagement letter’s function is largely mooted by written disclosures made to court, at time of initial employment.

- Client consent to conflicts is not enough. Full disclosure to clients is not enough. Happy client not enough. Greg Miller’s 17 pointers are not enough.

- Outside of bankruptcy, the usual “penalty” for an ethical breach is getting sued or not getting paid in full; inside bankruptcy, the usual “penalty” is not getting paid at all. Ethical breaches tend to be more “all or nothing” in the bankruptcy context.

- **Trustee’s attorney**

  - Appointment as general counsel - Section 327(a):
Must be “disinterested” and also not hold an “interest adverse” to the estate - Section 327(a).

“Disinterested person” is defined at Section 101(14).

101(14)(A) says that a “creditor” or an “insider” is not disinterested.

101(14)(C) means a person that “does not have an interest materially adverse to the interest of the estate or .... or for any other reason.”

Is the “disinterested” requirement a per se rule, or is there room for judicial discretion?

- Fourth, Sixth and Eighth Circuits have ruled that this is a per se rule. In re Pierce, 809 F.2d 1356 (8th Cir. 1987), In re Middleton Arms, 934 F.2d 723 (6th Cir. 1991), In re Harold & Williams, 977 F.2d 906 (4th Cir. 1992).

- First Circuit says there is some discretion (10-part test). In re Martin, 817 F.2d 175 (1st Cir. 1987).

- No Ninth Circuit level case, but In re Pacific Express, 56 B.R. 859 (Bankr. E.D. Cal. 1985) rejects per se test.

- If a lawyer is not disinterested, is his entire firm disqualified? Maybe. Chinese wall was approved in U. S. Trustee v. S. S. Retail Stores, 211 B.R. 699, 704 (B.A.P. 9th Cir. 1997), affirmed 216 F.3d 882 (9th Cir. 2000).

- Collier says that “Given the incidence of public corporations resort to protection under chapter 11, this more pragmatic construction of the definition may be justified.” 3 Collier on Bankruptcy ¶327.04[2][a], p. 327-36 (15th ed., supp 2008).

“Adverse” is not defined. Case-by-case.

Adverse means a claim for payment against estate or a preference exposure. In re First Jersey Securities, Inc., 180 F.3d 504 (3rd Cir. 1999).

No per se disqualification for representing creditor - Section 327(c).
Surprisingly, to Alaskans anyway, Section 327(d) expressly authorizes trustees to hire themselves as lawyers for the estate. This is a frequent fact pattern outside Alaska, but not an issue in Alaska since no Alaska panel trustees are lawyers.

**Appointment as special counsel - Section 327(e).**

- Designed for situation where, because of special expertise or familiarity with a particular dispute, it makes sense for some attorney other than trustee’s general counsel to handle. Typical example is debtor’s attorney in a particular piece of litigation, or a personal injury attorney to handle a tort claim.

- Slightly less rigorous requirement for employment: OK if counsel is NOT disinterested. However, such attorney may “not represent or hold any interest adverse to the debtor or the estate with respect to the matter on which such attorney is to be employed.”

**In In re Community Advocacy Project of Alaska, Inc., 7 ABR 381 (Bankr. D. Alaska 2002),** the Chapter 7 debtor (CAPA) had served as guardian for certain incapacitated wards. The trustee wished to retain special counsel who would represent the wards and the bankruptcy estate. Judge MacDonald approved the employment, finding that the dual representation was not a conflict in that case.

- If the trustee’s or debtor’s attorney forgets to file for an order appointing him, he may well be denied fees. *Nunc pro tunc* employment generally disfavored. *In re Martinson Gravel & Crane, Inc.,* 1 ABR 517 (Bankr. D. Alaska 1991). *In In re Polaris Investment,* 2 ABR 41 (Bankr. D. Alaska 1991), Judge Ross noted that “issuance for a *nunc pro tunc* order is far from a rubber stamp,” but authorized interim attorney fees be paid subject to disgorgement if *nunc pro tunc* approval was not later obtained.

**Employment can be revoked. Kemp-Palucci.**

**Chapter 11 Debtor’s attorney**

- Pretty much everything that applies to Trustees attorneys also applies to Debtors’ attorneys. And then some.
Debtors-in-possession (DIP) have a different function, but are vested with powers and obligations of a trustee. §1107(a). Therefore attorneys for trustee and attorneys for debtor must follow similar rules.

Attorneys must be authorized to act for Chapter 11 debtors, even if the attorney does not seek compensation from estate (e.g. payment will be from non-debtor source). Failure to obtain court approval can result in disgorgement of third party funds. *Land v. FNB*, 943 F.2d 1265, 1267 (10th Cir. 1991).

