ABTJ Ethics Roundtable

Edited by Christopher D. Hughes, Esq., Nossaman LLP, Sacramento, CA

We asked an attorney, a law professor, and a judge a series of hypotheticals regarding things you may see in your practice from time to time.

About The Ethics Roundtable Participants

Professor Nancy B. Rapoport [NR] is a UNLV Distinguished Professor and the Garman Turner Gordon Professor of Law, Boyd School of Law, UNLV, and an Affiliate Professor of Business Law and Ethics at Lee Business School, UNLV. The focus of Professor Rapoport's scholarship is business ethics, professional ethics and bankruptcy. Professor Rapoport is a *summa cum laude* graduate of Rice University and the Stanford Law School.

Dr. Sarah J. Keaton [SK] is an attorney specializing in conflicts, ethics, and risk management, with a particular focus on bankruptcy, in the Office of the General Counsel of Fox Rothschild. Prior to Fox Rothschild, she clerked for the President

...continued on next page

Judge of Carbon County, Pennsylvania, and practiced bankruptcy and general civil law. While working full time as an attorney, Keaton completed her PhD at Temple University's College of Public Health and before that, simultaneously earned her law degree from Villanova University School of Law and her Master of Business Administration degree from the Pennsylvania State University.

Judge Peter W. Bowie (ret.) [Judge] spent 27 years as a judge in the United States Bankruptcy Court for the Southern District of California. Judge Bowie is now a Partner of Counsel to Dinsmore & Shohl, LLP in their San Diego Office. Judge Bowie is a graduate of Wake Forest University and a *magna cum laude* graduate of the University of San Diego School of Law.

Andrea Dobin [Moderator] is a Partner at McManimon, Scotland & Baumann, LLC, in Trenton, NJ. and Editor In Chief of *The American Bankruptcy Trustee Journal*.

HYPOTHETICAL NO. 1

A trustee uses an independent contractor ("Jill") as her trustee assistant. Jill also acts as an independent contractor for other lawyers and occasionally prepares bankruptcy petitions as part of her business. The trustee does not have access to any of the confidential information in any of the petitions, but as the trustee's assistant, she reviews debtor petitions before 341 meetings. If the trustee that Jill works for is appointed to serve as a trustee in a case where Jill prepared the bankruptcy petition, must the trustee resign?

Dr. Sarah Keaton

My thoughts are whether the debtor was still a current client of the other lawyer and whether Jill would still be working on their case. And if so, then I would tend to agree that the trustee couldn't take the case. But if not, maybe the trustee doesn't necessarily have to resign, but that they certainly couldn't use Jill on the case. And that if the trustee did choose to keep the case that they might want to consider an ethical screen to wall Jill off from the file.

But then it would also depend on number of factors such as how big the practice was. I'm coming at this from a background of I used to practice in a pretty small area where everybody kind of knew everybody and an ethical screen might kind of only be for show in that instance, but you also didn't have many options in that area. So, if the person wanted representation, you didn't have much choice, and it was kind of an honor code system.

So, that was kind of the best you could do in that situation was to kind of work the honor system and put up the ethical screen and trust that people were doing the right thing.

Prof. Nancy B. Rapoport

Hey, Sarah. You raised an interest in point earlier, which is secrets are always a bad thing. And I'm trying to think if there are any things that the trustee could put on the record in a filing that would disclose this to the public at large. Can you think of anything?

SK: Right. You mean to disclose that the assistant had worked on the petition and provide parties in interest and opportunity to object.

Andrea Dobin, Moderator: Yeah, I mean, the question whether you would want to put her as a petition preparer, but she's not really.

NR: She's not really though, right? Yeah. Judge, what do you think?

Judge Peter Bowie

Well, I'm grappling with it from a couple of other perspectives. For me, one of the first questions I had is what does having an independent contractor really mean in terms of what the trustee is giving up or in terms of responsibility or obligation. And is there a way that a trustee can put himself or herself outside that box because they did it this way. That puzzled me and I want figure out how we could do that and whether that means we're talking a petition preparer situation.

