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Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Proceedings?

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HAS THE DIP'S ATTORNEY BECOME THE ULTIMATE CREDITORS' LAWYER IN BANKRUPTCY REORGANIZATION CASES?*

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Once upon a time, a hard-working Debtor's lawyer dropped dead from a heart attack on the eighteenth green of his[1] favorite golf course. When he regained his senses, he was sitting at a huge gold desk in a beautiful office. A white-winged being told him that he had died and that his services were needed in the afterlife. The lawyer, somewhat surprised at his "final reward" and puzzled that people in heaven could go broke, protested that he was tired of the law and asked that he be assigned to some other task. The winged being said that he understood and that the lawyer only had to represent one debtor, in full compliance with all ethical rules and decisions, and then he could rest for all eternity. The winged being then told him that he had 200 interesting prospective clients waiting in his office. The lawyer, hoping that he could remember his legal ethics course, agreed and went to work. Two weeks later, the winged being returned to the office and found the totally exhausted lawyer collapsed over his desk. The lawyer jumped up and screamed that he couldn't represent any of the 200 or so "clients" who had come through his door because of massive case conflicts, the unethical behavior of the person seeking to file bankruptcy, or conflicts with one or more of the lawyer's prior clients. The lawyer protested that this wasn't a very fair way to run heaven. The

** Law Clerk to the Honorable Henry H. Dickinson, Chief Judge of the United States Bankruptcy Court for the Western District of Kentucky. Chip wishes to thank Judge Dickinson and most of the Bankruptcy Bar of the Western District of Kentucky for their help and insights. Chip also wants to thank NBR for agreeing to work with him on this project, for without her insight and writing skill, none of this would be possible. Finally, he would like to thank his wife, Linda Bowles, and their son Charles, who allowed him to vanish for large periods of time to work on this piece.

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[1] Although it's tempting to refer to attorneys in a gender-neutral fashion (i.e., as "it"), such references would make the reading of this Article difficult. Therefore, we've arbitrarily chosen to deem the attorneys for Debtors, Debtors in Possession, and Creditors' Committees to be males and to deem all other attorneys to be females.

winged being turned away, revealing a set of well-concealed horns and a long, red, pointed tail, and sneered as he left: "Who told you this was heaven?"[2]

INTRODUCTION

Bankruptcy ethics problems have confronted attorneys since the time of the earliest English Bankruptcy laws.[3] Numerous commentators have observed that the duties that the Bankruptcy Code imposes on Debtors are complex and demanding.[4] Although the duties of the Debtor in Possession[5] are somewhat well-defined,[6] recently courts have

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[2] One of us (Chip) created this version of the dilemma posed by representing the DIP. Lynn LoPucki created another wonderful description of the dilemma in his *Teacher's Manual for the Debtor Creditor Game* 71 (West 1984), called *The Debtor's Lawyer as Trojan Horse, reprinted in* ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 780 (3d ed. 1996). We'd love to reprint the entire thing, but in the interests of space, we'll just give you a bit of the flavor:

> Shares [the sole shareholder of the troubled company, talking to Lawyer] interrupts. "This is ridiculous," he fumes. "I read in a newspaper article that about 90 percent of all corporations that file under chapter 11 are owned and managed by a single owner or a family, and that in about 90 percent of the cases the cause of the debtor's problems is that the businesses have bad managers. What you are telling me is that your code of Professional Responsibility requires that their lawyers work in the interests of the corporations even if it means working against the men or women who hired them. Why that means that in at least 81 percent of all chapter 11 proceedings in this country the attorney for the debtor-in-possession has an 'ethical' duty to work to oust his own client from control."
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> "Almost correct," says Lawyer, but that guy he's ousting *isn't* his client.

Id. at 782-83.

[3] For an excellent discussion of American bankruptcy laws and their English antecedents, see Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995); CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935). In their earliest form, English Bankruptcy laws were quasi-criminal statutes to protect creditors *from* debtors.

