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Money Talks: Getting Retained and Paid (Ethically) by the Bankruptcy Estate

Presented by the Young and New Members & Ethics and Professional Compensation Committees

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CONCURRENT SESSION

2020

Money Talks.

GETTING RETAINED AND PAID (ETHICALLY) FROM THE BANKRUPTCY ESTATE

Hypothetical No. 1: Getting Retained as Debtor's Counsel

Facing significant tort liability, Corporation Inc. filed a chapter 11 petition and wishes to retain Big Law Firm LLP as debtor's counsel. Corporation's insurer, however, is a longtime client of Big Law Firm. One of those matters included representing the insurer in obtaining reinsurance for future claims against Corporation. Big Law Firm never obtained a waiver of conflicts from either client. But Big Law Firm sought to withdraw from representing the insurer when it began representing Corporation in its restructuring efforts. Postpetition, the insurer objects to Big Law Firm's retention.

Should the bankruptcy court approve Big Law Firm's application?

In re: Boy Scouts of America and Delaware BSA, LLC, 20-10343

- Under 11 U.S.C. § 327(a), a professional (i) may not hold or represent an interest adverse to the estate, and (ii) must be disinterested.

-Under 11 U.S.C. § 327(c), a professional is not disqualified from employment solely because of such person's representation of a creditor unless there is an objection by *another* creditor or the United States Trustee, and there is an actual conflict.

-Here, only the insurer objected to debtor's counsel's retention. So even assuming an actual conflict existed, the *per se* disqualification rule of § 327(c) did not apply.

-Regardless, § 327 applies only if the professional presently holds interests adverse to the estate. The conflict between the insurer and firm in *Boy Scouts* had ended after the firm withdrew from representation.

-*Continued . . .*

In re: Boy Scouts of America and Delaware BSA, LLC, 20-10343

-But the applicable rules of professional responsibility are also relevant.

-Courts generally rely on those rules to monitor the conduct of attorneys and some bankruptcy courts have denied retention based on violations of those rules.

- Relevant here were model rules 1.7 and 1.9, raised by the insurer in its objection.

-Rule 1.7 prevents a lawyer from representing one current client against another current client absent a written waiver.

- Rule 1.9 prevents a lawyer from representing a party against a former client in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client.

- But Rule 1.7 did not apply because the insurer was not a current client, and Rule 1.9 did not apply because the law firm would not represent the debtor in any disputes involving the insurance policies.

Hypothetical No. 2: Employment of other Professionals

In a chapter 11, the Official Committee of Unsecured Creditors sought to hire Big Law Firm LLP. The debtor—a nursing home—objected to the employment application, arguing Big Law Firm was not disinterested. Apparently, Big Law Firm had represented one of the debtor's two 50% shareholders, providing her estate planning advice. This included preparing a buy-sell agreement for the purchase and sale of the debtor and all its assets, although that agreement was never consummated. The debtor—but not the former client—objects to Big Law Firm's employment.

Should the bankruptcy court sustain the debtor's objection?

In re Glenview Health Care Facility, Inc., 19-8028 (BAP 6th Cir. 2020).

- The bankruptcy court disqualified the law firm, but the Sixth Circuit BAP reversed.

- Under 11 U.S.C. § 1103, ""[a]n attorney or accountant employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case."

- The appellate panel noted that the Bankruptcy Code provides different standards for the employment of respective professionals.

- As seen in *Boy Scouts*, § 327 includes a disinterested standard, but § 1103 does not. While a trustee and its court-approved agents must be disinterested to represent the estate, a creditor need not be disinterested.

- The appellate panel held, "Indeed, unlike a trustee, a creditor's committee is, by design, a 'partisan representative,' not a detached fiduciary.'"

- *Continued . . .*

In re Glenview Health Care Facility, Inc., 19-8028 (BAP 6th Cir. 2020).

- Like *Boy Scouts*, Rule 1.9 of the applicable rules of professional conduct (here, Kentucky) played a role in *Glenview*.

- That rule provides, "[a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing."

- While a former attorney-client relationship did exist here, there was no evidence that the subject matter of the representation was the same or substantially related.

- The appellate court also applied Rule 1.10, which allows a firm to put up an "ethical wall" to prevent the imputation of conflicts. Here, no lawyer that represented the shareholder would represent the UCC.

Hypothetical No. 3: Getting Paid.

In *Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano*, the United States Supreme Court limited the ability of federal courts to enter orders *nunc pro tunc.* 140 S. Ct. 696 (2020). The Supreme Court held that a *nunc pro tunc* order must "'reflect[] the reality'" of what has occurred and "presupposes that a court has made a decree that was not entered on account of "inadvertence."

So imagine a chapter 7 debtor had retained Attorney and Associates LLP prepetition to pursue her personal injury claim on contingency. But also imagine the debtor failed to schedule the personal injury claim postpetition and received a discharge in what was filed and scheduled as a "no asset" case. Years later, the debtor gets a generous settlement offer, and the trustee moves to reopen the case and to approve the settlement, as well as to retain Attorney and Associates *nunc pro tunc*.

How should the bankruptcy court proceed under *Acevedo*?

In re: Joan Arlene Miller, 17-23606 (Bankr. E.D. Cal.)

- The bankruptcy court held that *Acevedo* is "not a *per se* prohibition of all retroactive relief in all instances." And "[s]tatutes may also serve as a basis, express or implied, for orders that have retroactive effect without need for inherent power *nunc pro tunc* orders."

- As an example, the court noted that the Bankruptcy Code allows retroactive orders under 362(d) by allowing bankruptcy courts to annul the automatic stay.

- Postpetition financing is also allowed under 364(c)(3) despite the loan having been made before entry of the order allowing the financing.

- And, important here, bankruptcy courts have allowed retroactive approval of *compensation* for the unauthorized services of professionals.

- *Continued . . .*

In re: Joan Arlene Miller, 17-23606 (Bankr. E.D. Cal.)

- So while *nunc pro tunc* employment of professionals may be barred under *Acevedo*, "there is no requirement that compensated services must have been performed only after the effective date of an employment order." And *Acevedo* did not expressly overrule Ninth Circuit precedent allowing orders approving such compensation.

- The bankruptcy court accordingly denied the request to *retain* the law firm *nunc pro tunc*, but granted the trustee's request to *compensate* the law firm *nunc pro tunc*, as "the power to award pre-employment compensation remain[ed] unchanged" after *Acevedo*.

Bonus Hypothetical No. 3(a)

After a contested hearing, the bankruptcy court granted Mr. Smith's application to serve as the representative for demand holders in a chapter 11 case. Mr. Smith and his law firm then sought reimbursement from the estate for preparing, filing, and prosecuting his application, including at the contested hearing.

How should the bankruptcy court rule on that fee application? Did those fees benefit the estate?

In re: Imerys Talc America, Inc., 19-10289 (Bankr. D. Del.)

- The bankruptcy court held that fees for work performed in the appointment process did not benefit the estate and denied the fee application.

- The bankruptcy court did provide guidance for those seeking to be appointed as legal representatives in the future, recommending they file: (i) a fulsome disclosure of connections, similar to that required under Bankruptcy Rule 2014; and (ii) a resume/ curriculum vitae.

- The bankruptcy court further advised that, in the future, whether and the terms under which discovery would be permitted would be the subject of a status conference to discuss the scheduling of the hearing on the appointment. That status conference would take place as soon as practicable after the filing of a request to appoint a representative.

- The bankruptcy court opined that, while parties-in-interest may have a legitimate interest in the appointment process, it should not be so cumbersome, litigious or expensive that the process itself dissuades capable candidates or becomes a barrier to entry.

Questions and Answers

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
IMERYS TALC AMERICA, INC., *et al.*,	:	Case No. 19-10289 (LSS)
Debtors.	:	(Jointly Administered)
	x	**Re: Docket Nos: 805, 1173, 1484**

MEMORANDUM ON COMBINED FIRST INTERIM FEE APPLICATION REQUEST OF JAMES L. PATTON, JR. AS THE LEGAL REPRESENTATIVE FOR FUTURE TALC PERSONAL INJURY CLAIMANTS AND YOUNG CONAWAY STARGATT & TAYLOR, LLP AS COUNSEL TO THE LEGAL REPRESENTATIVE FOR FUTURE TALC PERSONAL INJURY CLAIMANTS FOR ALLOWANCE OF COMPENSATION AND REIMBURSEMENT OF EXPENSES FOR THE PERIOD FROM FEBRUARY 13, 2019 THROUGH MAY 31, 2019

On June 3, 2019, I entered an order appointing James L. Patton, Jr. to serve as the representative for demand holders in these bankruptcy cases. The appointment was made after a contested hearing in which I took evidence and heard argument from multiple parties, including Debtors, the Office of the United States Trustee, the Official Committee of Tort Claimants and those Certain Excess Insurers.

Mr. Patton's law firm, Young Conaway Stargatt & Taylor, LLP ("YCST"), participated at that hearing and the proceedings leading up to it on Mr. Patton's behalf. In their first combined interim fee application, Mr. Patton and YCST seek compensation from the estate for their time in that endeavor. At a hearing on that fee application, I expressed the view that those fees might not be compensable from the bankruptcy estates and asked for supplemental briefing. Having reviewed the supplemental briefing and considered the issue, I now conclude that fees and expenses incurred by Mr. Patton in his quest to become the

future claimants' representative do not benefit the bankruptcy estates. Accordingly, to that extent, the fee application is denied.

Background

Imerys Talc America, Inc. and certain affiliated entities ("Debtors")[1] filed their bankruptcy cases on February 13, 2019. Two weeks later, on February 27, 2019, Debtors filed their motion to appoint Mr. Patton as the legal representative for future talc personal injury claimants ("Debtor Motion")[2] pursuant to § 524(g) of the United States Bankruptcy Code ("Bankruptcy Code"). At the March 25 hearing on the Debtor Motion, I was informed that Debtors and the United States Trustee ("UST") agreed to an adjournment of the hearing to April 26 with a response deadline of April 10. The UST also informed me that he might propose other candidates for the position which led Debtors to state that they would conduct interviews or mini depositions of those candidates.

On April 10, 2019, the UST filed an objection[3] to the Debtor Motion and also filed his own, separate motion to appoint a legal representative ("UST Motion").[4] In the UST Motion, the UST did not propose a particular candidate or propose a particular process. Rather, the UST simply requested that I permit other parties-in-interest to nominate alternative candidates as part of a "collective proceeding." On April 10, the Certain Excess Insurers filed an objection to the Debtor Motion and also sought to postpone the hearing

[1] Debtors are: Imerys Talc America, Inc., Imerys Talc Vermont, Inc. and Imerys Talc Canada Inc.
[2] Debtors' Mot. for Order Appointing James L. Patton, Jr., as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date, D.I. 100.
[3] United States Trustee's Obj. to Debtors' Mot. for Entry of an Order Appointing James L. Patton, Jr., as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date, D.I. 347.
[4] Mot. of the United States Trustee to Appoint a Legal Representative for Future Talc Personal Injury Claimants, D.I. 348.

pending discovery. Debtors and the Official Committee of Tort Claimants filed separate replies in support of the Debtor Motion and in opposition to the UST Motion.[5]

I held the April 26 hearing on both the Debtor Motion and the UST Motion. Mr. Patton testified and certain documents were admitted into evidence. I heard argument on various issues, including the UST's request for a collective process, and took the matter under advisement. On May 7, 2019, I ruled from the bench ("Bench Ruling").[6] In my Bench Ruling I found the process sufficient, ruled on the appropriate standard for appointment and required certain additional disclosures from Mr. Patton. After the additional disclosures were made[7] and I rejected a subsequently filed conflict objection,[8] I entered an Order appointing Mr. Patton as the legal representative for demand holders.[9] The UST Motion was denied.[10]

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[5] Official Committee of Tort Claimants' Omnibus (I) Reply in Supp. of the Debtors' Mot. for Entry of an Order Appointing James L. Patton, Jr. as Legal Representative for Future Talc Personal Injury Claimants and (II) Response in Opp. to the Mot. of the United States Trustee to Appoint a Legal Representative for Future Talc Personal Injury Claimants, D.I. 410; Debtors' (I) Reply in Supp. of the Debtors' Mot. for Order Appointing James L. Patton, Jr. as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date and (II) Obj. to the Mot. of the United States Trustee to Appoint a Legal Representative for Future Talc Personal Injury Claimants, D.I. 413.

[6] I subsequently cleaned up the Bench Ruling and it was filed on the docket. Bench Ruling on Mot. to Appoint James L. Patton, Jr. as the Legal Representative for Future Talc Personal Injury Claimants, D.I. 503.

[7] Suppl. Decl. of James L. Patton, Jr. in Supp. of the Debtors' Mot. for Entry of an Order Appointing James L. Patton, Jr., as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date, D.I. 527; Suppl. Decl. (Second) of James L. Patton, Jr. in Supp. of the Debtors' Mot. for Entry of an Order Appointing James L. Patton, Jr., as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date, D.I. 554.

[8] Cyprus Historical Excess Insurers Suppl. Obj. to Debtor's Proposed Form of Order Appointing James L. Patton as Future Claimants Representative, D.I. 571; Court's Letter Ruling, D.I. 636.

[9] Order Appointing James L. Patton, Jr., as Legal Representative for Future Talc Personal Injury Claimants, *Nunc Pro Tunc* to the Petition Date, D.I. 647.

[10] Order Denying Mot. of the United States Trustee to Appoint a Legal Representative, D.I. 648.

