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1

Ethical Issues in Bankruptcy Law Practice

2

Conflict of Interests:

- Non § 327(a) conflicts
- § 327(a) conflicts

3

Non § 327(a) conflicts

4

Akagi v. Turin Hous. Dev. Fund Co.,
2017 U.S. Dist. LEXIS 41321

Decided on March 22, 2017,

District Court for the Southern District of New York

5

Facts:

- Plaintiff John Sohei Akagi brought a housing discrimination action against Defendants Turin Housing Development Fund, Co., Inc. (Turin"), a housing co-operative that owned the building and Douglas Elliman its managing agents and employees ("DE").
- Co-defendants Turin and DE were represented by counsel Adam Leitman Bailey, P.C. ("ALB")

6

- Subsequently, Turin represented by ALB, sued DE in another action in New York Supreme Court.
- Plaintiff filed a motion to disqualify ALB.
- ALB filed an opposition on behalf of Turin and moved to withdraw from representing DE as counsel. Court granted the motion to withdraw as counsel.
- DE then retained new counsel and joined Plaintiff's motion to disqualify.

7

<u>Arguments:</u>

- Plaintiff and DE defendants argued that ALB conflicted itself out of the lawsuit when it decided to sue DE in state court. As such, ALB should be disqualified from representing any defendant in the Federal Action.
- ALB argued that DE defendants entered into a Joint Defense Agreement (JDA) which cured ABA's conflict through informed consent.
- Specifically, ALB argued that DE waived their rights to object to the conflicts when they executed the Join Defense Agreement (JDA).

8

Resolving a disqualification motion requires a "painstaking analysis of the facts of a case."

9

Court's two-step approach to deal with the disqualifying motion:

1. Recount relevant facts affecting the motion to disqualify:
   - Review terms of the JDA entered between Turin, DE and ALB's predecessor.
   - Explain how ALB came to represent both Turin and DE.
   - Review the complaint filed in the State Court Action that triggered the disqualification motion.
2. Review procedural history of the disqualification motion:
   - Focus on arguments raised in parties' briefs.
   - Address ALB's motion to withdraw as DE's counsel.

10

Facts relevant to the Plaintiff's disqualification motion.

11

Terms of the Joint Defense Agreement

- ALB's predecessor Schneider Mitola represented both Turin and DE and Mitola, Turin and DE entered into the JDA.
- JDA provided for sharing cost and also that the parties may be required to share confidential information relevant to the action.
- JDA provided that confidential information will remain privileged and protected communication among the parties and that information from one party to another party may be used by counsel in connection with the litigation.

12

- JDA provided for a waiver of conflicts.
- JDA referred to potential or actual conflicts between the parties but provided no explanation about these.
- JDA provides for non-waivable conflicts indicating that the DE defendants would get new counsel at the expense of Turin but did not define what kind of non-waivable conflict would trigger this provision.
- Parties to share confidential information.
- JDA spelled out that new counsel owed equal duty of loyalty and that the law firm cannot withhold relevant information from party at party's request.

13

ALB's involvement:

- ALB was substituted as counsel for both Turin and DE in the Federal Court Action upon ALB's filing of a consent to change attorneys form on behalf of Turin and DE.
- ALB filed submissions on behalf of both Turin and DE.

14

Turin's State-Court Complaint Against DE:

- ALB on behalf of DE filed the State Court Action complaint raining a number of claims including the claims that arose out of the Federal Action.
- Turin alleged that DE intentionally, knowingly, recklessly and/or negligently mismanaged the property that DE failed to procure insurance coverage for Turin with respect to the Federal Court matter.
- Referring to the Federal Court Action, Turin alleged that DE failed to implement affirmative fair marketing warehousing schemes.

15

Plaintiff's disqualification motion.

16

- In his disqualification motion, Plaintiff urged the Court to disqualify ALB from representing both groups of defendants i.e. Turin and DE.
- By suing DE on Turin's behalf, Plaintiff argued, ALB concurrently represented two adverse clients.
- Plaintiff also argued that ALB's concurrent representation of Turin and DE violated multiple New York Rules of Professional Conduct, including Rule 1.7, which concerns concurrent representations.

17

- DE did not consent to concurrent representation in the state court action. So ALB moved to withdraw from representing the DE defendants in both actions.

18

Issue 1:

Whether ALB's concurrent representation of Turin and DE is *prima facie* improper.

19

New York Rules of Professional Conduct
RULE 1.7
CONFLICT OF INTEREST: CURRENT CLIENTS

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

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

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

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

20

American Bar Association Rules:

Rule 1.7: Conflict of Interest: Current Clients

Client-Lawyer Relationship
(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

21

American Bar Association Rules:

Rule 1.7: Conflict of Interest: Current Clients

Client-Lawyer Relationship

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

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

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(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

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22

NY Rules are modeled based on the ABA Rules.

The New York Rules use the words "*differing interests*" while the ABA Rules use the words "*directly adverse*".

The New York Rules mention the words "*significant risk that the lawyer's professional judgment …will be affected*" while the ABA Rules mention "*significant risk that the representation of one or more clients will be materially limited*."

23

Concurrent representation vs. successive representation

24

As of April 1, 2009, New York courts have followed the New York Rules of Professional Conduct, not the Canons of the Code of Professional Responsibility.

25

The Second Circuit's canonical concurrent-representation case — *Cinema 5, Ltd. v. Cinerama, Inc*., 528 F.2d 1384 (2d Cir. 1976) — analyzed this type of conflict under then-governing Canon 5.

26

Canon 5 has been reconstituted as Rule 1.7 of the New York Rules of Professional Conduct.

27

The Court observed that the attorney should be disqualified where the attorney's conflict of interest undermines duty of loyalty to a client or the attorney can use privileged information concerning the other side through a prior representation of the other side.

28

These two types of conflicts correspond with concurrent representation conflicts where an attorney simultaneously represents two adverse parties and successive conflicts which occur when an attorney represents a client whose interests are adverse to those of a "former client."

These two types of conflicts are different and have different standards.

29

Rules of Professional Conduct provide guidance but are not binding.

30

To determine whether an attorney's conflict of interest is concurrent or successive the court must look to the status of the relation at the time when the conflict arises.

This avoids attorneys with concurrent representations simply dumping their clients like a "**hot potato**."

31

Hot potato termination transforms a relationship to client abandonment.

32

Successive adversary representation may but not necessarily disqualify an attorney.

33

In contrast, concurrently representing adverse parties is *prima facie* improper.

34

The attorney can rebut the *prima facie* case by showing there will be no actual or apparent conflict of loyalty.

The burden of proof is on the attorney opposing disqualification and will rarely be met.

35

Why did ALB need to withdraw from representing Turin when it had already withdrawn from representing DE?

Answer: The adverse interests of Turin and DE in the federal action.

36

Turin is blaming DE for being sued in the Federal Court Action and the complaint of Turin against DE even though represented by a different lawyer, now is essentially a cross claim.

ALB cannot represent both cross-claim plaintiff and the cross-claim defendant in a single action.