[4] *See, e.g.*, Robin Phelan & John Penn, *Professional Responsibility and the Bankruptcy Lawyer*, 32 BULL. BUS. L. SEC. ST. B. TEX. 1 (1995) [hereinafter *Professional Responsibility*]; Jay Lawrence Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287, 287 (1993) [hereinafter *Inherent Conflicts*] (noting inherent conflicts exist in representation of DIP under Bankruptcy Code); Martin J. Bienenstock, *Conflicts Between Management and the Debtor in Possession's Fiduciary Duties*, 61 U. CIN. L. REV. 543, 543 (1992) (discussing management's conflict of interest in chapter 11) [hereinafter *Fiduciary Duties*]; John D. Ayer, *How to Think About Bankruptcy Ethics*, 60 AM. BANKR. L. J. 355 (1986) [hereinafter *Bankruptcy Ethics*]; Arnold M. Quittner, *Employment and Compensation of Appointed Professionals*, 737 PLI/COM 297 (April-May 1996); Marcia L. Goldstein, et. al., *Ethical Considerations for Bankruptcy Professionals: Disinterestedness, Conflicts of Interest, and Retainers*, C995 ALI-ABA 397 (1995); Adrianne O'Connell McNamara & Carl A. Eklund, *Ethical Quandaries of a Debtor's Lawyer*, 389 PLI/REAL 243 (1994); Lillian E. Kraemer, *Ethical Issues Involving Case Professionals and Other Court-Appointed Parties in Chapter 11 Proceedings*, C946 ALI-ABA 1 (Sept. 29, 1994).

[5] For purposes of this Article, we'll use the term "Debtor" to refer to the individual and/or entity that filed a reorganization bankruptcy (essentially, the management and/or owners of the Debtor). We'll use "Debtor in Possession" or "DIP" to refer to the entity charged with directing the operations of the Bankruptcy Estate. The term "Bankruptcy Estate" (or "Estate") will denote the entity that owns all of the assets included in the definition of "estate" in 11 U.S.C. § 541 (or, where appropriate, § 1306) (1994). And, of course, the "Bankruptcy Code" is found in title 11 of the United States Code.

[6] See Part I of this Article for a brief description of the extent and nature of the Debtor in Possession's fiduciary duty. *See also Fiduciary Duties*, *supra* note 4, at 543 (noting Supreme Court's observation that officers and managing employees of DIP can be depended on to carry out fiduciary responsibilities); John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133, 133 (1993) (noting Debtor in

begun to reexamine the extent and scope of the duties owed by the court-appointed attorneys[7] for the Bankruptcy Estate (hereinafter "Estate Counsel") and the Creditors' Committee (hereinafter "Committee Counsel").[8]

In this Article, we'll discuss the emerging case law concerning the nature and scope of Counsel's duties to the Bankruptcy Estate. Part I begins this task with a brief overview of the duties of Debtors in Possession in chapter 11 and Debtors in chapter 13 cases. Part II reviews the case law concerning the duties of Estate Counsel and Committee Counsel, concentrating primarily on the duties of Estate Counsel, and it concludes that there are no clear answers to the questions about the nature and scope of Estate Counsel's duties.[9] Part III discusses the tension between the fiduciary duties of Estate Counsel in a reorganization and the traditional rules governing attorney ethics. Part IV creates, from the hazy misconceptions proffered in judicial opinions discussing this issue, a workable standard for Estate Counsel. That standard starts with the proposition that *Estate Counsel represents the Estate*—not its principals, not any of its creditors, but the Estate.[10] Keeping that proposition in mind, we can then recast

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Possession owes fiduciary obligation to all parties who own interest in Estate) [hereinafter *Fiduciary Obligations*].

[7] Although the bulk of this Article will deal with the duties of counsel for a DIP in a reorganization case or counsel for a bankruptcy trustee, Committee Counsel have also been found to owe fiduciary duties to the Bankruptcy Estate in some recent cases. *See In re* Bonneville Pacific Corp., 196 B.R. 868, 883 (Bankr. D. Utah 1996); *infra* Part II.G.2. We'll discuss the special ethical concerns of Committee Counsel as part of our general discussion of Estate Counsel's fiduciary duties. *See infra* Part II.

[8] In fact, it is with some trepidation that we try to resolve this complicated issue. If Jay Westbrook decided to defer such a discussion to another day, see *Inherent Conflicts, supra* note 4, at 290, who are we to broach this subject? (On the other hand, those who know us well also know that we have more than a modicum of *chutzpah*.)

[9] *See infra* notes Part II. It's not surprising that bankruptcy scholars can't agree on the nature and scope of these duties. We can't even agree on the purpose(s) of bankruptcy law. *See* John D. Ayer, *Through Chapter 11 With Gun or Camera, But Probably Not Both*, 72 WASH U. L.Q. 883 (1994); David A. Lander, *Musings During a Symposium Afternoon*, 72 WASH. U. L.Q. 905 (1994); James W. Bowers, *Rehabilitation, Redistribution or Dissipation: The Evidence for Choosing Among Bankruptcy Hypotheses*, 72 WASH. U. L.Q. 955 (1994).

