

**7. ETHICAL OBLIGATIONS OF COUNSEL
FOR DEBTORS AND FOR CREDITORS –
“PIGS GET FAT AND HOGS GET
SLAUGHTERED”**

ETHICAL OBLIGATIONS OF COUNSEL FOR DEBTORS AND CREDITORS – “PIGS GET FAT AND HOGS GET SLAUGHTERED”

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Updated October 2013 by Garry M. Graber, Esq.

INTRODUCTION

Every attorney is subject to the ethics rules of the state in which they practice law. New York bankruptcy attorneys are subject to the New York Rules of Professional Conduct.² In addition to state ethics rules, attorneys in bankruptcy practice are also subject to various rules of conduct and disclosure as contained in applicable Bankruptcy Code provisions and portions of the Federal Rules of Bankruptcy Procedure governing ethical considerations. Failure to strictly follow these rules could lead to various sanctions and consequences, including disqualification; denial of compensation; disgorgement of fees already received from the client; malpractice lawsuits; disciplinary proceedings and even criminal liability.

Because of the various competing constituencies involved, careful analysis of conflicts is vital for bankruptcy practitioners, with “disinterestedness” being the statutory watchword for qualified counsel, particularly for counsel to a debtor or a creditors’ committee. Even counsel appearing for one creditor in a bankruptcy case must review carefully conflict issues to ensure that other clients may not be involved or impacted. If so, counsel must then ensure that the dual or multiple representations of creditors in bankruptcy cases is promptly and properly disclosed and does not otherwise present a conflict situation.

A separate ethical issue, once counsel has determined that they *can* represent a debtor/creditor/committee in bankruptcy, is *what* they can counsel: for debtor attorneys, counsel must tread carefully between zealous and complete advice concerning options, exemptions and transfers on the one hand, and guarding against advice that may directly or indirectly lead to fraudulent transfers or wrongful conduct. For attorneys representing creditors, counsel must avoid conflicts among different clients in the same case. For attorneys representing committees, one concern is whether counsel for a particular creditor is a proper candidate to represent a committee, if, for example, that creditor received preferential transfers before the filing or if that creditor holds claims subject to disparate treatment, such as secured and unsecured claims.

In the end, it will be good judgment; reasonable investigation; careful analysis of actual and potential conflicts; transparency and disclosure that will most protect counsel from ethical violations in bankruptcy cases.

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² Excerpts of relevant provisions of the New York Rules of Professional Conduct are attached hereto as Exhibit “A”.

A. Pre-Filing Concerns – “Bankruptcy Planning” and Related Issues

Attorneys must be careful about what they advise clients prior to the filing of the petition.

1. Advice to Debtors Pre-Filing: Exempt v. Non-Exempt Property

One issue that often arises is the nature of advice that an attorney may provide regarding converting non-exempt assets to exempt assets lawfully versus a fraudulent conveyance. There seems to be little consistent case law on this, and bankruptcy attorneys may often be unsure as to what is permissible advice. The Tenth Circuit not too long ago recognized that “[o]ne of the more difficult issues in bankruptcy law is deciding when, if ever, an intent to defraud creditors can be shown by the debtor’s conversion of nonexempt assets to exempt assets.” *Mathai v. Warren (In re Warren)*, 512 F.3d 1241, 1249 (10th Cir. 2008). By definition, any such “conversion” causes harm to creditors, but a “debtor’s right to make full use of statutory exemptions is fundamental to bankruptcy law.” *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871, 877 (8th Cir. 1988) (Arnold, J. dissenting). For that reason, Judge Arnold of the Eighth Circuit has opined that a debtor’s desire simply to place his assets beyond the reach of creditors cannot amount to fraudulent intent as a matter of law. *See Hanson v. First Nat’l Bank*, 848 F.2d 866, 870 (8th Cir. 1988) (Arnold, J. concurring).

However, as the Tenth Circuit explained in *Warren*, “Judge Arnold’s view has not universally prevailed.” *Warren*, 512 F.3d at 1249. As a result, “**bankruptcy lawyers can face a dilemma in advising clients whether to acquire exempt assets**,” and the “same conduct can be malpractice *not* to advise in one jurisdiction, but voidable and grounds for denial of discharge and possible for disbarment in another. . . .” *Id.* (quoting John D. Ayer, *How to Think About Bankruptcy Ethics*, 60 Am. Bankr. L.J. 355, 374 (1986)). Thus, the Tenth Circuit decided that “we are most reluctant (for the reasons expressed by Judge Arnold) to recognize a conversion of nonexempt assets to exempt assets as fraudulent. . . .” *Id.* at 1250.

2. Applicable New York State Professional Rules

New York Rule of Professional Responsibility 1.2(d) is implicated here. It provides as follows: “A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, except that the lawyer may discuss the legal consequences of any proposed course of conduct with a client.”

According to Professor Roy Simon, this provision “aims to make clear as a bell that a lawyer who knows a client is bent on illegal conduct may neither explain to a client how to go about it ... nor provide legal services that enable the client to accomplish the illegal or fraudulent purpose.” Roy Simon, *New York’s Rules of Professional Conduct* (2009), at p. 41. Notably, a lawyer’s “knowledge” that a client’s act is illegal “may be inferred from the circumstances.” *Id.* (quoting Rule 1.0(k)).

B. The Attorney Certification Requirements

1. Statutory Certifications By Counsel in Bankruptcy Cases

a. Bankruptcy Rule 9011

Bankruptcy Rule 9011 (based on Rule 11 of the Federal Rules of Civil Procedure) requires every petition, pleading, written motion and other paper to be signed by at least one attorney of record (other than a *pro se* filing). Bankruptcy Rule 9011(b) provides, in pertinent part, as follows:

By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, **an attorney** or unrepresented party **is certifying** that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances –

- (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
- (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a non frivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
- (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; **and**
- (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

Fed. R. Bankr. Pro. Rule 9011 (2013) (emphasis added).

b. 11 U.S.C. §707(b)

Section 707 of the Bankruptcy Code governs the dismissal of Chapter 7 cases. Certain changes made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) arguably raise the stakes for counsel in bankruptcy cases in these circumstances.

11 U.S.C. §707(b)(4)(C) states as follows: “[t]he signature of an attorney on a petition, pleading, or written motion shall constitute a **certification** that the attorney has – (i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading or written motion; and (ii) determined that the petition, pleading, or written motion – (I) is well grounded in fact; and (II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1), [*i.e.*, an abuse of the provisions of Chapter 7 of the Bankruptcy Code]”. (Emphasis added).

11 U.S.C. §707(b)(4)(D) provides: “[t]he signature of an attorney on the petition shall constitute a **certification** that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.” (Emphasis added).

Pursuant to 11 U.S.C. §707(b)(4)(B), “[i]f the court finds that the attorney for the debtor violated rule 9011 of the Federal Rules of Bankruptcy Procedure, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order – (i) the assessment of an appropriate civil penalty against the attorney for the debtor; and (ii) the payment of such civil penalty to the trustee, the United States trustee (or the bankruptcy

administrator, if any).”

Notably, a wrongful attempt to have a debtor’s bankruptcy case dismissed can itself rise to the level of sanctions and liability, including for a **creditor’s** attorney. Section 707(b)(5)(A) provides, in pertinent part, as follows: “. . . [T]he court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in rule 9011 of the Federal Rules of Bankruptcy Procedure, may award a debtor all reasonable costs (including reasonable attorneys’ fees) in contesting a motion filed by a party in interest (other than a trustee or United States trustee (or bankruptcy administrator, if any)), under this subsection if –

- (i) the court does not grant the motion; and
- (ii) the court finds that –
 - (I) the position of the party that filed the motion violated rule 9011 of the Federal Rules of Bankruptcy Procedure; or
 - (II) the **attorney** (if any) who filed the motion did not comply with the requirements of clauses (i) and (ii) of paragraph 4(C), and the motion was made solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor under this title.

11 U.S.C. §707(b)(5)(A) (emphasis added).

c. Criminal Implications: 18 U.S.C. §§ 152, 157– Do Ask, Do Tell

18 U.S.C. §152, titled “Concealment of assets; false oaths and claims; bribery,” contains a list of nine categories of bankruptcy crimes, including knowingly and fraudulently concealing property of the debtor from custodians or trustees charged with custody and control of such property; knowingly and fraudulently making a false oath; or knowing and fraudulently making a false verification or certification, the consequences of which include a fine, imprisonment for not more than five years, or both. 11 U.S.C. §157, titled “Bankruptcy fraud,” makes it a crime to, *inter alia*, “file [] a petition under title 11, **including a fraudulent involuntary bankruptcy petition under section 303 of such title**,” for the purpose of concealing or devising a scheme or artifice to defraud.³ (Emphasis added).

United States of America v. Roti (In re Roti), 484 F.3d 934 (7th Cir. 2007), provides a cautionary tale for debtor attorneys. In *Roti*, the debtor was convicted of bankruptcy fraud for hiding assets from his creditors. While the debtor conceded many acts of fraud, including that he had parked assets with family members, he maintained that his attorney “put him up to it.” In support of his defense, Roti offered evidence that he subsequently sued his attorney, that the trustee in bankruptcy took over the suit and that the suit was settled by a payment from the attorney to the estate of \$15,000.

The Seventh Circuit affirmed the jury’s rejection of the defense asserted by the debtor as no defense at all in the case. Nevertheless, the Court closed its decision with the following acts and observations:_____

³ BAPCPA section 332(c) revised section 157 to insert the phrase “including a fraudulent involuntary bankruptcy petition under section 303 of such title” but the amendment is unclear as to whether the change is to be made the first time, or every time “title 11” is mentioned in section 157.

One observation before we close. Roti is in prison but [the attorney] 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 [the attorney] planned and executed a federal crime for which Roti has taken the fall. If Roti was lying at trial about [the attorney]'s role (as the district court judge concluded when holding that Roti obstructed justice by his perjury) there remains the possibility that [the attorney] turned a blind eye to his client's fraud and facilitated misuse of the bankruptcy process. The settlement may reflect [the attorney]'s recognition that he seriously mishandled the situation – though, as we mentioned, it may only show [his] desire to put costly litigation behind him and get on with his life. **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 [the attorney]'s fitness.** In asking these bodies to conduct an inquiry, we do not express an opinion about whether [the attorney] has engaged in sanctionable conduct.

Id. at 937-38 (emphasis added).

C. Retention, Compensation and Disclosure

1. 11 U.S.C. § 327

Section 327(a) of the Code requires court approval before the trustee may “employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons....” It is important to emphasize that court approval of a professional's retention must be obtained as soon as possible. *See, e.g., In re Neidig Corp.*, 117 B.R. 625, 630 (Bankr. D. Colo. 1990) (denying any compensation to professional who had prior connections to debtor and explaining that this case “graphically demonstrates the congressional wisdom in requiring prior Court approval of professional persons with the attendant notice to creditors”).

Nunc pro tunc applications by attorneys are disfavored in the Second Circuit, but have been permitted where the attorney performs services of value to the estate. *In re Hasset, Ltd.*, 283 B.R. 376, 377 (Bankr. E.D.N.Y. 2002).

Judge Glenn of the Southern District Bankruptcy Court has instructed that courts “must take the requirements of section 327 seriously, as they ensure that a professional fulfills his duties in accordance with his fiduciary duties to the estate.” *In re Project Orange Assocs., LLC*, 431 B.R. 363, 370 (Bankr. S.D.N.Y. 2010) (citing *In re Leslie Fay Cos.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (“The requirements of section 327 cannot be taken lightly, for they serve the important policy of ensuring that all professionals appointed pursuant to [such

section] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.”).

Professionals for trustees or debtors in possession must be “disinterested” and have no “materially adverse interest” to the estate. “These statutory requirements — disinterestedness and no adverse interest to the estate — serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice . . . in furtherance of their fiduciary responsibilities.” *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994); *In re Persaud*, 467 B.R. 26, 36 (Bankr. E.D.N.Y. 2012).

a. **The Conflicts Test**

“The structure of the Bankruptcy Code distills these dual requirements into a single test for analysis of a conflict of interest.” *In re Project Orange Assocs.*, 431 B.R. 363, 369-70 (Bankr. S.D.N.Y. 2010); *In re MF Global Inc.*, 464 B.R. 594, 600 (Bankr. S.D.N.Y. 2011).

“The term adverse interest is not defined under the Code and whether an adverse interest exists in any particular matter is determined on a case by case basis.” *In re Enron Corp.*, No. 01–16034, 2002 WL 32034346, at *8 (Bankr. S.D.N.Y. May 23, 2002), *aff’d*, 2003 WL 223455 (S.D.N.Y. Feb. 3, 2003). *See also In re Persaud*, 467 B.R. 26, 36 (Bankr. E.D.N.Y. 2012); *In re MF Global Inc.*, 464 B.R. 594, 600 (Bankr. S.D.N.Y. 2011); *In re Project Orange Assocs., LLC*, 431 B.R. 363, 370 (Bankr. S.D.N.Y. 2010) (same).

The Second Circuit has defined “adverse interest” to mean: “(1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.” *In re Enron Corp.*, 2002 WL 32034346, at *8 (quoting *In re Arachem Corp.*, 176 F.3d 610, 623 (2d Cir. 1999)); *In re MF Global Inc.*, 464 B.R. 594, 600 (Bankr. S.D.N.Y. 2011) (citing *Bank Brussels Lambert v. Coan (In re AroChem Corp.)* 176 F.3d 610, 623 (2d Cir. 1999)).

The key question is “whether an attorney has meaningful incentive to act contrary to the best interests of the estate.” *In re Leslie Fay Companies*, 175 B.R. 525, 532 (S.D.N.Y. 1994); *In re MF Global Inc.*, 464 B.R. 594, 600 (Bankr. S.D.N.Y. 2011) (quoting *In re Granite Partners, L.P.*, 219 B.R. 22, 23 (Bankr. S.D.N.Y. 1998)). The Court in *Leslie Fay* explained that “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.” *Id.* The most “difficult area is when a live conflict of interest has not yet emerged, yet the factual scenario is sufficiently susceptible to that possibility so as to make the conflict more than merely ‘hypothetical or theoretical.’” *Id.*

2. **Comparable New York State Rules**

N.Y. Rule of Professional Responsibility 1.7 provides as follows:

- (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:
 - (1) The representation will involve the lawyer in representing different

interests; or

- (2) There is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.
- (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client:
- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
 - (2) **the representation is not prohibited by law** [emphasis added];
 - (3) **the** representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
 - (4) each affected client gives informed consent, confirmed in writing.