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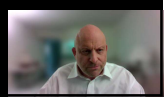
Again, it's relevant that ALB withdrew from representing DE in the State Court Action since the court must analyze this at the time when the conflict arises.



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The Federal Court could have determined that DE negligently violated HUD regulations.

The New York State Court could give effect to that holding.

39

Turin had a financial incentive to ensure that DE loses in State Court and recover new legal fees unless there was negligence.

ALB represented both Turin and DE at that time.

Therefore, ALB's representation of both Turin and DE are improper.

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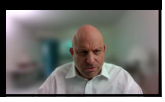
Issue 2:

Whether the conflict arising out of the concurrent representation of Turin and DE was cured by JDA?



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42

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(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

43

Court found that the JDA did not confirm that DE defendants knowingly waived or cured the ALB's conflict through informed consent.

Also JDA did not diminish a *prima facie* case for disqualifying ALB.

44

Concurrent representation conflicts can be waived by informed consent.

45

Comment 18 to New York Rule of Professional Conduct 1.7 defines "informed consent," in relenant part, as follows:

Informed consent requires that each affected client be aware of the relevant circumstances, including the material and reasonably foreseeable ways that the conflict could adversely affect the interests of that client. ... When representation of multiple clients in a single matter is undertaken, the information must include the implications of the common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege, and the advantages and risks involved.

N.Y. R. Prof'l Conduct 1.7 cmt. 18.

46

Court can conclude that belief and reasonableness could be wrong.

47

In New York, informed written consent, standing alone, does not cure an attorney's concurrent-representation conflict of interest: interest could adversely affect the other, a court may conclude that such a belief would not be reasonable.

Put another way: Client consent that is given is not valid if the objective test of a disinterested lawyer is not met.

Even when both affected clients have provided affidavits stating that each has been fully informed by counsel of the implications of the simultaneous representation, and each consents, New York law also requires a belief under a reasonable lawyer standard that the attorney will be able to provide competent and diligent representation to each affected client.

48

New York Rule of Professional Conduct 1.7(b) reflects the view that an attorney who wishes to represent concurrently two adverse parties needs more than those parties' informed consent. It provides:

Notwithstanding the existence of a concurrent conflict of interest ..., a lawyer may represent a client if:

[i] the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

[ii] the representation is not prohibited by law;

[iii] the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

[iv] each affected client gives informed consent, confirm

N.Y. R. Prof'l Conduct 1.7(b)

49

Where there is a concurrent representation conflict, not a successive representation conflict, neither JDA nor common client principles apply.

This principle does not apply where there is concurrent adverse representation.

50

The JDA's conflicts waiver did not cure ALB's Concurrent Representation conflict of Interest.

The closest legal analogue to the Turin' argument would be a claim that ALB, Turin, and DE entered into a novation once ALB replaced Schneider Mitola.

But that claim would fail.

51

No informed consent existed.

52

ALB did not have a concurrent conflict in the Federal Court but it did have a conflict when it sued DE in another court.

DE defendants could not consent to a current adverse conflict.

53

DE waived objection to continued representation of Turin by ALB by confidential information DE might have given ALB.

This is only relevant when assessing propriety of successive representations of adverse clients.

That is a factor in consideration in successive representations where the party that is left with the lawyer might use confidential information supplied by a former client of the lawyer.

54

Issue 3:

Whether there was any actual or apparent conflict in loyalties or diminution in the vigor due to ALB's concurrent representation of Turing and DE?

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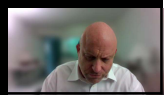
Whether the representation of an attorney is adverse to concurrently represented clients depends on the issue **whether there will be no actual or apparent conflict in loyalties**. That is the key determination.

The court dismissed the successive representation conflicts cases.



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Court applied the factors discussed in the Cinema5, 528 F.2d at 1387:

- Apparent conflict to loyalties
- Risk of trial taint
- Plaintiff's motivations

57

The conflict vitiated the court's confidence in ALB's ability to represent faithfully any defendant in this case.

58

The situation is Turin is that there was an actual adverse concurrent representation to spike ALB from dropping DE since the conflict under the "hot potato" rule is determined at the time of the beginning of the conflict.

The conflict continued to exist not in the federal action but by ALB representing plaint that the defendant suing the co-defendant in the state court which was directly adversarial.

59

The justification for terminating the representation of both parties is to avoid the hot potato situation and to protect the integrity of the legal process.

60

A lawyer cannot accept representations of two parties that have concurrent adverse interests and so must stop both client pursuing to the hot potato rule.

61

The difficulty in the case is that the conflict between Turin and DE was not direct in the main federal case. It was direct in another court in a different matter and so the court essentially made a ruling that that doesn't matter - whether there is direct adversarial interest in same litigation or in another litigation in another court - that is not waivable.

62

A concurrent actual conflict in the same action is not waivable and a concurrent conflict but not in the same action can be waived on informed consent and if its reasonable but its per se not waivable either.

So the presumption is that both of such situations are not waivable and the attorney has the burden of proving otherwise.

63

In successive conflicts, there is no per se rule and the movant has the burden of proving the three factors. There is a conflict that its danger of confidential information that could be used.

64

Conclusion:

The Court held that the attorney-client conflict in this case "unquestionably deemed disqualifying."

The Court granted the Plaintiff's motion to disqualify ALB and Turin defendants were ordered to retain new counsel.

65

El Camino Resources, Limited et al. v. Huntington National Bank, 623 F. Supp. 2d 863

Decided on September 13, 2007

United States District Court for the Western District of Michigan

66

Facts:

- Plaintiff companies El Camino Resources, Ltd. and ePlus Group, Inc. were computer leasing companies that engaged in commercial transactions with Cyberco.
- Plaintiff Bank Midwest National Bank entered into a secured loan transaction with Cyberco for $ 4.925 million.
- Defendant Huntington National Bank was Cyberco's principal financial institution and depository.
- All three plaintiffs alleged that they were the victims of fraud by Cyberco and that Huntington aided and abetted Cyberco's fraud.

67

- Huntington was represented in this action by law firm Pepper Hamilton, LLP.
- Plaintiffs ePlus Group and Bank Midwest moved to disqualify Pepper Hamilton as defense counsel contending that the firm had a conflict of interest arising from its status as counsel for each of the two moving plaintiffs in other litigation.

68

Arguments-

- The moving Plaintiff's asserted that Pepper Hamilton's decision to defend Huntington National Bank in this case was a breach of the firm's duty of undivided loyalty to them and that disqualification is required pursuant to Michigan Rule of Professional Conduct 1.7(a).