[10] Bruce Markell and Ronald Mann have both pointed out that what we're suggesting is akin to Justice Brandeis's famous conceptualization of "lawyer for the situation." *See* E/mail correspondence from Bruce A. Markell to Nancy B. Rapoport 2 (March 28, 1997) [hereinafter Markell Mail] (on file with author); telephone conversation with Ronald J. Mann, March 31, 1997 (notes on file with author). Our solution does have its roots in Brandeis's own finesse. There is a rich literature on "lawyer for the situation." *See, e.g.*, Clyde Spillenger, *Elusive Advocate: Reconsidering Brandeis as People's Lawyer*, 105 YALE L.J. 1445, 1504 (1996); Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. REV. 1547, 1619 (1996); Anthony T. Kronman, *The Fault in Legal Ethics*, 100 DICK. L. REV. 489, 498 (1996); Bill Ong Hing, *In the Interest of Racial Harmony: Revisiting the Lawyer's Duty to Work for the Common Good*, 47 STAN. L. REV. 901, 904 (1995); Rob Atkinson, *A Dissenter's Commentary on the Professionalism Crusade*, 74 TEX. L. REV. 259, 309 (1995); David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 801, 862 n.280 (1992); John S. Dzienkowski, *Lawyers as Intermediaries: The Representation of Multiple Clients in the Modern Legal Profession*, 1992 U. ILL. L. REV. 741, 743; Robert W. Gordon, *Corporate Law Practice as a Public Calling*, 49 MD. L. REV. 255, 266 n.48 (1990); David Luban, *The Noblesse Oblige Tradition in the Practice of Law*, 41 VAND. L. REV. 717, 721 (1988); Kenneth L. Penegar, *The Five Pillars of Professionalism*, 49 U. PITT. L. REV. 307, 330 (1988); Robert L. Nelson, *Social Values and Client Relationships in the Large Law Firm*, 37 STAN. L. REV. 503, 506 n.14 (1985); GEOFFREY C. HAZARD, JR., ETHICS IN THE PRACTICE OF LAW 58-68 (1978); Morgan Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statute*, 34 OHIO ST. L.J. 231, 237 (1973); John P. Frank, *The Legal Ethics of Louis D. Brandeis*, 17 STAN. L. REV. 683, 698-703 (1965).

questions of alleged Estate Counsel misconduct. We can ask whether Estate Counsel was acting to benefit the Estate (or, at least, whether Estate Counsel *intended* to benefit the Estate). We can ask whether, instead, Estate Counsel had an impermissible conflict of interest (by acting to benefit, e.g., officers, directors, shareholders, or individual creditors). We can ask whether Estate Counsel's conflict of interest caused it to violate Bankruptcy Rule 9011. And we might even get some answers.

As a final introductory note, we wish to point out that, even though we disagree with the *law* that some of the courts used in certain opinions discussing the duties of Debtors in Possession and/or Estate Counsel, few, if any, of those cases were "wrong"[11] on the *facts*. The judges writing in this area have attempted to uphold high standards of conduct, both in an effort to address issues in the cases before them and to provide some guidance on ethical issues for Estate Counsel to follow. Still, the question arises as to whether these individual opinions, when read together, have built a stairway to a heaven of ethical practice or paved a road to that region of hell where endless ethical quandaries and impossible conflicting duties torment lawyers as in the story at the beginning of this Article.[12]

I. VOLUNTARY SERVITUDE: THE FIDUCIARY DUTIES OF A DEBTOR IN POSSESSION IN A REORGANIZATION CASE

> But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?[13]

In this oft-cited[14] discussion of fiduciary law, Justice Felix Frankfurter set forth the three primary issues in any discussion of fiduciary duty:

(1) To *whom* does the fiduciary owe duties?

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[11] We all know that the concepts of right and wrong are extremely fluid (especially for lawyers), but in this *particular* context, we mean that courts have, in these cases, removed dishonest DIPs, sanctioned attorneys who did not faithfully represent the Bankruptcy Estate, and overruled objections where the facts indicated that the DIP and/or the EstateCounsel were *not* guilty of improper conduct. *But see In re* Perez, 30 F.3d 1209 (9th Cir. 1994), discussed more fully in *infra* notes 297-303 and accompanying text.

[12] Although we share full responsibility for most of the opinions and conclusions in this Article, sometimes we'll want to draw attention to something written by just one of us. We're doing this primarily because one of us (NBR) was so tickled by the other one's (Chip's) story at the beginning of this Article that she wanted to make sure that Chip got full credit for writing that part.