And how do we do that if the Trustee is still there and is the one responsible for purposes of dealing with the situation. So I'm still looking for those early facts.

AD: Maybe in the context of the trustee asking after the first meeting as debtor's counsel, you know, "how did you justify the value of the house?" And it comes back on Jill having run a Zillow. It becomes really circular that way. And that is usually challenged in the preparation process by the person on the keyboard for the trustee's side. And if that ends up being the same person, is that where the conflict is, but is it a conflict? But what's the problem? Can we can we articulate what the problem is?

NR: I think that part of is… it's not a conflict in the attorney sense of conflict, but if you've got a person, will leave aside the whole value through Zillow thing for another time. But if you have somebody doing Zillow and then immediately going, but wait, should I have done Zillow? Then you've got one person on both sides of that, that can't work, right?

AD: Well, most lawyers don't actually input the information into their software. That is usually a delegated responsibility of staff. So I don't think that it's a petition preparer issue because "Jill" in this situation is not getting paid by the debtor for the purpose of preparing the petition. The money is going to the law firm; the law firm has her on retainer to do their petitions. In theory, she's following the directives of the lawyer on the issues that require legal expertise.

Judge: But I thought we determined that in this instance, "Jill" was an independent contractor. And an independent contractor

About the Editor

Christopher Hughes is a partner at Nossaman LLP. Mr. Hughes is a litigator with extensive experience defending or pursuing fraudulent transfers and preferential payments. He also has extensive experience advising clients on the purchase and sale of assets in bankruptcy cases. In addition, he counsels clients on numerous claims, including securities fraud, embezzlement, Ponzi schemes, contract disputes and challenges to corporate formations and retirement plans. His past cases have involved businesses in the hospitality, entertainment, healthcare, construction, agriculture, telecommunications and technology industries.

Chris' current practice focuses on representing bankruptcy trustees and creditors in a wide range of bankruptcy and commercial litigation matters. His experience includes objections to claims, assumption or rejection of executory contracts and leases, objections to exemptions and denials of discharge. He also addresses objections to the dischargeability of debts, lien priority disputes and relief from the automatic stay. He has handled numerous cases before the bankruptcy court, obtaining favorable settlements or, when necessary, favorable rulings upon the conclusion of litigation.

with no responsibility or does she still have responsibilities and then in the instance where she gets it that way. But then you have to figure out what the two pieces are that come together. For me, I'm trying to figure out how she loses her authority. She's a petition preparer with limitations on what she can do and how much she gets paid and all those kinds of things.

AD: I don't think that this is a petition preparer issue because eventually it goes back to the lawyer to review who then signs it.

NR: But the judge raises another great point, which is under rule 5.3 the lawyer supervising the independent contractor has a duty to make sure that she's staying within the ethical guardrails, even though she's not a lawyer. Lawyers have a duty to supervise non lawyer staff and I think you can take that all the way to independent contractor non-lawyer staff.

AD: But at the end of the day, is Jill the one who is responsible for telling the trustee that one of the petitions that she prepared is now sitting on her 341 calendar?

NR: What would happen if as part of the contract between the trustee and Jill one of the duties was for Jill to have to inform the trustee. That puts the burden on Jill to make sure that the trustee knows. Do, those kinds of contracts exist where the burden is on Jill to report up?

SK: I think if it came out after the fact, I don't know that it would pass the sniff test. Even if there wasn't any law on point. I don't know that it would optically look right to anybody reviewing that.

AD: Yeah. I tend to think that the trustee should keep her hands off that case. And then that's what I intend to do if and when it happens. And in fact, in my case, my paralegal has advised the lawyers for whom she prepares petitions that if it happens, that that's what she intends to do is to tell me and have me resign.

HYPOTHETICAL NO. 2

Trustee is appointed to serve in a corporate 7. Debtor's counsel provides records and the trustee finds an insider preference to the debtors principal's father also. Can the debtor's counsel represent the father or should the trustee move to disqualify counsel?