69

Other events triggering the conflict:

11/17/2004	Cyberco scam came to a halt
11/2004	Bank Midwest retained Pepper Hamilton to represent it in proceedings leading to forfeiture actions against Cyberco.
12/9/2004	Involuntary bankruptcy filed against Cyberco by El Camino and two other creditors.
Around 12/14/2004	Bank Midwest acting through Pepper Hamilton filed a civil action against Cyberco (Midwest civil action).
1/14/2005	Bank Midwest filed AP in against Cyberco in the Cyberco bankruptcy case asserting claim for constructive trust over alleged proceeds to Cyberco. (Midwest AP)

70

- 1/24/2005, 4/21/2005, 6/22/2005 – Forfeiture actions were filed against Cyberco.
- Pepper Hamilton had represented Bank Midwest in related litigation, including nine (9) forfeiture actions and a bankruptcy adversary proceeding.
- In each forfeiture action, Pepper Hamilton attorneys filed an answer on behalf of Bank Midwest setting up a claim to the seized funds and alleging that the seized property "represents the direct and actual proceeds of fraud, conversion and theft against Bank Midwest committed in violation of law."

71

- El Camino and two other creditors filed an involuntary bankruptcy petition for Cyberco Holdings, Inc. and Thomas C. Richardson, was appointed as trustee.
- On 1/21/2005 - Teleservices Group Inc. an affiliate of Cyberco also filed a voluntary bankruptcy and Richardson was appointed as trustee in that case as well.

72

- Huntington was represented by the law firm Warner, Norcross & Judd in the Cyberco bankruptcy case.
- Among the many adversary proceedings filed in the Cyberco bankruptcy case, one was the Midwest AP (*Bank Midwest, N.A. v. Cyberco Holdings, Inc., et al., AP No. 05-80020)* where Pepper Hamilton represented Bank Midwest and asserted a claim over the alleged proceeds of the $4.925 million loan to Cyberco.
- In that adversary action, Pepper Hamilton served a subpoena on Huntington. This case was later settled where Huntington was to receive certain seized funds out of which a smaller amount would be received by Bank Midwest.

73

- Another case was the Midwest Civil Action (*Bank Midwest, N.A. v. Cyberco Holdings, Inc., et al*., Case No. 1:04-cv-795) in which Pepper Hamilton again represented Bank Midwest as Plaintiff to seek $5 million again Cyberco based on allegations of fraud, conversion and constructive trust. Court granted Pepper Hamilton on behalf of Midwest to conduct expedited discovery on a number of banks.
- on 6/24/2005, Bank Midwest filed an amended complaint adding Huntington National Bank as an additional defendant alleging that its rights to the $700,000 Cyberco account were superior to thos eof Huntington.

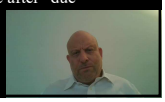
74

- In all of these proceedings, the objective of Pepper Hamilton's effort on behalf of Bank Midwest was to recover all or part of the $4,925 million loaned by the bank to Cyberco.
- The in-house counsel for Bank Midwest in his filed affidavit stated in the course of its representation of Bank Midwest, Pepper Hamilton attorneys participated in numerous confidential attorney/client conversations with the Bank Midwest's chief lending officer and other bank officials and that the bank provided Pepper Hamilton with confidential information including the documents relating to legal claims against Huntington and Huntington's possible defenses thereto.

75

Pepper Hamilton's assertions:

- Pepper Hamilton attorney representing Bank Midwest in the Forfeiture actions did not deny representing Huntington but asserted that he was not requested to undertake "any detailed factual review or analysis of any direct claims Bank Midwest may have against Huntington National Bank."
- Pepper Hamilton attorney representing Midwest in both the adversary proceedings in the bankruptcy court and in the civil action asserted that he "did not have any knowledge at that time (when he represented Bank Midwest) that Bank Midwest intended to pursue Huntington as one of the parties involved with the Cyberco fraud" and that there was no direction by Midwest to develop a lawsuit against Huntington.
- However, the attorney acknowledged that the subpoena raised a conflict of interest question which the firm apparently decided to ignore after "due consideration."



76

12/7/2006 – 12/8/2006 - Trustee actions were filed against Huntington.

Trustee's actions against Huntington National Bank:

- The trustee initiated an adversary action against Huntington in the Cyberco bankruptcy alleging claims for preferential payments or fraudulent transfers.
- The trustee also filed an adversary action against Huntington in Teleservices' bankruptcy case asserting claims within bankruptcy court's core jurisdiction.
- Law firm Warner, Norcross & Judd appeared for Huntington in both the proceedings (Trustee's actions).

77

- End of 3/2007 - Huntington sought to retain Pepper Hamilton in both the adversary cases.
- 3/30/2007 – Pepper Hamilton drafted conflict waiver based on discussions with Midwest.

78

- Pepper Hamilton, although unsure that there was a disabling conflict due to Pepper Hamilton's representation of Bank Midwest in the 9 forfeiture actions and other federal and bankruptcy court actions, discussed the issue with Huntington Bank, who was willing to waive any potential conflict.
- Pepper Hamilton attempted to procure a conflict waiver from Bank Midwest but Bank Midwest did not wish to agree to a broad waiver.
- The conflict letter disclosed that Huntington had asked Pepper Hamilton to represent in the two trustee actions as well as "generally with regard to all matters relating to or arising in the Cyberco Bankruptcy Case and the Teleservices Bankruptcy case."

79

- Specifically, Pepper Hamilton did not disclose to Bank Midwest that Pepper Hamilton anticipated to represent Huntington in future creditor lawsuits.
- The letter acknowledged that Pepper Hamilton's representation of Huntington and Bank Midwest might give rise to a potential conflict of interest in the absence of a waiver without identifying any specific conflict.
- Midwest granted the limited consent and conflicts waiver letter to Pepper Hamilton not identifying any specific conflict and specifically not agreeing to the broad waiver.

80

Earlier draft of conflict waiver letter:

- Letter only mentioned 3 matters including only 1 of the 9 forfeiture actions in which Pepper Hamilton was acting as counsel for Midwest was mentioned and the two bankruptcy matters.

Revised draft of the letter:

- 1 out of the 9 forfeiture actions where Pepper Hamilton was representing Huntington.
- 2 bankruptcy APs (which were closed)

81

- The only reasonable interpretation of the waiver letter, in its final form, is that the waiver was limited to the two identified "Huntington Matters" and did not extend to any other pending or future litigation.

82

- Pepper Hamilton represented Huntington in the trustee's actions with only a limited waiver without identifying any specific conflict, without the broad waiver and despite knowing of the Midwest's anticipated claim against Huntington for fraud.

83

- Sometime after 4/6/2007 – Midwest signed the revised conflict waiver letter.
- Sometime between 4/6/2007 and 5/4/2007, after obtaining the consent and waiver letter, Pepper Hamilton represented Huntington in the trustee's actions and filed Motion to dismiss Trustee's action.
- 6/22/2007 – Court heard Huntington's Motion to dismiss trustee actions.
- 6/22/2007 – Midwest files instant ap against Huntington alleging that Huntington aided and abetted debtor's fraud.

84

Around 7/2/2007	Pepper Hamilton sought a supplemental waiver from Midwest. Midwest refused. Midwest discussed the issued with pepper Hamilton re firm's options.
7/10/2007	Pepper Hamilton filed appearance for Huntington by filing a Motion to extend Answer deadline.
7/12/2007	Plaintiffs in present case filed response highlighting Pepper Hamilton's representation was adverse to Midwest and ePlus who were still the firm's clients.