In terms of the stairway (up or down) that these cases have created, we wanted to remind our readers of one of Karl Llewellyn's most famous quotes: "Within the law, I say, therefore, rules guide, but they do not control decision. There is no precedent the judge may not, at his heed, either file down to razor thinness or expand into a bludgeon. Why should you expect the ethics of the game to be different from the game itself?" KARL LLEWELLYN, THE BRAMBLE BUSH 180 (1930).

[13] SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943) (Frankfurter, J.).

[14] *See, e.g., Fiduciary Duties, supra* note 4, at 543; *Fiduciary Obligations, supra* note 6, at 144.

(2) Does a fiduciary owe fiduciary duties to *additional parties besides* the beneficiary?

(3) What is the *scope* of those duties?

With Justice Frankfurter's road map in mind, we'll briefly review the duties that Debtors and/or DIPs owe in bankruptcy cases.

A. An Extremely Brief Overview of Bankruptcy

Under the current Bankruptcy Code, there are five different forms, or chapters, of relief available[15] to entities seeking the protection of bankruptcy law: chapter 7 (Liquidation),[16] chapter 9 (Adjustment of Debts of a Municipality),[17] chapter 11 (Reorganization),[18] chapter 12 (Adjustment of Debts of a Family Farmer),[19] and chapter 13 (Adjustment of Debts of an Individual with Regular Income).[20]

Let's talk first about what we *won't* be discussing. Chapter 7 cases, which comprise the bulk of bankruptcy filings,[21] don't require the debtor to assume any fiduciary duties,[22] and so any further discussion of the chapter 7 *debtor's* duties is beyond the scope of this Article.[23] Chapter 9 municipal filings are exceedingly rare, and due to the very nature of the Debtor and DIP, are subject to fiduciary issues and concerns that are unique and that will likewise not be addressed here.[24] Chapter 12 bankruptcies are a

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[15] *See* 11 U.S.C. § 109 (1994) (governing what entities may be Debtors under various chapters of Bankruptcy Code).

[16] *See id.* §§ 701-766.

[17] *See id.* §§ 901-946.

[18] *See id.* §§ 1101-1174.

[19] *See id.* §§ 1201-1231. Chapter 12 is scheduled for repeal on October 1, 1998. *See id.* § 1221.

[20] *See* 11 U.S.C. §§ 1301-1330.

[21] 1,042,110 petitions were filed in the United States for the fiscal year ending on June 30, 1996. Of these petitions, 712,129 were chapter 7 cases, and 12,859 were chapter 11 cases. The remaining petitions were filed under chapters 9, 12, or 13. ADMIN. OFFICE OF THE U.S. COURTS, *reprinted in* 29 BCD WEEKLY NEWS & COMMENT A1 (September 10, 1996).

[22] *See* 11 U.S.C. § 521 (1997); *see also In re* Doors and More, Inc., 126 B.R. 43 (Bankr. E.D. Mich. 1991) (noting neither Debtor nor Debtor's attorney have any fiduciary obligation to Bankruptcy Estate). There are, however, some fiduciary duties for chapter 7 Debtors' counsel. *See* Mapother & Mapother v. Cooper (*In re* Downs), 103 F.3d 472, 478-79 (6th Cir. 1996) (denying fees to attorney due to intentional concealment of fee arrangement with Debtor and dual representations that were not disclosed to court); *In re* Freedom Solar Ctr., Inc., 776 F.2d 14, 17 (1st Cir. 1985) (finding only continuing duty of Debtor to be cooperation with trustee); *In re* Pine Valley Mach. Inc., 172 B.R. 481, 486 (Bankr. D. Mass. 1994) (noting duty of Debtor); *In re* Damon, 40 B.R. 367, 376 (Bankr. S.D.N.Y. 1984) (noting forfeiture of attorney fees is mandated if attorney violates duty as officer of court). These duties generally don't arise in connection with duties to the Bankruptcy *Estate*, but rather are fiduciary duties owed to the *court* under 11 U.S.C. § 329. *But see Pine Valley*, 172 B.R. at 486 (stating court's only role is as "look back" review under § 329(b) to determine whether compensation exceeds reasonable value of services).

[23] We will, of course, be discussing the *trustee's* duties in chapter 7 cases as compared to the DIP's duties in chapter 11. *See infra* note 319 and accompanying text.