Commentators have noted that “[d]ual representation, even in unrelated matters, becomes considerably more complex in bankruptcy cases. The strict section 327 requirements of disinterestedness and absence of an adverse interest overlay, if they do not in fact supplant, the professional conduct rules.” Robin E. Phelan and John D. Penn, *Bankruptcy Ethics: An Oxymoron*, 5 Am. Bankr. Inst. L. Rev. 5, 27 (1997). See also *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742, 752 (Bankr. N.D.Tex. 1988) (“The Bankruptcy Code provisions dealing with conflicts of interest find their counterparts in the ABA Code of Professional Responsibility. . . . Therefore, the Canons and Disciplinary Rules are particularly relevant when considering alleged conflicts of interest.”).

As a result, “[w]hat may be ethically acceptable in commercial settings (e.g., waivers upon informed consent) will not necessarily pass muster under section 327.” Phelan and Penn, *Bankruptcy Ethics*, 5 Am. Bankr. Inst. L. Rev. at 27.

3. Full Disclosure is Required (Disclose, Disclose, Disclose!)

a. Rule 2014

Rule 2014(a) of the Federal Rules of Bankruptcy Procedure provides that a trustee, a debtor in possession, or a committee seeking to retain a professional must file an application (with a proposed order) showing need, reasons for retention, the scope of services that will be performed, fee arrangements, and the professional's connections with all parties in interest. The application and proposed order must be accompanied by the professional's “verified statement” disclosing its “connections.” *Id.* ***Any time new facts come to light, the verified statement must be supplemented.***

These rules are meant to “ensur[e] that all professionals tender undivided loyalty and provide untainted service in furtherance of their fiduciary responsibilities.” *Rome v. Braunstein*, 19 F.3d 54, 57 (1st Cir. 1994). The purpose behind Rule 2014:

is to provide the court (and the United States Trustee) with

information necessary to determine whether the professional's employment meets the broad test of being in the best interest of the estate. To that end, a failure to disclose any fact which may influence the court's decision may result in a later determination that disclosure was inadequate and sanctions should be imposed on the professional. The fact that disclosure was made elsewhere (*e.g.*, in the debtor's schedules) is not likely to ameliorate a court's reaction to incomplete disclosure.

In re Leslie Fay Cos., 175 B.R. 525, 533 (S.D.N.Y. 1994) (quoting 8 L. King, *Collier on Bankruptcy*, ¶ 2014.03 (15th ed. 1994)).

Courts in the Second Circuit have repeatedly held that the required disclosure has no limit and the professional has no discretion regarding what must be disclosed – **all financial, business and personal connections**. *In re Granite Partners*, 219 B.R. 22 (Bankr. S.D.N.Y. 1998); *In re MF Global Inc.*, 464 B.R. 594, 600 (Bankr. S.D.N.Y. 2011).

Attorneys must supplement any disclosure in a timely fashion if and when additional conflicts, connections are discovered. *See, e.g., Rome*, 19 F.3d at 57-58 (explaining that because the court is empowered “to deter inappropriate influences upon the undivided loyalty of court-appointed professionals **throughout their tenure**, the need for professional self-scrutiny and avoidance of conflicts ... does not end upon appointment.”) (emphasis added).

One treatise opines that it is “prudent” to give all major parties in the case notice of any retention papers. This will elicit any objections at an early juncture in the case rather than at the end, when services have been performed and fees incurred are at risk. At the very least, most judges require prior review by the U.S. Trustee. Michael L. Cook, *Ethics in Bankruptcy Cases*, Practising Law Institute, 929 PL/Comm 763 (2010).

b. Section 329 and Rules 2016 and 2017

Section 329 of the Code requires that counsel for the debtor provide a “statement of the compensation paid or agreed to be paid” within one year prior to the bankruptcy filing “for services rendered or to be rendered in contemplation of or in connection with the case ... and the source of such compensation.” To the extent unreasonable, moreover, “the court may cancel any such agreement, or order the return of any such payment to . . . the estate . . . or . . . the entity that made such payment.” *Id.*

Rules 2016 and 2017 implement section 329. Rule 2016(b) requires debtor’s counsel to provide to the trustee a section 329 statement within 15 days after the order for relief outlining the details of any fee sharing agreement. Rule 2017(a) enables any party or the Court, to seek a hearing as to whether any payments by the debtor made to an attorney in contemplation of bankruptcy were excessive.

The Eighth Circuit has held that under section 329, a debtor's attorney must “account for” funds received from the debtor, that he “be examined as to the reasonableness of” those fees, and then to “reimburse” the amount of unreasonable fees to the estate. *In re Zepecki*, 277 F.3d 1041, 1044 (8th Cir. 2002). The lawyer there represented the debtor in a land transaction “within one month after [the debtor's] divorce from [his] largest creditor, and within four months prior to” bankruptcy. *Id.* at 1046. Not only was the transaction held to be “in

contemplation of” bankruptcy, but the bankruptcy court had “the authority to disregard” the debtor’s fee agreement in determining the reasonableness of counsel’s fees” *Id.*

The Sixth Circuit reached a similar result in *In re Kissberth*, 273 F.3d 714, 721 (6th Cir. 2001). After finding that Code section 329 gave the bankruptcy court jurisdiction, the court (citing an earlier case from the Fourth Circuit) affirmed the lower court’s finding that the “fees

were excessive . . . because [the lawyer] worked on matters that he had not been asked or authorized to address, and [his time was] unnecessary given the relative lack of complexity of the [debtor’s] case.” *Id.* at 719–20. And even if the fees were not excessive, the attorney’s “incomplete” disclosure under Code section 329 justified the “disgorgement” of fees in the case. *Id.* at 720–21.

c. Retainer Fees – Section 330

The Court has the authority to award reasonable legal fees pursuant to section 330 of the Code. In determining what amounts to “reasonable” compensation, the court must consider, among other things: (i) the time spent; (ii) the rates charged; (iii) whether the services were necessary or beneficial to the completion of a case; (iv) whether the services were performed in a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue or task addressed; and (v) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than bankruptcy cases. *See In re Value City Holdings, Inc.*, 436 B.R. 300, 307 (Bankr. S.D.N.Y. 2010) (“The best way to attract skilled professionals to represent clients in bankruptcy cases is by ensuring that fees are commensurate with those of professionals in non-bankruptcy practice.”).

“The Court has an independent duty to review fee applications and evaluate the compensation requested.” *In re Parklex Assocs., Inc.*, 435 B.R. 195, 207 (Bankr. S.D.N.Y. 2010) (citing cases). In *Parklex*, the Court denied a law firm’s fee application **in its entirety**, when (1) the firm failed to obtain court approval before spending a pre-petition retainer; (2) the court had only approved the retention of the firm as debtors’ counsel on an interim basis; (3) the court dismissed the case soon after the interim retention hearing; (4) **the firm failed to disclose to the court the source of the retainer**; (5) the pre-petition retainer might have derived from a fraudulent transfer (which the law firm failed to investigate), and (6) the firm was aware of the potential fraudulent transfer but failed to investigate the source of the funds. *In re Parklex Assocs., Inc.*, 435 B.R. at 205. The firm filed its fee application nearly a year after the debtor’s case had been dismissed. Moreover, the pre-petition retainer was subject to a state court turnover proceeding initiated by the debtor’s investors when the case had been dismissed and over eight months before the firm filed its fee application.

Notably, the Court held that the attorney’s “failure to disclose the source of his retainer, debtor Management Associates LLC, until” his fee application was filed “warrants a complete denial of the Application.” *Parklex*, 435 B.R. at 209.

In a recent case, the District Court in the Eastern District of New York affirmed the Bankruptcy Court’s decision to greatly reduce the amount of compensation paid to an attorney due to the attorney’s “lack of experience in the bankruptcy field, ‘incompetency’ during the

relatively simple bankruptcy proceeding and potential impropriety in accepting payments during the pendency of the bankruptcy proceeding did not justify the amount of compensation sought by [the attorney].” *Xiu v. U.S. Trustee (In re Arabelo)*, No. 10 CV 2025, 2011 WL 1336676, at *3 (E.D.N.Y. March 31, 2011).

A law firm that is retained by a Chapter 7 debtor must have its employment approved pursuant to § 327 **before it may be paid for post-petition services**. The Supreme Court in

Lamie v. U.S. Trustee, 540 U.S. 526, 537-38 (2004) carved out a “retainer” exception to section 330’s payment restrictions. The Court held that the Bankruptcy Code “does not prevent a debtor from engaging counsel before a Chapter 7 conversion and paying reasonable compensation in advance to ensure that the filing is in order. Indeed, the Code anticipates these arrangements.”

One court has held that *Lamie*’s “retainer” exception only applies to flat fee retainers (that become the attorney’s property when received), and not to security retainers (that become the attorney’s property only later, when earned). Because a security retainer remains property of the debtor’s estate post-petition, a debtor’s attorney may only receive payment from that retainer if its employment is approved pursuant to section 327. *See In re Wagers*, 514 F.3d 1021 (10th Cir. 2007) (bankruptcy court’s decision allowing debtors’ counsel to recover post-petition attorney fees from a pre-petition security retainer reversed).

4. Major Illustrative Cases

a. Second Circuit Cases

David R. Kittay, Trustee v. Daniel J. Kornstein, et al. (In re Luckey Platt), 230 F.3d 531 (2d Cir. 2000)

This case involved allegations by a Chapter 7 trustee in a case converted from Chapter 11, that counsel who had previously been retained by Bankruptcy Court order to represent the debtor had, *inter alia*, breached his fiduciary duties and committed malpractice by concurrently representing both the debtor and its sole limited partner in proceedings against, among others, the debtor’s former general partner. The Bankruptcy Court had previously authorized such retention pursuant to 11 U.S.C. § 327(e). The Second Circuit found that a conflict situation existed when counsel was originally retained in the case, because the law firm was representing the competing and “differing interests” of parties for the same *res*. The Court of Appeals nevertheless determined that the Bankruptcy Court had resolved the conflict through a retention and escrow order with respect to any funds recovered by the parties, which effectively “aligned the interests” of the parties and eliminated “any incentive to compete.” *Kittay*, 230 F.3d at 538. In addition, the Second Circuit deemed significant the fact that the debtor had, after full disclosure, consented to the concurrent representation. The Second Circuit Court noted that “Bankruptcy judges’ findings on conflict of interest questions are entitled to deference because a bankruptcy judge is on the front line, is in the best position to gauge the ongoing interplay of factors and to make the delicate judgment calls which such a decision entails.” *Id.* (citing *In re AroChem Corp.*, 176 F. 3d 610, 628 (2d Cir. 1999)).

In re United Merchants & Manufacturers, Inc., No. 99-5011, 1999 WL 972653 (2d Cir. Sept. 22, 1999)

The Bankruptcy Court reduced the fees of debtor's counsel **by approximately 16%** (\$225,000) due to counsel's late disclosure of certain potential conflicts. A shareholder and former attorney for the debtor appealed the fee award to debtor's counsel seeking a denial of all of the fees based on the belated disclosure and other potential conflicts. The District Court affirmed the Bankruptcy Court's decision finding that although the disclosure should have been made earlier in the proceeding, the Bankruptcy Court had not abused its discretion in awarding the reduced fee given the insignificant nature of the potential conflicts and the fact that no party ever moved to disqualify debtor's counsel even after the disclosure was made.

In re United

Merchants and Manufacturers, Inc., 1999 WL 4929 (S.D.N.Y. 1999). The Second Circuit affirmed the District Court's decision reasoning that "although the bankruptcy code requires that professionals retained for the estate be 'disinterested,' *see* 11 U.S.C. § 327(a), it also acknowledges that compensation of professionals who are not disinterested may be appropriate in some circumstances. This is evidenced by the permissive language of 11 U.S.C. § 328(c), which provides that 'the court may deny fees and disbursements where serious breaches of fiduciary obligations occur.'" [Citation omitted]. The record established there was no finding of a breach of any fiduciary duty and the firm's fees had been significantly reduced.

Bank Brussels Lambert, et al. v. Coan (In re AroChem Corp.), 176 F.3d 610 (2d Cir. 1999)

The Bankruptcy Court authorized the trustee to retain a law firm to act as special counsel in an action against certain creditors even though the firm had previously represented another creditor in a litigation against the creditor defendants. The decision was affirmed by the District Court and, on further appeal, the Second Circuit decided that this matter had to be analyzed in the context of §§ 327(a) and (c), but believed that the Bankruptcy Court should reason by analogy to § 327(e) (which by its terms applies only to instances where the attorney represented the debtor). *Id.* at 622. In affirming the decision, the Second Circuit explained that it "interpret[ed] that part of § 327(a) which reads that attorneys for the trustee may not hold or represent an interest adverse to the estate to mean that the attorney must not represent an adverse interest relating to the services which are to be performed by that attorney. Thus, where the interest of the special counsel and the interest of the estate are identical with respect to the matter for which special counsel is retained, there is no conflict and the representation can stand." *Id.* The Second Circuit then analyzed the record below to determine whether counsel "(1) holds or represents an interest that is adverse to the estate, and (2) is [counsel] a 'disinterested person,'" with respect to the matters for which it was seeking to be employed. *Id.*

b. Eastern District Cases

In re Persaud, 467 B.R. 26 (Bankr E.D.N.Y. 2012).

The debtor declared chapter 11 bankruptcy in 2010. Her case was subsequently converted to chapter 7. After the chapter 7 trustee was appointed, he filed an application seeking

authorization to retain a certain law firm as his general counsel and bankruptcy counsel. A creditor filed an objection to the trustee's application, arguing that the same law firm represented the creditor in a real estate venture in China in 2008. The Bankruptcy Court overruled the creditor's objection and found that the law firm was not disqualified under section 327(a) of the Bankruptcy Code because it did not hold or represent an interest adverse to the bankruptcy estate and was a "disinterested person" pursuant to 11 U.S.C. § 101(14). In addition, the disclosures made by the trustee and the law firm to the Bankruptcy Court satisfied Bankruptcy Rule 2014. Moreover, the creditor failed to show that there was a substantial relationship between (i) the work the law firm performed when it represented the creditor in the venture in China; and (ii) the work it would perform for the trustee. The law firm stopped representing the creditor after his venture in China was placed on hold due to a downturn in the economy. Further, there was no evidence that the creditor provided the law firm with confidential information that it could use in representing the trustee in the debtor's bankruptcy case.