On July 15, 2019, Mr. Patton and YCST filed their Combined First Interim Fee Application[11] for the period of February 13, 2019 to May 31, 2019. In it, Mr. Patton and YCST sought a total of $761,932.50 in fees and $7,580.27 in expenses.[12] No objections were filed to the Combined First Interim Fee Application, but the Fee Examiner appointed in these cases raised certain issues and YCST and/or Mr. Patton agreed to reduce their requested compensation by $8,828.[13]

On October 15, 2019, I held a hearing on the first interim fee applications of all professionals retained in these cases. At the hearing I raised, *sua sponte*, the question of whether YCST should be compensated by the estates for time spent in connection with Mr. Patton's appointment. I compared this request to one by a committee member for fees and expenses incurred in attending a formation meeting, which I have previously held are not compensable. Given that I was raising the issue for the first time, I asked YCST to supplement the Combined First Interim Fee Application with any legal authority supporting payment of these fees and expenses. Other than that, I accepted the reduction negotiated with the fee examiner and asked for a revised form of order granting the Combined First Interim Fee Application, on an interim basis, after subtracting the fees and expenses related

[11] Combined First Interim Fee Application Request of James L. Patton, Jr. as the Legal Representative for Future Talc Personal Injury Claimants and Young Conaway Stargatt & Taylor, LLP as Counsel to the Legal Representative for Future Talc Personal Injury Claimants for Allowance of Compensation and Reimbursement of Expenses for the Period from February 13, 2019 through May 31, 2019, D.I. 805. The applicants stated that they were submitting a combined fee application to conserve costs because Mr. Patton is a member of YCST. Combined First Interim Fee Application 1.

[12] The aggregate fees and expenses were attributed: (i) YCST: $661,497.50 in fees, $6,207.62 in expenses and (ii) Mr. Patton: $100,435 in fees and $1,372.65 in expenses. *Id.*

[13] Fee Examiner's Final Report on the First Interim Fee Application of Young Conaway Stargatt & Taylor, LLP as Counsel to the Legal Representative for Future Talc Claimants for Allowance of Compensation and Reimbursement of Expenses for the Period from February 13, 2019 through May 31, 2019, D.I. 1111.

to Mr. Patton's appointment.[14] On October 18, 2019, an Order was entered approving the Combined First Interim Fee Application, less the agreed to reduction of $8,828 and $232,471.50 identified by YCST as fees incurred in connection with the appointment process.[15]

YCST filed its supplement to the Combined First Interim Fee Application on February 19, 2020.[16] In it, YCST argues that the services provided by YCST to Mr. Patton in his pursuit of appointment as the future claimants' representative are "actual" and "necessary" as those terms are used in § 330 of the Bankruptcy Code as "they were based upon Young Conaway's special expertise in the appointment process of future claimants' representatives and could only have been rendered prior to the appointment."[17] YCST's arguments boil down to:

- Because Mr. Patton served in the role of representative for future demand holders prepetition, his appointment postpetition protected the interests of the futures constituency.[18]

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[14] Tr., D.I. 1166.

[15] First Omnibus Order Awarding Interim Allowance and Compensation for Services Rendered and for Reimbursement of Expenses, D.I. 1173.

[16] Suppl. to Combined First Interim Fee Application Request of James L. Patton, Jr. as the Legal Representative for Future Talc Personal Injury Claimants and Young Conaway Stargatt & Taylor, LLP as Counsel to the Legal Representative for Future Talc Personal Injury Claimants for Allowance of Compensation and Reimbursement of Expenses for the Period from February 13, 2019 through May 31, 2019 ("Supplement"), D.I. 1484.

[17] *Id.* 3.

[18] Mr. Patton had already served as the prepetition fiduciary of the future claimants of Imerys, and retention of him in that role was integral to protecting the interests of that constituency. Preserving Mr. Patton as the FCR provided a material benefit to the estate, namely that of maintaining the pre-petition knowledge that Mr. Patton and Young Conaway had acquired about the Debtors and the circumstances leading to these cases, and facilitating continuity of representation of the class of creditors consisting of the future claimants so that they would not be at a disadvantage as the bankruptcy cases and negotiations toward a consensual plan of reorganization commenced.
Supplement 4.
In supporting the Debtors' motion to appoint him as the FCR, Mr. Patton was acting as the proposed fiduciary for future claimants and not out of any personal or self-interest. With Mr. Patton having already been serving as the fiduciary for the future

- Because of its long-standing experience in the space, YCST is "unique[ly] equipped" to provide assistance to Debtors in supporting their motion to appoint Mr. Patton as the future claimants' representative.[19]

- YCST was instrumental in overcoming the UST's newly-formed position in this and multiple cases across the country challenging the process for appointment of a claimants' representative and proposing other nominees.

- Mr. Patton was required to respond and supplement his disclosures on discrete issues and attend the evidentiary hearing. YCST conducted Mr. Patton's direct testimony and presented argument.

YCST also attached to its Supplement filings from six bankruptcy cases in which fees were awarded, presumably for such services.[20] Finally, YCST distinguished Mr. Patton's role as a future claimants' representative from a committee member's role arguing that while

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claimants, it was in the interests of the future claimants to have the same fiduciary retained, thereby maintaining the continuity of representation by a knowledgeable and highly experienced fiduciary. Accordingly, the Pre-Appointment Services were rendered by the proposed FCR in performance of his duties as a fiduciary to serve the interests of the future claimants, and not for the purpose of advancing any personal interest of Mr. Patton.

Supplement 9.

[19] Young Conaway supplemented the Debtors' services in support of the motion, providing input on strategy and precedent that Young Conaway was uniquely equipped to provide. The alternative would have been for the Debtors' counsel to provide all the services in support of the motion; while Debtors' counsel is ably qualified, the Debtors would not have had the benefit of Young Conaway's unique experience and expertise. It was more economical for Young Conaway to provide a portion of the services in support of the motion when billing rates are considered, and also more efficient when experience and expertise are considered. Young Conaway was uniquely qualified to provide insight and analysis in support of the Debtors' motion to appoint the FCR. Young Conaway is a preeminent firm in this field, having represented future claimants' representatives in nearly 30 matters. That deep experience and expertise is one reason why the Debtors sought to engage Mr. Patton and Young Conaway. The Debtors and their estates benefited from calling upon Young Conaway's previous experience in successfully overcoming objections to appointment of a proposed future claimants' representative.

Supplement 5.

[20] Supplement Exs. A-R. These exhibits include retention applications, fee applications, orders approving of same and a hearing transcript.

creditors serving on official committees advance that creditor's personal interest, Mr. Patton has no personal interest to advance by serving as the future claimants' representative.[21]

Discussion

In my Bench Ruling, I explored the origins of the court-developed position of future claimants' representative as well as its codification in the Bankruptcy Code in connection with my consideration of the proper standard for the appointment of a representative under § 524(g). As I noted then, the Bankruptcy Code does not expressly provide a process for the selection of the representative or the applicable standard. To those observations, I now add that the Bankruptcy Code does not specifically provide for the compensation of the representative or his counsel.

But, as with the appropriate standard, the seminal cases give guidance as to retention of professionals and thus compensation of them. The *Johns-Manville*,[22] *UNR*[23] and *Amatex*[24] courts based their respective appointment of a representative for future claimants on the ground that demand holders are parties-in-interest and deserve representation in the bankruptcy case.[25] As a future representative is worthy of a voice in the proceedings, retention of professionals to provide that voice is appropriate, if not critical.[26] Consistent with this theory, I permitted Mr. Patton to retain YCST. But, as neither § 327 nor § 1103

[21] *See* Supplement 7–9.
[22] *In re Johns-Manville Corp.*, 52 B.R. 940 (S.D.N.Y. 1985).
[23] *In re UNR Indus., Inc.*, 46 B.R. 671 (Bankr. N.D. Ill. 1985).
[24] *In re Amatex Corp.*, 755 F.2d 1034 (3d Cir. 1985).
[25] *Id.* at 1043 ("Terming future claimants parties in interest will permit them to have a voice in proceedings that will vitally affect their interests.").
[26] *Cf. Johns-Manville*, 52 B.R. 943 ("The importance of the future claimants to this reorganization is undeniable, regardless of their status or dischargeability. Given the great importance of having their position adequately represented . . . *it is wholly appropriate to provide for such compensation.*") (emphasis added).

provide for retention of professionals by a future claimants' representative, I granted the request to retain YCST under § 105(a) and § 524(g) of the Bankruptcy Code ("Retention Order").[27]

In the Retention Order, I also provided for compensation to be awarded consistent with § 330 and § 331 of the Bankruptcy Code, the relevant Bankruptcy Rules and orders entered in these cases regarding procedures for interim compensation and reimbursement of expenses of professionals. Although the compensation of a future claimants' representative and his professionals does not fit squarely into a particular statutory section,[28] compensating his professionals fits naturally into the sections of the Bankruptcy Code by which other professionals are compensated.

YCST analyzes its fees and expenses under § 330, but it fails to fully assess the singular context in which it rendered services. Unlike a debtor or an official committee, at the time Mr. Patton retained YCST, Mr. Patton was not an estate representative and he might not ever become one. YCST acknowledges this challenge by explaining that both the Debtor Motion and Mr. Patton's application to retain YCST sought orders effective on a *nunc pro tunc* basis, "the purpose of [which] was to provide assurance to Mr. Patton and Young Conaway that they were able to render services in their proposed capacities while their appointments were pending, thereby facilitating the continuation of diligence and negotiations toward a consensual plan of reorganization, and to seek reasonable compensation for their services."[29] This statement ignores the element of risk inherent in

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[27] Order Authorizing the Future Claimants' Representative to Retain and Employ Young Conaway Stargatt & Taylor, LLP as his Attorneys, *Nunc Pro Tunc* to the Petition Date, D.I. 669.
[28] Section 330(a)(1) does not expressly provide for compensation or payment of expenses to legal representatives or professional persons they employ.
[29] Supplement 2.

every *nunc pro tunc* retention application filed by a professional, namely, that his retention may not be approved. More importantly, regardless of *nunc pro tunc* approval, the services rendered in the interim must still meet the § 330 standard. The question before me is whether a professional retained by a legal representative candidate can be compensated by the bankruptcy estate for services performed to get him appointed.[30] It is not surprising that YCST did not cite any caselaw directly on point as this appears to be a matter of first impression.[31]

Section 330 permits the court to award reasonable compensation for "actual and necessary" services. In the Supreme Court's *ASARCO* opinion, the Court provides the starting point for a § 330 analysis—the services must benefit the estate or a particular constituency (e.g. an official committee).[32] In *ASARCO*, debtor's counsel was awarded fees under § 330 based on services which indisputably benefitted the bankruptcy estates. Debtors (under new control) appealed the award of attorneys fees and counsel was forced to defend it. Counsel prevailed on appeal and subsequently asked the bankruptcy court to award it fees for its successful work defending its initial fee award.

The Supreme Court's decision ultimately turned on the application of the American Rule in the context of § 330.[33] In its analysis the Court explained that § 330 only permits

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[30] Arguably, no compensation should be awarded for counsel to a future claimants' representative before the representative is appointed. But, I have already permitted compensation for services unrelated to Mr. Patton's appointment and I will not revisit that decision here. I do note, however, that YCST performed this work at its own risk. If Mr. Patton had not been appointed, it is not clear there would be any basis for awarding compensation for this work.

[31] The orders and other filings attached to the Supplement are unhelpful. None discuss this issue.

[32] *See Baker Botts L.L.P. v. ASARCO LLC*, 576 U.S. 121, 128–29 (2015).

[33] *ASARCO*, 576 U.S. 126 ("the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise . . . departures from the American Rule only in specific and explicit provisions for the allowance of attorneys' fees under selected statutes . . . they tend to authorize the award of a reasonable attorney's fee, fees, or litigation costs, and usually refer

compensation "in service of" the estate administrator. The Court zeroed in on the actual words of the statute which "specifically" allows "reasonable compensation for *actual, necessary services rendered"* by the applicant.[34] Finding these qualifying words "significant," the Court states that professionals may be compensated for services only if that service is rendered to another and is "disinterested service." The Court concluded that fee litigation could not be described as rendering service to another, much less rendering "disinterested service" to the debtor. Rather, the Court ruled that counsel fees incurred in defending its fee application benefitted *the firm*, not the bankruptcy estates. The Court analogized that "it would be natural to describe a car mechanic's preparation of an itemized bill as part of his 'services' to the customer because it allows a customer to understand—and, if necessary, dispute—his expenses. But it would be less natural to describe a subsequent court battle over the bill as part of the 'services rendered' to the customer."[35]

Applying that standard here, I see no basis to award YCST compensation for work it performed in support of Mr. Patton's appointment. Services rendered on behalf of Mr. Patton to attain his appointment as the future claimants' representative benefit Mr. Patton and his firm, not the estate or demand holders. While YCST argues that Mr. Patton has no personal interest to advance and serves merely as a fiduciary for the interest of future claimants,[36] his personal interest is obvious. The appointment furthers Mr. Patton's

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to a prevailing party in the context of an adversarial action.") (internal quotation and citations omitted).

[34] *Id.* at 128.

[35] *Id.* at 132.

[36] *See, e.g.*, Supplement 9 ("Mr. Patton had (and still has) no personal interest to advance by serving as the FCR.")

professional career and provides his law firm with a lucrative engagement.[37] Services performed by YCST for the purpose of his appointment, therefore, advance Mr. Patton's and YCST's personal interests.