[24] For a general discussion of chapter 9 bankruptcy practice, see David S. Kupetz, *Municipal Debt Adjustment under the Bankruptcy Code*, 27 URB. LAW. 531 (1995). The thought of considering the ethical and fiduciary obligations of politicians is truly frightening. Luckily for everyone, Kathleen Clark is an expert in that area. *See,*

hybrid form of reorganization, with characteristics of both chapter 11 and chapter 13 cases.[25] For purposes of this Article, however, the fiduciary duties of a chapter 12 DIP are sufficiently similar to the duties of a chapter 11 DIP[26] that they will be subsumed in the section discussing the chapter 11 DIP's fiduciary duties.[27]

B. *Duty of DIPs in Chapter 11*

It is beyond all speculation that DIPs managing the affairs of a Bankruptcy Estate are fiduciaries.[28] Nonetheless, courts are divided as to (1) the parties to whom the fiduciary duties are owed,[29] and (2) the nature of those duties.[30]

1. "I am the Master!"[31]

The question as to whom Debtors in Possession owe their fiduciary duties has produced essentially two lines of case authority.[32] The older (minority) line of cases[33] holds that a Debtor in Possession has a fiduciary obligation to the creditors of the Bankruptcy Estate to "protect and conserve the property in his possession for the benefit

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e.g., Kathleen Clark, *Do We Have Enough Ethics in Government Yet?: An Answer From Fiduciary Theory*, 1996 U. ILL. L. REV. 57.

[25] *See generally* H.R. CONF. REP. NO. 99-958, at 48-49 (1986).

[26] *See, e.g.*, *In re* Erickson, 183 B.R. 189, 193-94 (Bankr. D. Minn. 1995) (discussing fiduciary duty of chapter 12 Debtor in Possession); *In re* French, 139 B.R. 485, 488 (Bankr. D.S.D. 1992) (discussing difference between individual chapter 12 Debtor and chapter 12 DIP).

[27] *See infra* Part I.B.1.

[28] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (noting obligations of DIPs as trustees); Gumport v. China Int'l Trust & Inv. (*In re* Intermagnetics Am., Inc.), 926 F.2d 912, 917 (9th Cir. 1991) (stating officers of DIP are officers of court and have fiduciary duties as such); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461 (6th Cir. 1982) (listing various DIP duties); *see also* Raymond Nimmer & Richard Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANK. DEV. J. 1, 2 (1989) (arguing that attorneys for DIP have fiduciary duty only to client, not to creditors and shareholders whose interests may be adverse to Debtor) [hereinafter *Chapter 11 Governance*]. *But see* St. Angelo v. Sidco (*In re* Sidco, Inc.), 173 B.R. 194, 196 (E.D. Cal. 1994) (discussing fiduciary obligations placed on those who operate business); *infra* note 304 and accompanying text (discussing fiduciary obligations more fully); *see also In re* Coin Phones Inc., 148 B.R. 391, 394-95 (Bankr. S.D.N.Y. 1992) (finding third party that contracted to manage Bankruptcy Estate's business for DIP *did not* have fiduciary duty to Bankruptcy Estate).

[29] *See infra* notes 32-52 and accompanying text.

[30] *See Fiduciary Obligations*, *supra* note 6, at 134-35; *Chapter 11 Governance*, *supra* note 28, at 8; *see also infra* Part I.B.

[31] *See* Darth Vader, STAR WARS (20th Century Fox 1997) (rerelease).

[32] Although there are two separate and distinct lines of case authority in this area, problems on this issue rarely arise except in the odd case in which there is a serious question as to whether the Bankruptcy Estate can pay all of its creditors. *Cf. infra* notes 48-52, and accompanying text; *In re* Central Ice Cream Co., 836 F.2d 1068, 1072 n.3 (7th Cir. 1987) (discussing options available to maximize assets for creditors and shareholders).

[33] *See, e.g.*, Yellowhouse Mach. Co. v. Mack (*In re* Hughes), 704 F.2d 820, 822 (5th Cir. 1983) (holding DIP has duties of trustee); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 462 n.8 (6th Cir. 1982) (same); *In re* Anchorage Nautical Tours, Inc., 145 B.R. 637, 644 (9th Cir. BAP 1992) (same); *In re* Tudor Assocs. Ltd. II, 64 B.R. 656 (E.D.N.C. 1986) (same).

of creditors."[34] Under these decisions, DIPs don't owe any fiduciary duties to parties other than the secured[35] and unsecured creditors of the estate.[36] These duties, however, don't run to any specific creditor but rather to the body of secured and unsecured creditors as a whole.[37] This line of cases has been the subject of significant criticism.[38]