SK: Well, I don't want to speak for my firm. But I will say that we have joint representation letters for such a situation, but thought in this situation that the father might want his own counsel just as a matter of course. But if the father wanted to stick with the debtor's counsel, obviously you would get a joint representation letter. But I wasn't a hundred percent certain why the trustee would take issue with it and not the father themselves wanting their own counsel for this situation to make sure that his interests alone were fully protected. That's where I got stuck on it.

AD: So Debtor's counsel may be uncomfortable or should be uncomfortable because they are responsible for producing documents and providing information that is adverse to the to the interests of the father. That's the rub. And for example, on issues of insolvency, the debtor's principal may be called to testify to establish insolvency against the father and that creates a real problem. The question is whether a joint representation letter will work In light of the fact that you're now post petition and the debtor only speaks through the trustee.

SK: That's why I kind of thought why would the father even want this?

AD: Because maybe it's a lawyer that the family is familiar with or you know, a lawyer that has guided them through this process thus far. Judge, this seems like something that you might have stumbled across in your years on the bench. What do you think?

Judge: Well, I haven't seen that one, but I was, I was concerned and looking in this context that the counsel had been doing the work producing records, all that kind of stuff and got the information and access to the information and then to cross the hall and to get in touch with the father -- and to be in a relationship to the father while having painted the box for the problem in the first place, I think it would be very uncomfortable.

NR: And I'm just going to go with a hard no here. The way I always approach these things first is to start with --- who is the client? And here, first off, it looks to me that the client is the corporation, not the debtor's principal. So that's the first point. To the extent that sometimes you can only interact through the principal if there's only one person at the corporation, but it's still the corporation.

That being said, to the extent that Debtor's counsel is providing information that might help bring assets into the estate, standing on the other side of that with the debtor's principal's father seems to be a problem under rule 1.7.

Rule 1.7 is the conflicts of interest for concurrent clients. Rule 1.7(a) is the "shall not" provision and it says you cannot represent one client against another client if they go head-to-head. Well, that's not what's happening here. So then 1.7(a)(2) says you can't do it if there is a significant risk that the representation of

...continued on next page

one or more clients will be "materially limited" and then it gives you a laundry list. Materially limited by the lawyer's responsibilities to another client, to a former client, or a third person, or by a personal interest of the lawyer.

So, debtor's counsel is talking to the principal, debtor's counsel represents the company, not the debtor's principal, but you think they might get all adversarial if they're going after dad and then representing dad, I have a problem with that.

HYPOTHETICAL NO. 3

The trustee files suit against a debtor's spouse for authority to sell the debtor's interest under section 363(h), can the debtor's counsel defend the spouse?

AD: Although if the debtor doesn't want the house sold, their interests are aligned, which is somewhat different than the debtor situation in the prior hypothetical. Is that an easier dual representation?

Judge: I actually think, in many instances, that can happen. And because the nature of the interest and the fact that they can be aligned so long as they do align, I would allow it if it were raised.

AD: What if they're getting divorced? Is that going to change the dynamic between the two of them enough to create a conflict?

NR: I think it would. Sarah, what about you?

SK: Oh yes, you can't have the same attorney in that situation. Well, not without one heck of a waiver.

NR: Even then I would have a problem with the waiver. In the where the interests are aligned, I'd still want to waiver on file to protect myself saying, this is what's happening. We don't see a problem right now. Your interests are aligned. Should that change, then we would have to withdraw from….

AD: Both?

NR: The better practice is both but again I'm in an "Ivory Tower". The other option is a fully informed client understanding she's going to be dropped. Then you have to go back to a lawyer's fiduciary duty. Is that really the right thing to do is to drop one and not the other?

Judge: I think choosing to not represent either client is the better answer because you're just asking for ongoing arguments about who's doing what the whom.

HYPOTHETICAL NO. 4

A trustee who is a partner in a small firm and decides to join a big firm. The trustee wishes to bring her whole case load with her. What kind of search are you conducting to try to make sure that you don't run afoul of internal policies, US Trustee guidelines and the rules of professional conduct?