85

7/16/2007	Midwest tried to contact Pepper Hamilton to discuss the conflict issues.
7/16/2007	Pepper Hamilton filed answer on behalf of Huntington.
7/17/2007	Pepper Hamilton advised Midwest that waiver was broad enough to encompass present case, and supplemental conflict waiver was not necessary.
7/23/2007	Pepper Hamilton, by e-mail, informed Midwest that it had decided to withdraw as counsel from all pending matters on behalf of Midwest.
7/24/2007	Midwest filed this present Motion to disqualify Pepper Hamilton as counsel for Huntington.

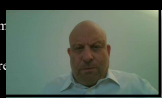
86

- In the present case, after further inconclusive discussions, Pepper Hamilton sent a letter to Midwest informing that it had decided to move to withdraw from all pending matters on behalf of Midwest and that in the circumstances the firm's conduct was consistent with the Rules of Professional Conduct.
- This led to the present motion of Midwest to disqualify Pepper Hamilton as defense counsel after it appeared for Huntington.

87

Summary of important events:

12/2004 and 1/14/2005	-	Midwest was represented by Pepper Hamilton, served subpoena to Huntington
1/24/2005 – 6/22/2005	-	9 forfeiture actions were filed
6/24/2005	-	Midwest filed amended complaint in the Adversary action adding Huntington Bank.
12/7/2006 – 12/8/2006	-	Trustee filed actions against Huntington.
4/6/2007	-	Huntington sought to retain Pepper Hamilton. Midwest signed Pepper Hamilton's limited waiver of conflict letter
7/2/2007	-	Pepper Hamilton sought supplemental waiver. Midwest refused.
7/16/2007	-	Pepper Hamilton filed answer for Huntington.
7/17/2007	-	Pepper Hamilton advised Midwest that supplemental waiver was no longer required as earlier waiver was broad enough.
7/23/2007	-	Pepper Hamilton informed Midwest that it wanted to withdraw as counsel.
7/24/2007	-	Midwest filed Motion to disqualify Pepper Ham counsel.
8/24/2007	-	Pepper Hamilton moved to withdraw from repr all pending matters.



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Issue:

- Is Pepper Hamilton's representation of Huntington National Bank in the present case a clear breach of its ethical duties?

89

"The power to disqualify an attorney from a case is incidental to all courts, and is necessary for the preservation of decorum, and for the respectability of the profession."

S.D. Warren Co. v. Duff-Norton, 302 F. Supp. 2d 762, 766 (W.D. Mich. 2004) (quoting *Ex Parte Burr*, 22 U.S. (9 Wheat) 529, 531, 6 L. Ed. 152 (1824)).

90

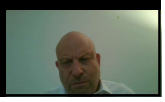
"Rather, the extreme sanction of disqualification should only be utilized when there is a 'reasonable possibility that some specifically identifiable Impropriety' actually occurred, and where the public interest in requiring professional conduct by an attorney outweighs the competing interest of allowing a party to retain counsel of his choice."

(quoting *Woods v. Covington County Bank*, 537 F.2d 804, 810 (5th Cir. 1976)); accord, *Moses v. Sterling Commerce (Am.), Inc.,* 122 F. App'x 177, 183 (6th Cir. 2005).

91

"While motions to disqualify are legitimate and necessary to protect the integrity of judicial proceedings and the ethics of the bar, courts must be vigilant in viewing motions to disqualify counsel, as the 'ability to deny one's opponent the services of capable counsel is a potent weapon.'"

Manning v. Waring, Cox, James, Sklar & Allen, 849 F.2d 222, 224 (6th Cir. 1988).



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"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."

In re Snyder, 472 U.S. 634, 645 n.6, 105 S. Ct. 2874, 86 L. Ed. 2d 504 (1985

93

RULE 1.7 of Michigan Rules of Professional Conduct 1.7(a)
CONFLICT OF INTEREST: CURRENT CLIENTS

(a) A lawyer shall not represent a client if the representation will be directly adverse to another client, unless:

(1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and

(2) each client consents after consultation.

94

Michigan rules are analogous to the New York Rules and the ABA Model Rules.

95

New York Rules of Professional Conduct,
RULE 1.7
CONFLICT OF INTEREST: CURRENT CLIENTS

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

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

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

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

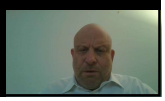
96

Court's observations relating to facts affecting conflict:

- With regard to Bank Midwest, the fact of current representation was established by the court's records including the forfeiture actions that were pending at that time.

97

"…that a law firm that knowingly undertakes adverse concurrent representation may not avoid disqualification by withdrawing from the representation of the less favored client before hearing."



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"The offense inherent in taking on the conflicting representation is **compounded by seeking to "fire" the client** in pursuit of the attorney's interest in taking on a new, more attractive representation."

99

"If, as one judge has written, the act of suing one's client is a **'dramatic form of disloyalty,'** what might be said of trying to drop the first client in an effort to free the attorney to pursue his or her self-interest in taking on a newer and more attractive professional engagement?"

100

The conflict having undertaken representation with two conflicting client, dropping the former client which one is suing, adds insult to injury.

101

The rule is not triggered by greed or bad motive or by assertion of attorney's requirement of a duty of loyalty.

102

The purpose of prohibition against concurrent client relationship is to preserve duty of loyalty, not confidentiality.

103

Vindication of the integrity of the bar.

104

“There can be no question that the interests of plaintiffs on one hand and Huntington National Bank on the other hand are adverse.”

Consequently, the law firm has a conflict of interest since it represented Midwest in the forfeiture actions and was also simultaneously representing Huntington.

105

The Court stated, “The conflict of interest was not cured by Pepper Hamilton's purported termination of the attorney/client relationship by e-mail sent January 10, 2007. The courts universally hold that a law firm will not be allowed to drop a client in order to resolve a direct conflict of interest, thereby turning a present client into a former client.”

106

The Court stated, “This unilateral abrogation of the duty of loyalty cures nothing, but serves to make matters worse.”

“Indeed, the offense inherent in taking on the conflicting representation is compounded by seeking to "fire" the client in pursuit of the attorney's interest in taking on a new, more attractive representation. If, as one judge has written, "the act of suing one's client is a 'dramatic form of disloyalty,' what might be said of trying to drop the first client in an effort to free the attorney to pursue his or her self-interest in taking on a newer and more attractive professional engagement?” *Universal City Studios, Inc. v. Reimerdes*, 98 F. Supp. 2d 449, 453 (S.D.N.Y. 2000) (quoting *British Airways PLC v. Port Authority*, 862 F. Supp. 889, 899 (E.D.N.Y. 1994)).

107

The court observed and stated, “In its briefing, Pepper Hamilton attempts to do just that, by relying not on the strict rule of preclusion embodied in Rule 1.7(a), but on the more lenient standard set forth in Rule 1.9, which deals with former clients.”

108

"The federal courts have recognized that the stringent rule against advocating a position adverse to a current client is designed to vindicate the fundamental duty of loyalty, while the rule involving former clients focuses on the existence of confidential information and a substantial relationship between the present matter and the former one. See *Cinema 5 Ltd. v. Cinerama, Inc*., 528 F.2d 1384, 1386 (2d Cir. 1976).