The majority line of cases takes a far broader view of the parties to whom Debtors in Possession owe fiduciary duties.[39] According to these cases, DIPs are "officers of the court"[40] who have a fiduciary duty to act in the best interests of the Bankruptcy Estate *qua* Estate, including its creditors, equity interest holders, and possibly even other parties in interest.[41] Even though—prior to insolvency—officers and directors of a corporation,[42] partners in a partnership, and individuals[43] have little or no duty to their

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[34] *See Weaver*, 680 F.2d at 461; *cf. In re* O.P.M. Leasing Servs., Inc., 28 B.R. 740, 760 (Bankr. S.D.N.Y. 1983) (stating Debtor has duty not to give away security without bringing in corresponding value for creditors). For a recent discussion of this line of authority, see Janet M. Meiburger, *Directors of Insolvent Corporations Owe Fiduciary Duties to Creditors*, ABI JOURNAL 38 (May 1996).

[35] *See* Second Nat'l Bank of Nazareth v. Marcincin (*In re* Nadler), 8 B.R. 330, 333 (Bankr. E.D. Pa. 1980) (noting bankruptcy trustee and/or DIPs will have fiduciary duties to both secured and unsecured creditors). Some older Bankruptcy Act cases, however, indicate that a DIP's primary duty is to unsecured creditors and that a lesser duty is owed to secured creditors. *See, e.g.*, In re American Fidelity Corp., 28 F. Supp. 462, 471 (S.D. Cal. 1939).

[36] *See Weaver*, 680 F.2d at 462 n.8.

[37] *See id.*

[38] *See, e.g.*, *Central Ice Cream*, 836 F.2d at 1072 (noting that risk creditors that face in bankruptcy parallels risk outside of bankruptcy process); Erica M. Ryland, Note, *Bracing for the "Failure Boom": Should a Revlon Auction Duty Arise in Chapter 11?*, 90 COLUM. L. REV. 2255 (1990).

[39] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (stating duty runs to shareholders and creditors); Gumport v. China Int'l Trust & Inv. (*In re* Intermagnetics America, Inc.), 926 F.2d 912, 917 (9th Cir. 1991) (noting duty owed as "officer of the court"); National Convenience Stores Inc. v. Shields (*In re* Schepps Food Stores, Inc.), 160 B.R. 792, 797 (Bankr. S.D. Tex. 1993) (holding duty is owed to Debtor and its shareholders and all of Debtor's creditors); *In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) (noting duty to both equity interests and creditors).

[40] *See, e.g.*, *Intermagnetics*, 926 F.2d at 917 (noting chapter 11 Debtors occupy fiduciary role with respect to contents of Estate); Continental Illinois Nat'l Bank & Trust Co. v. Wooten (*In re* Evangeline Refining Co.), 890 F.2d 1312, 1322-23 (5th Cir. 1989) (stating those who perform duties in administration of Bankruptcy Estate are officers of the court); *In re* Consupak, Inc., 87 B.R. 529, 548 (Bankr. E.D. Ill. 1988) (same).

[41] *See supra* note 39 and accompanying text; *see also In re* DN Assocs., 144 B.R. 195, 199 (Bankr. D. Me. 1992) (indicating that DIP has fiduciary duties to all constituencies of estate); Harvey R. Miller, *Corporate Governance in Chapter 11: The Fiduciary Relationship Between Directors and Stockholders of Solvent and Insolvent Corporations*, 23 SETON HALL L. REV. 1467, 1485-86 (1993) (discussing DIP's role in chapter 11 to perform all duties of trustee) [hereinafter Miller]; Nancy B. Rapoport, *Seeing the Forest* and *the Trees: The Proper Role of the Bankruptcy Attorney*, 70 IND. L.J. 783, 807-17 (1995) (noting that DIPs may owe some duties to those who are neither creditors nor owners) [hereinafter *Forest*].

[42] *See, e.g.*, C-T of Virginia, Inc. v. Barrett, 124 B.R. 689, 692 (W.D. Va. 1990) (noting director's duties limited to shareholders); Simons v. Cogan, 549 A.2d 300, 304 (Del. 1988) (stating directors owe no special duty to debenture holder). *But see* Pittsburgh Terminal Corp. v. Baltimore & O.R.R., 680 F.2d 933, 940 (3d Cir. 1982) (finding that when dealing with equity securities, fiduciary duty will exist). Hartford Fire Ins. Co. v. Federated Dep't Stores, 723 F. Supp. 976, 991 (S.D.N.Y. 1989) (stating duties to creditors limited to those set forth in debt instrument);