SK: This has happened a few times during my career at my firm. I think we've worked out a pretty good process that keeps us on the right side of the law although maybe you'll tell me otherwise. I used to practice bankruptcy before I joined my firm. And just to give you guys some background, I'm in the office of the general counsel at my firm.

My responsibilities there, part of them, are to clear the firm's bankruptcy related conflicts because I speak the language and bankruptcy conflicts are a whole different animal as you guys all know.

So every once in a while, we do have a trustee join the firm or a bankruptcy attorney or at one point we had a whole bankruptcy practice that joined. We worked out a bifurcated conflict check process. So first, as I'm sure as you know, trustees have a tremendous case load and each one of those cases is huge. So this bifurcated conflict check process – for each case we check what I would call the critical parties. That includes the debtors, the principals and secured creditors and any key party such that if there was irresolvable conflict, the trustee would not be able to bring that case to the new firm. So we do all of those checks upfront so that we can get the trustee up and running as quickly as possible.

And then when things have settled down a little bit, we go back and we run the conflicts on the parties for which we would merely need to update the disclosure information for the trustee's new retention application - such as the unsecured creditors and the remaining parties in interest. In other words, those parties that would not necessarily create conflicts, and as you know, those can run into the thousands. So it's less about whether it's an asset or no asset case and more about making sure each case is handled appropriately depending on kind of a combination of factors such as the jurisdiction or the judge or where exactly in the process the case is, e.g. is it a new case or is the case is winding down.

We do the same thing with trustees because when the trustees or when we have attorneys that serve as trustee's counsel, it's very similar because you have to run all of those conflicts and do the disclosure. We also treat the creditors' committee cases quite similar as far as running all over the conflicts and the disclosures for those kinds of cases.

AD: Professor Rapoport, do you think that they could get away with a less extensive review?

NR: I love the way they're actually doing it and Sarah I was going to applaud your firm for doing it bifurcated in terms of the "go/no-go" on which cases you bring over right from the get-go. We know that Rule 2014 requires connection disclosures, not conflict disclosure, so you want to know all the connections in everything all the time. And there's a pretty famous issue right now going on in a particular jurisdiction down south about people who didn't disclose an important connection and that has created an enormous mess. So it is always, always better to over disclose.

What you don't want is whiplash later. It's both in terms of partner intake or lawyer intake period. I know Sarah is great at this. You want to make sure that when you bring somebody over, you know what is in their brain and what they're putting the firm at risk for. Over disclosure is better than under disclosure.

SK: But like I said, I work pretty closely with the attorneys and I always defer to them and what they need, because my role is the service role.

HYPOTHETICAL NO. 4A

If a professional discloses specific instances of connections like family members or close relationships, can professionals use general language to satisfy the disclosure requirements in general instances, such as: "attorneys in this firm may have sat on a panel with members from the US Trustee's office on presentations for CLE."

NR: Yeah, but I always put in my disclosures, "I may have served on CLEs with…" or "I may have done other things with…" some of these people, because if you keep trying to keep track of all of those,

you're just dealing with a connection, again, not a conflict when you're doing service activities like CLE. Judge, what do you think?

Judge: Well, I favor disclosure over non-disclosure. I favor that specifically, but I haven't had any occasion to take a good look at it in some time.

NR: I do disclose that I once did pro bono work for the United States trustee, but then it became not pro bono because they paid me with 6 pints of Graeters ice cream, but then again, it's fun to disclose that.

HYPOTHETICAL NO. 5

The trustee sells some real estate in a hot market. She retained a broker, put it on the MLS, but her next-door neighbor's son is looking to buy the house. Can the son make an offer to buy?

Judge: My answer when I was working through it was that so long as somebody else is involved on the sale of the property, I think it can happen, but the concern is when you get too close in relationship so that people do not believe it's going to be fair, open, and so on.

There are several statutes dealing with what judges can do in terms of participating and acquiring a piece of property that's being sold through the bankruptcy of state, that kind of thing.