YCST's arguments to the contrary are not persuasive; in essence, they assume the end result. First, YCST suggests Mr. Patton was the best candidate for the position, so furthering his candidacy benefitted the estates. This is an argument any candidate could make. YCST's, Mr. Patton's or even Debtors' view of the best candidate does not support a finding that the fees and expenses of YCST benefitted the estates. Under the Bankruptcy Code, the court must determine who is best qualified. A debtor's nominee is not entitled to any particular deference.[38]

Second, YCST suggests that its assistance in overcoming the UST's positions on the appointment process and potential alternative nominees benefitted the estates. This argument is simply a variant of the first and suffers from the same failing. It appears to be correct that the UST has only recently taken views in court regarding the process for appointing a legal representative and/or suggested alternative candidates for the position. But I cannot conclude that opposing the UST's participation or nominee is a benefit to the estates or to demand holders. In this case, for example, the UST's participation led me to explore and establish a standard for appointment admittedly different than that which other

[37] YCST admits as much despite having generally disclaimed any personal interest in the outcome. Supplement 10 ("The only potential personal or self-interest derived by Mr. Patton in continuing as the future claimants' representative is the pecuniary interest of being paid to serve as the FCR.").
[38] *See* Bench Ruling 6 ("I agree with Judge Carey in *Maremont*, that neither more nor less deference should be given to a candidate simply because he is proposed by a debtor. *Maremont Corp.*, No. 19-10118 (KJC), Tr. at 100 (Bankr. D. Del. Mar. 8, 2019), D.I. 126. And, I would add that there should be neither more nor less deference given to a candidate proposed by any movant."); *id.* at 11 ("[W]hile it seems apparent that any person retained prepetition as the legal representative has a leg up in the post-bankruptcy appointment process, there is no guarantee.").

courts have used over the years.[39] Further, a representative will be appointed in every case where one is required; opposing the UST's nominee or proposed process is not a benefit to the estates.

Third, YCST seeks fees for preparing Mr. Patton for the hearing, preparing for argument and assisting Mr. Patton in supplementing his disclosures on discrete issues. While hearing preparation may have been necessary for Mr. Patton's appointment, YCST's assistance may not have been. Debtors' counsel could have (and did) prepare for and attend the hearing, making argument in support of their motion. YCST's voluntary assistance, even if helpful to Debtors, was either duplicative, or primarily benefitted Mr. Patton and YCST.[40]

As for supplementing Mr. Patton's disclosures, this work was a necessary part of the appointment process to answer outstanding questions regarding whether Mr. Patton's appointment was appropriate. These fees and expenses are simply the cost of doing business. While there was not an alternate candidate vying for the position in this case, these same expenses would be incurred by other candidates, if any, who were not appointed. This highlights the truism that expenses incurred in the appointment process are for the benefit of the candidate and not the bankruptcy estate.

In my Bench Ruling appointing Mr. Patton, I found a future claimants' representative to be akin to the client in the attorney/client relationship. Or, in bankruptcy parlance, most like a committee member. I recently concluded that a committee member is

[39] That standard was not the one advanced by YCST.
[40] YCST suggests that its work did not duplicate Latham's work on Debtors' behalf. Assuming this is a relevant consideration, a review of Latham's fees for the appointment of the claimants' representative does not support that position.

not entitled to be compensated for attending a formation meeting. Expenses incurred in getting appointed are not expenses incurred in the performance of one's duties as a committee member.[41] A creditor that truly believes it can best contribute to the committee may or may not get appointed, but it must pick up its own expenses in the attempt. Similarly, the bankruptcy estate does not pick up the expenses for professionals pitching the committee—even those that get selected.[42] So too, a future claimants' representative must bear the cost associated with getting the job.

The services YCST rendered to Mr. Patton in the appointment process were not services to an estate representative and they were not "disinterested service;" they were services that benefitted Mr. Patton and YCST. Extending the *ASARCO* analogy, the service for which YCST seeks compensation is the equivalent of a mechanic advocating for the use of its services over those of its competition. This self-advocacy—even if accompanied by a genuine belief in the superiority of one's services—is performed to benefit the mechanic, not the customer.

Process for Appointment of a Representative for Demand Holders

Having presided over three appointments in the last year and a half, I have some thoughts on the appointment process. In an attempt to avoid, or at least mitigate, the

[41] *See e.g.*, Tr. 12–18, *In re CR Liquidating, Inc., et al.*, No. 19-10210 (Bankr.D.Del. Oct. 16, 2019), D.I. 1054.

[42] *Cf. In re The Fairbanks Co.*, No. 18-41768-pwb (Bankr. N.D. Ga.), July 16, 2019, Tr. 23:25-24:12 ("[THE COURT:] if candidates for future claims representative have to go through this litigious process and have to employ counsel to do it, which I, I've already said, I just reject that proposition. It seems unseemly to me that someone who is proposed to be the candidate thinks we have to litigate about whether I'm gonna be appointed. It's sort of like, it's different obviously, but it's like a beauty show to represent the committee. You go in, you put your stuff together. You, you take your shot and the committee makes a decision. Lawyers don't get paid for that. And so this is a similar process except it has to take place or did take place under this process in Court.").

expense of the process for all parties involved, in future cases before me, any person seeking to be appointed as a legal representative should file with the court: (i) a fulsome disclosure of connections, similar to that required under Bankruptcy Rule 2014 and (ii) a resume/curriculum vitae. Whether and the terms under which any discovery will be permitted will be the subject of a status conference to discuss the scheduling of the hearing on the appointment. The status conference will take place as soon as practicable after the filing of a request to appoint a representative. While parties-in-interest may have a legitimate interest in the appointment process,[43] it should not be so cumbersome, litigious or expensive that the process itself dissuades capable candidates or becomes a barrier to entry.

Conclusion

My decision today is consistent with the Bankruptcy Code. It also furthers the process I believe is appropriate for appointing a representative for demand holders and to some degree levels the playing field at least so far as the expense associated with appointment is concerned. I decline to award YCST fees for work performed in the appointment process.

Dated: November 20, 2020

LAURIE SELBER SILVERSTEIN
UNITED STATES BANKRUPTCY JUDGE

[43] In my Bench Ruling I observed, as did the *Amatex* and *Johns-Manville* Courts that no party in the case has interests similar to those of the demand holders and indeed others' interests may conflict with that of the legal representative. Bench Ruling 7, 8.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
IMERYS TALC AMERICA, INC., *et al.*,	:	Case No. 19-10289 (LSS)
Debtors.	:	(Jointly Administered)
	x	**Re: Docket No: 805, 1173, 1484**

ORDER DENYING, IN PART, THE COMBINED FIRST INTERIM FEE APPLICATION REQUEST OF JAMES L. PATTON, JR. AS THE LEGAL REPRESENTATIVE FOR FUTURE TALC PERSONAL INJURY CLAIMANTS AND YOUNG CONAWAY STARGATT & TAYLOR, LLP AS COUNSEL TO THE LEGAL REPRESENTATIVE FOR FUTURE TALC PERSONAL INJURY CLAIMANTS FOR ALLOWANCE OF COMPENSATION AND REIMBURSEMENT OF EXPENSES FOR THE PERIOD FROM FEBRUARY 13, 2019 THROUGH MAY 31, 2019

For the reasons set forth in the accompanying Memorandum of even date, it is hereby **ORDERED THAT:**

1. The *Combined First Interim Fee Application Request of James L. Patton, Jr. as the Legal Representative for Future Talc Personal Injury Claimants and Young Conaway Stargatt & Taylor, LLP as Counsel to the Legal Representative for Future Talc Personal Injury Claimants for Allowance of Compensation and Reimbursement of Expenses for the Period From February 13, 2019 through May 31, 2019* [Docket. No. 1484] is **DENIED IN PART.**

2. The request for fees in the amount of $232,471.50 identified by the applicants as fees incurred in connection with the appointment of Mr. Patton as the futures claimants' representative is denied.[44]

Dated: November 20, 2020

LAURIE SELBER SILVERSTEIN
UNITED STATES BANKRUPTCY JUDGE

[44] *See* First Omnibus Order Awarding Interim Allowance and Compensation for Services Rendered and for Reimbursement of Expenses, D.I. 1173.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
BOY SCOUTS OF AMERICA AND DELAWARE BSA, LLC,	)	Case No. 20-10343 (LSS)
	)	
	)	Jointly Administered
Debtor.	)	
	)	**Re: Docket No. 204**

BENCH RULING DELIVERED MAY 29, 2020
ON DEBTORS' APPLICATION TO RETAIN SIDLEY AUSTIN LLP AS ATTORNEYS FOR THE DEBTORS AND DEBTORS IN POSSESSION

This is my ruling on Debtors' application to retain Sidley Austin as their restructuring counsel under section 327(a) of the Bankruptcy Code. The sole objection to Sidley's retention was filed by Century Indemnity Company, a subsidiary of Chubb, and one of Debtors' many insurers. I held an evidentiary hearing on May 4, entertained argument on May 6 and took the matter under advisement.

Facts

While the witness testimony reflects vastly different views of the dealings between Century and Sidley, based on the record before me, the following facts are largely undisputed, but in any event, I find that:

- Chubb is a longtime client of Sidley's Insurance and Financial Services Group. Over the years, Sidley represented Chubb and/or its predecessors and subsidiaries on various reinsurance matters, including both specific arbitration proceedings and general counseling matters.
- On October 5, 2018, Century retained Sidley in connection with Century's efforts to obtain reinsurance from Lloyd's of London for claims Century paid or in the future would pay to BSA under insurance policies Century issued to BSA. Sidley was brought on to review the work of previous counsel which had resulted in an arbitration award adverse to Century. That arbitration proceeding is the subject of a

decision of the United States District Court for the District of Massachusetts styled *Certain Underwriters at Lloyd's, London v. Century Indemnity Company* and found at 2020 WL 1083360.

- In August, 2019, Century again retained Sidley in connection with Century's efforts to obtain reinsurance from another insurer for claims Century paid or in the future would pay to BSA under insurance policies Century issued to BSA.
- At substantially the same time that Sidley took on its first BSA-specific engagement for Century, Sidley's restructuring group was hired by BSA to render restructuring planning, advice and implementation.
- At no time did Sidley obtain from Century a waiver of any conflict with respect to its concurrent representation of Century in reinsurance matters and BSA in restructuring matters.
- On January 16, 2020, Sidley wrote Chubb stating its intention to withdraw from all of its pending representations of Century and Chubb and set out a timeframe and methodology for that process. The last action taken to withdraw from any Chubb matter was either on February 20 or 24, 2020.
- In the meantime, BSA filed its bankruptcy petition on February 18, 2020.
- Century's insurance policies with BSA are assets of the BSA bankruptcy estate. Those policies include the same underlying Century/BSA insurance policies for which Century sought to collect reinsurance from Lloyds and the second reinsurer.
- The operative agreement between Sidley and Century with respect to the Sidley engagement on reinsurance matters is a 2015 Service Level Agreement. Generally, Chubb's service level agreement is Chubb's standard agreement by which it engages counsel. Chubb has chosen not to negotiate separate engagement letters with each law firm it engages.
- The 2015 Service Level Agreement with Sidley provides that if Century and Sidley are unable to resolve any dispute with respect to a matter handled by the law firm, the sole means for redressing that dispute shall be an arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules. Century is pursuing this remedy.

Parties' Positions

Century argues that Sidley's retention application cannot be granted because Sidley does not meet the standard of section 327 as Sidley's representation would violate Rule 1.7 of the Rules of Professional Responsibility in that Sidley would be representing one current client—BSA—against another current client—Century.

Sidley argues that Rule 1.7 is not relevant to its retention. It argues that Century is a former client, not a current client, and that under Rule 1.9 of the Rules of Professional Responsibility, Sidley does not need a waiver from Century because Sidley's representation of BSA in its restructuring is not substantially related to its previous representation of Century in reinsurance matters. It further argues that it does not hold or represent any interest adverse to the BSA estate and is disinterested. Finally, Sidley argues that Sidley was never adverse to Chubb/Century even when Century was a client because Haynes and Boone is BSA's insurance coverage counsel in connection with the restructuring.

Debtors argue that they will be severely prejudiced if they cannot retain Sidley because of the extensive work that Sidley performed in preparing BSA for these chapter 11 cases and in representing BSA both pre- and post-petition in negotiations with all relevant constituencies over the past 18 months. Replacing Sidley would not only delay the restructuring, but impose additional significant expense on BSA. The impact of the covid-19 pandemic has caused BSA to close almost all of its 175 Scout Shops and BSA is facing the potential cancellation or reduction of its programming at its high adventure facilities this summer. These events have or will cause a significant decrease in BSA revenue.

Discussion

A. Section 327

The starting point for a professional retention is section 327(a). In *BH&P*,[1] the Third Circuit states that § 327(a) creates a two-part test. To be employed, a professional (i) may not hold or represent an interest adverse to the estate and (ii) must be disinterested. The

[1] *In re BH & P, Inc.*, 949 F.2d 1300 (3d Cir. 1991) (addressing a professional's concurrent representation of related bankruptcy estates).

purpose behind these requirements is to ensure effective representation of the estate; in other words, it is to ensure that the professional is able to act in the best interest of the estate and can competently and vigorously represent the trustee or debtor-in-possession.

This purpose is also consistent with subsection 327(c). Subsection (c) provides that a professional is not disqualified for employment solely because of such person's representation of a creditor unless there is an objection by another creditor or the UST and there is an actual conflict of interest. Again, the concern embodied in subsection (c) is that the estate be adequately represented.

Section 327 does not seek to vindicate the rights of non-debtor entities. The Third Circuit cases interpreting section 327 bear out this perspective. In *BH&P*, the Third Circuit examined whether a single trustee could be appointed to represent multiple related debtors and whether his counsel could be approved under section 327 to concurrently represent related bankruptcy estates. The Court did not find error in the bankruptcy court's factual findings that the existence of current inter-debtor disputes created an actual conflict of interest because of "the possibility that [the professionals] would favor one estate over the other in their attempt to serve all of them." In *Pillowtex*, the Third Circuit examined whether a professional against which a "facially plausible claim of a substantial preference" exists may hold an interest adverse to the estate. The Court recognized that if a transfer is avoided, the professional will become a creditor of the estate.[2] And, in *Marvel Entertainment*, the Third Circuit reversed the district court, and permitted the debtor's retention of its chosen law firm over objection notwithstanding that prepetition the firm represented a

[2] *In re Pillowtex, Inc.*, 304 F.3d 246, 255 (3d Cir. 2002).

major secured creditor of the estate; the firm's representation was on matters unrelated to the bankruptcy case, and the attorney client relationship had been consensually severed in anticipation of the firm's retention in the bankruptcy case.[3] In each instance, the Court looked at the factual scenario in front of it from the perspective of the estate.

