Educational Materials

Saturday October 11, 2014 10:15 AM - 11:15 AM

NCBJ Plenary Session

Wait, Wait...Don't Tell Me!
An Ethics Show Game

Presented By

NCBJ | National Conference of Bankruptcy Judges

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Wait, Wait, Don't Tell Me...
Ethical Considerations for Bankruptcy Practice

Game Show Host: Honorable James B. Haines, Jr.

<u>Judicial Contestants</u>
Honorable A. Benjamin Goldgar
Honorable Neil P. Olack
Honorable Erithe A. Smith

<u>Attorney Contestants</u>
Professor Nancy B. Rapoport
Christine E. Devine, Esq.
Timothy F. Nixon, Esq.

Hypothetical

- Billem & Phalen ("B&P"), an international law firm, formed in 2005 when a U.S.-based firm merged with a British firm.
- Shortly after the merger, cultures clashed and B&P struggled.
- In August of 2014, B&P filed Chapter 11 in New York.
- B&P operated for a short time in Chapter 11.
- For various reasons, in October of 2014, B&P's case converted to Chapter 7, and a Chapter 7 Trustee was appointed.

Question 1

Background:

- B&P hired a New York law firm ("NY Law") as Chapter 11 counsel. Pre-petition, Lead counsel ("Fran") focused on first-day motions. Her associate ("Ted") prepared B&P's Petition, Schedules and SOFA.

- Ted had little contact with B&P's managing principals, but reviewed B&P's files on site in New York for assets and liabilities. Prior to the filing, Ted obtained B&P's managing partner's signature on the Petition and he signed as counsel.

- At the § 341 meeting, the U.S. Trustee questioned B&P's managing partner about B&P's Western European offices, some of which were completely omitted from the Schedules. He confirmed that assets related to those offices were also missing. Fran assured the U.S. Trustee that B&P would promptly amend.

- In the next 30 days, Fran and Ted are consumed with Rule 2004 examinations and fail to amend the Schedules.

Question 1

Question:

The U.S. Trustee files a motion to compel B&P to amend. The Judge enters an Order to Show Cause as to why NY Law should not be sanctioned for the omissions. Should NY Law be sanctioned?

Multiple Choice Answers

1. **Yes.** The Court should exercise its discretion and impose sanctions on NY Law. NY Law cannot simply reply on what B&P told NY Law. If NY Law had thoroughly reviewed B&P's files, it would have identified the international offices. In these circumstances, it would be appropriate for the Court to determine further inquiry was necessary and impose a sanction.

2. **No.** Because NY Law did not purposefully omit the international offices, the Court cannot determine that NY Law submitted the Schedules for the purpose of misleading the Court and B&P's creditors. Therefore, the Court will not impose a sanction.

3. **No.** NY Law conducted a reasonable investigation of B&P's business before the filing. The onus was on B&P's managers to correct any omissions by NY Law. NY Law is not responsible for independently verifying the accuracy of the information included in B&P's Petition.

Correct Answer

Question 2

Background:

- During the Chapter 11, Suzy Gamble, a senior associate, decided to set up a solo firm in Nevada. Her practice includes consumer bankruptcies.
- One of her first clients ("Sam") seeks a "quick and easy" bankruptcy to eliminate $100,000 of credit card debt.
- Suzy recommends Chapter 7 and presents Sam with a fee agreement, which requires $1,500 from Sam for (i) preparing Schedules and SOFA, (ii) filing the Petition and (iii) representing Sam at the § 341 meeting. The fee agreement explicitly excludes adversary proceedings. Sam signs the agreement.
- Eventually, Sam is served with three separate nondischargeability actions related to his credit card debt. Sam answers the complaints *pro se* and admits various transgressions.

Question 2

Question:

The Judge presiding over Sam's case enters an Order to Show Cause as to why Suzy should not be sanctioned for her limited scope representation in this case. Should she be sanctioned?

Multiple Choice Answers

1. **No.** Sam voluntarily signed the fee agreement and, thus, consented to Suzy's limited scope representation. Sam hired Suzy only to file Sam's bankruptcy and provide the services in the agreement. The agreement explicitly excluded dischargeability actions. Also, the fee charged was reasonable.

2. **Yes.** Suzy breached her duty of competence and failed to provide informed consent. Suzy knew that Sam's objective was to eliminate his credit card debt. She should have advised Sam of the risks.