"The more stringent per se rule vindicates an entirely different ethical principle than does the substantial relationship test. The propriety of representing interests adverse to a current client must be measured not so much against the similarities in litigation as against the duty of undivided loyalty which an attorney owes to each of his clients." *Ehrich,* 210 F.R.D. at 24; accord *Concat LP v. Unilever, Inc*., 350 F. Supp. 2d 796, 822 (N.D. Cal. 2004) (purpose of prohibition against concurrent adverse client relationships is to preserve duty of loyalty, not confidentiality).

The court stated that a law firm is not privileged to extinguish it to a present client by unilaterally turning it into a former client.

109

Court concluded that Midwest Bank and Huntington have a direct conflict of interest.

Pepper Hamilton represented Midwest in those forfeiture actions where Midwest argued that it was entitled to a constructive trust. That is not in conflict.

110

When Midwest added Huntington as a defendant in its amended complaint arguing that it aided and abetted in Cyberco's fraud, that was a direct lawsuit against Huntington raising a direct conflict.

111

Waiver letter:

"We further confirm that Midwest's consent, if given, would not be deemed to be a consent to our representation of Huntington as a party in any **other** litigation in which Midwest may be or become adverse."

The court stated, "This language unmistakably negates any reading of the document that would extend Midwest's waiver to the present case, or to any case beyond the two specific Trustee's Actions identified in the waiver letter."

112

Pepper Hamilton argued that 'other' litigation meant completely unrelated litigation.

The court said that if Pepper Hamilton meant that, they should have been more clear about that but based on the rejection of Midwest to the detailed draft, Midwest never agreed to including potential litigation of Midwest against Huntington in the waiver.

113

The Court stated, "By no stretch of construction can Bank Midwest's consent to its counsel's representation of Huntington National Bank in the Trustee's Actions, where Bank Midwest had only a remote interest, be deemed a prospective waiver of any conflict of interest that would arise when Bank Midwest asserted claims, even identical claims, against Huntington National Bank in its own right. The criticism of Bank Midwest, contained in Pepper Hamilton's affidavits, that it somehow rendered its consent "illusory" by failing to disclose its intent to sue Huntington National Bank is preposterous."

114

The court stated, “Pepper Hamilton's argument stands the law on its head. The law firm, and not the client, had a burden of full disclosure.”

115

“In order to sustain its argument that Bank Midwest somehow waived the actual conflict of interest posed in the present case, Pepper Hamilton has the burden of clearly establishing that the waiver applies to this case (which it has not), and of establishing the sufficiency of its disclosures to the client to support such a waiver.” *Glidden*, 173 F.R.D. at 480; *General Cigar Holdings, Inc. v. Altadis,* S.A., 144 F. Supp. 2d 1334, 1338 (S.D. Fla. 2001).

“To be sufficient, the disclosure of risks must be "in such detail that the person can understand the reasons why it may be desirable to withhold consent." *Glidden*, 173 F.R.D. at 480.

As the Restatement puts it, "informed consent requires that the client or former client had reasonably adequate information about the material risks of such representation to that client or former client." 2 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 122(1) (2000).”

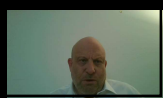
116

It was not Midwest’s burden but was Pepper Hamilton’s burden to disclose the possibility of conflicts.

It is not the client’s burden, it is the law firm’s burden.

117

The court stated, “Pepper Hamilton's disclosures in the present case are utterly insufficient to support a waiver of the direct conflict of interest presented in the present case. Pepper Hamilton's waiver letter identified no direct conflict but said only that continued representation of Bank Midwest "might give rise to a potential conflict of interest in the absence of a conflict waiver." The firm's affidavits are similarly general.”



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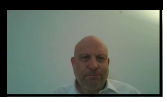
“Significantly, the record does not disclose that Pepper Hamilton ever directly discussed the possibility that the firm would seek to take a position adverse to Bank Midwest if Bank Midwest ever decided to sue Huntington on similar claims, even though both Huntington and Pepper Hamilton considered such claims to be "very likely" and Huntington had asked Pepper Hamilton to secure a waiver from Bank Midwest broad enough to cover not only the Trustee's claims but claims "which likely would be asserted by other creditors.”



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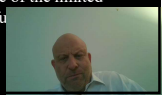
“The only inference possible on this record is that the law firm did not disclose to its client the likely possibility that undertaking the Huntington defense would lead to a direct conflict of interest in the future.”

120

The court stated as follows:

"In summary, Pepper Hamilton's waiver argument is untenable. In order to undertake representation of Huntington National Bank in the Trustee's Actions, Pepper Hamilton realized that a broad waiver of conflict of interest from Bank Midwest was necessary, covering both the Trustee's Actions and all related matters, because of the likelihood that other creditors like Bank Midwest would bring similar claims against Huntington. The firm asked for a broad waiver, which Bank Midwest denied. The waiver as ultimately executed was limited to the two pending Trustee's Actions and specifically excluded any other litigation. Pepper Hamilton failed to procure the necessary broad waiver, but undertook the defense of Huntington anyway. The creditor lawsuit that the firm knew was "very likely" came to fruition only months later. The firm, having failed to get a broad waiver, now tortures the language of the limited waiver in an effort to gain the benefit of the broad waiver refu
Such conduct is unbecoming a great law firm."



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"Pepper Hamilton failed to procure the necessary broad waiver, but undertook the defense of Huntington anyway. The creditor lawsuit that the firm knew was "very likely" came to fruition only months later. The firm, having failed to get a broad waiver, now tortures the language of the limited waiver in an effort to gain the benefit of the broad waiver refused by its client. Such conduct is unbecoming a great law firm."

At that time Pepper Hamilton attempted to withdraw as counsel for Midwest in order to represent Huntington which apparently may have been a more profitable opportunity.

122

The court stated as follows:

"This court has concluded that Pepper Hamilton's representation of Huntington National Bank in the present litigation is a violation of Rule 1.7(a) of the Michigan Code of Professional Responsibility and a breach of its duty of undivided loyalty to its clients Bank Midwest and ePlus Group."

"The finding of an ethical violation, however, does not automatically require disqualification. The court should order disqualification only where some "specifically identifiable impropriety" has actually occurred and the balance of relevant factors requires vindication of the integrity of the legal profession over defendant's interest in retaining counsel of its choice."

123

"In cases involving a direct conflict of interest involving current clients, most courts give decisive weight to vindication of the integrity of the bar."