Here, the only party objecting to Sidley's retention is Century. Neither the UST nor another creditor has objected to Sidley's retention and the only party arguing that Sidley cannot adequately represent the estate is Century. Under these circumstances, even assuming an actual conflict, the per se disqualification rule of section 327(c) does not kick in. And, I am in no way convinced that Sidley generally cannot effectively represent BSA. This is not a situation where the court is concerned that proposed counsel has a bias in favor of a non-debtor entity such as a parent or significant creditor.

Further, and important in the context of the arguments made here, section 327 (including both subsections (a) and (c)) are written in the present tense. As Judge Walrath observed in *In Re Muma Services, Inc.*, Congress' use of a verb tense is significant in construing statutes, and section 327 is phrased in the present tense.[4] Quoting from the Second Circuit's *AroChem* decision, Judge Walrath agreed that "counsel will be disqualified under § 327(a) only if it **presently** 'holds or represents an interest adverse to the estate,' notwithstanding any interests it may have held or represented in the past."[5] So, section

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[3] *In re Marvel Entm't Grp., Inc.*, 140 F.3d 463, 477 (3d Cir. 1998).
[4] *In re Muma Servs., Inc.*, 286 B.R. 583, 591 (Bankr. D. Del. 2002) (citing *United States v. Wilson*, 503 U.S. 329, 333 (1992).
[5] *Muma* at 591 quoting *Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 623 (2d Cir. 1999); 11 U.S.C. § 101(14)(B) (emphasis added):

> The term 'disinterested person' means a person that—
> (A) is not a creditor, an equity security holder, or an insider;

327's prohibition against representing an adverse interest does not work to prohibit Sidley's retention because of its previous representation of Chubb. Whether the attorney-client relationship ended as Sidley asserts with its January 16, 2020 letter to Chubb, or as Century asserts several days after the bankruptcy petition was filed is of no consequence. For purposes of section 327, the attorney-client relationship has ended. I note that Chubb has not cited any case law to the contrary. Therefore, I conclude that Sidley meets the two-part test of section 327 in that it does not hold or represent an interest adverse to the estate and it is disinterested.

Nonetheless, the Rules of Professional Responsibility are not irrelevant to a retention application. First, there are some decisions in which courts have denied retention because of a professional's violation of its ethical responsibilities that do not implicate section 327. These courts generally rely on the court's ability to monitor the conduct of the attorneys practicing before it or note an impact on the integrity of the bankruptcy process. For example, in *Universal Building Products*,[6] Judge Walrath denied the committee's application to retain a law firm that violated professional rules of conduct in soliciting committee members. Second, Chubb argues that Sidley is not capable of effectively representing the debtors because whether Chubb is a current client or a former client, Sidley cannot be adverse to Chubb in this bankruptcy case. Chubb contends that insurance issues in a mass

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(B) is not **and was not**, withing 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or *for any other reason.*

[6] *In re Universal Building Products*, 486 B.R. 650 (Bankr. D. Del. 2010) (denying retention application in part because of violations of Rules 7.3 and 8.4 of the Model Rules of Professional Conduct).

tort case are so pervasive that Sidley's inability to be adverse to Chubb means Sidley's retention cannot be approved. Thus, a review of Rules 1.7 and 1.9 are necessary.

B. The Model Rules of Professional Conduct of the American Bar Association

Unlike section 327 of the Bankruptcy Code, Rules 1.7 and 1.9 of the Model Rules of Professional Responsibility address the attorney-client relationship.

Rule 1.7 looks out for the interest of the client. It prevents an attorney from representing one current client against another current client absent a written waiver. As the comments to Rule 1.7 make clear "a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated."[7] Thus, Rule 1.7 reflects the complete and undivided loyalty an attorney owes to its client: a lawyer can never be adverse to a current client.

Rule 1.9 similarly looks out for the interest of the client. It provides that a lawyer cannot represent a party against a former client in the "same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client." The rule is designed to serve three purposes: (i) to prevent even the potential that a former client's confidences and secrets may be used against him; (ii) to maintain public confidence in the integrity of the bar; and (iii) to uphold the duty of loyalty owed to a client.[8]

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[7] Model Rules of Prof'l Conduct R. 1.7 cmt. 6 (2019).

[8] *Golden Guernsey Dairy, LLC*, 2015 WL 3669932, at *4 (Bankr. D. Del. June 12, 2015) (citing *In re Corn Derivatives Antitrust Derivatives Litig.*, 748 F.2d 157, 162 (3d Cir. 1984)).

To determine whether a "substantial relationship" exists, courts generally look to three factors: (i) the nature and scope of the prior representation, (ii) the nature and scope of the current representation; and (iii) the possibility that the former client disclosed confidences to his attorney in the prior representation which could be relevant to the current action and used to the detriment of the former client in the current action.[9] Simply put, the question is whether the attorney learned things in the prior matter that would give the lawyer's new client an advantage in the current matter. In assessing the nature of the action and the types of information that might be disclosed to a lawyer in that action, the former client need not disclose the privileged information imparted. Rather, the court should make a realistic appraisal of the possibility that confidences have been disclosed which would be harmful to the client in the other matter.[10]

The testimony of Mr. Sneed, Ms. Russell and Mr. Schwartz addressed all three factors. Mr. Sneed drew a bright line between reinsurance and the underlying claims for which reinsurance is sought. Mr. Sneed's testimony is that his work on reinsurance matters is never adverse to the insured on the underlying policy (here, BSA). He testified that a reinsurance dispute involves only a dispute on the reinsurance contract between the ceding insurer (here, Century) and the reinsurer (here, Lloyds of London and a second reinsurer) and that matters related to the underlying insurance claims are not implicated. Mr. Sneed also testified that in the two BSA-related reinsurance matters he was handling for Century he received a

[9] *Talecris Biotherapeutics, Inc. v. Baxter Healthcare LLC*, 491 F.Supp. 2d 510, 514 (D. Del. 2007).
[10] *Golden Guernsey,* 2015 WL 3669932, at *4.

limited and extremely narrow set of documents, the documents did not implicate the underlying claims and that the arbitration proceeding only included claims that Century had already paid, not future claims. Any declaratory relief regarding future BSA claims in the reinsurance matter was boilerplate.

Ms. Russell's testimony was directly to the contrary. She testified that although a reinsurance claim does involve the interpretation of the reinsurance contact, in order to properly advise a client on reinsurance matters, a lawyer must familiarize himself with the underlying claims. She further testified that while Mr. Sneed testified truthfully about the categories of documents he received from Century in the BSA-related reinsurance matters, he downplayed the significance of what he received. She further testified that he did receive information regarding the underlying insurance that Century issued to BSA. And, that in the BSA-related reinsurance matters, the relief sought included not only relief with respect to claims already paid under the policy Century issued to BSA, but claims that BSA would make under the policy in the future. Ms. Russell further testified that those future claims were significant assets of Chubb. Finally, Ms. Russell testified that no decisions had been made about how to approach the second Lloyd's arbitration, rather that was exactly what Chubb would be discussing with counsel.

A review of the District Court's decision[11] regarding the arbitration against Lloyds of London that Sidley was engaged to take over in October 2018 supports Ms. Russell's testimony. The District Court states that in the arbitration Century sought an award requiring Lloyds to pay all outstanding bills and requiring Lloyd's to pay any future billings

[11] *Certain Underwriters at Lloyd's, London v. Century Indemnity Company*, 2020 WL 1083360 (D. Mass. Mar. 6, 2020).

related to BSA molestation claims. Further, in its recitation of facts, the District Court describes the First Encounter Agreement entered into between BSA and Century in 1996 which sets forth a methodology for allocating molestation claims made against BSA under the insurance policies issued by Century to BSA. The Court then sets forth a portion of the Final Award entered in the reinsurance arbitration, as follows:

> Century has not demonstrated that the **First Encounter Agreement** ("FEA") that it entered into with BSA is the product of a reasonable and business-like investigation. Accordingly, Underwriters are not bound to follow the FEA. And thus, Century's Billings for sexual molestation claims submitted in this matter under [the Reinsurance Contracts] are not covered by those treaties.[12]

The District Court's description of the reinsurance matter shows that it did not involve only the reinsurance contract. It also involved an agreement between BSA and Century—the First Encounter Agreement. The First Encounter Agreement has already been the subject of testimony in this court in connection with the BSA's motion for preliminary injunction with respect to the abuse victims' lawsuits.

Further, the evidence shows that in the BSA coverage action brought against Century in Texas, BSA propounded discovery to Century seeking all documents and communications between Century and its reinsurers involving sexual abuse claims against BSA, including in connection with Century's arbitration against Lloyds described in the District Court opinion. Century's response to the discovery was that it was not relevant to the coverage action. Accordingly, there is a disagreement on relevancy.

Based on the record before me, I conclude that the reinsurance litigation could be "substantially related" to at least some aspects of Boy Scout's bankruptcy case for purposes of Rule 1.9. Specifically, I find that Sidley received from Century information relevant to

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[12] *Id.* at *2.

the BSA bankruptcy, but it is less clear exactly how that information could be used to Century's detriment in the bankruptcy case.

Sidley, however, contends that it is not representing BSA on any aspect of the bankruptcy case that could be an issue. The question becomes therefore whether, as Sidley contends, conflicts counsel solves any ills here.

C. Conflicts Counsel

Conflicts counsel is often used by debtors when their main restructuring counsel cannot be adverse to a particular party in a bankruptcy case. As noted by both Professor Rapoport in her declaration and by courts struggling with retention issues, mega bankruptcies can pose retention issues for debtors.

Here, from the outset and as reflected in Sidley's engagement letter with BSA, Sidley carved out from its engagement any advice on insurance coverage issues. The evidence is unrefuted that Haynes & Boone has taken the lead on all coverage-related matters, is the firm charged with both analyzing BSA's insurance policies and negotiating with its insurers. And, Haynes & Boone drafted the portions of BSA's placeholder plan of reorganization pertaining to insurance neutrality. Haynes & Boone was involved from the outset of the restructuring negotiations and initiated substantive discussions with BSA's insurers, including Century.

Further, both Mr. Sneed and Ms. Boelter testified that there have been no substantive discussions between Sidley's reinsurance group and BSA's restructuring team. Mr. Sneed has not passed on any information he received in the course of his representation of Century in the reinsurance matters. And, an ethical screen has been in place since November 4,

2019. While a retroactive ethical screen may not work for purposes of violations of the Rules of Professional Conduct, based on the unrefuted testimony, I conclude that any confidential or privileged information that Mr. Sneed received in his representation of Century in its reinsurance matters has not and will not be passed along to Sidley's restructuring team. I do not find this surprising given the nature of large firms with specialized departments.

Also, one of Ms. Russell's primary concerns appears to be that the bankruptcy itself could hurt Century in its reinsurance collections. As Ms. Russell put it: "certain things that could be said in the bankruptcy action by Sidley could harm us in our reinsurance [collection] . . . and our [ceded] asset, our reinsurance collections are an important asset to Chubb and that we could be harmed in that collection by things Sidley would say."[13] This is also consistent with the position taken by Century's counsel in argument that even if Sidley had not taken on the two BSA-related reinsurance engagements, Sidley would still be prohibited from representing BSA in this bankruptcy case.

It may be that certain legal positions taken in the bankruptcy case regarding the BSA/Century insurance policies could be harmful to Century's efforts to collect on its insurance—I make no conclusions on that. But, if that is the case, that is a function of the Bankruptcy Code and law, and not any information learned by Sidley in the reinsurance litigation.

Accordingly, I conclude that Sidley may continue to represent BSA generally in this bankruptcy case.

[13] Retention Hr'g Tr. 147:11-148:5, May 4, 2020, D.I. 572.

This decision is consistent with the numerous cases cited to me addressing disqualification of counsel in the context of conflicts of interest with current or former clients. Disqualification is never automatic.[14] Indeed, I was surprised with the overwhelmingly body of caselaw (including in this district) in which courts deny disqualification motions in the face of what appear to be obvious conflicts.[15] In doing so, courts consider the facts and circumstances of each case and are particularly mindful of a party's right to counsel of its choice.[16] Courts also consider the prejudice that could inure to a client if it is required to obtain new counsel.[17]

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[14] *Golden Guernsey,* 2015 WL 3669932, at *2 ("Although disqualification ordinarily is the result of a finding that a disciplinary rule prohibits an attorney's appearance in a case, disqualification never is automatic." (quoting *United States v. Miller*, 624 F.2d 1198, 1201 (3d Cir. 1980))); *Elonex I.P. Holdings, Ltd. v. Apple Computer, Inc.*, 142 F.Supp.2d 579, 583 (D. Del. 2001) ("Although disqualification is ordinarily the result of a finding that an ethical rule has been violated, disqualification is never automatic.").

[15] *Apple Computer, Inc.,* 142 F.Supp.2d at 583 ("Even if the court were to find that there was no waiver and that [conflicted counsel] has violated Rule 1.7(a), disqualification is not warranted in this case. As the court has already stated, disqualification is a severe sanction."); *Boston Scientific Corp. v. Johnson & Johnson Inc.*, 647 F.Supp.2d 369 (D. Del. 2009) (finding a violation of Rule 1.7, but denying disqualification motion); *End of Road Trust v. Terex Corporation*, 2002 WL 242464 (D. Del. 2002); *TQ DELTA, LLC, Plaintiff, v. 2WIRE, INC.*, 2016 WL 5402180, at *6-7 (D. Del. 2016) (finding violation of Rule 1.9, but denying disqualification motion). *See Airgas, Inc. v. Cravath, Swaine & Moore LLP*, 2010 WL 3046586 at *2 n.3 (E.D. Pa. Aug. 3, 2010) (recognizing that Delaware Chancery Court determined it need not resolve question of whether law firm breached its ethical obligations in denying disqualification motion). *But see Intellectual Ventures I LLC v. Checkpoint Software Technologies*, 2011 WL 2692968, at *15 (D. Del. 2011).