3. **Yes.** Insolvency attorneys are prohibited from excluding the defense of adversary proceedings in Chapter 7 cases. Although there might be situations where unbundling is possible, counsel for an individual cannot "unbundle" a dischargeability defense.

Correct Answer

Question 3

Background:

- Shortly after the filing, B&P filed an application to retain a partner ("Jan") of Turnaround Associates ("Turnaround") as its Chief Restructuring Officer.

- At Turnaround's request, B&P sought approval of Jan's retention pursuant to §§ 105(a) and 363(b)(1). The retention application sought to retain and pay Turnaround "other than in the ordinary course of business". Jan and Turnaround also disclosed all connections with interested parties in B&P's case.

- The U.S. Trustee filed a limited objection to Jan's retention, arguing that, if approved, Jan's retention should be subject to § 327.

Question 3

Question:

Should the Court allow B&P's retention of Jan on the statutory bases asserted (§§ 105(a) and 363(b)(1))?

Multiple Choice Answers

1. **No.** CROs constitute "professional persons" within the meaning of § 327. Jan must comply with § 327 and must also file fee applications. Otherwise, the Court will be unable to oversee Turnaround's compensation or ensure that Jan is impartial. If the Court is inclined to grant Jan's retention, it should rely on § 327.

2. **Yes.** The Court may approve Jan's retention pursuant to §§ 105(a) and 363(b)(1). Jan has satisfied any "disinterestedness" requirement by disclosing all connections with interested parties. It is not necessary for Jan or Turnaround to submit formal fee applications, but Turnaround's compensation can still be scrutinized throughout the case.

3. **Yes.** The Court may approve Jan's retention pursuant to §§ 105(a) and 363(b)(1) provided that B&P gives a sound business decision for Jan's retention and Jan agrees to comply with §§ 330 and 331 by filing fee applications.

Correct Answer

Question 4

Background:

- A year ago, NY Law hired B&P's former Senior Vice President and General Counsel Russell "Rusty" Nife. NY Law instituted a screening process ("Chinese Wall") under which neither Nife nor his assistant will have any involvement in B&P's case. In addition, Nife waived any claim he had against B&P.

- NY Law retained conflict counsel in the event any claims arise against Nife. Nife will receive no share of the compensation from B&P's case. B&P has consented to the representation.

- The U.S. Trustee objected to NY Law's retention, arguing that because Nife is not disinterested, his lack of disinterestedness is imputed to NY Law.

Question 4

Question:

May NY Law be retained by B&P as a professional under §327(a)?

Multiple Choice Answers

1. **Yes.** NY Law has complied with applicable ethics rules and opinions. The conflict is waivable, and B&P has waived it.

2. **Yes.** Although Nife might not be disinterested under § 101(14), NY Law is a person and is disinterested under § 101(14) as a firm. Therefore, NY Law satisfies the disinterestedness requirement.

3. **No.** Nife's lack of disinterestedness is imputed to NY Law. Therefore, NY Law is not disinterested under § 327(a).

Correct Answer

Question 5

Background:

- B&P owned two subsidiaries. One was a title insurance agency ("Eternalnopay Title Agency") and the other a public relations/lobbying firm ("Peytuplae Public Affairs"). Both have now filed for Chapter 11 protection, and both have retained Seeh, Noe, Eiveel, S.C. ("SNE") as bankruptcy counsel.

- There are intercompany claims among the subsidiaries and the B&P estate.

- The U.S. Trustee has objected to SNE's retention, arguing that the intercompany claims are an actual conflict and as a result SNE is *per se* not disinterested.

Question 5

Question:

May SNE be retained to represent Eternalnopay and Peytuplae jointly in the bankruptcy?

Multiple Choice Answers

1. **No.** There is a rebuttable presumption that the representation is improper. The intercompany claims mean that SNE cannot rebut the presumption.

2. **Yes.** There is no *per se* rule. The intercompany claims do not automatically prevent the retention, and a case-by-case analysis is needed.

3. **Yes.** The representation is fine as long as B&P had previously waived any conflict.

Correct Answer

Question 6

Background:

- B&P hires NY Advisory Group, LLC ("Advisory"). The Advisory engagement was orchestrated by a corporate partner at NY Law.
- NY Law and Advisory have a separate arrangement where Advisory pays NY Law a small percentage commission of Advisory's compensation from recommended clients.
- In its retention pleadings, Advisory stated that it had no "fee-sharing" agreement with any other entity in connection with B&P's case. The Court approved B&P's retention of Advisory as its financial advisor.
- Advisory eventually files its first interim fee application, seeking payment of $100,000 from B&P's estate. After the Court approves the fee application, per its arrangement with NY Law, Advisory pays $5,000 to NY Law.