Nisselson v. Wong, et al. (In re Best Craft General Contractor and Design Cabinet, Inc.), 239 B.R. 462 (Bankr. E.D.N.Y. 1999)

The Chapter 7 trustee sought and obtained Bankruptcy Court approval to retain special litigation counsel in a no asset case to litigate possible fraudulent conveyance claims, primarily against the debtor-corporation's principals. The principals subsequently moved to disqualify special counsel based on the law firm's failure to disclose that it was representing the debtor's largest creditor in a state court action pending against the Chapter 7 debtor and its principals. The principals argued that counsel should be disqualified due to the firm's lack of disinterestedness. The District Court analyzed the retention issue, which involved the retention of a creditor's attorney to represent the trustee as special counsel for a limited purpose, in the context of §§ 327(a), (c) and (e). The District Court provided an in-depth analysis of the interrelationship of these sections and the quandary created because none of these Code sections dealt squarely with the facts of the case. In denying the disqualification motion, the Bankruptcy Court had determined that special counsel was retained for a very narrow purpose (to pursue fraudulent conveyance claims) and the largest creditor for whom counsel was providing services effectively agreed to subordinate its individual claims to those of the estate by agreeing to turn over any recovery in the state court action to the estate to be divided *pro rata* among the unsecured creditors. The largest creditor whom counsel was representing also shared the parallel

interest of maximizing the estate through a recovery of assets. The District Court found no actual conflict of interest existed and ruled that the lack of disclosure did not warrant the purging remedy of disqualification.

In re Iorizzo, 35 B.R. 465 (Bankr. E.D.N.Y. 1983)

Debtors moved for reconsideration of previous orders authorizing the retention of a law firm as special counsel to the Chapter 11 operating trustee on the basis of an alleged conflict of interest where the firm also acted as general counsel to a related Chapter 11 debtor. The Bankruptcy Court analyzed the particular facts of the case in the context of the New York's Code of Professional Responsibility and §§ 327(a) and 101(13)(E)(now § 101(14)(E)). The Bankruptcy Court found that counsel did not represent an interest adverse to any of the estates involved in the cases. The record established that by serving in its narrow capacity as special counsel to the trustee to investigate and recover concealed assets, the firm

would be representing interests shared by the estates. The Bankruptcy Court concluded that there was no conflict of interest requiring disqualification of the firm and approving the employment served the efficient and economic administration of the bankruptcy cases which was in the best interests of the debtors' estates.

c. Northern District Case

In re Matco Elec. Group, Inc., 383 B.R. 848 (Bankr. N.D.N.Y. 2008)

In this Chapter 11 case, the U.S. Trustee made an application asking the Court to disallow and disgorge fees paid to Berkman, Henoch, Peterson & Peddy ("BHPP") as former counsel to the Official Committee of Unsecured Creditors. (BHPP's representation was terminated by Court order about 10 months after the case was commenced, when an attorney at BHPP left that firm and went to Nixon Peabody, LLP, which was substituted as Committee Counsel at that time). The Court had previously approved BHPP as Committee Counsel in 2002. That approval was based in part on an affidavit from one of the firm's attorneys, who would be handling the case. In the portion of his affidavit disclosing the firm's potential conflicts of interest, the attorney noted that some members or employees of BHPP had *de minimus* stock holdings in creditors of the debtor and that one of BHPP's attorneys was somehow related to an officer and shareholder of one of the general unsecured creditors (Jaco). Later in the case, it became apparent that the attorney at issue, was the son-in-law of the CEO and President of Jaco, who held a significant claim against the debtors and was a petitioning creditor and active member of the Committee. Later, the attorney at issue's wife also became Jaco's in-house counsel.

In its application for disgorgement, the U.S. Trustee argued that BHPP had been purposefully vague in its retention application regarding the attorney at issue, depriving the court and other parties of the opportunity to fully examine that relationship at the time of retention. The Trustee pointed out that Nixon Peabody voluntarily withdrew from the case and waived all fees following the attorney at issue's disclosure that his father-in-law was Jaco's CEO and his wife was its in-house counsel (by that point, the attorney at issue was a member of Nixon Peabody and was no longer associated with BHPP).

BHPP argued that there was a key distinction – when Nixon Peabody was Committee Counsel, the attorney at issue was the lead attorney handling the case. But when BHPP was

previously Committee counsel, another attorney at BHPP (not the attorney at issue) was the lead attorney (the Trustee disputed this, pointing to numerous pleadings and correspondence which the attorney at issue signed while BHPP was Committee counsel). Moreover, Nixon Peabody represented Jaco in other matters while BHPP did not. In addition, it was only during Nixon Peabody's representation of the Committee that the attorney at issue's wife began working for Jaco. BHPP also contended that no party asked for further disclosures after the affidavit in support of BHPP's retention was filed. Finally, section 1103(b) of the Code does not mandate disqualification simply because an attorney in the firm is married to one of the committee members.

First, the Court rejected the notion that the failure of other parties to request additional disclosure had any relevance. Rule "20104 is not intended to condone a game of cat and mouse

where the professional seeking appointment provides only enough disclosure to whet the appetite of the UST, the court or other parties [in] interest, and the burden shifts to those entities to make inquiry in an effort to expand disclosure.” *Id* at 853-54.

Next, the Court rejected BHPP’s argument that the only known creditors were those on the Committee, who all knew of the BHPP/Jaco relationship. The Court held that the obligations set forth in Rule 2014 are not “somehow defined by what knowledge may already have been possessed by those parties to whom disclosure must be provided. **Such an interpretation would stand the rule on its head, making its application purely subjective and virtually impossible to enforce.**” *Id* at 854 (emphasis added).

The Court recognized that the attorney at issue’s relationship with Jaco may not have created a per se conflict of interest when BHPP was appointed, but later developments in the case “suggest that it may have created an atmosphere of hostility between the Committee and the Debtors that ultimately led to another member of the Committee” seeking to have the attorney at issue and Nixon Peabody removed as Committee counsel. Moreover, the Court took note of the fact that an “extremely litigious” adversary proceeding was commenced by the Committee against the Debtors which was settled “with relative ease” within six months after Nixon Peabody and the attorney at issue withdrew. *Id*.

The Court also rejected BHPP’s section 1103(b) argument, pointing out that BHPP had confused the issue by “focusing its attention on the issue of conflict of interest, whereas [Rule] 2014 focuses on disclosure.” *Id*.

Ultimately, the Court concluded that the disclosure contained in the affidavit submitted in support of BHPP’s retention in 2002 regarding the attorney at issue’s relationship with Jaco had been purposefully vague. Indeed, Jaco had apparently introduced BHPP to “the creditor group in the case,” and Jaco was one of the original petitioning creditors that forced the Debtors into bankruptcy. Moreover, it was obvious even in 2002 that the attorney at issue would play a prominent role in the case --- indeed, the attorney at issue billed more than twice the amount of hours that other attorney handling the matter at BHPP did on the matter between March 2002 and December 2002.

d. Southern District Cases

In re Borders Group, Inc., 456 B.R. 195 (Bankr. S.D.N.Y. 2011)

The debtors, a corporation and its affiliated businesses, filed petitions under chapter 11 of the Bankruptcy Code. The Bankruptcy Court approved the debtors’ request to hire a compensation consultant, and the consultant later hired a law firm to provide legal counsel. The consultant submitted an application seeking interim compensation. The U.S. Trustee filed an objection to the consultant’s application, arguing that the consultant could not recover amounts it paid the law firm from the debtors’ bankruptcy estate because the consultant had not asked the Bankruptcy Court for permission under section 327 of the Bankruptcy Code to hire the law firm. In ruling on the U.S. Trustee’s objection, the Bankruptcy Court refused to adopt a rule that professionals – such as the consultant – could not obtain reimbursement for legal fees they incurred unless they first obtained permission under section 327 to hire counsel. However, the Bankruptcy Court held that reimbursement was limited to the services that the law firm performed for the debtors’ bankruptcy estate, and that the amount charged by the consultant’s counsel was

subject to court review for reasonableness and had to be an “actual, necessary expense” under 11 U.S.C. § 330(a)(1)(B). Thus, the Bankruptcy Court’s order approving the debtors’ request to hire the consultant permitted the consultant to hire outside counsel. The Bankruptcy Court overruled the U.S. Trustee’s objection.

In re JMK Construction Group, Ltd., 441 B.R. 222 (Bankr. S.D.N.Y. 2010)

In this case, multiple debtors in four different cases sought to retain the same law firm Pick & Zabicki LLP (“P&Z”). The application was denied. The problem was that the debtors held potential contribution claims against each other (arising out of a state court verdict against the debtors) and some of the debtors were creditors of the others.

After reviewing the general standard for disinterestedness under the Code, the Court pointed out that the “existence of claims among debtor individuals or entities is scrutinized closely as it relates to representation of multiple parties (creditors and debtors) in reorganization proceedings.” *Id.* at 230. One “problem area that does influence courts to disqualify attorneys or deny their requests for compensation is the potential assertion of intercompany claims among the debtor entities.” *Id.* (quoting 3 Collier On Bankruptcy ¶ 327.04(5)(b) (16th ed. Rev. 2010).

P&Z argued that no potential contribution claims existed among the debtors arising out of the state court verdict because the jury had made specific findings as to the liability and damages of each single defendant, “and, thus, no rights to contribution exist between and among the Debtors in connection with the specific amounts awarded against them.” *Id.* at 231. The Court, however, exhaustively reviewed New York law on contribution, and found that there may be a continuing right of contribution between the debtors “notwithstanding the fact that the jury apportioned damages to each defendant individually.” *Id.* The Court held that New York recognized that a jury’s apportionment of fault or damages among defendants “does not necessarily determine the type of liability (joint and several or independent and successive) and thus does not necessarily determine the ability of the parties against whom judgment was entered to seek contribution from other defendants.” *Id.* at 232 (emphasis in original).

As a fall-back position, P&Z argued that the claims bar date had passed in most of the debtors’ cases without any proof of claim for contribution being filed. The Court rejected this argument as well, finding that under New York law, the right to seek contribution does not accrue until payment of the underlying claim. *Id.* at 233 n.2. Moreover, the “right to contribution may be a contingent claim in the Bankruptcy Code.” *Id.* (citing 11 U.S.C. § 101(5)).

In addition to the contribution problem, the Court also relied on the creditor-debtor relationship among three of the debtors in denying P&Z’s application. P&Z asked “the Court to look past the inter-debtor claims in favor of judicial economy and minimizing costs to the estate.” *Id.* at 234. P&Z analogized the situation to large multi-debtor reorganization cases. In response, the Court noted the potential problems that occur in multi-debtor cases “become more acute when each debtor has its own creditors, different officers from other debtor entities, separate directors, and, perhaps, different ownership interests as well as significant intercompany claims.” *Id.* In such situations, the Court decided that the interests of secured creditors would be best served if more than one law firm was retained to represent the debtors. *Id.*

The Court went on to articulate a broad rule: “**The representation of both debtors and creditors may create an irremediable conflict of interest.**” *Id.* (emphasis added). The Court contended that this rule is in line with numerous decisions from outside the Second Circuit. *Id.* (citing cases).

The Court also pointed out that the conflict in this case was greater than the conflict in *Project Orange* (cited below) because in this case, the law firm sought to represent creditors and debtors **in the same matter.**

In re Project Orange Assocs., 431 B.R. 363 (Bankr. S.D.N.Y. 2010).

In an interesting case from last year, the debtor sought to retain DLA Piper as its general bankruptcy counsel. In its section 327 disclosures, DLA Piper revealed that certain partners at the firm currently represented affiliates of GE (the debtor’s largest secured creditor) in matters unrelated to the debtor’s bankruptcy, and work for GE accounted for between 1 and 2 percent of DLA Piper’s revenue in 2009 and 2010. Additionally, the declarations disclosed that, although the GE affiliate at issue was not DLA Piper’s client, that particular GE entity was represented by DLA Piper International LLP--an affiliate of DLA Piper operating outside of the United States. Moreover, the declarations also disclosed that DLA Piper was prohibited from suing GE as well as certain other parties involved in the case with which DLA Piper had conflicts.

Nevertheless, DLA Piper took the position that it was a “disinterested person” under section 327(a) because (1) the debtor had retained conflicts counsel “to handle all matters for which DLA Piper cannot adequately represent the Debtor,” including matters involving GE,” (*Id.* At 368) and (2) GE had granted DLA Piper a conflict waiver that allowed it to negotiate with and represent parties that were adverse to GE in certain situations. However, nothing in the conflict waiver allowed DLA Piper to commence an action against GE. The U.S. Trustee took the position that DLA Piper had and a conflict and thus objected to DLA Piper’s retention application.

The Bankruptcy Court (Judge Glenn) held that DLA Piper could not be retained as the debtor’s counsel. First, the Court emphasized that DLA Piper’s affiliate -- DLA Piper International LLP -- was currently representing the specific GE entity that was a creditor in this case. The Court found that the conflict waiver was issued by DLA Piper, not by DLA Piper International LLP. Moreover, the waiver treated all GE affiliates as one single entity. Thus, the Court found that “DLA Piper holds itself out to the world as one firm, although it now tries to separate itself into separate firms for conflict purposes.” *Id.* At 371 n.3.

The Court also rejected DLA Piper’s argument that any conflict was vitiated by a proposed settlement resolving the secured portion of GE’s claim. That argument was unpersuasive because the settlement had not yet been approved. *Id.* At 372. Moreover, the Court noted that even if the settlement was approved, it was dependent on a number of contingencies. *Id.* At 372-73. The Court also distinguished cases in which firms that represented a debtor’s significant creditor in matters unrelated to the bankruptcy were authorized to serve as general bankruptcy counsel where no ongoing litigation with that creditor existed or was envisioned.

DLA Piper also argued that the conflict waiver that GE executed vitiated any conflict. The Court was not persuaded. The Court was particularly troubled by the fact that the conflict waiver only permitted DLA Piper to represent the debtor in some matters adverse to GE and barred DLA Piper from bringing or threatening to bring suit against GE or its affiliates for damages or equitable relief. Finding that such a waiver “severely limit[ed] DLA Piper's ability to act in the best interests of the Debtor with regards to GE,” the Court stated that it “does not believe that DLA Piper can negotiate [with GE] with full efficacy without at least being able to hint at the possibility of litigation.”