[16] *TQ DELTA, LLC,* 2016 WL 5402180, at *6-7 ("[S]ome of the factors weighed by courts in the Third Circuit: attorney loyalty, prejudice to parties, protection of the integrity of the judicial process, geography, timing of disqualification motion, duration of prior representation, delay, stage of proceedings, whether confidential information from the prior representation had passed to the client, cost to obtain new counsel, complexity of the case, size of the firm, nature and degree of prior involvement, and whether there was any ulterior motive for filing the motion to disqualify. . . . I am cognizant of the need to balance 'the sacrosanct privacy of the attorney-client relationship (and the professional integrity implicated by that relationship) and the prerogative of a party to proceed with counsel of its choice.'" (citation omitted)).

[17] *Apple Computer, Inc.*, 142 F.Supp.2d at 584 ("Also, in light of [conflicted counsel's] knowledge of the case, it is certain that [client] will be prejudiced if it has to retain new counsel. There is no doubt that it will be both inefficient and costly for [client] to get new counsel up to speed in this matter.").

Here, once again, the testimony was unrefuted. Mr. Whittman's declaration describes the significant prejudice that would befall BSA if it is forced to replace Sidley, which has been working with BSA for almost 18 months.

Having concluded that Sidley may remain BSA's restructuring counsel, Haynes and Boone must handle all matters adverse to Century that address the substantive treatment of BSA's insurance policies with Century, claims thereunder, proceeds therefrom or that otherwise implicate insurance coverage. This is consistent with the self-imposed restriction in Sidley's engagement letter with BSA that does not permit Sidley to work on coverage matters. I believe that conflicts counsel can work here given Haynes & Boone's involvement with the restructuring since its inception. Both Sidley and Haynes & Boone will need to continue to be tuned in to their respective scope of work.

Permitting Sidley to continue to work on the BSA bankruptcy case does not leave Chubb without further remedies. As already stated, the 2015 Service Level Agreement contains an arbitration provision and Chubb is invoking it. Violations of the professional rules of conduct will be addressed in that forum, which was Chubb's chosen forum for Sidley's breach of the terms of engagement.

In all events, I am comfortable that no privileged information that Sidley obtained in its work for Century can or will be used in this bankruptcy case in any way.

Chubb contends that my approval of Sidley's retention will encourage law firms to impermissibly drop clients in order to take on more lucrative bankruptcy cases. Perhaps I should be more cynical, but I still believe the law is a profession and persons take their

professional obligations seriously. I do not think any law firm wants to become embroiled in disqualification motions or in arbitrations or lawsuits with their clients or former clients.

D. Three Final Items

Finally, I note three more items.

i. Disclosures

First, Century objected to Sidley's Rule 2014 disclosure of its connections. Having reviewed the disclosures, I find them sufficient. Paragraph 22 of Ms. Boelter's declaration specifically addresses Chubb and Century. While Chubb quarrels with the characterization of the representation, it accurately reflects Sidley's view of the representation and provides parties and the court with enough information to ask questions.

ii. Waiver/Tactical Use of Objection to Retention

Second, in its pre-hearing submission and in the testimony adduced at the hearing, Sidley spent significant time arguing and adducing evidence to support its position that Chubb knew of Sidley's representation of BSA in December, 2018 and that its delay in taking any action regarding the alleged conflict was either tactical or constitutes a waiver. At argument, however, Sidley abandoned any argument that Chubb's pre-bankruptcy conduct constituted a waiver, and instead argued that Chubb waited too long post-bankruptcy filing to raise the matter. While Chubb could have been more proactive once the bankruptcy case was filed, it filed a timely objection to Sidley's retention. Having heard the evidence, I do not find that Chubb's actions, or lack thereof, postpetition, amount to a waiver of its position.

iii. Expert Opinions

Third, each side objected to the admission into evidence of the declaration of the other's expert and/or the consideration of his/her respective testimony. I took the objections under advisement. I overrule both objections, but quite frankly find that neither opinion aided my consideration. This was through no fault of the respective experts. Both were hamstrung by the assumptions they were asked to make and the limited facts they were provided. I appreciate their time and would have liked to hear their respective views on the issues I struggled with it coming to my conclusion. Unfortunately, I don't get to frame the questions they opine on.

Dated: June 2, 2020

Laurie Selber Silverstein
United States Bankruptcy Judge

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FOR PUBLICATION

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FILED
OCT 13 2020
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

In re:	Case No. 17-23606-B-7
JOAN ARLENE MILLER,	DC No. DNL-3
Debtor(s).	

OPINION REGARDING RETROACTIVE EMPLOYMENT AND COMPENSATION

J. Russell Cunningham, Desmond, Nolan, Livaich & Cunningham, Sacramento, California, for Chapter 7 Trustee.

JAIME, Bankruptcy Judge:

The matter before the court is a request by the chapter 7 trustee to retroactively employ attorneys as special counsel under 11 U.S.C. § 327 pursuant to a *nunc pro tunc* order and an exercise by the bankruptcy court of its equitable discretion to compensate the professionals under 11 U.S.C. § 330 for pre-employment services. Although Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano, ___ U.S. ___, 140 S. Ct. 696, 206 L. Ed. 2d 1 (2020), prohibits the court from approving the professionals' employment *nunc pro tunc*, or effective on the date before employment is actually approved, it does not prohibit the court from exercising its equitable discretion to compensate the professionals for pre-employment services. The court's conclusion is consistent with long-standing Ninth Circuit precedent which remains unchanged by Acevedo.

Background

The facts are relatively straightforward and are not disputed.

On March 3, 2013, debtor Joan Miller entered into a 40% contingency fee agreement with Mostyn Law, Arnold & Itkin, and Pulaski Law Firm, PLLC (collectively, "Special Counsel") to investigate, prepare, and prosecute any claim or suit for personal injuries arising out of the surgical placement of a medical device implant. Since that time Special Counsel has represented the debtor in litigation pending in the United States District Court for the Southern District of West Virginia.

More than four years later, on May 30, 2017, and at the age of 87, the debtor filed a voluntary chapter 7 petition. Neither the debtor's medical device claim nor her contingency fee agreement with Special Counsel were listed in the initial or in any amended schedules. According to the chapter 7 trustee, the debtor "forgot" about both when she filed her bankruptcy petition. Unsecured claims were scheduled at $31,999.00. A discharge was entered on September 11, 2017. The bankruptcy case was closed as a no-asset case on September 15, 2017.

In May 2019, the claims administrator in the debtor's medical device litigation communicated an offer to settle the debtor's claim for $165,000.00. Nobody disputes that the omission of the debtor's medical device claim from the bankruptcy schedules means it was not administered as an asset and it therefore remains property of the estate.

On the motion of the United States trustee, the chapter 7 case was ordered reopened on August 1, 2019, to administer the asset. The chapter 7 trustee was re-appointed on August 5, 2019. And the chapter 7 trustee's motion to employ general bankruptcy counsel was granted in an order filed on August 13, 2019.

The chapter 7 trustee identified Special Counsel and Special Counsel's contingency fee agreement with the debtor in a September 24, 2019, motion to approve a stipulation that allowed the debtor a $30,000.00 exemption in the settlement proceeds of the medical device claim without litigating the fact-intensive basis for the claimed exemption under state law. The court approved the stipulation as a fair and equitable compromise by order entered on October 30, 2019.

Timely proofs of claim filed by the December 9, 2019, bar date totaled $32,270.66. No tardy claims have been filed.

Although the debtor's bankruptcy case was reopened on August 1, 2019, and the chapter 7 trustee disclosed Special Counsel and the contingency fee agreement shortly thereafter, the chapter 7 trustee did not file an application to employ and compensate Special Counsel until July 14, 2020. The application requests the employment of and compensation for Special Counsel "retroactively to March 3, 2013." The application was filed with a motion to approve the $165,000.00 settlement of the debtor's medical device claim and the chapter 7 trustee's attorneys' application for compensation.

The settlement terms and Special Counsel's role in settling the debtor's medical device claim are not at issue. If Special

Counsel is employed under the contingency fee agreement with the debtor, it would receive $62,700.00 in attorney's fees, and $1,151.54 in expenses, for a total of $63,851.54. The debtor would also be allowed a $30,000.00 exemption. And after mandatory litigation deductions, the estate would recover approximately $54,001.06. That amount is sufficient to pay administrative expenses consisting of compensation for the chapter 7 trustee and his attorneys of approximately $15,500.00, pay 100% of unsecured claims in the approximate amount of $32,270.66, and provide the debtor with a surplus.

The issues concern the chapter 7 trustee's request for a *nunc pro tunc* order that approves Special Counsel's appointment retroactive to a March 3, 2013, effective date and compensates Special Counsel for services they provided from the retroactive date forward. In the absence of *nunc pro tunc* employment, the court must also address the issue of Special Counsel's compensation for its pre-employment services.

Jurisdiction

Jurisdiction is founded on 28 U.S.C. § 1334(a). Employment of professional persons under 11 U.S.C. § 327(e) is a matter of exclusive jurisdiction. 28 U.S.C. § 1334(e)(1). Employment and compensation of professionals is a core proceeding concerning the administration of the estate that a bankruptcy judge may hear and determine. 28 U.S.C. § 157(b)(2)(A).

Analysis

I

As a general matter, authority for federal courts to make

retroactive orders derives either from inherent authority, statute, or rule.

A

The "*nunc pro tunc*" or "now for then" order is the paradigm example of a retroactive order issued under the court's inherent authority. Acevedo effectively ends federal courts use of *nunc pro tunc* orders to the extent such orders rewrite history to retroactively make the record reflect something that never occurred in the first instance.

Acevedo arose in a jurisdictional context. Acevedo, 140 S. Ct. at 699-700. In March 2018, and thus after the Archdiocese removed the case against it from the Puerto Rico Court of First Instance to the United States District Court for the District of Puerto Rico in February 2018 and before the district court remanded by *nunc pro tunc* order in August 2018, the Court of First Instance issued certain payment and seizure orders against the Archdiocese. Id. Concluding that the payment and seizure orders were void because the Court of First Instance lacked jurisdiction to enter the orders after removal and before remand, the Supreme Court explained:

> The Court of First Instance issued its payment and seizure orders after the proceeding was removed to federal district court, but before the federal court remanded the proceeding back to the Puerto Rico court. At that time, the Court of First Instance had no jurisdiction over the proceeding. The orders are therefore void.

Id. at 700.

The Supreme Court also rejected the idea that the district court's *nunc pro tunc* remand order, made effective to a few days

before the payment and seizure orders were entered, created the non-federal jurisdiction necessary to validate the orders. Id. at 700. Noting that the applicable remand statute prohibited the local court from exercising jurisdiction "unless and until" there was an actual remand, id. at 700, and further noting that nothing occurred in the district court on the purported effective date of the *nunc pro tunc* remand order, id. at 701, the Supreme Court stated:

> Federal courts may issue *nunc pro tunc* orders, or 'now for then' orders, to 'reflect the reality' of what has already occurred[.] 'Such a decree presupposes a decree allowed, or ordered, but not entered, through inadvertence of the court.' Put colorfully, '*nunc pro tunc* orders are not some Orwellian vehicle for revisionist history - creating 'facts' that never occurred in fact.' Put plainly, 'the court cannot make the record what it is not.'

Id. at 700-01 (emphasis in original, internal citations omitted).[1]

Acevedo's significant limit on the use by federal courts of *nunc pro tunc* orders has necessitated a change in bankruptcy

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[1]In this respect, Acevedo is consistent with what has been the Ninth Circuit position regarding *nunc pro tunc* orders for effectively 50 years. See Wirum v. Warren (In re Warren), 568 F.3d 1113, 1116 n.1 (9th Cir. 2009) (inherent limited power to be used only to correct the record to reflect actual events); Sherman v. Harbin (In re Harbin), 486 F.3d 510, 515 n.4 (9th Cir. 2007) (used to correct errors in the record, are extremely limited in scope, and refer to situations where the court, after discovering the record does not accurately reflect its actions, corrects the record to accurately show what happened); United States v. Sumner, 226 F.3d 1005, 1009-10 (9th Cir. 2000) (limited to making the record reflect what the trial court actually intended to do at an earlier date, but which it did not sufficiently express or did not accomplish due to some error or inadvertence); Martin v. Henley, 452 F.2d 295, 299 (9th Cir. 1971) (Bankruptcy Act § 17 - *nunc pro tunc* power may be used only where necessary to correct clear mistake and prevent injustice).

practice. *Nunc pro tunc* orders have been common, particularly with respect to employment under § 327. Bankruptcy courts have recognized that practice must now stop. In re Roberts, 618 B.R. 213, 217 (Bankr. S.D. Ohio 2020); In re Benitez, 2020 WL 1272258, *2 (Bankr. E.D.N.Y. March 13, 2020).

Acevedo is, however, not a *per se* prohibition of all retroactive relief in all instances. Acevedo curtails only the inherent authority of federal courts to grant retroactive relief by *nunc pro tunc* orders which purport to create facts or rewrite history to support the retroactive relief granted. There is a distinct difference between retroactive relief granted by *nunc pro tunc* orders which purport to create facts and rewrite history, as with the remand order in Acevedo, and discretionary grants of retroactive compensation in orders that do neither—as explained below.

B

Statutes may also serve as a basis, express or implied, for orders that have retroactive effect without need for inherent power *nunc pro tunc* orders.

Express retroactive authority is exemplified by the power within the bankruptcy court's discretion to "annul" the automatic stay under 11 U.S.C. § 362(d). Merriman v. Fattorini (In re Merriman), 616 B.R. 381, 391-93 (9th Cir BAP 2020). Annulling the automatic stay typically operates retroactively to validate acts that violated the stay.