Question 6

Question:

After investigating the matter more closely, the U.S. Trustee files a motion to vacate the Court's Order approving Advisory's retention and for disgorgement of Advisory's and NY Law's full compensation. Is NY Law's compensation subject to disgorgement?

Multiple Choice Answers

1. **Yes**. Unless NY Law can prove that it lacked knowledge of the "fee-sharing" arrangement. Otherwise, both Advisory and NY Law knowingly violated the mandatory bankruptcy disclosure rules. The Court may rely on § 329 to disgorge all of NY Law's fees and potentially impose additional sanctions.

2. **Yes.** NY Law ignored its ethical obligations as an estate professional by failing to disclose its "fee-sharing" arrangement with Advisory. The Bankruptcy Court has broad discretion to impose sanctions on these facts, including the return of all compensation NY Law received in B&P's case (fees, plus commission).

3. **Yes**. Section 329 allows the Court to regulate attorney compensation by entering disgorgement orders for excessive compensation. The Court also has authority to discipline attorneys for violating bankruptcy disclosure requirements. However, the Court must use the least restrictive sanction to deter NY Law's bad conduct. Disgorging the commission is appropriate, but full disgorgement of fees may be excessive.

Correct Answer

Question 7

Background:

- While B&P was in Chapter 11, certain members of B&P took control of its governing board. At that time, B&P was in the midst of a trial in an adversary proceeding.

- Despite a questionable valuation methodology, the new directors ordered NY Law lawyers to use a recently-obtained valuation rather than the previous valuation.

- They also ordered NY Law to appeal if the Court ruled against B&P regardless of the merits of the decision.

Question 7

Question:

May NY Law withdraw as counsel?

Multiple Choice Answers

1. **No**. Clients get to make decisions.

2. **Yes.** It is mandatory or at least permissible to withdraw.

3. **Yes.** But withdrawal is subject to Court approval.

Correct Answer

Question 8

Background:

- A bankruptcy partner at B&P ("Bob") is contacted by an old law school friend ("Liz"). Liz filed a Chapter 11 in Illinois *pro se* to address delinquent taxes.

- Liz intends to object to claims filed by the Internal Revenue Service and the Illinois Department of Revenue. Liz asks Bob to send her a "sample" claim objection. Bob prepares drafts for Liz.

- Liz files the claim objections "as is" with the Court. Liz signs them as "*pro se* Chapter 11 Debtor".

- In their responses, the IRS and DOR express doubt that Liz prepared the objections without counsel.

Question 8

Question:

After reviewing the pleadings, the Judge presiding over Liz's case enters an Order to Show Cause to determine who prepared the claim objections on Liz's behalf. Should Bob be sanctioned for "ghostwriting"?

Multiple Choice Answers

1. **No.** Assuming Liz has meritorious objections to the claims, Bob's ghostwriting does not constitute sanctionable misconduct. Liz disclosed Bob's assistance when questioned and, as a result, Liz will not unfairly benefit from her *pro se* status.

2. **Maybe.** At a minimum, Bob is not licensed to practice in Illinois, plus he drafted the objections, but he failed to sign them in violation of Rule 9011. Therefore, the Court will exercise discretion depending on Bob's response to the Show Cause Order.

3. **No.** Bob was unaware that Liz intended to file the drafts "as is". The Court should not sanction Bob unless the Court determines that Bob's nondisclosure of his involvement was misleading to the Court.

Correct Answer

Question 9

Background:

- B&P worked closely with both counsel to the Creditors' Committee and individual Committee members to propose a Plan.
- Because of their contributions during Plan negotiations, the Plan provides for payment of the fees of counsel to individual members of the Committee.
- Before the Plan can be confirmed, the case converts. Shortly after, the individual Committee members filed requests for reimbursement of the fees paid to their professionals as Chapter 11 administrative expenses.
- The U.S. Trustee objects, arguing that the Bankruptcy Code does not provide for payment of those types of professional fees as administrative expenses.

Question 9

Question:

Should the Court sustain the U.S. Trustee's objection and deny the Committee members' administrative claim requests?

Multiple Choice Answers

1. **Yes.** The Court should sustain the U.S. Trustee's objection unless the individual Committee members can show that the professionals made a substantial contribution to B&P's case. Official Committee membership by itself is insufficient grounds for payment of expenses incurred by counsel as a priority administrative expense.