Finally, the Court rejected the argument that the debtor's retention of conflicts counsel somehow saved DLA Piper from being disqualified. The Court focused on the fact that DLA Piper's conflict of interest was with a creditor “central to the debtor's reorganization.” In further support of his decision not to allow retention, Judge Glenn relied on the facts that (1) GE was the debtor's largest unsecured creditor, (2) debtor's reorganization was highly dependent on GE's repair and installation of certain turbines in accordance to the proposed settlement between the parties, (3) GE was highly active in the chapter 11 cases, having filed numerous motions seeking various forms of relief, and (4) GE was certain to play a key role in any plan negotiations or confirmation hearing. Accordingly, because of GE's central and active role, the Court determined that DLA Piper could not effectively represent the debtor in its chapter 11 case -- even if conflicts counsel handled all matters involving GE -- and denied the firm's retention application.

In re Innomed Labs, LLC, No. 07-Civ. 4778, 2008 WL 276490 (S.D.N.Y. Jan. 29, 2008)

This case involved an application by the trustee of a Chapter 7 debtor to retain Robinowitz Cohlan Dubow & Doherty, LLP (“RCDD”) as special counsel for the purpose of investigating possible claims the debtor had against Howard Wendy, one of the debtor's owners, and a related entity. The debtor's other owner (Spector) agreed to pay RCDD's legal fees, subject to the court's approval. The other owner, Howard Wendy, objected, claiming that RCDD was not disinterested and if appointed special counsel, it would be used to pursue a vendetta against Wendy and his family. Wendy contended that RCDD has represented the Spectors in prior litigation against Wendy, and Spector agreed to pay the firm's fees and costs in this matter. The Court rejected this argument, noting that while there was great animosity between Spector and Wendy, there was no evidence to indicate that either side had engaged in frivolous or harassing litigation. Wendy also contended that the representation was inappropriate because Spector was a creditor of the debtor so RCDD is not disinterested. However, the Court noted that the test under *Arochem* for “disinterestedness” involves only the *personal* interests of the professional seeking to be retained. Thus, RCDD's prior representation of a creditor did not render it an “interested person” who could not be retained. In addition, RCDD and Spector denied that RCDD was currently representing Spector (the Court noted that in some cases, this would be a “critical determination”). In any event, the Court held that there was no way RCDD could be an interested party because it was only being retained as *special* counsel with the express purpose of pursuing claims on behalf of the estate (as opposed to defending against creditors' claims), and representation of a creditor in such instances does not create a conflict of interest.

Ronald A. Bergin v. Eerie World Entertainment, LLC (In re Eerie World Entertainment, LLC), No. 03 Civ. 4501 (SAS), 2003 WL 22861948 (S.D.N.Y. Dec. 2, 2003)

In this case, Bergin, a defendant in an adversary proceeding brought by the chapter 11 debtor, moved to disqualify the debtor's counsel. Bergin claimed that the law firm had a conflict of interest in violation of section 327(a) of the Code. Bankruptcy Judge Blackshear denied summarily Bergin's motion, and the District Court reversed. (While the District Court disqualified debtor's counsel from the case, the law firm was not required to disgorge its fees already received).

The adversary proceeding arose after Bergin sold \$1,750,000 worth of the debtor's stock back to the debtor ten months before the debtor filed for bankruptcy. The debtor then brought an adversary proceeding against Bergin to avoid the sale as a preferential transfer under section 544(b) of the Code and a fraudulent conveyance under section 548(b). Bergin claimed the transfer was proper because the debtor was only a "conduit" in the transaction and that the shares of stock were actually purchased by James J. Burke, the debtor's chairperson and controlling shareholder.

Bergin contended that debtor's counsel had an impermissible conflict because it received \$130,000 in legal fees from Burke in 2001. Bergin claimed the payments created an attorney-client relationship between Burke and the firm, especially since one of the law firm's members made several comments on the record to the effect that Burke was "my client," and Burke referred to the firm as "my counsel." The law firm also represented Burke at his deposition (which the U.S. Trustee claimed violated the Bankruptcy Court's retention order). The firm's member denied that he ever represented Burke individually and that his client was always the debtor.

Ultimately, the District Court decided that while Burke's payments to debtor's counsel did not merit disqualification standing alone, those payments raised "serious concerns" (primarily since numerous requirements must be met before payments from a debtor's insider will be permitted). And combined with the law firm's other conduct, disqualification was warranted.

For example, the law firm received \$25,000 in 2001 from the debtor's subsidiary (a non-debtor third party), which the creditors' committee contended was a breach of the firm's duty of undivided loyalty to the debtor and "blatant self-dealing." *Id.* at *4. Apparently, the law firm made sure that its own fees were paid from an outside source controlled by the debtor while at the same time advising other professionals that sufficient funds might not be available to pay *their* fees. Debtor's counsel responded that non-debtor subsidiaries make often make payments to debtor's counsel after full disclosure. The problem, however, was that debtor's counsel received payments both from an outside source and from the debtor's principal. According to the Court, this could lead to the law firm turning a blind eye to certain transactions. Indeed, the court found that the law firm failed to pursue a number of potentially avoidable transfers, including a \$100,000 severance payment to the debtor's CFO that was expressly barred by the CFO's employment agreement.

Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy, LLP (In re Enron Corp.), 02 Civ. 5638 (BSJ), 2003 WL 223455 (S.D.N.Y. Feb. 3, 2003).

The District Court affirmed the Bankruptcy Court's denial of an unsecured creditor's motion to disqualify counsel for the Official Committee of Unsecured Creditors. In January 2002, the Bankruptcy Court signed an order approving the retention of Milbank Tweed Hadley & McCloy ("Milbank") as Committee counsel. In March 2002, Exco Resources, Inc., a creditor of debtor Enron North America, objected to Milbank's monthly fee statement and moved to disqualify the firm.

After a hearing, the Bankruptcy Court denied the disqualification motion, which was appealed to the District Court. Exco raised three reasons to warrant Milbank's disqualification. First, Exco claimed that Milbank failed to disclose substantial conflicts and connections. Second, Exco argued that Milbank failed to meet the "disinterested person" standard and violated the requirement of no "adverse interest" under 11 U.S.C. §§ 101, 327, 328 and 1103. Third, Exco complained that Milbank's retention violated the Canons of Professional Ethics and Disciplinary Rules. *Id.* at *4. In considering Milbank's disclosures, the District Court began with Bankruptcy Rule 2014(a), which requires a professional seeking employment in a bankruptcy case to submit an application that states, "to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, and any party in interest" *Id.* (quoting Fed. R. Bankr. Pro. 2014(a)). In affirming the Bankruptcy Court determination, the District Court noted that Milbank submitted a twenty-nine page affidavit, fully disclosing its relationships with the transactions challenged by the appellant. Both Courts also looked favorably on six supplemental disclosures provided by Milbank.

The District Court also found that Milbank satisfactorily avoided the challenge of disinterestedness due to potential preferences owed by Milbank to certain debtors by Milbank's agreement to waive any challenge to the Examiner's findings of preferential transfers. *Id.* at *9. Interestingly, although the District Court agreed that Milbank met the more rigid requirements for retention found in 11 USC §327(a), the Court noted that the retention of Committee counsel may not necessarily be governed by that section, which "concerns only employment of a professional *by a trustee or a debtor*" *Id.* at *7 (emphasis added). The District Court also noted, however, that section 328(c) allows a bankruptcy court to deny compensation to a professional employed under either section 327(a) or 1103 if that professional is not disinterested or holds an adverse interest. *Id.* Finally, the District Court acknowledged that bankruptcy courts looked to the Code of Professional Responsibility in analyzing conflicts of interest (*citing In re Caldor*, 193 BR at 178), but found no violation by Milbank in this case.

Angelika Films 57th, Inc. v. Silverman (In re Angelika Films 57th, Inc.), 246 B.R. 176 (S.D.N.Y. 2000)

In *Angelika Films*, the debtor's counsel and other professionals retained in the case, including counsel to the Chapter 11 operating trustee appointed in the case, filed applications for allowance of compensation for the services rendered in the case. Prior to the hearing on the applications, the parties reached a compromise on their fees and a proposed settlement agreement was submitted to the Bankruptcy Court for approval. The settlement was subject to court approval and did not affect the rights of the U.S. Trustee to object to the amounts to be awarded. During the hearing on the firm's fee application the Bankruptcy Court questioned the disinterestedness of debtor's counsel based on its conduct in the case. The Bankruptcy Court

noted that “[u]ltimately the determination of counsel’s disinterestedness is a fact-specific inquiry ... [and it] is the court’s duty to review the attorney’s conduct for circumstantial evidence of bias in such cases and determine if a conflict of interests exists.” *In re Angelika Films 57th, Inc.*, 227 B.R. 29, 39 (Bankr. S.D.N.Y. 1999). The Bankruptcy Court found that the law firm was not disinterested and represented an interest adverse to the estate from the inception of the case by its predisposition to take actions to protect the interests of the debtor’s principal, even if contrary to the interests of the debtor. This was based on, among others, the following facts: (1) the law firm’s retainer was funded by the debtor’s principal, (2) the debtor’s principal guaranteed the firm’s fees, (3) the debtor had entered into a management contract with a company controlled by the debtor’s principal, and (4) the law firm filed a motion on behalf of the debtor seeking to assume and assign the debtor’s lease to its principal for \$100,000, when the firm had only days earlier represented to the court that the same lease was worth at least \$500,000.⁴ The Bankruptcy Court noted that “[w]hen considered separately, each action taken by [debtor’s counsel] prior to its filing the Motion to Assign was not unusual in a case involving a closely-held corporation. Nor would it be unusual for the Court to approve such action, recognizing that as a practical matter a level of tension between the interests of a debtor and its principal may need to be tolerated. However, the sum total of [the firm’s] actions, as amplified by the testimony and documents in the record, ... makes clear that [the firm] never intended to fulfill its obligations to the Debtor.” *Id.* at 40.

The Bankruptcy Court determined that the law firm was either not disinterested at the time of its retention or, alternatively lost its disinterestedness during the pendency of the case. The Court disallowed all of the firm’s fees (which were in excess of \$450,000) and expenses, and required the firm to disgorge its retainer of \$22,000. The District Court subsequently affirmed the Bankruptcy Court’s decision, finding the court had based its opinion “upon extensive findings of fact ... and a thorough (and accurate) analysis of the law.” *Angelika Films 57th, Inc.*, 246 B.R. at 179. The District Court ruled that the record supported the Bankruptcy Court’s finding that debtor’s counsel ceased to be disinterested when it filed the motion to assign. Although severe, the District Court would not disturb the Bankruptcy Court’s decision to deny the firm’s request for compensation in its entirety. The Bankruptcy Court has wide discretion on such matters.

In re Mercury, 280 B.R. 35 (Bankr. S.D.N.Y. 2002)

Prior to the bankruptcy filings, in or around 1996, debtor Mrs. Mercury retained Fellows & Hymowitz, P.C. (“F&H”) to represent her in a personal injury action. Mrs. Mercury and her husband thereafter filed for voluntary relief under Chapter 7 of the Bankruptcy Code on March 29, 1999. Although the petition was filed as “pro se,” F&H received a \$1,200.00 retainer from the Mercurys and represented them at the §341 meeting of creditors. At the same time, F&H continued to represent Mrs. Mercury in the personal injury action. On the eve of trial, defendant’s insurance carrier requested mediation, during which it offered \$190,000 to settle the case, which the Mercurys rejected. Meanwhile, in January 2000, F&H approached the Chapter 7 trustee concerning retention as special litigation counsel to the trustee. By application dated April 6, 2000, the Chapter 7 trustee sought an order to retain F&H as special litigation counsel. It was never served on the debtors and did not disclose an actual or potential conflict. After the

⁴ The motion to assign the lease was denied and the lease was eventually sold at auction by the Chapter 11 trustee for \$1,000,000.

mediation session, F&H filed an *ex parte* motion to withdraw as counsel for the Mercurys in the bankruptcy case. The Court found that F&H's conduct effectively deprived the Mercurys of counsel in either the personal injury action or the bankruptcy case. The Bankruptcy Court relied heavily on the ethical rules requiring zealous representation of clients and full disclosure of conflicts. "The consequence of counsel's apostasy was disastrous for the Mercurys." *Id.* at 62. On June 6, 2000, the Trustee moved to authorize a settlement of the personal injury action for \$190,000. Mr. Mercury appeared *pro se* to oppose the Trustee's settlement. The settlement was approved. The Mercurys thereafter moved to oppose F&H's application for fees. The Court ruled that F&H had violated several ethical canons and determined that "there was an actual, luminous conflict between the Chapter 7 Trustee and the [debtors] with respect to the settlement of their personal injury action," *Id.* at 60, and that the partners of the law firm had "acted in defiance of [their] obligations [when] they repudiated their contractual, ethical and legal duties as counsel ... by abandoning their clients and joining in the Trustee's application to retain [them] as special counsel to the Trustee for the precise purpose of moving for Court approval of the settlement which their clients had rejected." *Id.* at 62. The Court noted that "an attorney can no more represent the interests of both trustee and debtor than he can the interests of debtor and creditor in a Chapter 7 case." *Id.* at 60. The Court also relied on *Angelika Films* (discussed below) and held that counsel had an actual undisclosed conflict. Although the settlement was ultimately approved, by failing to disclose this conflict, pursuant to section 327(a) and (e) of the Bankruptcy Code, F&H was held to have forfeited all of its fees.

In re Kurtzman, 220 B.R. 538 (S.D.N.Y. 1998)

The District Court affirmed two Bankruptcy Court orders: (1) denying the Chapter 7 trustee's application to retain his own law firm as counsel for the trustee in several bankruptcy cases, and (2) denying the trustee's request to employ another firm as counsel for the trustee in several other cases. In denying the first application, the Bankruptcy Judge concluded that based on his prior, extensive, first-hand dealings with the trustee's firm, the retention of that firm under § 327(d) would not be in the best interest of the several estates. As for the second application, the Bankruptcy Court found that the rate proposed to be charged by the lead partner at the firm was too excessive. The Court would have allowed the firm to be retained if it agreed to a lower rate, but since the firm would not, the Court exercised its broad discretion and denied the firm's retention. In affirming the Bankruptcy Court, the District Court found that while the disinterestedness of the attorney is one aspect for the court to consider, the court's discretion is not limited to determinations of disinterestedness. *Id.* at 541. The District Court stated that the purpose of § 327 is to "insure in advance that the person's employment is necessary to the estate and the person is disinterested and able to serve the best interests of the estate." *Id.* at 540-41 (quoting *In re That's Entertainment Marketing Group, Inc.*, 168 B.R. 226, 229 (N.D. Cal. 1994)). The District Court further noted that § 327(a) vests the authority for "approval" within the sound discretion of the bankruptcy court. Accordingly, the appellate court held that the Bankruptcy Court's denial of representation with respect to the trustee's own firm based on its extensive dealings with that firm was not an abuse of discretion. The District Court also held that the Bankruptcy Court's denial of representation by the second firm based solely on its excessive billing rate was not erroneous as the bankruptcy court is permitted to take into account local billing rates in determining the proper compensation for attorneys.