Implied retroactive authority reposes in Bankruptcy Code provisions that require court approval but that do not mandate

that such approval actually precede the statutory activity. Two Ninth Circuit opinions illustrate this point.

In Harbin, the Ninth Circuit contrasted *nunc pro tunc* orders with the equitable discretion that remains with bankruptcy courts to grant retroactive approval under provisions of the Bankruptcy Code which do not expressly require approval to precede the approved act. Harbin, 486 F.3d at 515 n.4, 521-22. As an example of this distinction in the context of the case before it, the Ninth Circuit stated that "[s]ection 364(c)(2) does not, by its express terms, require the bankruptcy court to authorize the financing transaction before the debt is incurred." Id. at 522. The salient point is that retroactive approval of the postpetition debt did not depend on the fact of prior authorization by the bankruptcy court to enter into the financing transaction. In other words, there was no need to create facts or rewrite history with a *nunc pro tunc* order in order support the retroactive relief granted.

The same distinction exists in the specific context of employment under § 327 and compensation under § 330. In Atkins v. Wain, Samuel & Co., 69 F.3d 970 (9th Cir. 1995), the Ninth Circuit reaffirmed the long-recognized principle that "[t]he bankruptcy courts in this circuit possess the equitable power to approve retroactively a professional's valuable but unauthorized services." Id. at 973.[2] Harbin described Atkins as an example

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[2]See also Law Offices of Ivan W. Halperin v. Occidential Fin. Group, Inc. (In re Occidential Fin. Group), 40 F.3d 1059, 1062 (9th Cir. 1994) ("A bankruptcy court may sometimes exercise discretion to make an award for attorneys fees not authorized in

under § 327 of "circumstances that warrant an equitable exception to the prior authorization requirement." Harbin, 486 F.3d at 522 (citing Atkins, 69 F.3d at 973).

Harbin amplifies Atkins' conclusion that although an order authorizing employment under § 327 is a prerequisite to awarding compensation under § 330, there is no requirement that compensated services must have been performed only after the effective date of an employment order. These circumstances distinguish Acevedo from circuit precedent, which means circuit precedent that recognizes the power to award pre-employment compensation remains unchanged by Acevedo.

C

Retroactive authority to compensate estate professionals under § 330 for services provided before employment is formally approved under § 327 also derives from federal rules of procedure without need for inherent power *nunc pro tunc* orders.

The concept of retroactive compensation is incorporated into the Federal Rules of Bankruptcy Procedure, as prescribed by the Supreme Court. Under Bankruptcy Rule 6003(a) an application for employment may not be approved within the first 21 days of a bankruptcy case, absent a need to avoid immediate and irreparable harm. Fed. R. Bankr. P. 6003(a).

The first 21 days of a chapter 11 case usually require significant postpetition professional services that will be

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advance[.]"); Jerrel v. Martinson (In re Jerrel), 24 F.3d 247, 1994 WL 171166 at *4 (9th Cir. May 5, 1994) ("Jerrel is correct that this circuit allows a bankruptcy court to award retroactive fees for services rendered without court approval.") (Table).

eligible for compensation under § 330 after employment is approved. This necessarily entails retroactive compensation for pre-employment services to avoid the absurdity of the need to find immediate and irreparable harm regarding employment in virtually every chapter 11 case. Bankruptcy Rule 6003(a) thus contemplates employment orders that provide for an effective retroactive date of compensation. See Fed. R. Bankr. P. 6003, Advisory Committee Note to 2011 Amendment.[3] Nothing in Acevedo suggests the Supreme Court intended to undermine the vitality of Bankruptcy Rule 6003(a).

II

The Ninth Circuit standard for an award of compensation under § 330 for pre-employment services is found in Okamoto v.

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[3]The Judicial Conference Advisory Committee on Bankruptcy Rules has clarified that a degree of retroactivity is implicit in Bankruptcy Rule 6003:

> The rule is amended to clarify that it limits the timing of the entry of certain orders, but does not prevent the court from providing an effective date for such an order that may relate back to the time of the filing of the application or motion, or to some other date. For example, while the rule prohibits, absent immediate and irreparable harm, the court from authorizing the employment of counsel during the first 21 days of a case, it does not prevent the court from providing in an order entered after expiration of the 21-day period that the relief requested in the motion or application is effective as of a date earlier than the issuance of the order. Nor does it prohibit the filing of an application or motion for relief prior to expiration of the 21-day period. Nothing in the rule prevents a professional from representing the trustee or a debtor in possession pending the approval of an application for the approval of the employment under Rule 2014.

Fed. R. Bankr. P. 6003, Advisory Committee Note to 2011 Amendment.

THC Fin. Corp. (In re THC Fin. Corp.), 837 F.2d 389 (9th Cir. 1988), and Atkins, 69 F.3d at 973-74. Notably, both are retroactive compensation and not *nunc pro tunc* employment cases.

In THC, Bankruptcy Rule 215, § 327's predecessor, required the court to approve a professional's employment in order for the professional to be compensated by the estate. THC, 837 F.2d at 391. At the request of the bankruptcy trustee, an attorney provided services to the estate over a four-year period without prior court approval of her employment. Id. at 390. The attorney then filed a fee application with the district court which the bankruptcy trustee opposed because the attorney had not sought prior approval of her employment. Id. Although the Ninth Circuit noted that the attorney's employment should have been approved before services were provided, it also concluded that the absence of prior approval did not necessarily preclude compensation, stating: "In this circuit, a retroactive award of fees for services rendered without court approval is not necessarily barred." Id. at 392. The court further noted that a court may exercise its discretion to compensate for valuable pre-employment services and it set the standard for such an award as follows: "[S]uch awards should be limited to exceptional circumstances where an applicant can show both a satisfactory explanation for the failure to receive prior judicial approval and that he or she has benefitted the bankrupt estate in some significant manner." Id.

Professionals who request retroactive compensation must also satisfy the criteria for employment pursuant to § 327, other than

the usual requirement of pre-employment approval. Atkins, 69 F.3d at 976.

Fee applicants bear the burden of proof in all such instances, and the ultimate decision is within the discretion of the court. See Neben & Starret v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d 877, 880-81 (9th Cir. 1995).

And of course, the length of the delay in seeking judicial approval of employment affects the analysis of extraordinary circumstances—the longer the delay, the more difficult to explain. Emergency services early in a case followed by prompt application for employment are better explanations than neglect and inattention. In re B.E.S. Concrete Products, Inc., 93 B.R. 228, 232 n.5 (Bankr. E.D. Cal. 1988).

III

Turning now to the chapter 7 trustee's application to employ Special Counsel in this case, the application references the THC standard to some degree. That reference permits the court to address whether the standard for awarding pre-employment compensation is satisfied in this case.

The court will grant the chapter 7 trustee's application to employ Special Counsel under § 327(e). However, the request for *nunc pro tunc* approval of employment effective March 3, 2013, will be denied. Special Counsel's employment under § 327(e) will be effective September 29, 2020, which is the application approval date.

The court will also allow the chapter 7 trustee to compensate Special Counsel under § 330 for the reasonable,

necessary, and beneficial services that Special Counsel provided to the trustee and the estate prior to approval of their employment. However, compensation is subject to the conditions explained below.

Special Counsel qualifies for employment under § 327(e) in that it is well-qualified to serve the estate in the capacity of the debtor's litigation counsel.

There also has been a plausible representation that the debtor "forgot" about her medical device claim when she filed bankruptcy. The debtor is an octogenarian. And communications from counsel in mass tort cases are oftentimes sparse. All of this is consistent with good faith.

Special Counsel's services have provided a tremendous benefit to creditors and the estate. Settlement of the debtor's medical device claim will result in full payment to all creditors, permit the debtor to realize an exemption, and provide the debtor with surplus funds. A very rare outcome in a chapter 7 case. Certainly under these circumstances no one can complain about prejudice from the lack of prior approval of Special Counsel's employment. Moreover, under these circumstances, the contingency fee compensation requested is reflective of a reasonable value of the services that Special Counsel provided to the estate prior to the approval of their employment. And it is permissible under § 328(a).

The chapter 7 trustee has also provided a satisfactory explanation for the delay in seeking the approval of Special Counsel's employment. The debtor did not initially schedule her

medical device claim so delay is measured from the time the case was reopened to administer the asset. That delay is approximately one year. Although not ideal, neglect in seeking Special Counsel's employment earlier is excusable.

The debtor's medical device claim was largely settled before the case was reopened. Special Counsel and the applicable contingency fee arrangement were also disclosed very shortly after the case was reopened. And during the months that followed the 2019 reopening and disclosure through mid-2020, the chapter 7 trustee worked with the litigation administrator to iron out details of the settlement and payment of the settlement award.

Further, although not relied on by the chapter 7 trustee, the court takes judicial notice that the COVID-19 pandemic struck shortly after the debtor's bankruptcy case was reopened and it continues to persist. The pandemic has resulted in a shutdown of most of the country with a significant number of individuals out of the office and subject to stay-at-home orders. As one court described the situation:

> Meanwhile, the world is in the midst of a global pandemic. The President has declared a national emergency. The Governor has issued a state-wide health emergency. As things stand, the government has forced all restaurants and bars [] to shut their doors, and the schools are closed, too. The government has encouraged everyone to stay home, to keep infections to a minimum and help contain the fast-developing public health emergency.

Art Ask Agency v. Individuals, Corporations, et al., 2020 WL 1427085 at *1 (N.D. Ill. March 18, 2020). The story in California is similar. See In re Dudley, 617 B.R. 149 (Bankr. E.D. Cal. 2020).

Conclusion

For the foregoing reasons, the chapter 7 trustee's application will be granted in part and denied in part.

The relief requested in the application will be granted as to Special Counsel's employment which shall be effective September 29, 2020, and as to compensation to Special Counsel in the amount of the contingency fee requested. Compensation to Special Counsel is conditioned on the requirement that the chapter 7 trustee and Special Counsel execute a contingency fee agreement substantially in the form of the contingency fee agreement between the debtor and Special Counsel which shall be signed by all parties and filed with the court. To be clear, there shall be no payment to Special Counsel (and no distribution of any settlement funds) unless and until the new contingency fee agreement is signed and filed.

The request for *nunc pro tunc* approval of Special Counsel's employment retroactive to March 3, 2013, will be denied.

A separate order will issue.

Dated: October 13, 2020.

UNITED STATES BANKRUPTCY JUDGE

INSTRUCTIONS TO CLERK OF COURT
SERVICE LIST

The Clerk of Court is instructed to send the attached document, via the BNC, to the following parties:

J. Russell Cunningham
1830 15th St
Sacramento CA 95811

Jason M. Blumberg
501 I St #7-500
Sacramento CA 95814

Gabriel E. Liberman
1545 River Park Drive, Ste 530
Sacramento CA 95815

RECOMMENDED FOR PUBLICATION

File Name: 20b0002p.06

BANKRUPTCY APPELLATE PANEL

OF THE SIXTH CIRCUIT

IN RE: GLENVIEW HEALTH CARE FACILITY, INC.,
Debtor.

BINGHAM GREENEBAUM DOLL LLP, The Proposed Counsel to the Unsecured Creditors' Committee,
Appellant,

v.

GLENVIEW HEALTH CARE FACILITY, INC.,
Appellee.

No. 19-8028

Appeal from the United States Bankruptcy Court
for the Western District of Kentucky at Bowling Green.
No. 1:19-bk-10795—Joan A. Lloyd, Judge.

Decided and Filed: November 6, 2020

Before: BUCHANAN, DALES, and MASHBURN, Bankruptcy Appellate Panel Judges.

COUNSEL

ON MERITS AND SUPPLEMENTAL BRIEFS: James R. Irving, April A. Wimberg, DENTONS BINGHAM GREENEBAUM LLP, Louisville, Kentucky, for Appellant. Mark H. Flener, LAW OFFICE OF MARK H. FLENER, Bowling Green, Kentucky, for Appellee.

OPINION

SCOTT W. DALES, Bankruptcy Appellate Panel Judge. The Official Committee of Unsecured Creditors of chapter 11 debtor Glenview Health Care Facility, Inc., retained a law

firm to represent it in connection with the case, the Debtor objected, and the bankruptcy court disqualified the law firm. After the Committee was disbanded, the disappointed law firm timely appealed from the disqualification order, arguing that the bankruptcy court abused its discretion in withholding its approval. We agree with the law firm and, expressing no opinion on whether the law firm should be appointed, we vacate the disqualification order and remand for further proceedings.

ISSUES ON APPEAL

The issue on appeal is whether the bankruptcy court erred in holding that Dentons Bingham Greenebaum LLP ("DBG")[1] could not represent the Committee due to lack of disinterestedness or disqualification under the Kentucky Rules of Professional Conduct for its prior representation of an insider.

JURISDICTION AND STANDARD OF REVIEW

Before reaching the merits of an appeal, the Panel is obligated to first ascertain its own jurisdiction. *BN1 Telecommunications, Inc. v. Lomaz* (*In re BN1 Telecommunications, Inc.*), 246 B.R. 845, 848 (B.A.P. 6th Cir. 2000) ("The Panel, like all federal courts, is obligated to determine its own subject matter jurisdiction."). To this end, after expressing doubts about the finality of the order under review and the justiciability of the appeal, the Panel requested additional briefing.