The US Marshals have got the same problem with respect to that because they're going be in charge of any auction, the sale of real property going on, the over bidding on that, and they're told to back off, even if it's a totally open market and everybody can see exactly what's happening.

HYPOTHETICAL NO. 5A

Would it make a difference if the neighbor's son came in as a competing bidder and not an original bidder? The trustee received an offer at $300,000 and the neighbor's son comes in and offers $325,000 when everyone thought that $300,000 was going to be the fair market value. Do you think that insulates the trustee and insulates the transaction?

Judge: I think that is a better fact pattern, but I'd have to go back to the statutes and in terms of what the official is obligated to do with respect to the sale of the property and to whom they can discuss privately or otherwise. That's part of what makes it really tough. I know telling judges that was a problem, because a judge really should not be seen as having anything to do with buying a property that's being managed by trustees, even with all the transparent sunshine you want, but it's still that same problem that there's no telling what information is coming in through the record or otherwise.

HYPOTHETICAL NO. 6

What about a judge in California buying property in a bankruptcy case in Florida. Where there's almost no chance that that judge could be involved in that bankruptcy case. Either on an appellate level or otherwise?

Judge: I haven't looked at that specific set of facts, but that would in theory make me more comfortable depending upon how the statute read with respect to the judge and what the judge is doing in that context.

AD: So do you think that trustees should be held to the same level of sort of hands-offedness as Judges are?

Judge: The short answer I think is yes. I think it should be hands off until it becomes fully open and there may come a point in time (as Chris is talking about) where you can swallow it, I guess, but it's what the neutrality of the process that you're trying to ensure by the use of a trustee in the system anyway. We need to protect that individual trustee while negotiating the sale of the property.

AD: Sarah, what do you think?

SK: Well. Before the judge weighed in, I was thinking that because there was a broker and then it's on the MLS and the hypo says that the market is hot, it seemed to me unlikely that any kind of a low-ball offer would be accepted. And if I recall from what I practiced, I think that there was a period of time for objections for a sale like this. So I thought that there was a pretty low risk of any wrongdoing. But if there are statutes or law against this sort of thing, then perhaps they're very deep in my memory and I don't recall them. Or it's that trustees are held at the same standard as judges and that this is not allowed then I'm not familiar with those. But I was thinking, based on the facts, it seemed like there was low risk for wrongdoing in this in this scenario.

NR: Let's talk about the things the trustee shouldn't do. Trustee shouldn't go, "Pssst. Neighbor's son, there's a property coming on the market." That one's a no-go. Once it's listed, I think one of the things I would worry about is any secret information passing back and forth, whether it's the neighbor's son or if it's Jill's son. You don't want any of that. But I am the most comfortable in an over-bid situation where the market's already set. As long as it's not a low-ball original bid from a fake person, but we know those are bad in bankruptcy anyway. But if it's a real bid that sets the market and then it's a bidding war, I think it's an arm's length transaction at that point and it's very different.

HYPOTHETICAL NO. 6B

What about a term in the purchase agreement or motion to sell that says, "The next bid has to be for $50,000 more" on a $300,000 offer? That term would tend to favor (depending upon specific instance) the stalking horse. Would you want to take out a term like that if there's likely to be a close relationship between the parties?

NR: Personally, I'd want to treat every single one the same - close relationship or not. This is Judge Bowie's point -- once the trustee starts shaving things a little bit, we end up with less faith in the trustee as a really important player in the whole system of bankruptcy justice here. So I'd want to see exactly the same kind of deal every time. I mean the amount of over-bid can differ depending on the size of the house. If the trustee treats similarly situated things the same, including minimum over bids, then I don't think the trustee is in as much trouble.

AD: I tend to believe that you do that as long as they're not the first bid and that the property was placed on the market at a justifiable fair market price and that there's a market analysis that supported the bid price - the original list price. And they got a bid so that you can say it's arm's length and then the motion discloses who the person is and how they came to know of the listing.