[43] *See, e.g.*, *In re* Hargis, 73 B.R. 622, 626 (Bankr. N.D. Tex. 1987); (stating that the individual used filing of reorganization as a shield from creditors and dismissing proceeding) *rev'd on other grounds*, 887 F.2d 77 (5th Cir. 1989).

creditors, other than any duties set forth in a creditor's debt instrument,[44] the entity's insolvency or its filing of a bankruptcy petition creates a fiduciary duty in favor of the Bankruptcy Estate's creditors.[45] But the creation of a fiduciary duty to creditors does *not* exclude a concomitant duty to equity interest holders, or—in the case of an individual chapter 11 or 12 case—to the Debtor who filed the case.[46] Indeed, the Supreme Court, in *Commodity Futures Trading Commission v. Weintraub*,[47] held that the fiduciary duty of a DIP runs to the equity holders as well as to the creditors.[48] The Supreme Court noted the limited nature of that duty, stating:

> [T]he fiduciary duty of the trustee runs to shareholders as well as to creditors. [R]espondents do not explain why, out of all management powers, control over the attorney-client privilege should remain with those elected by the corporation's shareholders. Perhaps most importantly, respondents' position ignores the fact that bankruptcy causes fundamental changes in the nature of corporate relationships. One of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors. In cases in which it is clear that the estate is not large enough to cover any shareholder claims, the trustee's exercise of the corporation's attorney-client privilege will benefit only creditors, but there is nothing anomalous in this result; rather, it is in keeping with the hierarchy of interests created by the bankruptcy laws.[49]

The language of *Weintraub*, in some respects, harmonizes the older "creditor duty only" cases by indicating that a DIP's duty to equity holders ends in cases where "the

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[44] For a comprehensive discussion of the relationship between business organizations and their alleged fiduciary duties to creditors, see Bruce A. Markell, *The Folly of Representing Insolvent Corporations: Examining Lawyer Liability and Ethical Issues Involved in Extending Fiduciary Duties to Creditors*, __ J. BANKR. L.&P. ___ (forthcoming 1997) [hereinafter *Folly*].

[45] *See* Xonics Med. Sys. v. Haverty, 99 B.R. 870, 872 (Bankr. N.D. Ill. 1989) (stating that position of trust to creditors is created when corporation becomes insolvent).

[46] *See infra* notes 48-52 and accompanying text. There appear to be two types of "conflicts" in the literature: conflicts between the Debtor/DIP/TIB and a *particular* creditor or equity interest, and conflicts between the Debtor/DIP/TIB and *all* creditors or equity interests (or all of the creditors or equity interests, within a single class). We believe that the conflicts get worse the *more* particular they are, and that conflicts are *less* of a problem the more group-related or generalized they are.

[47] 471 U.S. 343 (1985). Donald Board does a marvelous job of discussing *Weintraub* in Donald P. Board, *Retooling "A Bankruptcy Machine That Would Go of Itself,"* 72 B.U. L. REV. 243, 266-68 (1992) (reviewing DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY (2d ed. 1990) (book review)).

[48] *See id.* at 355; *see also In re* Delta Petroleum, Ltd., 193 B.R. 99, 110 n.22 (D. P.R. 1996) (finding that "while the Trustee should be commended for looking out for [the creditors'] interests, he seems to have forgotten that a course of action which preserves the debtor's viability while substantially guaranteeing the rights of creditors is preferable. After all, unlike chapter 7 proceedings, chapter 11 proceedings are aimed at preserving the debtor company wherever possible.").

[49] *Weintraub*, 471 U.S. at 355 (citations omitted).

estate is not large enough to cover any shareholder claims."[50] In most of the "creditor duty only" cases, the Bankruptcy Estate was already clearly insolvent. Given the significant amount of case law[51] restricting the state law rights of shareholders where the Debtors are insolvent or the existence of equity is highly questionable, a finding of "creditor duty only" is understandable.[52]

2. "What is Thy Bidding, My Master?"[53]

It is bad enough that the DIP may not know *which* interests must be served. But the problem gets worse: the exact nature and extent of those duties is also open to serious debate.[54] Courts considering the question of whether a chapter 11 DIP has met its fiduciary duties to the Bankruptcy Estate have applied two different standards:[55] the "corporate fiduciary" standard[56] and the "common-law trustee" standard.[57]

The majority line of cases holds that the fiduciary duties that DIPs owe to the Bankruptcy Estate is similar to the duties that officers and directors of a solvent corporation owe their shareholders outside bankruptcy.[58] Under this standard, DIPs are

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[50] *See id.; see also supra* note 32.