In re Lar-Dan Enterprises, Inc., 221 B.R. 93 (Bankr. S.D.N.Y. 1998)

Debtor sought to retain a law firm as special counsel to oppose its landlord's motion to lift the automatic stay. The law firm disclosed that it had received compensation from a third party-insider in the form of a \$3,000 retainer and that it intended to make application to the Court for additional fees in the event the services rendered exceeded the retainer amount. During a hearing on the matter, the law firm further revealed that in addition to the \$3,000, the insider had paid the firm additional monies for its services and the firm anticipated receiving additional similar compensation. The issue before the Court was whether the payments by a third-party insider to a firm seeking to be retained as special counsel for a limited purpose undermined the firm's duty of undivided loyalty to the debtor creating a conflict of interest. The Court noted "that several courts have found that where an attorney for the debtor is compensated by a third party, it does not give rise to a *per se* impermissible conflict of interest." *Id.* at 95. The Court referred to a five-factor test to determine whether compensation to a debtor's counsel from a third party is an impermissible conflict of interest. "These factors include: (1) the arrangement must be fully disclosed to the debtor/client and the third party payor/insider; (2) the debtor must expressly consent to the arrangement; (3) the third party payor/insider must retain independent legal counsel and must understand that the attorney's duty of undivided loyalty is owed exclusively to the debtor/client; (4) the factual and legal relationship among the third party payor/insider, the debtor, the respective attorneys, and their contractual arrangement concerning the fees, must be fully disclosed to the Court at the outset of the debtor's bankruptcy representation; [and] (5) the debtor's attorney/applicant must demonstrate and represent, to the [C]ourt's satisfaction, the absence of facts which otherwise create non disinterestedness, actual conflict, or impermissible potential for a conflict of interest." *Id.* at 96 (*citing In re Kelton Motors Inc.*, 109 B.R. 641, 658 (Bankr D. VT. 1989)). Applying these factors, the Court concluded that the attorney was sufficiently disinterested to represent the debtor for the narrow purpose of defending it against the landlord's motion to lift the stay.

In re Granite Partners, L.P., 219 B.R. 22 (Bankr. S.D.N.Y. 1998)

In *Granite Partners*, the law firm representing the Chapter 11 trustee was also representing, and receiving substantial fees from, a third-party against whom the estate had potential claims. Upon application for compensation and reimbursement of expenses, the Bankruptcy Court found that the law firm "had a meaningful incentive, or the perception of one, to act contrary to the interests of the estates." *Id.* at 36. The Court noted that an adverse interest "includes any interest or relationship, however slight, 'that would even faintly color the independence and impartial attitude required by the Code and the Bankruptcy Rules.'" *Id.* at 32 (*quoting In re Roberts*, 46 B.R.815, 828 n. 26 (Bankr. D. Utah 1985), *aff'd in relevant part and rev'd and remanded in part on other grounds*, 75 B.R. 402 (Bankr. D. Utah 1987)). The Court further noted that conflicts are policed through mandatory disclosure and the scope of disclosure is much broader than the question of what interests will disqualify a professional. The Court found that while "Rule 2014(a) does not expressly require supplemental or continuing disclosure ... section 327(a) implies a duty to make continuing disclosure, and requires professionals to reveal connections that arise after their retention." *Id.* at 35. While the Court found that the trustee's counsel should have disclosed the potential conflicts of interest, they noted that section 328(c) authorizes, but does not necessarily mandate, the denial of all fees and that a conflict does not necessarily taint every aspect of the representation. Finding that the law firm provided valuable services and the denial of all fees might result in an "inequitable windfall to the estate." *Id.* at 41, the Court denied the law firm's application with respect to the entire portion of the fee

(approximately \$2,000,000) relating to the law firm's investigatory work (the aspect of the case relating to the conflict of interest) and reduced the firm's fee relating to its non-investigative work by 15% (approximately \$375,000). The total fee awarded the firm represented approximately 41% of the amount requested.

In re Caldor, Inc. - NY, 193 B.R. 165 (Bankr. S.D.N.Y. 1996)

The U.S. Trustee objected to the proposed retention of a law firm and an accounting firm by the creditors' committee in a Chapter 11 case, where the firms also represented the creditors' committee in a competitor's Chapter 11 case. The Court, *quoting In re The Leslie Fay Companies, Inc.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994), overruled the U.S. Trustee's objection explaining that for the purposes of determining whether professionals have conflicts of interest, interests are not adverse "merely because it is possible to conceive of a set of circumstances under which they might clash." *Id.* at 172. Finding that there was no actual or potential conflict of interest, the Court authorized the Committee to retain both professional firms.

In re The Leslie Fay Companies, Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994)

The U.S. Trustee moved to disqualify Chapter 11 debtors' counsel from further representing the debtors and for economic sanctions based on the firm's failure to file a full and complete disclosure as required by Bankruptcy Rule 2014 and because the firm allegedly was not disinterested at the time it was retained under § 327(a). The Bankruptcy Court found that the law firm represented interests that were materially adverse to the debtors where it was retained to complete a fraud investigation and had significant ties to potential targets of the investigation. While the Court found that the law firm should have disclosed these potential conflicts, recognizing the potential harm to the debtors' estates and their creditors in requiring them to replace their counsel, the Court permitted the law firm to continue its representation with respect to matters in which it was then engaged, but ordered new counsel to be brought in to handle new matters. The Court also imposed a monetary sanction on the law firm in the form of disgorgement of the costs, direct and indirect, of the examiner's investigations to determine whether the firm was disinterested and the law firm's failure to disclose.

e. Western District Case

U.S. Trustee for the Western Dist. Of N.Y. v. Gross, Shuman, Brizdle & Gilfillan, P.C. (In re Platinum Mgmt. Corp.), 226 B.R. 762 (W.D.N.Y. 1998)

The Bankruptcy Court retroactively approved the appointment of the appellee law firm, and the United States Trustee appealed. The District Court partially reversed and vacated the Bankruptcy Court's decision. The central issue on the appeal was whether the law firm had provided a sufficient explanation for its failure to obtain the Bankruptcy Court's prior approval of its section 327 application. At the outset, the District Court noted that the case law and the Code are both "unclear as to exactly who has the burden of providing a sufficient explanation for the failure of a firm to obtain the Bankruptcy Court's approval of its retention." *Id.* at 763 (citing cases). In this particular case, the Bankruptcy Court looked to the law firm for an explanation so the District Court put the burden on the law firm as well.

Section 327 requires that professionals (including attorneys) be employed only with court permission. However, the court is permitted, as a court of equity, to grant relief where there is a reasonable explanation for the firm's failure to file a timely application. In this case, the debtor filed its section 327 application nearly two years after its counsel attended a section 341 creditors meeting. The only explanation given for the debtor's counsel's failure to file before that point was "due to oversight and misunderstanding." *Id.* at 764. In the Second Circuit most courts have held that strict compliance with section 327 is excused only in situations of excusable neglect or unavoidable hardship. The District Court held that "attorney oversight – *i.e.*, simple neglect – does not rise to the dignity of a reasonable explanation." *Id.* Indeed, allowing simple neglect to serve as a reasonable explanation would undermine the functions served by requiring approval in the first case. In the past Bankruptcy Judge Kaplan, who was the presiding judge in the case, had refused to approve an application for retroactive employment where the applicant's explanation amounted to "I forgot." *Id.* at 765. In the opinion below, Bankruptcy Judge Kaplan attempted to draw a distinction between section 327 applications and a Chapter 7 trustee's failure to obtain prior approval of his appointment of himself as his own attorney.

The District Court rejected the distinction since the Bankruptcy Court offered no statute or case law to support it. "Simply put, section 327 pertains both to Chapter 7 and to Chapter 11 cases." However, the District Court noted that the U.S. Trustee has a role in monitoring and commenting on applications for employment. Thus, it would have been proper for the U.S. Trustee to have brought the fact that the appellant law firm had not been appointed to the judge's attention, though the trustee has no obligation to do so.

Thus, even though the appellee law firm's work was satisfactory, if not exemplary, the court reversed the bankruptcy judge's fee award as premature, vacated the *nunc pro tunc* approval of employment and remanded the case "for further articulation of the legal standard employed and the facts to which that standard is applied." *Id.*

D. Discharge and Dischargeability

In re Litwok, 246 B.R. 1 (E.D.N.Y. 2000)

In *Litwok*, the debtor appealed the Bankruptcy Court's finding that a \$2.3 million debt owed to a creditor was non-dischargeable pursuant to 11 U.S.C. § 523(a)(6) as a result of her willful and malicious conduct. In appealing the decision, the debtor asserted, among other things, that the Bankruptcy Court committed reversible error by proceeding with the non-dischargeability hearing after her counsel had filed a request to withdraw as counsel. The debtor argued that the Court was required to conduct an evidentiary hearing concerning whether there was a conflict of interest between her and her counsel prior to proceeding with the non-dischargeability hearing.

In affirming the Bankruptcy Court's decision, the District Court acknowledged that the debtor was "correct that, once alerted to the possibility of a conflict of interest, the Bankruptcy Court 'must satisfy itself that no conflict of interest exists.' [Citation omitted]. An actual, relevant conflict of interest occurs if, during the course of the representation, the attorney's and client's interests diverge with respect to a material factual or legal issue or to a course of dealing. [Citation omitted]." *Id.* at 9. The District Court reviewed the record and determined that no

conflict of interest existed and that the Bankruptcy Court had no obligation to hold a hearing on counsel's motion to withdraw prior to the non-dischargeability hearing. See D.C. Ethics Op. 236 (1993) (when client has filed bankruptcy petition to discharge debt owed to lawyer's firm, lawyer may reveal information regarding client's assets provided disclosure is limited and lawyer has good-faith expectation of recovering more than minimal amount)

E. Other Ethical Considerations.

1. Duty to Report Attorney Misconduct

“The American legal profession has long recognized the necessity of reporting lawyers' ethical misconduct.” Luke Scheuer, *Duty to Report Attorney Misconduct*, American Bankr. Institute, 17th Annual Northeast Bankruptcy Conf., 070810 ABI-CLE 445 (2010) (quoting *In re Michael G. Riehlman*, 891 So. 2d 139, 1246 (La. 2005)). New York's Rule of Professional Conduct Rule 8.3(a) states “[a] lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation.” In interpreting its model rules (on which the New York rules are based⁵), the American Bar Association has held that this obligation applies “even if they observe misconduct while not themselves practicing law.” Scheuer, *Duty to Report* (citing *Obligation of a Lawyer to Report Professional Misconduct by a Lawyer not Engaged in the Practice of Law*, ABA Formal Op. 04-433 (2004)).

As Professor Scheuer explains, “[R]ule 8.3's mandate to report ethical violations, and the individual attorney's desire to not get involved, creates a tension that attorneys need to struggle with.” *Id.* Compliance with the duty to report “is made more difficult by some of the ambiguities within the rule itself. Most important of these ambiguities are the degree of knowledge required on the part of the reporting attorney, and the materiality of the violation required before reporting becomes mandatory.” *Id.*

The rule only requires an attorney to report ethical breaches if she “knows” of the violation. Importantly, the rule does not define or otherwise explain the amount of knowledge necessary to trigger that obligation. New York's Rule 1.0(k) defines “knowingly”, “known”, “know” and “knows” as “actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.” Since New York's current rules became effective in 2009, there is scant case law interpreting them. See *Attorney U. v. Miss. Bar*, 678 So.2d 963 (Miss. 1996) (noting that there is very little case law in the country interpreting the duty to report). New Jersey's Appellate Division that in New Jersey's Rule 8.3(a) (which is identical to New York's rule) “the concept of knowledge is defined narrowly.” *Estate of Spencer v. Gavin*, 400 N.J. Super. 220, 252, 946 A.2d 1051, 1069 (App. Div. 2008).

The Committee on Professional Ethics of the Association of the Bar of the City of New York has spoken on the issue while interpreting New York's prior disciplinary rules, which are no longer in effect. The Committee gave a strict definition of knowledge stating, “[t]he degree

⁵ See, Simon, *Simon's New York Rules of Professional Conduct Annotated*, at p. 3.

of certainty required to constitute knowledge under the rule must be greater than a mere suspicion; the reporting lawyer must be in possession of facts that clearly establish a violation of the disciplinary rules.” *New York City Ethics, Op.* 1990-3 (1990).

Unlike New York’s old disciplinary rules, New York’s new Rule 8.3 does not mandate reporting all violations. Scheuer, *Duty to Report* (citing Comment 3 to ABA Model Rule 8.3). Rather, Comment 3 to Rule 8.3 states “[t]his Rule limits the reporting obligation to those offenses that a self-regulating profession must vigorously endeavor to prevent. The Comment further states that a “measure of judgment is therefore required” in complying with the Rule.

Professor Scheuer advises that “if it is unclear whether the ethical violation rises to the level requiring mandatory reporting, attorneys should consider contacting the state bar ethics authority and explain the situation without using names and while complying with Rule 1.6 to receive guidance on whether reporting is required.” *Scheuer, Duty to Report*.

New York’s Rule 8.3(c) states that an attorney is not required to report confidential information protected by Rule 1.6. However, Comment 2 to Rule 8.3 states that while a report is not required where it conflict with Rule 1.6, “a lawyer should encourage a client to consent to disclosure where prosecution would not substantially prejudice the client’s interests.” The ABA has opined that while a client’s good faith decision not to allow disclosure should be respected, a lawyer is prohibited from manipulating a client into making that decision. Scheuer, *Duty to Report* (citing ABA Formal Op. 04-433). In addition, if the violation is truly serious, “the lawyer has at least a moral duty – even putting aside the ethical duty – to urge the client to come forward (or to permit the lawyer to come forward) in the public interest.” *Id.*

Attorneys are also often required to report ethical violations by other attorneys in their firm. New York’s Rule 5.1(d)(1) states that a lawyer is responsible for an ethical violation by another lawyer in the firm if that lawyer directs the specific conduct at issue to take place or ratifies that conduct (with knowledge of it). In addition, pursuant to Rule 5.1(d)(2)(i), partners or attorneys with managerial responsibility are responsible for any ethical violations by other attorneys in the firm when they know of such conduct with sufficient time to prevent it or mitigate it and fails to “take reasonable remedial action” to do so. Rule 5.1(d)(2)(ii) is even stricter. Pursuant to that section, a partner is responsible for any ethical violation which they **should have** known about in time to prevent or mitigate had they exercised reasonable management or supervisory authority.