An attorney who fails to observe his obligation of undivided loyalty to his client injures his profession and demeans it in the eyes of the public. The maintenance of the integrity of the legal profession and its high standing in the community are important additional factors to be considered in determining the appropriate sanction for a Code violation. The maintenance of public confidence in the propriety of the conduct of those associated with the administration of justice is so important a consideration that we have held that a court may disqualify an attorney for failing to avoid even the appearance of impropriety. Indeed, the courts have gone so far as to suggest that doubts as to the existence of an asserted conflict of interest should be resolved in favor of disqualification. *Int'l Bus. Mach. Corp. v. Levin*, 579 F.2d 271, 283 (3d Cir. 1978)

124

The seminal case on the thrust upon defense is *Gould, Inc. v. Mitsui Mining & Smelting Co*., 738 F. Supp. 1121 (N.D. Ohio 1990))

- In that case, Jones Day Reavis & Pogue (Jones, Day) represented Gould, Inc. (Gould) in a lawsuit against Petchney regarding the alleged theft of trade secrets. Later, Petchney acquired IG Technologies.
- Jones, Day had represented IGT in various matters prior to the acquisition.
- Jones Day continued to represent IGT in contractual and licensing matters through the date of the court's decision.
- Jones, Day never attempted to obtain Petchney's consent to Jones Day's continuing representation of both IGT and Gould.
- Petchney discovered that Jones, Day continued to represent both Gould and IGT.
- Jones, Day refused a request that they withdraw as counsel f

125

Court examined certain factors referred to as Gould factors.

- First, there was no evidence that Petchney had been prejudiced in any way by Jones.
- No confidential Petchney information had passed to Gould as a result of Jones
- Second, disqualifying Jones, Day from representing Gould would not only cost Gould a great deal of time and money, in retaining new counsel, it would significantly delay the progress of the case.
- The conflict was created by Petchney's acquisition of IGT several years after the instant case was commenced, not by any affirmative act of Jones, Day.
- Court found ethical violation, however, Jones, Day can remain counsel for both Gould and IGT only if Petchney consents, and it is clear no consent will be given. Therefore, Jones, Day must discontinue its represe
Gould or IGT.

126

Gould factors:

1. No prejudice to the present client from representation of a new client. No exchange of confidential information.
2. Delay in the process of the case.
3. Conflict was created subsequently after commencement of the case of the new client.

127

Pepper Hamilton cited an opinion issued New York Disciplinary Rule 5-105(A)

The opinion defines "thrust upon" conflicts as conflicts between two clients that (1) did not exist at the time either representation commenced but arose only during the ongoing representation of both clients, where (2) the conflict was not reasonably foreseeable at the outset of the representation, (3) the conflict arose through no fault of the lawyer, and (4) the conflict is of a type that is capable of being waived under DR 5-105(C). Although not all aspects of the formal opinion are persuasive, its definition of "thrust upon" conflicts is an accurate reflection of those limited circumstances in which courts have seen fit to apply the flexible approach.

128

New York City Bar Formal Opinion 2005-05 emphasizes that the conflict "must truly be unforeseeable," and that the conflict must "truly be no fault of the lawyer." *Accord, Eastman Kodak Co. v. Sony Corp*., 2004 U.S. Dist. LEXIS 29883, 2004 WL 2984297, at *7-8 (W.D.N.Y. Dec. 27, 2004) (accepting the flexible approach "for disqualification issues generated by mergers and acquisitions" but disqualifying counsel because the conflict was foreseeable). Pepper Hamilton cannot qualify under either of these definitional requirements.

129

In this action the conflict between Midwest and Huntington was predictable.

The Cyberco fraud had generated over $100 million in losses and Huntington had received payments over $17 million.

It was clear that Midwest could assert the rights against Huntington in the future and it specifically had preserved its defenses.

This was revealed by the affidavit of Huntington's principal counsel who noted that during that Huntington had opposed the 2004 examination and pre complaint discovery by the Trustee and various creditors including Midwest.

130

The court stated, "Pepper Hamilton cannot be heard to argue that the assertion of claims in this case by the firm's clients Bank Midwest and ePlus Group was unforeseeable when the firm agreed to represent Huntington National Bank. Both Huntington and Pepper Hamilton considered such creditor claims to be 'very likely.'"

131

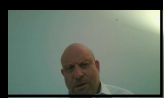
Court stated that Pepper Hamilton's argument that it was Midwest's fault for suing Huntington cannot be accepted otherwise.

This argument would always allow a law firm to blame its plaintiff client and keep its defendant client.

132

"Finally, the court holds that Huntington National Bank's interest in retaining a lawyer of its choice does not outweigh the gravity of the ethical violation that would be countenanced if Pepper Hamilton were allowed to continue in this case."

"Although the firm's breach of its duty of loyalty to other clients will certainly impose some hardship on Huntington National Bank, that is not the fault of the court or the other clients, but the firm itself."



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Court's decision:

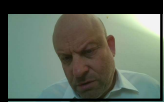
- Interest of Midwest and ePlus Group were adverse to the interests of Huntington.
- Pepper Hamilton violated its duty of loyalty to each moving plaintiff by taking a position directly adverse to them.
- Pepper Hamilton was ethically precluded from attempting to discharge the moving plaintiffs as clients in order to free itself of the conflict.
- Midwest Bank did not waive its right to object to the conflict of interest.
- Huntington's interest in retaining a lawyer of its choice did not outweigh the gravity of the firm's ethical violation.

134

Filippi v. Elmont Union Free Sch. Dist. Bd. of Educ., 722 F. Supp. 2d 295

Decided on July 2, 2010

United States District Court for the Eastern District of New York



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Facts of the case:

- Plaintiff Karen Filippi filed a complaint alleging discrimination against a school board.
- Flippi was represented by the Law Offices of Steven A. Morelli and of counsel Eric Tilton of Eric S. Tilton, P.L.L.C.
- An associate at the Morelli Firm, Lorraine Ferrigno, was also the Vice-President of the defendant Board of Education.
- Ferrigno started full time with Morelli Firm with Board's consent as long as she did not work with the plaintiff's case.

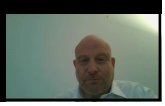
136

- The Board said they did not have any problem with Ferrigno working for Morelli Firm as long as they did not have access to the Flippi file.
- The Board filed the motion for disqualification of Morelli Firm as counsel for Flippi based on the fact that Ferrigno was acting as the Vice-President of the School Board as of the date of the current case and worked for the Morelli Firm.

137

Arguments:

- The Board contended that this was a substantial and inescapable conflict of interest under Rule 1.7 of the New York State Rules of Professional Conduct, which prohibits lawyers from representing parties with conflicting interests.
- Flippi asserted that no such conflict exists as Ferrigno was not an attorney for the Board, and therefore there was no attorney-client conflict, and that, assuming arguendo that a conflict did exist, the Morelli Firm had sufficiently screened off Ferrigno from the lawyers at the Firm who are handling Flippi's case.
- The Board argued that they did not give valid informed consent as required in writing with respect to the conflict.



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Issue:

Whether Morelli firm have a conflict of interest for which it could be disqualified.