Section 1107(b) says that attorney’s pre-petition representation of debtor does not automatically disqualify attorney from representing DIP. (However, attorney will have to waive any pre-petition claim for unpaid fees so as to be “disinterested”).

In *In re Alaska Towboat Corp*, 2 ABR 166 (Bankr. D. Alaska 1991) Judge Ross approved Chapter 11 debtor’s application to employ attorney, where the attorney also represented debtor’s 50% shareholder (KTAI) in unrelated litigation. KTAI was also the debtor’s primary unsecured creditor, and had supplied a $20,000 retainer to the attorney for the Chapter 11. Calling it a “close question,” Judge Ross approved the application to employ provided that the attorney return the retainer to KTAI.

Frequently, the same attorney will represent related Chapter 11 debtors. Court will review these applications on a case by case basis, although in practice joint representation is allowed even if there are claims between debtors. In *In re Adelphia Communications Corp.*, 342 B.R. 122 (S.D. N.Y. 2006) district court affirmed bankruptcy court’s finding that the presence of intercompany claims between Chapter 11 debtors represented by same counsel did not automatically warrant disqualification of counsel. Likewise, *In re Global Marine*, 108 B.R. 998 (Bankr. S.D. Tex. 1987).

Part of the attorney’s application to be appointed is an affidavit from him setting forth “arrangements for compensation,” as well as “connections” with the debtor, creditors, other parties in interest, or the U. S. Trustee’s office, that he is disinterested. Bankruptcy Rule 2014(a). This affidavit sets forth basis that the attorney is disinterested.

In addition to the affidavit of disinterestedness required of debtor’s attorney under Bankruptcy Rule 2014(a), Section 329(a) and Rule 2016(b) requires that the attorney file a Disclosure of Compensation paid or promised to paid within a year of the bankruptcy filing. This must be supplemented within 15 days of any new development.
In *In re Park-Helena Corp.*, 63 F.3d 877 (9th Cir., 1995), corporation’s shareholder paid attorneys $150,000 retainer to represent the corporation in a Chapter 11. The shareholder owed the corporation $1.35 million, and the $150,000 was credited against that debt. Attorneys filed statements under Rule 2014(a) and Rule 2016(b) saying that the corporation had paid the retainer. When the true facts were revealed at the end of the case, the court disallowed all fees to the attorney as a sanction for the attorneys’ failure to disclose the true facts. Court rejected attorneys’ “form over substance” defense, and held that “even a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees.” Reading between lines, court may have believed that attorneys may have been aware of debtor attempt to deplete bankruptcy estate, but this was not an explicit part of court’s decision.

In *In re Browning Timber of Alaska*, 6 ABR 202 (Bankr. D. Alaska 1999) Chapter 11 attorney received $15,000 retainer on petition date, and was owed $4,000 that date for pre-petition services. One month after the petition, he used $4,000 of the retainer to pay the pre-petition bill, then on an order to show cause for failure to file the Section 329(a) disclosure statement, advised the Court that the retainer had been only $11,000. On these and other facts, Judge MacDonald disqualified counsel and ordered disgorgement. “An attorney cannot be coy or selective about what he chooses to disclose...”


In *In re Jore Corp.*, 298 B.R. 703 (Bankr. D. Mont. 2003), Perkins Coie represented the debtor, Jore, in a large Montana Chapter 11 case in which Wells Fargo was the primary secured lender. Perkins represented Wells in other unrelated matters, and at the beginning of the case the bank consented to Perkin’s representing the debtor on the condition that the firm would not represent Jore in any matter against bank. Perkins filed a series of Rule 2014(a) disclosures but failed to mention this “no litigation” condition of Wells’s conflict waiver. Wells became Jore’s DIP lender. Only when the case fell apart and converted to a Chapter 7, and Perkins and Wells went to war over the interpretation of the carveout provision of the DIP order, did the Court learn of this “no litigation” agreement. Incensed, the court disallowed all but a small portion of the $1.8 million in fees and costs sought by the firm.

- Committee attorney
Section 1102 sets forth the duties of committees, which basically is to act on behalf of the class of creditors, or other persons, that the committee represents.

Section 1103 authorizes committees to hire attorneys. Rules are the same as for Chapter 11 debtor’s attorneys or Chapter 7 attorneys.

Here, Section 327(c)’s provisions, that “an attorney shall not be disqualified ... merely by reason of his representation of a general creditor,” is particularly important, since committee counsel frequently represent a creditor on the committee.

Committees are fiduciaries to the bankruptcy estate, and some creditors, e.g. competitors of the debtor, may be (wisely) unwilling to serve on a committee if there is a problem with a creditor desiring to advance his own interests. These considerations may rebound to the attorney for that creditor.