As previously indicated in the Order dated June 25, 2020, the confirmation of the Debtor's plan and the closing of its case removes all doubt about the finality of the order on appeal. With respect to earlier doubts about justiciability, specifically concerns about mootness and standing stemming from the dissolution of the Committee before the perfection of this appeal, the parties' responses to the Order dated June 25, 2020 sufficiently addressed the concerns. While there can be no doubt that the dissolution of the Committee on December 26, 2019 rendered moot any ruling regarding employment after that date, the Panel is satisfied that the "collateral consequences" of the bankruptcy court's retention order on the Appellant's ability

[1]The firm was known as Bingham Greenebaum Doll, LLP when the Committee sought approval for retention, but the Panel will refer to the firm by its current name throughout this opinion.

to seek compensation for pre-dissolution work under § 330 supply a sufficient "case or controversy" to warrant appellate review under Article III of the Constitution. *See Michel v. Federated Dep't Stores* (*In re Federated Dep't Stores*), 44 F.3d 1310, 1315–16 (6th Cir. 1995). Likewise, the Appellant has an obvious pecuniary interest in pursuing the appeal, sufficient to permit the Panel to recognize Article III standing. Finally, any possible quarrel with the Appellant's *de facto* substitution for the Committee in pursuing the *Committee's* application under Federal Rule of Bankruptcy Procedure 2014(a) would arise from a non-jurisdictional defect[2] that has apparently been waived. *See Hood v. Tennessee Student Assistance Corp.* (*In re Hood*), 319 F.3d 755, 760 (6th Cir. 2003) *aff'd and remanded sub nom*. *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 124 S. Ct. 1905 (2004) ("It is well-settled that this court will not consider arguments raised for the first time on appeal unless our failure to consider the issue will result in a plain miscarriage of justice.") (citations omitted).

The Panel reviews the bankruptcy court's order denying the Committee's application for approval of counsel's employment for an abuse of discretion. *See Federated Dep't Stores, Inc*., 44 F.3d at 1315 (citations omitted). "An abuse of discretion occurs when the bankruptcy court relies upon clearly erroneous findings of fact, improperly applies the law, or uses an erroneous legal standard." *Nischwitz v. Miskovic* (*In re Airspect Air, Inc.*), 385 F.3d 915, 920 (6th Cir. 2004).

FACTS

Glenview Health Care Facility, Inc. ("Debtor") operated a sixty-bed nursing home facility located in Glasgow, Kentucky. Kay Bush and Lisa Howlett have jointly owned the Debtor, in equal shares, for over 30 years. On August 1, 2019, Debtor filed a voluntary chapter 11 bankruptcy petition. The Official Creditors Committee was formed around August 30, 2019. On September 5, 2019, DBG filed notices of appearance in the case. The Committee filed an application to retain DBG on September 25, 2019.

[2]Although "[a]n order approving the employment of attorneys . . . pursuant to . . . § 1103 . . . of the Code shall be made only on application of the … committee," Fed. R. Bankr. P. 2014(a), courts have treated the requirement flexibly. *See, e.g., Mehdipour v. Marcus & Millichap (In re Mehdipour)*, 202 B.R. 474 (B.A.P. 9th Cir. 1996). And, as with other procedural rules, Rule 2014(a) does not extend or limit jurisdiction. Fed. R. Bankr. P. 9030; *Kontrick v. Ryan*, 540 U.S. 443, 453, 124 S. Ct. 906, 914 (2004).

The Committee's application included a declaration from David Irving, managing partner of DBG, disclosing potential conflicts (the "Irving Declaration"). (Application, Ex. A., Case No. 19-10795 ECF No. 52-1, Sept. 25, 2019.)[3] The Irving Declaration stated:

> [DBG] has previously represented Lisa Howlett in estate planning matters which pre-date and are unrelated to the Chapter 11 case. [DBG's] representation of Ms. Howlett concluded in 2017. Out of an abundance of caution, the professionals who represented Ms. Howlett will not represent the Committee.

(Irving Declaration, ECF No. 52-1, at 4, ¶ 5(d).)

On October 16, 2019, the Debtor filed an objection to the employment of DBG, although Ms. Howlett did not. (ECF. No. 62.) The Debtor asserted that DBG "was more directly involved with Glenview Heath Care Facility, Inc. Specifically, [DBG] assisted Glenview and Lisa Howlett with the preparation of a buy-sell agreement for the purchase and sale of Glenview and all its assets." (*Id*.) Debtor attached an invoice from DBG for the period April 19, 2016 through June 10, 2016 showing that DBG provided estate planning advice for Lisa Howlett, one of the Debtor's two 50% shareholders. The invoice includes several entries regarding a buy-sell agreement for Glenview Health. Through the Committee's reply, DBG asserted that no buy-sell agreement was consummated, and that the representation related only to estate planning.

The bankruptcy court heard arguments on the matter on November 21, 2019 but did not conduct an evidentiary hearing. The attorney for Debtor asserted that Ms. Howlett felt that DBG's prior representation of her should disqualify DBG; again, however, Ms. Howlett did not file her own objection. On December 17, 2019, the bankruptcy court entered a memorandum opinion and order denying the Committee's application to employ DBG ("Opinion"). (Op., ECF No. 94 at 8.) After the bankruptcy court rendered its Opinion but before the deadline for appealing, the Committee dissolved, evidently for reasons unrelated to the Opinion. DBG picked up the baton and filed this appeal within 14 days after entry of the Opinion.

[3]All ECF citations are to the Debtor's bankruptcy case, 19-10795, unless stated otherwise.

DISCUSSION

I. 11 U.S.C. § 1103

The bankruptcy court began its analysis by citing 11 U.S.C. § 1103,[4] which provides that "[a]n attorney or accountant employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case." (Op. at 3 citing 11 U.S.C. § 1103(b).) The court noted that "[h]ere, the alleged conflicting representation occurred three years prior to the initiation of the case currently before the Court." (*Id.*) Further, the bankruptcy court acknowledged that "[w]hile the burden of proof in seeking disqualification of opposing counsel is on the party seeking disqualification, a professional seeking appointment under § 327 bears the initial burden of proof that they meet all qualifications of the statute in order to obtain the appointment." (*Id*. at 3–4.)

DBG asserts that it meets the requirements for employment contained in § 1103 because it did not represent Ms. Howlett while employed by the Committee. Further, DBG argues that "[s]ection 1103(b) is the only statutory provision that concerns the committee's right to select counsel." (Appellant Br. at 10, BAP ECF No. 14, quoting *In re Enron Corp*., No. 01-16034 (AJG), 2002 WL 32034346, at *6 (Bankr. S.D.N.Y. May 23, 2002).) DBG argues, based on the text of § 1103, that proposed committee counsel should not be disqualified for its prior representation of a party holding an adverse interest so long as that representation has concluded prior to its appointment. (*Id*. at 11 citing *Exco Resources, Inc. v. Milbank, Tweed, Hadley & McCloy LLP* (*In re Enron Corp*.), No. 02-CIV. 5638 (BSJ), 2003 WL 223455, at *7 (Bankr. S.D.N.Y., Feb. 3, 2003).)

In its brief, Debtor acknowledges that "Section 1103, unlike Section 327(a) lacks the disinterested requirement; however, the section of the Code governing actual payment to employed professionals does impose a disinterested requirement." (Appellee Br. at 11, BAP ECF No. 16.) Debtor does not assert that DBG concurrently represented the Committee and a party with an adverse interest. Likewise, the bankruptcy court did not make such a finding.

[4]All code sections refer to the Bankruptcy Code, 11 U.S.C. § 101, et seq., unless otherwise stated.

Probably reflecting the different duties of representatives for committees and estate fiduciaries, the Bankruptcy Code provides different standards for the employment of the respective professionals. *Compare* 11 U.S.C. § 327(a) (authorizing a trustee or debtor-in-possession to employ professionals "that do not hold or represent an interest adverse to the estate, and that are disinterested persons"), *with* § 1103(b) (forbidding a committee's attorney "while employed by such committee, [to] represent any other entity having an adverse interest in connection with the case"). Because every trustee must be a "disinterested person,"[5] it makes sense that the trustee's court-approved agents must be disinterested, too. A creditor, however, can never qualify as a "disinterested person" under the Bankruptcy Code so it comes as no surprise, as the statute recognizes, that a professional who represents a group of creditors (the committee) need not qualify as a disinterested person, either. Indeed, unlike a trustee, a creditor's committee is, by design, a "partisan representative," not a detached fiduciary. *In re National Liquidators, Inc.*, 182 B.R. 186, 191 (S.D. Ohio 1995).

Recognizing this distinction as reflected in the text of § 1103, other courts have held that a law firm's prior employment, if ended, will not preclude representation of a creditors' committee:

> Prior representations, even if adverse to the interests of the committee or unsecured creditors, do not disqualify committee counsel. *See, e.g.*, *In re Enron Corp*., No. 02 Civ. 5638 (BSJ), 2003 WL 223455, *6–7 (S.D.N.Y. Feb. 3, 2003) (finding committee counsel did not hold an adverse interest because it had previously represented debtor-related entities and stating that the "argument under § 1103 fails because [counsel's] alleged adverse interests . . . predated [counsel's] representation of the committee"); *In re Diva Jewelry Design, Inc*., 367 B.R. 463, 473–74 (Bankr. S.D.N.Y. 2007) (finding that discussions that proposed trustee's counsel had with creditors regarding their possible consignment claims prior to retention by trustee did not disqualify counsel from employment); [*In re*] *Nat'l Century Fin*., 298 B.R. at 118 [(Bankr. S.D. Ohio 2003] (finding firm not disqualified from representing committee although it had previously represented the debtor in a discreet matter that ended before bankruptcy).

In re Universal Bldg. Prod., 486 B.R. 650, 662–63 (Bankr. D. Del. 2010).

[5] *See* 11 U.S.C. § 101(14) (defining "disinterested person"); § 1104(d) (United States Trustee may appoint "one disinterested person" to serve as trustee).

It is true, as the bankruptcy court implied, that § 328(c) permits a court to deny a committee professional's compensation "if, at any time during such professional person's employment under section . . . 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed," but DBG was not seeking compensation. Instead, its client (the Committee) was seeking approval of its choice of counsel. Although the Panel does not fault the bankruptcy court for forecasting its concerns about DBG's ultimate right to compensation,[6] it erred by withholding its approval of DBG as committee counsel under § 1103 by engrafting into that statute the term "disinterested person" where it nowhere appears.[7] The bankruptcy court's Opinion simply conflates § 1103 with § 327 and proceeds as if § 1103 contains the same disinterestedness requirement. It does not, and this misapplication of § 1103 reflects an abuse of discretion.

II. Kentucky Rule of Professional Conduct 1.9

In withholding approval of DBG's employment, the bankruptcy court apparently read the Debtor's objection to DBG's employment as, in effect, a motion to disqualify counsel, and relied on Kentucky Rule of Professional Conduct 1.9, which governs disqualification and discusses duties to former clients.[8]

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[6]The bankruptcy court suggested its concerns this way at the hearing: "if I'm wrong . . . in a way of letting you spend out a big bill, . . . if I am wrong at the get go on your conflict, and you rely upon that, and I end up, I am overturned at some point in the future, you bear the burden of that, not me." (Nov. 21, 2019 Hr'g Tr. 11:14–20, ECF No. 131.)

[7]The Panel is not suggesting that DBG's prior and concluded representation of Ms. Howlett necessarily licenses the bankruptcy court to deny compensation for lack of disinterestedness if or when the firm eventually files its fee application, because the term "disinterested person" is defined in the present tense, and DBG reportedly represented Ms. Howlett in the past. "Congress' use of a verb tense is significant in construing statutes," *United States v. Wilson*, 503 U.S. 329, 333, 112 S. Ct. 1351, 1354 (1992), including the Bankruptcy Code as the Sixth Circuit recently demonstrated in a different context. *Cf. Coslow v. Reisz*, 811 F. App'x 980, 984 (6th Cir. 2020) ("In fact, the abandonment section uses the present tense when discussing abandonment of valueless property."). Just as the issue of compensation and disinterestedness was not properly before the bankruptcy court, it is not before the Panel.

[8]Kentucky Supreme Court Rule 3.130 comprises the Kentucky Rules of Professional Conduct ("KRPC"). For convenience, however, the Panel will refer to Kentucky Supreme Court Rule 3.130(1.9) (Duties to Former Clients) as "KRPC 1.9," and Kentucky Supreme Court Rule 3.130(1.10) (Imputation of Conflicts of Interests: General Rule) as "KRPC 1.10."

Although it did not provide a complete explanation for applying the KRPC in bankruptcy proceedings, the bankruptcy court cited a case from the United States District Court for the Western District of Kentucky holding that "[a]ttorneys that practice in the Western District of Kentucky must follow the standards set forth in the Rules for Professional Conduct as adopted by the Kentucky Supreme Court." *Encore Energy, Inc. v. Morris Kentucky Wells, LLC*, No. 118CV00180GNSHBB, 2019 WL 2011062, at *1 (W.D. Ky. May 7, 2019) (citing *Harper v. Everson*, 2016 WL 9149652 at *3 (W.D. Ky. 2016); *See* 6th Cir. R. 46(b); LR 83.1, 83.2, 83.3; Ky. Sup. Ct. R. 3.130).

Likewise, other courts within the Sixth Circuit have acknowledged the role that state ethics rules can play in disqualification disputes. *See El Camino Res., Ltd. v. Huntington Nat'l Bank*, 623 F. Supp. 2d 863, 876 (W.D. Mich. 2007) ("Ethical rules involving attorneys practicing in the federal courts are ultimately questions of federal law. The federal courts, however, are entitled to look to the state rules of professional conduct for guidance."); *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Alticor, Inc*., 466 F.3d 456, 457–58 (6th Cir. 2006), *vacated in part on other grounds*, 472 F.3d 436 (6th Cir. 2007) (applying Michigan Rules of Professional Conduct)). *See also In re Ralph Roberts Realty, LLC*, 500 B.R. 862, 864 (Bankr E.D. Mich. 2013) (quoting *El Camino* for same). Indeed, the Sixth Circuit itself has held that KRPC 1.9 adopts essentially the same test for disqualification as prescribed by the Sixth Circuit in *Dana Corp*. *Bowers v. Ophthalmology Grp*., 733 F.3d 647, 651 (6th Cir. 2013) ("the effect of using the Kentucky Rules of Professional Conduct in place of or in conjunction with our *Dana* analysis is minimal at best because the relevant Kentucky Rule is essentially the same").