139

New York Rules of Professional Conduct, RULE 1.7
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(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
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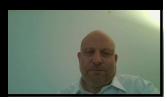

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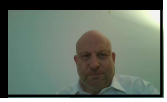
"The Second Circuit has instructed that the issue in a disqualification Case is not whether counsel's relationship to the moving party is in all respects that of attorney and client, but whether there exist sufficient aspects of an attorney-client relationship 'for purposes of triggering inquiry in to the potential conflict involved in counsel's role as plaintiff's counsel in this action.'" *Glueck*, 653 F.2d at 749-50"



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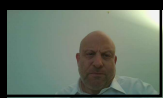
Court cited Westinghouse Elec. Corp. v. Kerr-McGee Corp., 580 F.2d 1311, 1318-20 (7th Cir. 1978) which states "There are several fairly common situations where there is no express attorney-client relationship, there exists nonetheless a fiduciary obligation or an implied professional relation. . . . A fiduciary relationship may result because of the nature of the work performed and the circumstances under which confidential information is divulged.")."

"To be sure, "the requirements of confidentiality and the necessary limitations on subsequent representation [may] apply even though the adverse interests are not those of a client in the traditional sense." *Marshall*, 952 F. Supp. at 108.



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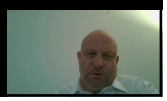
The court found that Ferrigno had confidential information as Vice-President of the Board including decision making with respect to Filippi's another potential legal claim.



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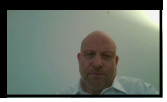
"According to the Second Circuit, disqualification should be granted 'upon a showing that the relationship between the issues in the prior and present cases is 'patently clear' [or] when the issues involved have been 'identical' or 'essentially the same.'" *Gov't of India*, 569 F.2d at 740.



144

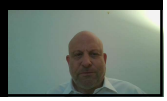
The Court asked if there was a substantial relationship between issues in the prior and present case.

Court found that there was a substantial relationship between the two cases because Ferrigno was a member of the Board and one of the jobs of the Board was to analyze complaints like this present complaint.

145

"Next, the Court must inquire whether the potentially conflicted attorney involved had access to confidences or other privileged information. New York Rule of Professional Responsibility 1.6 provides that '[a] lawyer shall not knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client.'

Rule 1.6(a).



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Court must require whether potentially conflicted attorney had access to confidences or privileged information.

147

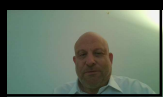
The court defines confidential information as follows:

"Confidential information" consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential."

148

The court did not have to determine whether Ferrigno might have acquired the confidential information.

The court concluded that she had **access** to confidential information related to this case.



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Court discussed presumption that if client confidences are communicated among attorneys within the firm; that then the whole firm is conflicted.

150

If there is a conflict under Rule 1.7, the attorney must show or appear to show that at the very least there would be no actual or apparent conflict or diminishing of the vigorous representation.

151

The court found that the conflict was not waivable because this representation involved the assertion of claim by one client against another client represented by the lawyer in the same litigation.

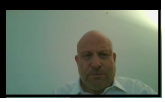
The court found that there was no waiver.

152

Court noted that it was unclear whether the Board had retained counsel and whether it understood the possible implications for appearing with the Morelli Firm.

If they did waive it, it was not informed because the client did not reasonably understand.

Also, they revoked consent.



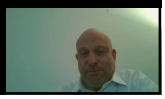
153

Danger of inadvertent disclosure and appearance of impropriety.

154

The court cited *Papanicolaou v. Chase Manhattan Bank*, 720 F. Supp. 1080, 1086-87 (S.D.N.Y. 1989) which states that "This Court doubts whether any Chinese walls, which are meant to be preemptive, can ever function effectively when erected in response to a motion and not prior to the arising of the conflict.").

The court also cited *In Cheng v. GAF Corp*., 631 F.2d 1052 (2d Cir. 1980) and stated that the Second Circuit found that proposed screening measures were not sufficient when the conflicted attorney was "a member of a relatively small firm, because there existed 'a continuing danger that [the conflicted attorney] may unintentionally transmit information he gained through his prior association with [the plaintiff] during his day-to-day contact with defense counsel.'"



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The Court held that there was even the appearance of impropriety in this case which was of particular concern with regards to screening procedures in a small firm, and in a firm as small as the Morelli Firm--which has only six (6) lawyers, the appearance of impropriety due to concerns about the efficacy of screening procedures, is heightened.

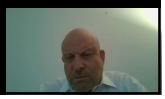
156

Court's decision:

- The Court held that a substantial conflict of interest did exist, and the Morelli Firm's screening procedures were insufficient to overcome the conflict.

157

§ 327(a) conflicts



158

In re Leslie Fay Cos., 175 B.R. 525

Decided on December 15, 1994

United States Bankruptcy Court for the Southern District of New York

159

Facts:

- In Jan 1993, Leslie Fay Companies Inc.'s controller disclosed that he was making unsupported entries in the general ledger.
- The Board of Directors directed its audit committee to investigate the irregularities.
- The Audit Committee employed Weil, Gotshal and Manges (WGM), an accounting firm to assist with the tasks.
- By April 1993, WGM's role expanded and it filed for bankruptcy on behalf of Leslie Fay and applied for retention as Leslie Fay's counsel.
- The Court approved the retention and directed WGM to continue its work for the Audit committee.

160

- In November 1993, the Creditor's Committee and the Trustee objected to WGM's disinterestedness and its disclosures.
- In December 1993, the court appointed an examiner to investigate WGM's disclosures and disinterestedness.
- The examiner found that class actions and derivative suits had been filed against Leslie Fay's directors, including members of the Audit Committee on grounds that they should have known about the irregularities in Leslie Fay's ledgers.
- WGM represented some of the Audit Committee members in these actions.

161

- Represented an officer of Bear Sterns. WGM said that it would not initiate lawsuit against Bear Stearns (which was a client of WGM) without Bear Stearns consent. It was a potential litigation defendant.
- Friedmann of Odyssey partners was another client of WGM. Another potential target.
- WGM had also represented BDO Seidman.
- WGM also represented seventh largest creditor
- WGM did not disclose relationships despite the fact that WGM recognized that Leslie Fay may have claims against them.

162

Issue:

Whether WGM disinterested at the time of its retention by Leslie Fay.

163

11 U.S. Code § 327 - Employment of professional persons
U.S. Code

(a)Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

164

Under 11 U.S.C.S. § 327(a), an attorney must be disinterested and cannot hold an interest adverse to the interest of the estate.

165

According to the examiners there was a fair perception, because of client relations, WGM would be unable to act solely in the debtor's best interest.

166

Courts did not define adverse interest, conflicts that are hypothetical or theoretical not a basis for disqualification.

In re Kelton Motors, Inc., 109 Bankr. 641, 650 (Bankr. D.Vt. 1989)

167

When factual scenario makes it so that the possibility of a conflict is more than hypothetical or theoretical, that situation is more problematic.

168

Some courts say that only actual conflicts are problem, other courts say only potential conflicts are problem, other courts say there is no distinction.

169

Court noted that the results of those cases were simply driven by the facts of those cases.

Court cited cases where bankruptcy court has broad discretion.

No need for Brightline rules.

170

It is more productive to ask whether professional has either meaningful incentive to act contrary to the best interests of the estate and its sundry creditors an incentive sufficient to place those parties at more than acceptable risk -- or the reasonable perception of one." *In re Martin*, 817 F.2d at 180-81.

171

If it is it plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that other representation, then they have a conflict and an interest adverse to the estate.