Indeed, Rule 5.1(a) mandates that a law firm take reasonable efforts to ensure that all of the lawyers in the firm conform to the Rules of Professional Responsibility. Rule 5.1(b) places a more specific obligation on attorneys with management and supervisory authority to make sure that all of the lawyers they supervise conform to the rules. Comment 2 explains that attorneys with management and supervisory authority must

make reasonable efforts to establish internal policies and procedures designed to provide reasonable assurance that all lawyers in the firm will conform to these Rules. Such policies and procedures include those designed (i) to detect and resolve conflicts of interest (*see* Rule 1.10(e)), (ii) to identify dates by which actions must be taken in pending matters, (iii) to account for

client funds and property, and (iv) to ensure that inexperienced lawyers are appropriately supervised.

Professor Scheuer explains that as a consequence of the breadth of Rule 5.1, “there can be a duty to investigate mere suspicions of violations.” Scheuer, *Duty to Report*. “The precise nature of the measures a firm must implement under Rule 5.1 necessarily will depend on the size of the firm, the experience of its members, and the nature and frequency of the ethical problems it encounters.” *Id.* (citing *In-House Consulting on Ethical Issues*, ABA Formal Op. 08-453 (2008)). However a common measure is to designate an “ethics counsel”, an attorney that members of the firm can direct their ethical concerns to.

2. The Duty of Candor in the Bankruptcy Context

New York’s Rules 3.3 and 3.4 govern an attorney’s conduct before the Court and with opposing counsel. There is a general duty to act fairly and honestly in both contexts. Comment 2 to Rule 3.3 explains that “although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law and may not vouch for the evidence submitted in a cause, the lawyer must not allow the tribunal to be misled by false statements of law or fact or by evidence that the lawyer knows to be false.” The Southern District recently opined on the nature of the attorney’s responsibility:

The rules of professional responsibility also impose upon attorneys a duty of candor in all representations they make before a tribunal. The ABA Model Rules of Professional Conduct and the New York Rules of Professional Conduct provide that, in an *ex parte* proceeding, “a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.” ABA Model Rule 3.3(d); N.Y. Rule 3.3(d). Likewise, the Model Rules and New York Rules provide that “[a] lawyer shall not knowingly make a false statement of fact or law to a tribunal” or “offer evidence that the lawyer knows to be false.” ABA Model Rule 3.3(a); N.Y. Rule 3.3(a). If a lawyer subsequently comes to know that any material evidence previously offered by him to the tribunal under the belief that it was true turns out, in fact, to be false, the lawyer must take reasonable remedial measures, including, if necessary, disclosure of the error to the tribunal. ABA Model Rule 3.3(a)(3) & cmt. 10; N.Y. Rule 3.3(a)(3) & cmt. 10

Mason Agency Ltd. v. Eastwind Hellas S.A., No. 09-Civ-6474, 2009 WL 3169567, at *2 (S.D.N.Y. Sept. 29, 2009).

Comment 8 to Rule 3.3 clarifies that

The prohibition against offering or using false evidence applies only if the lawyer knows that the evidence is false. A lawyer’s reasonable belief that evidence is false does not preclude its

presentation to the trier of fact. A lawyer's actual knowledge that evidence is false, however, can be inferred from the circumstances. *See* Rule 1.0(k) for the definition of "knowledge." Thus, although a lawyer should resolve doubts about the veracity of testimony or other evidence in favor of the client, the lawyer cannot ignore an obvious falsehood.

N.Y. Rule of Professional Conduct 3.3, at Cmt. 8.

In the bankruptcy context, one court as has noted that the duty of "attorneys is one of complete candor and primary loyalty to the court before which they practice, and an attorney's duty to the client can never outweigh his or her responsibility to see that the American system of justice functions smoothly." *In re Creative Desperation, Inc.*, 415 B.R. 882, 898 (S.D. Fla. 2009). Moreover, the attorney duties of candor and honesty:

are actually duties owed to the legal system. Because the attorney is an essential player in the judicial process, performance of duties to the court are important to the outcome in pending litigation and to public confidence in the legal system. Such duties are not subject to negotiation and do not vary from case-to-case based upon the needs and desires of a given client. Regardless of a client's desire for a particular outcome, an attorney has an ethical responsibility to act only within proper bounds and to be honest with the court. Stated otherwise, the role of an ethical lawyer is "as an officer of the court and a key component of a system of justice, dedicated to a search for truth..."

In re Merriam, 250 B.R. 724, 736-37 (Bankr. D.Colo. 2000) (quoting *Nix v. Whiteside*, 475 U.S. 157, 174 (1986)).

Indeed, in a recent case, Judge Glasser of the Eastern District felt compelled to remind the debtor's counsel of his duty of candor after debtor's counsel cited "out-of-circuit opinions for the applicable legal standard without alerting the Court that the holdings of these cases had been explicitly and unequivocally rejected by the Second Circuit." *Liani v. Baker*, No. 09-Cv-2651, 2010 WL 2653392, at *9 (E.D.N.Y. June 28, 2010) ("Counsel is reminded of his duty of candor to this Court. *See* N.Y. Rules of Professional Conduct, Rule 3.3(a)(2).").

This duty is also reflected in Rule 9011 of the Federal Rules of Bankruptcy Procedure. Under that rule, an attorney may be sanctioned for signing his or her names to filings or motion papers that are frivolous or without any evidentiary or legal support. Rule 9011 imposes a "strict standard" on parties and attorneys and "intended to encourage and is expected to produce increased care, candor and responsible conduct by litigants and their counsel in all judicial proceedings." *Mauna Lani Resort, Inc. v. Endrex Investments, Inc. (In re Endrex Investments, Inc.)*, 84 B.R. 207, 216 (Bankr. D.Colo. 1988), *rev'd on other grounds*, 111 B.R. 939 (D.Colo. 1990).

So what happens if the attorney offers evidence that he or she later finds out is false? Comment 10 to Rule 3.3 explains what must be done:

In such situations, or if the lawyer knows of the falsity of testimony elicited from the client during a deposition, the lawyer must take reasonable remedial measures. The advocate's proper course is to remonstrate with the client confidentially, advise the client of the lawyer's duty of candor to the tribunal, and seek the client's cooperation with respect to the withdrawal or correction of the false statements or evidence. If that fails, the advocate must take further remedial action. If withdrawal from the representation is not permitted or will not undo the effect of the false evidence, the advocate must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal confidential information that otherwise would be protected by Rule 1.6. It is for the tribunal then to determine what should be done, such as making a statement about the matter to the trier of fact, ordering a mistrial, taking other appropriate steps or doing nothing.

N.Y. Rule of Professional Conduct 3.3, at Cmt. 10.

The framers of New York Rules of Professional Conduct recognized that the disclosure of false evidence and testimony can have "grave consequences" for a client. N.Y. Rule of Professional Conduct 3.3, at Cmt. 11. This includes "not only a sense of betrayal but also loss of the case and perhaps a prosecution for perjury." *Id.* However:

[T]he alternative is for the lawyer to cooperate in deceiving the court, thereby subverting the truth-finding process, which the adversary system is designed to implement. *See* Rule 1.2(d). Furthermore, unless it is clearly understood that the lawyer will act upon the duty to disclose the existence of false evidence, the client can simply reject the lawyer's advice to reveal the false evidence and insist that the lawyer keep silent. The client could therefore in effect coerce the lawyer into being a party to a fraud on the court.

Id.

In addition to the duty of candor, there is a recognized duty of civility that lawyers owe their fellow members of the profession. *See, e.g.,* Shalini Srinivasan, *Zealous Advocacy Tempered by Candor and Civility*, American Bankr. Institute, 17th Annual Northeast Bankruptcy Conf., 070810 ABI-CLE 445 (2010). New York's Rules of Court include statewide "Standards for Civility." Indeed, on October 28, 2010, the United States Bankruptcy Court for the Eastern District issued Administrative Order No. 568 which adopted the New York statewide civility standards "as guidelines for practice in all cases and proceedings in this Court."⁶

⁶ A copy of the Administrative Order with New York's statewide civility standards is attached hereto as Exhibit "B".

f. Other Cases of Interest

In re Universal Building Prods., No. 10-12453, 2010 WL 4642046 (Bankr. D.Del. Nov. 4, 2010)

In this case, the Official Unsecured Creditors Committee sought to retain Arent Fox LLP (“AF”) and Elliot Greenleaf & Siedzikowski, P.C. (“EG”) as counsel. Both the debtors and the U.S. Trustee opposed the retentions applications, which the Court denied for several reasons.

The crux of the objections to retention were the two firms’ relationship with Dr. Haishan Liu, who the Committee had retained as a translator (and who has relationships with Asian creditors who attempt to collect debts in the United States). The Court held that the two firms could not be retained because they: (i) violated the applicable Codes of Professional Conduct by having Dr. Liu solicit creditors to serve on the committee and give him their proxy so that he could vote for the Committee’s counsel in exchange for being retained as a translator on the committee; and (ii) violated Section 2014 of the Code by failing to adequately disclose their relationship with Dr. Liu.

Immediately after the debtors filed their petitions, AF and EG faxed copies of the petitions and the list of the 30 largest creditors to Dr. Liu, who understood that the two firms were interested in being retained as the Committee’s counsel. (Other firms sent Dr. Liu this information as well. All of the firms who contacted Dr. Liu had a prior relationship with either Dr. Liu or his clients). After receiving the information, Dr. Liu contacted a number of Asian creditors (with whom AF and EG had no relationship) “to see if they would give him a proxy to represent them at the Committee formation meeting.” *Id.* at *3. Throughout the process, Dr. Liu was in daily contact with the two law firms regarding his efforts to locate creditors and get their proxies. Two Asian creditor entities ultimately agreed, but Dr. Liu decided only to act as a proxy for the larger of the two creditors, feeling that the U.S. Trustee would not allow him to act as proxy for two. Dr. Liu then asked the two firms to get him a “reliable person” to act as a proxy for the other creditor, which ultimately occurred. The proxies that Dr. Liu obtained included the right to vote on the Committee’s counsel. AF and EG were ultimately chosen as counsel by unanimous vote. Then, on AF’s recommendation, Dr. Liu was hired by the committee as a translator.

The Court held that AF and EG violated Delaware Rule of Professional Conduct 7.3, which prohibits a lawyer from soliciting prospective clients (when the lawyer’s motive for doing so is pecuniary gain). Delaware’s rule is identical to ABA Model Rule 7.3 and similar to New York’s Rule 7.3. *Id.* at *6. The court noted that the comments to Model Rule 7.3 “make it clear that a lawyer is also prohibited from using another as an intermediary to solicit prospective clients,” which is what EG and AF did with Dr. Liu. AF and EG contended that Rule 7.3 could not be applied to them in a manner consistent with the constitution. They argued that committee members are often sophisticated business entities, and restricting attorney communication with them violates the First amendment.

The Court dismissed this argument as a red herring. There was nothing wrong with sending the list of creditors to the firms’ clients and contacts with whom they had a professional relationship. The problem in this case was that once EG and AF learned that Dr. Liu did not represent any creditor on the list, “they actively encouraged and assisted him in his efforts to solicit creditors to get their proxies to attend the formation meeting and vote for counsel.” *Id.* at

*7. The Supreme Court expressly held that state bar associations may prohibit direct oral communications by attorneys (or anybody acting on the attorney's behalf) to prospective clients. The problem was particularly acute in this case because the prospective clients here were foreign creditors who were unfamiliar with the United States bankruptcy system. Indeed, the Bankruptcy Code was enacted in part to address the problem of creditors' attorneys with proxies participating in the election of committee members so that they could be retained as counsel. *Id.* In addition, the two firms argued that other firms had sought Dr. Liu's assistance as well. But that all that showed was that the problem was even wider since "others may not be complying with the rules either." *Id.* at 8.

The debtors also contended that AF's application should be denied because AF is not disinterested – AF provided legal advice to several creditors that they could assert administrative claims for goods in transit, which is contrary to the interests of the general unsecured creditors represented by the Committee. The court rejected this argument because the fact that the Committee's counsel also represents an individual creditor has been held to be, at most, only a potential conflict. *Id.* at *10 (citing cases). "A potential conflict alone does not mandate disqualification of counsel for the Committee." *Id.* Moreover, the adverse interest determination is done as of the time of retention. "Prior representations, even if adverse to the interest of the committee or unsecured creditors, do not disqualify committee counsel." *Id.* (citing *In re Enron Corp.*, 2003 WL 223455, at *6-7)).

Finally, the Court held that EG and AF had failed to adequately disclose their connections with Dr. Liu and the two creditors he solicited in violation of Section 2014. While AF did disclose that it had a prior relationship with Dr. Liu, that alone was not sufficient. AF made subsequent disclosures after discovery revealed the entirety of what had occurred, but that was not enough to cure the original deficiencies. The firms should have fully disclosed from the beginning their efforts in support of Dr. Liu's attempts to obtain proxies from creditors to attend the Committee formation meeting. Moreover, the fact that AF gave legal advice to two creditors should have been disclosed as well.

EXHIBIT A

NEW YORK RULES OF PROFESSIONAL CONDUCT

Rule 1.2: Scope of representation and allocation of authority between client and lawyer.

- (a) Subject to the provisions herein, a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer shall abide by a client's decision whether to settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.
- (b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.
- (c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances, the client gives informed consent and where necessary notice is provided to the tribunal and/or opposing counsel.
- (d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, except that the lawyer may discuss the legal consequences of any proposed course of conduct with a client.
- (e) A lawyer may exercise professional judgment to waive or fail to assert a right or position of the client, or accede to reasonable requests of opposing counsel, when doing so does not prejudice the rights of the client.
- (f) A lawyer may refuse to aid or participate in conduct that the lawyer believes to be unlawful, even though there is some support for an argument that the conduct is legal.
- (g) A lawyer does not violate this Rule by being punctual in fulfilling all professional commitments, by avoiding offensive tactics, and by treating with courtesy and consideration all persons involved in the legal process.

Rule 1.6: Confidentiality of information.

(a) A lawyer shall not knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client or for the advantage of the lawyer or a third person, unless:

- (1) the client gives informed consent, as defined in Rule 1.0(j);
- (2) the disclosure is impliedly authorized to advance the best interests of the client and is either reasonable under the circumstances or customary in the professional community; or
- (3) the disclosure is permitted by paragraph (b).