2. **Yes.** Section 503(b)(4) explicitly excludes professional fees incurred by individual Committee members from treatment as administrative expenses. To allow the Committee members' requests would constitute an impermissible contravention of a Congressional mandate.

3. **No.** The Court may grant the administrative claim requests pursuant to § 503(b)(3)(F). Courts have consistently interpreted the expenses incurred by individual Committee members performing committee duties to include reimbursement of professional expenses.

Correct Answer

Question 10

Background:

- After conversion, NY Law filed a fee application, seeking payment of fees in the amount of $1,500,000.
- NY Law's fee application shows that more than 25 attorneys and paralegals worked on B&P's case during August and September. Additionally, 5 summer associates and 3 administrative assistants billed time to B&P's case.
- In its application, NY Law explained that, given the size and complexities of the case, the work performed and the fees charged (i) were reasonable and (ii) conferred a benefit on B&P's estate.
- The U.S. Trustee objected to the fee application for various reasons, including the number of professionals working on the case and NY Law's high billable hourly rates.

Question 10

Question:

Should the Court sustain the U.S. Trustee's objection and deny portions of NY Law's fee request?

Multiple Choice Answers

1. **Yes.** The Court may decide to deny requests for compensation based on duplicative work performed by an unreasonable number of legal professionals. Also, time spent by summer associates and law clerks is not compensable and should be treated as overhead costs of NY Law's practice.

2. **Maybe.** The Court may sustain the U.S. Trustee's objection, but only if the U.S. Trustee can demonstrate that the fees requested are unreasonable compared to the services rendered and the benefit conferred on the estate from such services.

3. **No.** Assuming NY Law can demonstrate that its fees charged were reasonable and necessary expenses of administering B&P's estate. Should the Court overrule the U.S. Trustee's objection, NY Law may be compensated for the costs incurred defending its fee application.

Correct Answer

Question 11

Background:

- After the case converts, several B&P partners move on to practice with new law firms. A litigation partner ("Pam") and her new firm are retained by a former client of B&P ("Sue Happy, Inc.") to continue prosecuting unresolved actions on an hourly-fee basis.

- Eventually, B&P's Chapter 7 Trustee files an adversary proceeding against Pam and her new firm to recover all profits derived from her representation of Sue Happy, Inc. The complaint includes claims under New York law and bankruptcy law for an accounting, turnover, unjust enrichment and conversion.

Question 11

Question:

Can the B&P Trustee recover the profits derived from Pam's representation of Sue Happy, Inc.?

Multiple Choice Answers

1. **No.** B&P is only entitled to be paid for the services it provided prior to conversion. Because Sue Happy, Inc. has the unfettered right to hire and fire counsel, B&P has no property interest in future hourly legal fees. Sue Happy, Inc. owns its own legal matters.

2. **Yes.** Assuming that there is no provision in B&P's partnership agreement to the contrary, Sue Happy, Inc.'s business is the property of B&P. Sue Happy, Inc. was a client of B&P, not Pam. B&P's partners could have tailored their partnership agreement to specify that "books of business" belong to the individual partner.

3. **No.** While hourly matters might constitute B&P's unfinished business, Sue Happy, Inc. effectively fired B&P when it hired Pam and her new firm. Because Sue Happy Inc. fired B&P, there are no profits from "unfinished business" for the Trustee to recover.

Correct Answer

Question 12

Background:

- Ima Klutz has a malpractice claim against B&P for $23 million. Her lawyer, Chance Strykesuut, signed Klutz's proof of claim.
- The Chapter 7 Trustee served a deposition notice and discovery directly on Strykesuut.
- Strykesuut filed a motion for a protective order claiming attorney-client privilege. The Chapter 7 Trustee cross-moved to compel.

Question 12

Question:

May the B&P Trustee compel Strykesuut to testify and produce documents regarding Klutz's claim against the estate?

Multiple Choice Answers

1. **No.** A proof of claim is a pleading like a complaint, and signing it does not turn an attorney into a fact witness.

2. **Yes.** A proof of claim is signed under penalty of perjury just like an affidavit. By signing the proof of claim, Strykesuut represented that he had personal knowledge of the facts supporting the claim.

3. **No.** Attorney-client privilege protects Strykesuut. The privilege is held by the client, not the lawyer, and the client has not expressly waived the privilege.

Correct Answer