Because § 1103 requires the bankruptcy court's approval for employment of committee counsel, it is perfectly appropriate for the bankruptcy court to consider state rules governing the professional responsibility of an attorney to the extent adopted by the federal court and put in issue by the parties. Section 1103 addresses the employment of one or more "attorneys," a term the Bankruptcy Code defines by reference to the authorization to practice law under "applicable law." 11 U.S.C. § 101(4). Although the laws of Kentucky did not make the Kentucky Rules of Professional Conduct applicable in bankruptcy court, the Western District of Kentucky certainly did. LR 83.3(c) (W.D. Ky.). *In re Snyder*, 472 U.S. 634, 645 n.6, 105 S. Ct 2874, 2881 n.6

(1985) ("The state code of professional responsibility does not by its own terms apply to sanctions in the federal courts. Federal courts admit and suspend attorneys as an exercise of their inherent power; the standards imposed are a matter of federal law.").

The bankruptcy court's reliance on state laws governing attorney ethics should come as no surprise to DBG given the Bankruptcy Code's express reference to "applicable law" in defining and, thus, determining who may be employed as an "attorney." More generally, incorporation of state law as a federal rule of decision in this area is sensible given the states' traditional hegemony over the regulation of the attorney-client relationship and the fact that "[t]he uniform first step for admission to any federal court is admission to a state court." *Snyder*, 472 U.S. at 645 n. 6, 105 S. Ct at 2881 n.6; *see also* LR 83.1(a) (W.D. Ky.) (requiring membership in Kentucky bar as condition of admission to federal bar) and LR 83.2(a)(3) (attorneys who seek admission *pro hac vice* must consent "to be subject to the jurisdiction and rules of the Kentucky Supreme Court governing professional conduct"). It would be anomalous for a bankruptcy court to approve the employment of an attorney to represent a committee in the bankruptcy court if that attorney were not permitted to practice in that same tribunal.

The Panel finds that the bankruptcy court properly looked to the Kentucky Rules for guidance in exercising its discretion to approve DBG's employment, or not, under § 1103(b), after the Debtor challenged DBG's qualifications on state law grounds. Whether the bankruptcy court abused its discretion in applying KRPC 1.9, however, requires a separate analysis.

As noted above, the bankruptcy court relied largely on KRPC 1.9 governing conflicts of interest between an attorney and a former client, and the remedies available to the former client. That rule states in relevant part:

> A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

KRPC 1.9(a). The bankruptcy court also cited the Sixth Circuit's three-part test for determining whether grounds for disqualification exist, which as it noted, tracks Rule 1.9. (Op. at 4–5 citing

Dana Corp. v. Blue Cross & Blue Shield Mut. of N. Ohio, 900 F.2d 882, 889 (6th Cir.1990).) In *Dana Corp*., the Sixth Circuit articulated the following test for disqualification:

> (1) a past attorney-client relationship existed between the party seeking disqualification and the attorney it seeks to disqualify; (2) the subject matter of those relationships was/is substantially related; and (3) the attorney acquired confidential information from the party seeking disqualification.

Dana Corp., 900 F.2d at 889 (citing *City of Cleveland v. Cleveland Elec. Illuminating*, 440 F. Supp. 193, 207 (N.D. Ohio 1976), *aff'd*, 573 F.2d 1310 (6th Cir. 1977), *cert. denied*, 435 U.S. 996, 98 S. Ct. 1648 (1978)).

A. Prior Relationship

Regarding the first prong of the test under *Dana Corp.* and KRPC 1.9, the bankruptcy court found: "Here it is clear that an attorney-client relationship previously existed between Ms. Howlett, an insider of the Debtor, and [DBG]." (Op. at 5.) The bankruptcy court did not delve into this prong any further. While Ms. Howlett is the party who had a prior relationship with DBG, she is not the party who sought disqualification; rather, the Debtor filed the objection to DBG's employment. Courts are generally split on whether non-clients have standing to seek opposing counsel's disqualification, though many recognize standing upon a non-client's showing of particular injury. *See Ambush v. Engelberg*, 282 F. Supp. 3d 58, 63–64 (D.D.C. 2017) (collecting cases). The non-client's particular injury in this case is assumed rather than established. Relatedly, neither the bankruptcy court nor Debtor have cited any authority for the bankruptcy court's seeming inference that under the circumstances Ms. Howlett and the Debtor are the same party. The bankruptcy court concluded that "[h]ere, the client does not consent and objects to the representation." (Op. at 4.) This statement, however, is without factual support: the former client, Lisa Howlett, did not file an objection to DBG's employment, nor did she file any sort of affidavit. The only support for the finding that she objected is the Debtor's attorney's statement to that effect during the hearing and in briefing.[9]

[9]Ironically, if Debtor's counsel were doing the insider's bidding, counsel's disinterestedness might itself be an issue.

Under state and federal law, a client's choice of counsel, even in a civil matter, merits respect and deference from the court. *Marcum v. Scorsone*, 457 S.W.3d 710, 718 (Ky. 2015) (because a litigant has a right to counsel of his or her choice, counsel should not be disqualified merely for an appearance of impropriety); *Manning v. Waring, Cox, James, Sklar & Allen*, 849 F.2d 222, 224 (6th Cir. 1988) (While motions to disqualify are legitimate and necessary to protect the integrity of judicial proceedings and the ethics of the bar, they can also be abused as a "potent weapon" providing the "ability to deny one's opponent the services of capable counsel"); *Official Unsecured Creditors Comm. of Valley-Vulcan Mold Co. v. Ampco-Pittsburgh Corp.* (*In re Valley-Vulcan Mold Co.*), 237 B.R. 322, 337 (B.A.P. 6th Cir. 1999) ("[T]he party seeking disqualification must carry a 'heavy burden' and must meet a 'high standard of proof' before a lawyer is disqualified," because "[a]lthough a party has no right to specific counsel, 'a party's choice of counsel is entitled to substantial deference.'"), *aff'd*, 5 F. App'x 396 (6th Cir. 2001). Given Debtor's burden of proof, and the interests at stake, the mere assertion by Debtor's attorney that a third party (insider Lisa Howlett) objects to DBG's representation of the Committee is not sufficient evidence, even assuming she did. *Cf. Marcum*, 457 S.W.3d at 718 (under Kentucky Rules, trial courts must hold evidentiary hearings to resolve disqualification questions).

B. Subject Matter

The second prong of the test under *Dana Corp.* and KRPC 1.9 requires the court to determine if the subject matter of the two representations is substantially related. For this part of the test, the bankruptcy court consulted the official commentary to the KRPC, which states, "matters are substantially related . . . if they involve the same transaction or legal dispute or if there is otherwise a substantial risk that confidential factual information as would have normally been obtained in the prior representation would materially advance the client's position in the subsequent matter." (Op. at 5 citing KRPC 1.9 (cmt 3).) The bankruptcy court noted that "[t]here is no need of a commonality of legal claims or issues." (*Id*.) Rather, "[t]he court must determine the type of information [to which] the potentially conflicted attorney would have been exposed[.]" (*Id*. citing *Bowers*, 733 F.3d at 652; KRPC 1.9 (cmt 3).)

The bankruptcy court held that the type of information that DBG would have had access to while conducting estate planning, including the preparation of a buy-sell agreement affecting Ms. Howlett's interest in the Debtor, would include "information about Debtor and its assets and business practices[.]" (Op. at 6.) The bankruptcy court determined that this would include confidential information "related to the confirmation issues that typically involve detailed and proprietary information of Debtor." (*Id*.) Neither Debtor nor the bankruptcy court, however, gave any examples of what proprietary information might be at stake. Moreover, the bankruptcy court did not explain why Debtor would not be required to fully disclose this type of information as part of the chapter 11 bankruptcy process in any event. It is fair to say that the bankruptcy court's conclusions on the "subject matter" aspect of KRPC 1.9, based on argument and inference rather than evidence, fall short of the strong showing required, again given the interests at stake in any disqualification controversy.

C. Confidential Information

The bankruptcy court speculated that Glenview Health Care Facility's chapter 11 reorganization and confirmation of a new business plan using the same or substantially similar assets, with the same management and funding, "is not so different than what [DBG] tried to accomplish in 2016." (Op. at 7.) The Irving Declaration,[10] which stated that the services provided to Ms. Howlett were for estate planning and tax guidance, contradicts this conclusion. Debtor's exhibits reference a buy-sell agreement but do not provide any level of detail or explanation as to what the proposed agreement entailed. Those invoices do not contradict the Irving Declaration. Nor has anyone contradicted DBG's assertion that a buy-sell agreement was not consummated. Moreover, Debtor did not provide an affidavit or testimony from Lisa Howlett to contradict DBG's assertion that its prior representation of her created no conflict of interest.

[10]The Irving Declaration was the only testimonial evidence considered in connection with the contested matter, even though the bankruptcy court clearly considered "facts outside the record." *See* Fed. R. Civ. P. 43(c), applicable by Fed. R. Bankr. P. 9017 ("When a motion relies on facts outside the record, the court may hear the matter on affidavits or may hear it wholly or partly on oral testimony or on depositions.").

The Committee met its initial burden of showing that DBG was eligible for employment pursuant to § 1103 because the firm did not represent an adverse party concurrently. When the Debtor objected to DBG's employment under KRPC 1.9, it bore the burden of proving that DBG was not eligible. The Debtor has not carried that burden. Rather, the bankruptcy court relied on assumptions regarding the possibility of confidential information and a false equivalency between the Debtor and its insider.

A potential conflict alone does not mandate disqualification of counsel for the Committee. *In re Universal Bldg. Prod.*, 486 B.R. at 662 (citing *In re First Jersey Secs., Inc*., 180 F.3d 504, 509 (3d Cir. 1999) (stating that the Bankruptcy Code "mandates disqualification when there is an actual conflict, allows for it when there is a potential conflict, and precludes it based solely on an appearance of a conflict.")). As the Kentucky Supreme Court observed when rejecting the appearance of a conflict as a basis for disqualification:

> Disqualification under that standard is "little more than a question of subjective judgment by the former client." SCR 3.130–1.9 Sup. Ct. Cmt. 5. In essence, all the former client has to do is claim discomfort with the subsequent representation to create the appearance that something untoward is going on and thus that there is an appearance of impropriety. Moreover, "since 'impropriety' is undefined, the term 'appearance of impropriety' is question-begging." *Id*. Even if impropriety is the same as an actual conflict, there should be something more substantive than just a possible conflict before disqualification takes place.

Marcum, 457 S.W.3d at 717. Here, the bankruptcy court disqualified DBG not based on an actual conflict at the behest of a former client, but on a potential conflict at the behest of a company in which the former client had a 50% equity stake, and did so on a thin record.

III. Kentucky Rule of Professional Conduct 1.10

DBG contends that the bankruptcy court compounded its error by failing to consider an exception to disqualification available under the Kentucky Rules of Professional Conduct, asserting that most of the attorneys who had represented Ms. Howlett were no longer with the firm, and that any remaining attorneys would be "walled off." The bankruptcy court rejected the suggestion that screening off the attorneys would resolve the possible conflict.

The bankruptcy court cited the "rule of imputed disqualification" which charges all lawyers with the conflicts of their colleagues within a firm. The bankruptcy court noted that the rule presumes that confidential information about clients is shared or generally available to all lawyers in a firm. Accordingly, the bankruptcy court held that "[t]he screening procedures proposed by [DBG] with respect to its attorneys who formerly represented M[s]. Howlett are insufficient to overcome this presumption of shared confidences." (Op. at 7.)

DBG asserts that the bankruptcy court erred by failing to consider the applicable exception found in Kentucky Rule of Professional Conduct 1.10(d), which states:

> (d) A firm is not disqualified from representation of a client if the only basis for disqualification is representation of a former client by a lawyer presently associated with the firm, sufficient to cause that lawyer to be disqualified pursuant to Rule 1.9 and:
>
> (1) the disqualified lawyer is screened from any participation in the matter and is apportioned no specific part of the fee therefrom; and
>
> (2) written notice is given to the former client.

KRPC 1.10. DBG asserts that none of the attorneys who previously represented Ms. Howlett was in the Bankruptcy & Restructuring Practice Group, and that given the firm's size it is able to screen the attorneys who did work with Ms. Howlett on her estate planning from involvement in the bankruptcy case. DBG submitted an affidavit to this effect, which no one refuted. Moreover, DBG contends that the bankruptcy court did not articulate a reason why Rule 1.10(d) is not applicable in the present case. The Panel agrees that the bankruptcy court should address the issue on remand.

The bankruptcy court gave no substantial reason for not applying KRPC 1.10 under the circumstances. Indeed, the rule directly addresses, and rejects, the imputed disqualification upon which the bankruptcy court premised its decision to disqualify DBG. The court erred in not applying the rule or justifying its failure to do so.

CONCLUSION

The Panel appreciates the bankruptcy court's desire to foreshadow its concerns about DBG's risk of spending time on the case only to be denied compensation for lack of disinterestedness, and understands the desire to economize by limiting the expense and delay of protracted hearings on an employment issue collateral to the main reorganization proceedings. The task of balancing scarce resources and important interests—a staple of a bankruptcy judge's steady diet—is never easy.

Nevertheless, both state and federal courts jealously guard the attorney-client relationship and that solicitude extends to a committee's choice of counsel in bankruptcy. When the bankruptcy court countermanded that choice based on an erroneous application of the law and an inadequate record, it abused its discretion under § 1103. Accordingly, the Panel will VACATE the bankruptcy court's Order Denying the Committee's Application to Retain and Employ Bingham Greenebaum Doll LLP as Counsel and REMAND the matter for further proceedings consistent with today's decision.