“Confidential information” consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential. “Confidential information” does not ordinarily include (i) a lawyer's legal knowledge or legal research or (ii) information that is generally known in the local community or in the trade, field or profession to which the information relates.

(b) A lawyer may reveal or use confidential information to the extent that the lawyer reasonably believes necessary:

- (1) to prevent reasonably certain death or substantial bodily harm;
- (2) to prevent the client from committing a crime;
- (3) to withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud;
- (4) to secure legal advice about compliance with these Rules or other law by the lawyer, another lawyer associated with the lawyer's firm or the law firm;
- (5) (i) to defend the lawyer or the lawyer's employees and associates against an accusation of wrongful conduct; or
(ii) to establish or collect a fee; or
- (6) when permitted or required under these Rules or to comply with other law or court order.

(c) A lawyer shall exercise reasonable care to prevent the lawyer's employees, associates, and others whose services are utilized by the lawyer from disclosing or using confidential information of a client, except that a lawyer may reveal the information permitted to be disclosed by paragraph (b) through an employee.

Rule 1.7: Conflict of interest: current clients.

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:

- (1) the representation will involve the lawyer in representing differing interests; or
- (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

Rule 3.3: Conduct before a tribunal.

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal controlling legal authority known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer or use evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client before a tribunal and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

(e) In presenting a matter to a tribunal, a lawyer shall disclose, unless privileged or irrelevant, the identities of the clients the lawyer represents and of the persons who employed the lawyer.

(f) In appearing as a lawyer before a tribunal, a lawyer shall not:

(1) fail to comply with known local customs of courtesy or practice of the bar or a particular tribunal without giving to opposing counsel timely notice of the intent not to comply;

(2) engage in undignified or discourteous conduct;

(3) intentionally or habitually violate any established rule of procedure or of evidence; or

(4) engage in conduct intended to disrupt the tribunal.

Rule 3.4: Fairness to opposing party and counsel.

A lawyer shall not:

(a) (1) suppress any evidence that the lawyer or the client has a legal obligation to reveal or produce;

(2) advise or cause a person to hide or leave the jurisdiction of a tribunal for the purpose of making the person unavailable as a witness therein;

(3) conceal or knowingly fail to disclose that which the lawyer is required by law to reveal;

(4) knowingly use perjured testimony or false evidence;

(5) participate in the creation or preservation of evidence when the lawyer knows or it is obvious that the evidence is false; or

(6) knowingly engage in other illegal conduct or conduct contrary to these Rules;

(b) offer an inducement to a witness that is prohibited by law or pay, offer to pay or acquiesce in the payment of compensation to a witness contingent upon the content of the witness's testimony or the outcome of the matter. A lawyer may advance, guarantee or acquiesce in the payment of:

(1) reasonable compensation to a witness for the loss of time in attending, testifying, preparing to testify or otherwise assisting counsel, and reasonable related expenses; or

(2) a reasonable fee for the professional services of an expert witness and reasonable related expenses;

(c) disregard or advise the client to disregard a standing rule of a tribunal or a ruling of a tribunal made in the course of a proceeding, but the lawyer may take appropriate steps in good faith to test the validity of such rule or ruling;

(d) in appearing before a tribunal on behalf of a client:

(1) state or allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence;

(2) assert personal knowledge of facts in issue except when testifying as a witness;

(3) assert a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused but the lawyer may argue, upon analysis of the evidence, for any position or conclusion with respect to the matters stated herein; or

(4) ask any question that the lawyer has no reasonable basis to believe is relevant to the case and that is intended to degrade a witness or other person; or

(e) present, participate in presenting, or threaten to present criminal charges solely to obtain an advantage in a civil matter.

Rule 5.1: Responsibilities of law firms, partners, managers and supervisory lawyers.

(a) A law firm shall make reasonable efforts to ensure that all lawyers in the firm conform to these Rules.

(b) (1) A lawyer with management responsibility in a law firm shall make reasonable efforts to ensure that other lawyers in the law firm conform to these Rules.

(2) A lawyer with direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the supervised lawyer conforms to these Rules.

(c) A law firm shall ensure that the work of partners and associates is adequately supervised, as appropriate. A lawyer with direct supervisory authority over another lawyer shall adequately supervise the work of the other lawyer, as appropriate. In either case, the degree of supervision required is that which is reasonable under the circumstances, taking into account factors such as the experience of the person whose work is being supervised, the amount of work involved in a particular matter, and the likelihood that ethical problems might arise in the course of working on the matter.

(d) A lawyer shall be responsible for a violation of these Rules by another lawyer if:

(1) the lawyer orders or directs the specific conduct or, with knowledge of the specific conduct, ratifies it; or

(2) the lawyer is a partner in a law firm or is a lawyer who individually or together with other lawyers possesses comparable managerial responsibility in a law firm in which the other lawyer practices or is a lawyer who has supervisory authority over the other lawyer; and

(i) knows of such conduct at a time when it could be prevented or its consequences avoided or mitigated but fails to take reasonable remedial action; or

(ii) in the exercise of reasonable management or supervisory authority should have known of the conduct so that reasonable remedial action could have been taken at a time when the consequences of the conduct could have been avoided or mitigated.

Rule 8.3: Reporting professional misconduct.

(a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation.

(b) A lawyer who possesses knowledge or evidence concerning another lawyer or a judge shall not fail to respond to a lawful demand for information from a tribunal or other authority empowered to investigate or act upon such conduct.

(c) This Rule does not require disclosure of:

(1) information otherwise protected by Rule 1.6; or

(2) information gained by a lawyer or judge while participating in a bona fide lawyer assistance program.

EXHIBIT B

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

-----x

In re:

Adoption of New York State Standards of Civility

Administrative Order No. 568

-----x

UPON the resolution of the Board of Judges for the United States Bankruptcy Court for the Eastern District of New York, it is

ORDERED, that the New York State Standards of Civility for the legal profession, New York Rules of Court, Part 1200, Appendix A, a copy of which is annexed hereto, are hereby adopted as guidelines for practice in all cases and proceedings in this Court.

Dated: Brooklyn, NY
October 28, 2010

/s/Carla E. Craig
CARLA E. CRAIG
Chief United States Bankruptcy Judge

STANDARDS OF CIVILITY

1. *Preamble*

The New York State Standards of Civility for the legal profession set forth principles of behavior to which the bar, the bench and court employees should aspire. They are not intended as rules to be enforced by sanction or disciplinary action, nor are they intended to supplement or modify the Rules Governing Judicial Conduct, the Code of Professional Responsibility and its Disciplinary Rules, or any other applicable rule or requirement governing conduct. Instead they are a set of guidelines intended to encourage lawyers, judges and court personnel to observe principles of civility and decorum, and to confirm the legal profession's rightful status as an honorable and respected profession where courtesy and civility are observed as a matter of course. The Standards are divided into four parts: lawyers' duties to other lawyers, litigants and witnesses; lawyers' duties to the court and court personnel; court's duties to lawyers, parties and witnesses; and court personnel's duties to lawyers and litigants.

As lawyers, judges and court employees, we are all essential participants in the judicial process. That process cannot work effectively to serve the public unless we first treat each other with courtesy, respect and civility.

LAWYERS' DUTIES TO OTHER LAWYERS, LITIGANTS AND WITNESSES

I. Lawyers should be courteous and civil in all professional dealings with other persons.

- A. Lawyers should act in a civil manner regardless of the ill feelings that their clients may have toward others.
- B. Lawyers can disagree without being disagreeable. Effective representation does not require antagonistic or acrimonious behavior. Whether orally or in writing, lawyers should avoid vulgar language, disparaging personal remarks or acrimony toward other counsel, parties or witnesses.
- C. Lawyers should require that persons under their supervision conduct themselves with courtesy and civility.

II. When consistent with their clients' interests, lawyers should cooperate with opposing counsel in an effort to avoid litigation and to resolve litigation that has already commenced.

- A. Lawyers should avoid unnecessary motion practice or other judicial intervention by negotiating and agreeing with other counsel whenever it is practicable to do so.
- B. Lawyers should allow themselves sufficient time to resolve any dispute or disagreement by communicating with one another and imposing reasonable and meaningful deadlines in light of the nature and status of the case.

III. A lawyer should respect the schedule and commitments of opposing counsel, consistent with protection of the client's interests.

- A. In the absence of a court order, a lawyer should agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of the client will not be adversely affected.

B. Upon request coupled with the simple representation by counsel that more time is required, the first request for an extension to respond to pleadings ordinarily should be granted as a matter of courtesy.

C. A lawyer should not attach unfair or extraneous conditions to extensions of time. A lawyer is entitled to impose conditions appropriate to preserve rights that an extension might otherwise jeopardize, and may request, but should not unreasonably insist on, reciprocal scheduling concessions.

D. A lawyer should endeavor to consult with other counsel regarding scheduling matters in a good faith effort to avoid scheduling conflicts. A lawyer should likewise cooperate with opposing counsel when scheduling changes are requested, provided the interests of his or her client will not be jeopardized.

E. A lawyer should notify other counsel and, if appropriate, the court or other persons at the earliest possible time when hearings, depositions, meetings or conferences are to be canceled or postponed.

IV. A lawyer should promptly return telephone calls and answer correspondence reasonably requiring a response.

V. The timing and manner of service of papers should not be designed to cause disadvantage to the party receiving the papers.

A. Papers should not be served in a manner designed to take advantage of an opponent's known absence from the office.

B. Papers should not be served at a time or in a manner designed to inconvenience an adversary.

C. Unless specifically authorized by law or rule, a lawyer should not submit papers to the court without serving copies of all such papers upon opposing counsel in such a manner that opposing counsel will receive them before or contemporaneously with the submission to the court.

VI. A lawyer should not use any aspect of the litigation process, including discovery and motion practice, as a means of harassment or for the purpose of unnecessarily prolonging litigation or increasing litigation expenses.

A. A lawyer should avoid discovery that is not necessary to obtain facts or perpetuate testimony or that is designed to place an undue burden or expense on a party.

B. A lawyer should respond to discovery requests reasonably and not strain to interpret the request so as to avoid disclosure of relevant and non-privileged information.

VII. In depositions and other proceedings, and in negotiations, lawyers should conduct themselves with dignity and refrain from engaging in acts of rudeness and disrespect.

- A. Lawyers should not engage in any conduct during a deposition that would not be appropriate in the presence of a judge.
- B. Lawyers should advise their clients and witnesses of the proper conduct expected of them in court, at depositions and at conferences, and, to the best of their ability, prevent clients and witnesses from causing disorder or disruption.
- C. A lawyer should not obstruct questioning during a deposition or object to deposition questions unless necessary.
- D. Lawyers should ask only those questions they reasonably believe are necessary for the prosecution or defense of an action. Lawyers should refrain from asking repetitive or argumentative questions and from making self-serving statements.

VIII. A lawyer should adhere to all express promises and agreements with other counsel, whether oral or in writing, and to agreements implied by the circumstances or by local customs.

IX. Lawyers should not mislead other persons involved in the litigation process.

- A. A lawyer should not falsely hold out the possibility of settlement as a means for adjourning discovery or delaying trial.
- B. A lawyer should not ascribe a position to another counsel that counsel has not taken or otherwise seek to create an unjustified inference based on counsel's statements or conduct.
- C. In preparing written versions of agreements and court orders, a lawyer should attempt to correctly reflect the agreement of the parties or the direction of the court.

X. Lawyers should be mindful of the need to protect the standing of the legal profession in the eyes of the public. Accordingly, lawyers should bring the New York State Standards of Civility to the attention of other lawyers when appropriate.

LAWYERS' DUTIES TO THE COURT AND COURT PERSONNEL

I. A lawyer is both an officer of the court and an advocate. As such, the lawyer should always strive to uphold the honor and dignity of the profession, avoid disorder and disruption in the courtroom, and maintain a respectful attitude toward the court.

- A. Lawyers should speak and write civilly and respectfully in all communications with the court and court personnel.
- B. Lawyers should use their best efforts to dissuade clients and witnesses from causing disorder or disruption in the courtroom.

C. Lawyers should not engage in conduct intended primarily to harass or humiliate witnesses.

D. Lawyers should be punctual and prepared for all court appearances; if delayed, the lawyer should notify the court and counsel whenever possible.

II. Court personnel are an integral part of the justice system and should be treated with courtesy and respect at all times.

JUDGES' DUTIES TO LAWYERS, PARTIES AND WITNESSES

I. A Judge should be patient, courteous and civil to lawyers, parties and witnesses.

A. A Judge should maintain control over the proceedings and insure that they are conducted in a civil manner.

B. Judges should not employ hostile, demeaning or humiliating words in opinions or in written or oral communications with lawyers, parties or witnesses

C. Judges should, to the extent consistent with the efficient conduct of litigation and other demands on the court, be considerate of the schedules of lawyers, parties and witnesses when scheduling hearings, meetings or conferences.

D. Judges should be punctual in convening all trials, hearings, meetings and conferences; if delayed, they should notify counsel when possible.

E. Judges should make all reasonable efforts to decide promptly all matters presented to them for decision.

F. Judges should use their best efforts to insure that court personnel under their direction act civilly toward lawyers, parties and witnesses.

DUTIES OF COURT PERSONNEL TO THE COURT, LAWYERS AND LITIGANTS

I. Court personnel should be courteous, patient and respectful while providing prompt, efficient and helpful service to all persons having business with the courts.

A. Court employees should respond promptly and helpfully to requests for assistance or information.

B. Court employees should respect the judge's directions concerning the procedures and atmosphere that the judge wishes to maintain in his or her courtroom.

STATEMENT OF CLIENT'S RIGHTS

1. You are entitled to be treated with courtesy and consideration at all times by your lawyer and the other lawyers and personnel in your lawyer's office.
2. You are entitled to an attorney capable of handling your legal matter competently and diligently, in accordance with the highest standards of the profession. If you are not satisfied with how your matter is being handled, you have the right to withdraw from the attorney- client relationship at any time (court approval may be required in some matters and your attorney may have a claim against you for the value of services rendered to you up to the point of discharge).
3. You are entitled to your lawyer's independent professional judgment and undivided loyalty uncompromised by conflicts of interest.
4. You are entitled to be charged a reasonable fee and to have your lawyer explain at the outset how the fee will be computed and the manner and frequency of billing. You are entitled to request and receive a written itemized bill from your attorney at reasonable intervals. You may refuse to enter into any fee arrangement that you find unsatisfactory.
5. You are entitled to have your questions and concerns addressed in a prompt manner and to have your telephone calls returned promptly.
6. You are entitled to be kept informed as to the status of your matter and to request and receive copies of papers. You are entitled to sufficient information to allow you to participate meaningfully in the development of your matter.
7. You are entitled to have your legitimate objectives respected by your attorney, including whether or not to settle your matter (court approval of a settlement is required in some matters).
8. You have the right to privacy in your dealings with your lawyer and to have your secrets and confidences preserved to the extent permitted by law.
9. You are entitled to have your attorney conduct himself or herself ethically in accordance with the Code of Professional Responsibility.
10. You may not be refused representation on the basis of race, creed, color, religion, sex, sexual orientation, age, national origin or disability.