172

Rule 2014 requires that a professional seeking employment in a bankruptcy case submit a "verified statement… setting forth the person's connections" to the debtor, creditors and any other party in interest.

173

The purpose of Rule 2014, as expressed by the Collier treatise, is to provide the court (and the United States Trustee) with information necessary to determine whether the professional's employment meets the broad test of being in the best interest of the estate.

174

A failure to disclose any fact which may influence the court's decision may result in a later determination that disclosure was inadequate and sanctions should be imposed on the professional.

The fact that disclosure was made elsewhere (e.g. in the debtor's schedules) is not likely to ameliorate a court's reaction to incomplete disclosure.

175

Since the case was filed because of fraud and the audit committee examination was not complete and the bankruptcy estate might have had claims against senior management or board of directors, it was important for the court to ensure that counsel was disinterested.

176

WGM did not give Court the ability to consider whether the firm had disabling conflicts.

It had significant ties with three potential clients till the investigation.

177

Due to financial ties with Bear Stearns and Odyssey WGM might not have pursued with the same vigor and intensity that they might have otherwise applied.

178

WGM contented that at the time it was retained there were no new claims against Tarnopol and Friedman and so there was only a potential hypothetical conflict.

179

Court concluded that WGM's claim that it knew at the time of its court-approved retention that the outside directors could not have been liable were hollow.

Determination of the likely immunity of the two directors should have been made by counsel who had an independent judgment. Here the attorneys who were deciding had entanglements.

180

WGM had an adverse interest because it had an incentive to discount any possible liability so as to preserve its substantial client relationships with the firms of which the directors were principals.

181

WGM was not disinterested and the point is that they could not objectively evaluate their own disinterestedness.

182

The disclosure was inexcusable since now the investigation of facts was biased and the estate may have wanted to sue Seidman.

183

As Judge Friendly noted in *In re Ira Haupt & Co*., 361 F.2d 164, 168 (2d Cir. 1966), quoted with approval in *Bohack,* 607 F.2d at 263, "the conduct of bankruptcy proceedings not only should be right but must seem right."

Here, WGM's conduct of an investigation where it had undisclosed ties to three of the targets just did not seem right.

184

The requirements of Fed.R.Bankr.P. 2014 are more-encompassing than those governing the disinterestedness inquiry under section 327.

185

While retention under section 327 is only limited by interests that are "materially adverse," under Rule 2014, "all connections" that are not so remote as to be *de minimus* must be disclosed.

186

In re Source Enters., 49 Bankr. Ct. Dec. 200;2008 Bankr. LEXIS 940

Decided on December 15, 1994

United States Bankruptcy Court for the Southern District of New York

193

Facts:

- The law firm of Windels Marx Lane & Mittendorf, LLP ("Windels") sought payment of fees and reimbursement of expenses in connection with its representation of the Debtor Source Enterprises, Inc.
- Windels also had represented an equity holder and was a creditor of Source prior to its application for retention.
- Windels withdrew from representing as counsel for Source for non-payment and then after on March 15, 2007, it filed a proof of claim for $548,438.64.
- On March 28, 2007, Windels filed its first fee application.

194

- Source along with one of its investors and the United States Trustee filed objections to the fee application contending that Windel was not qualified to be Source's counsel, was not "disinterested" and held an interest adverse to the estate in contravention of section 327 of the Bankruptcy Code.
- Additionally, they argued that Windel's failure to disclose these and other relevant connections constitutes a breach of Federal Rule of Bankruptcy Procedure 2014.

195

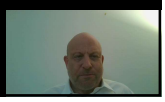
Issue:

Whether Windel was "disinterested" and whether it violated the disclosure requirements under Bankruptcy Rules for Bankruptcy Rule 2014.

196

11 U.S. Code § 327 - Employment of professional persons
U.S. Code

(a)Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.



197

Rule 2014 of the Federal Rules of the Bankruptcy Procedure

(a) Application for and Order of Employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or a employed in the office of the United States trustee.

198

"An interest adverse to the estate," the first prong of section 327(a), is not defined by the Bankruptcy Code.

But, as one court explained, "if it is plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that other representation, then they have a conflict and an interest adverse to the estate." *In re Leslie Fay Cos.*, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994).

199

The second prong of section 327(a), that an attorney be a "disinterested person," means, as defined in section 101(14) of the Bankruptcy Code, a person that "(A) is not a creditor," and "(C) does not have an interest materially adverse to the interest of the estate . . . by reason of any direct or indirect relationship to, connection with or interest in, the debtor." 11 U.S.C. § 101(14)(A), (C).

200

In furtherance of section 327, Bankruptcy Rule 2014 requires a court order authorizing the debtor's retention of a professional pursuant to an application setting forth, among other things, "any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest . . . ." Fed. R. Bankr. P. 2014(a).

201

In furtherance of section 327, Bankruptcy Rule 2014 requires a court order authorizing the debtor's retention of a professional pursuant to an application setting forth, among other things, "any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest . . . ." Fed. R. Bankr. P. 2014(a).

202

Compliance with Bankruptcy Rule 2014 is the responsibility and burden of the professional.

203

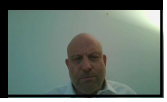
The court stated that the persons to be employed must disclose all facts that bear on their disinterestedness and cannot usurp the court's function by choosing, *ipse dixit*, which connections impact disinterestedness and which do not.

"The existence of an arguable conflict must be disclosed if only to be explained away . . . ." *In re C&C Demo, Inc.,* 273 B.R. 502, 507 (Bankr. E.D. Tex. 2001)

204

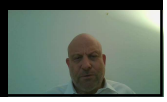
"Nor can the adequacy of disclosure be judged by whether other parties made inquiry."

In re Matco Elecs. Group, Inc., No. 02-60835, 383 B.R. 848, 2008 Bankr. LEXIS 129, 2008 WL 141908, at *5 (Bankr. N.D.N.Y. Jan. 11, 2008)



205

- Windels was owed $480,000 by Source entities and requested that BEGS, the funder of the Source entities pay the invoice.
- Told the US Trustee that it would write off debt but did not.
- BEGS paid about $275,000 of the invoice and the rest remain unpaid so that Windels was a creditor of Source entities which were subsidiaries to the Debtor, Enterprises.
- Windels also filed a claim for pre-petition fees.
- Windels also had agreed to defer payment until the end of the case.



206

- Windels instead of disclosing, spent his time with the Bankruptcy counsel "creating or preserving opportunities for payment in conflict with its professional obligation."

207

- Court cited evidence that Windels was favoring BEGS, an equity holder over unsecured creditors possibly to obtain later payment.
- Source was breaching its fiduciary duties because of the control exercised by BEGS for BEGS owed Windels money.

208

- The Court held that Windels was conflicted by its relationship with entity which was not a debtor but that had agreed to pay its fees after the bankruptcy case.

209

Court's ruling:

- The court denied fees and directed Windels to disgorge the payment previously received with respect to its fees.
- The court denied reimbursement of expenses subject to Windels identifying the relevant expenses in a manner sufficient for the court to determine their allowability.

210