**NEW UNITED STATES DEPARTMENT OF
JUSTICE GUIDELINES FOR REVIEWING
APPLICATIONS FOR COMPENSATION
(FEE GUIDELINES)**

See next 4 pages for larger text and easier reading



THE COMMON LAW IS THE WILL OF *Mankind* ISSUING FROM THE *Life* OF THE *People*

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Home » About DOJ » Agencies » U.S. Trustee Program » Rules, Guidelines, and Federal Register Notices » Guidelines for Reviewing Applications for Compensation » Fee Guidelines

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- [U.S. Trustee Program](#)
- [About the Program](#)
- [Strategic Plan & Mission](#)
- [Bankruptcy Information Sheet](#)
- [United States Trustee Manual](#)
- [Rules, Guidelines, and Federal Register Notices](#)
- [Significant Pleadings and Briefs](#)
- [Meet the Director](#)
- [Regions and Offices](#)
- [Private Trustee Information](#)
- [Consumer Information](#)
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- [Bankruptcy Reform](#)
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FEE GUIDELINES

Guidelines for Reviewing Applications for Compensation (Fee Guidelines)

(Reprinted at 28 C.F.R. Part 58, Appendix)

(a) General Information.

- (1) The Bankruptcy Reform Act of 1994 amended the responsibilities of the United States Trustees under 28 U.S.C. 586 (a)(3)(A) to provide that, whenever they deem appropriate, United States Trustees will review applications for compensation and reimbursement of expenses under section 330 of the Bankruptcy Code, 11 U.S.C. 101, et seq. ("Code"), in accordance with procedural guidelines ("Guidelines") adopted by the Executive Office for United States Trustees ("Executive Office"). The following Guidelines have been adopted by the Executive Office and are to be uniformly applied by the United States Trustees except when circumstances warrant different treatment.
- (2) The United States Trustees shall use these Guidelines in all cases commenced on or after October 22, 1994.
- (3) The Guidelines are not intended to supersede local rules of court, but should be read as complementing the procedures set forth in local rules.
- (4) Nothing in the Guidelines should be construed:
 - (i) To limit the United States Trustee's discretion to request additional information necessary for the review of a particular application or type of application or to refer any information provided to the United States Trustee to any investigatory or prosecutorial authority of the United States or a state;
 - (ii) To limit the United States Trustee's discretion to determine whether to file comments or objections to applications; or
 - (iii) To create any private right of action on the part of any person enforceable in litigation with the United States Trustee or the United States.
- (5) Recognizing that the final authority to award compensation and reimbursement under section 330 of the Code is vested in the Court, the Guidelines focus on the disclosure of information relevant to a proper award under the law. In evaluating fees for professional services, it is relevant to consider various factors including the following: the time spent; the rates charged; whether the services were necessary to the administration of, or beneficial towards the completion of, the case at the time they were rendered; whether services were performed within a reasonable time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and whether compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases. The Guidelines thus reflect standards and procedures articulated in section 330 of the Code and Rule 2016 of the Federal Rules of Bankruptcy Procedure for awarding compensation to trustees and to professionals employed under section 327 or 1103. Applications that contain the information requested in these Guidelines will facilitate review by the Court, the parties, and the United States Trustee.
- (6) Fee applications submitted by trustees are subject to the same standard of review as are applications of other professionals and will be evaluated according to the principles articulated in these Guidelines. Each United States Trustee should establish whether and to what extent trustees can deviate from the format specified in these Guidelines without substantially affecting the ability of the United States Trustee to review and comment on their fee applications in a manner consistent with the requirements of the law.

(b) Contents of Applications for Compensation and Reimbursement of Expenses.

All applications should include sufficient detail to demonstrate compliance with the standards set forth in 11 U.S.C. § 330. The fee application should also contain sufficient information about the case and the applicant so that the Court, the creditors, and the United States Trustee can review it without searching for relevant information in other documents. The following will facilitate review of the application.

- (1) **Information about the Applicant and the Application.** The following information should be provided in every fee application:
 - (i) Date the bankruptcy petition was filed, date of the order approving employment, identity of the party represented, date services commenced, and whether the applicant is seeking compensation under a provision of the Bankruptcy Code other than section 330.
 - (ii) Terms and conditions of employment and compensation, source of compensation, existence and terms controlling use of a retainer, and any budgetary or other limitations on fees.
 - (iii) Names and hourly rates of all applicant's professionals and paraprofessionals who billed time, explanation of any changes in hourly rates from those previously charged, and statement of whether the compensation is based on the customary compensation charged by comparably skilled practitioners in cases other than cases under title 11.
 - (iv) Whether the application is interim or final, and the dates of previous orders on interim compensation or reimbursement of expenses along with the amounts requested and the amounts allowed or disallowed, amounts of all previous payments, and amount of any allowed fees and expenses remaining unpaid.

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Fee Guidelines

Guidelines for Reviewing Applications for Compensation (Fee Guidelines)

(Reprinted at 28 C.F.R. Part 58, Appendix)

(a) General Information.

(1) The Bankruptcy Reform Act of 1994 amended the responsibilities of the United States Trustees under 28 U.S.C. 586(a)(3)(A) to provide that, whenever they deem appropriate, United States Trustees will review applications for compensation and reimbursement of expenses under section 330 of the Bankruptcy Code, 11 U.S.C. 101, et seq. ("Code"), in accordance with procedural guidelines ("Guidelines") adopted by the Executive Office for United States Trustees ("Executive Office"). The following Guidelines have been adopted by the Executive Office and are to be uniformly applied by the United States Trustees except when circumstances warrant different treatment.

(2) The United States Trustees shall use these Guidelines in all cases commenced on or after October 22, 1994.

(3) The Guidelines are not intended to supersede local rules of court, but should be read as complementing the procedures set forth in local rules.

(4) Nothing in the Guidelines should be construed:

(i) To limit the United States Trustee's discretion to request additional information necessary for the review of a particular application or type of application or to refer any information provided to the United States Trustee to any investigatory or prosecutorial authority of the United States or a state;

(ii) To limit the United States Trustee's discretion to determine whether to file comments or objections to applications; or

(iii) To create any private right of action on the part of any person enforceable in litigation with the United States Trustee or the United States.

(5) Recognizing that the final authority to award compensation and reimbursement under section 330 of the Code is vested in the Court, the Guidelines focus on the disclosure of information relevant to a proper award under the law. In evaluating fees for professional services, it is relevant to consider various factors including the following: the time spent; the rates charged; whether the services were necessary to the administration of, or beneficial towards the completion of, the case at the time they were rendered; whether services were performed within a reasonable time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and whether compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases. The Guidelines thus reflect standards and procedures articulated in section 330 of the Code and Rule 2016 of the Federal Rules of Bankruptcy Procedure for awarding compensation to trustees and to professionals employed under section 327 or 1103. Applications that contain the information requested in these Guidelines will facilitate review by the Court, the parties, and the United States Trustee.

(6) Fee applications submitted by trustees are subject to the same standard of review as are applications of other professionals and will be evaluated according to the principles articulated in these Guidelines. Each United States Trustee should establish whether and to what extent trustees can deviate from the format specified in these Guidelines without substantially affecting the ability of the United States Trustee to review and comment on their

fee applications in a manner consistent with the requirements of the law.

(b) Contents of Applications for Compensation and Reimbursement of Expenses.

All applications should include sufficient detail to demonstrate compliance with the standards set forth in 11 U.S.C. § 330. The fee application should also contain sufficient information about the case and the applicant so that the Court, the creditors, and the United States Trustee can review it without searching for relevant information in other documents. The following will facilitate review of the application.

(1) Information about the Applicant and the Application. The following information should be provided in every fee application:

- (i) Date the bankruptcy petition was filed, date of the order approving employment, identity of the party represented, date services commenced, and whether the applicant is seeking compensation under a provision of the Bankruptcy Code other than section 330.
- (ii) Terms and conditions of employment and compensation, source of compensation, existence and terms controlling use of a retainer, and any budgetary or other limitations on fees.
- (iii) Names and hourly rates of all applicant's professionals and paraprofessionals who billed time, explanation of any changes in hourly rates from those previously charged, and statement of whether the compensation is based on the customary compensation charged by comparably skilled practitioners in cases other than cases under title 11.
- (iv) Whether the application is interim or final, and the dates of previous orders on interim compensation or reimbursement of expenses along with the amounts requested and the amounts allowed or disallowed, amounts of all previous payments, and amount of any allowed fees and expenses remaining unpaid.
- (v) Whether the person on whose behalf the applicant is employed has been given the opportunity to review the application and whether that person has approved the requested amount.
- (vi) When an application is filed less than 120 days after the order for relief or after a prior application to the Court, the date and terms of the order allowing leave to file at shortened intervals.
- (vii) Time period of the services or expenses covered by the application.

(2) Case Status. The following information should be provided to the extent that it is known to or can be reasonably ascertained by the applicant:

- (i) In a chapter 7 case, a summary of the administration of the case including all moneys received and disbursed in the case, when the case is expected to close, and, if applicant is seeking an interim award, whether it is feasible to make an interim distribution to creditors without prejudicing the rights of any creditor holding a claim of equal or higher priority.
- (ii) In a chapter 11 case, whether a plan and disclosure statement have been filed and, if not yet filed, when the plan and disclosure statement are expected to be filed; whether all quarterly fees have been paid to the United States Trustee; and whether all monthly operating reports have been filed.
- (iii) In every case, the amount of cash on hand or on deposit, the amount and nature of accrued unpaid administrative expenses, and the amount of unencumbered funds in the estate.

(iv) Any material changes in the status of the case that occur after the filing of the fee application should be raised, orally or in writing, at the hearing on the application or, if a hearing is not required, prior to the expiration of the time period for objection.

(3) Summary Sheet. All applications should contain a summary or cover sheet that provides a synopsis of the following information:

- (i) Total compensation and expenses requested and any amount(s) previously requested;
- (ii) Total compensation and expenses previously awarded by the court;
- (iii) Name and applicable billing rate for each person who billed time during the period, and date of bar admission for each attorney;
- (iv) Total hours billed and total amount of billing for each person who billed time during billing period; and
- (v) Computation of blended hourly rate for persons who billed time during period, excluding paralegal or other paraprofessional time.

(4) Project Billing Format.

- (i) To facilitate effective review of the application, all time and service entries should be arranged by project categories. The project categories set forth in [Exhibit A](#) should be used to the extent applicable. A separate project category should be used for administrative matters and, if payment is requested, for fee application preparation.
- (ii) The United States Trustee has discretion to determine that the project billing format is not necessary in a particular case or in a particular class of cases. Applicants should be encouraged to consult with the United States Trustee if there is a question as to the need for project billing in any particular case.
- (iii) Each project category should contain a narrative summary of the following information:
 - (A) a description of the project, its necessity and benefit to the estate, and the status of the project including all pending litigation for which compensation and reimbursement are requested;
 - (B) identification of each person providing services on the project; and
 - (C) a statement of the number of hours spent and the amount of compensation requested for each professional and paraprofessional on the project.
- (iv) Time and service entries are to be reported in chronological order under the appropriate project category.
- (v) Time entries should be kept contemporaneously with the services rendered in time periods of tenths of an hour. Services should be noted in detail and not combined or "lumped" together, with each service showing a separate time entry; however, tasks performed in a project which total a de minimis amount of time can be combined or lumped together if they do not exceed .5 hours on a daily aggregate. Time entries for telephone calls, letters, and other communications should give sufficient detail to identify the parties to and the nature of the communication. Time entries for court hearings and conferences should identify

the subject of the hearing or conference. If more than one professional from the applicant firm attends a hearing or conference, the applicant should explain the need for multiple attendees.

(5) Reimbursement for Actual, Necessary Expenses. Any expense for which reimbursement is sought must be actual and necessary and supported by documentation as appropriate. Factors relevant to a determination that the expense is proper include the following:

- (i) Whether the expense is reasonable and economical. For example, first class and other luxurious travel mode or accommodations will normally be objectionable.
- (ii) Whether the requested expenses are customarily charged to non-bankruptcy clients of the applicant.
- (iii) Whether applicant has provided a detailed itemization of all expenses including the date incurred, description of expense (e.g., type of travel, type of fare, rate, destination), method of computation, and, where relevant, name of the person incurring the expense and purpose of the expense. Itemized expenses should be identified by their nature (e.g., long distance telephone, copy costs, messengers, computer research, airline travel, etc.) and by the month incurred. Unusual items require more detailed explanations and should be allocated, where practicable, to specific projects.
- (iv) Whether applicant has prorated expenses where appropriate between the estate and other cases (e.g., travel expenses applicable to more than one case) and has adequately explained the basis for any such proration.
- (v) Whether expenses incurred by the applicant to third parties are limited to the actual amounts billed to, or paid by, the applicant on behalf of the estate.
- (vi) Whether applicant can demonstrate that the amount requested for expenses incurred in-house reflect the actual cost of such expenses to the applicant. The United States Trustee may establish an objection ceiling for any in-house expenses that are routinely incurred and for which the actual cost cannot easily be determined by most professionals (e.g., photocopies, facsimile charges, and mileage).
- (vii) Whether the expenses appear to be in the nature nonreimbursable overhead. Overhead consists of all continuous administrative or general costs incident to the operation of the applicant's office and not particularly attributable to an individual client or case. Overhead includes, but is not limited to, word processing, proofreading, secretarial and other clerical services, rent, utilities, office equipment and furnishings, insurance, taxes, local telephones and monthly car phone charges, lighting, heating and cooling, and library and publication charges.
- (viii) Whether applicant has adhered to allowable rates for expenses as fixed by local rule or order of the Court.

[61 Fed. Reg. 24890 (May 17, 1996); 28 CFR Part 58, Appendix]

Thursday, February 21, 2013 4:50 PM