[51] *See, e.g.*, Manville Corp. v. Equity Sec. Holders Comm.(*In re* Johns-Manville Corp.), 801 F.2d 60, 65 (2d Cir. 1986) (restricting shareholders' rights if debtor is insolvent); *In re* Lifeguard Indus., 37 B.R. 3, 16 (Bankr. S.D. Ohio 1983) (same); Louisiana World Expo v. Federal Ins. (*In re* Parkway Calabasas Ltd.), 89 B.R. 832, 835-36 (Bankr. C.D. Cal. 1988) (same).

[52] *But see* Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 143 (1990) (noting only one of many attorneys interviewed, who were all representing equity holders' committees, believed shareholders had right to share in payout) [hereinafter *Equity's Share*].

Bruce Markell has pointed out that there's been a lot of confusion over what the attorney-client privilege does and doesn't cover:

> Take the base case. Person walks in; talks to lawyer. Lawyer[] says *X* has to be disclosed. Person walks out, goes to other lawyer and does not disclose *X*. Second lawyer files without disclosure. Government finds out[] and prosecutes client for concealment. Can the first lawyer be compelled to testify in the criminal trial on the issue of whether the person/client had the requisite criminal intent[?] Yes. The crime/fraud exception to the attorney[-]client privilege applies.

Markell Mail, *supra* note 10, at 1 (citing 1 COLLIER ON BANKRUPTCY ¶ 7.10[2][c] (Lawrence P. King ed., 15th ed. rev. 1996). *See* United States v. Ballard, 779 F.2d 287 (5th Cir.), *cert. denied*, 475 U.S. 1109 (1986).

[53] *See* Darth Vader, THE EMPIRE STRIKES BACK (20th Century Fox 1997) (rerelease).

[54] *See Fiduciary Obligations, supra* note 6, at 133.

[55] *See id.*, at 133-36, 144-150; *see also* Miller, *supra* note 41, at 1486.

[56] *See Fiduciary Obligations, supra* note 6, at 136; *see also* Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 515 (7th Cir. 1991) (noting lower court's analogy of DIP's general fiduciary standard to duties of a corporate fiduciary); *In re* Bellevue Place Assocs., 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994) (same).

[57] *See Fiduciary Obligations, supra* note 6, at 136; *see also In re* Frankel, 77 B.R. 401, 404 (Bankr. W.D.N.Y. 1987) (discussing traditional standard of trustee); Schechter v. Department of Revenue, (*In re* Markos Gurnee Partnership), 182 B.R. 211, 214 (Bankr. N.D. Ill 1995) (same).

[58] *See, e.g., Schipper*, 933 F.2d at 515 (finding duty owed by DIP analogous to that of corporate officer to shareholder); Institutional Continental Airlines v. Continental Airlines (*In re* Continental Airlines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986) (holding DIP must use sound business judgment); *In re* Bellevue Place Assocs., 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994) (applying *Schipper* to find duty analogous to that of corporate fiduciary duty); National Convenience Stores Inc. v. Shields (*In re* Schepps Food Stores, Inc.), 160 B.R. 792, 797 (Bankr.

prohibited from any form of self-dealing, including taking a corporate opportunity at the expense of the estate.[59] Further, DIPs must exercise reasonable care in making decisions but, once those decisions have been made, they are protected by the business judgment rule.[60] DIPs simply have to act in the best interests of the Bankruptcy Estate.[61]

The standard of care under the "common-law trustee" line of cases isn't that much different from the standard of care under the "corporate fiduciary" standard—it's just more stringent. The primary differences between the two standards are: 1) common-law trustees may be liable for ordinary negligence in the performance of their duties, but more than mere negligence is required under the "corporate fiduciary" standard,[62] and 2) common-law trustees may have a higher duty to reveal information surrounding a proposed transaction.[63]

The author of one Note on this issue has argued that the "corporate fiduciary" standard is too lenient, advocating instead the adoption of the "common-law trustee" standard in order to more completely prevent the DIP from placing its own self-interest ahead of the interests of the Estate.[64] As creative as that suggestion is, we believe that, in practice, these two different standards are actually applied as if they were the same standard, and they impose similar duties on the DIP.[65]

In one of the leading series of cases under the "corporate fiduciary" line, *Fulton State Bank v. Schipper (In re Schipper)*,[66] the bankruptcy court,[67] district court[68] and court of appeals[69] all noted that they would have come to the same result in ruling on

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S.D. Tex. 1993) (stating that trustee owes certain fiduciary duties similar to director's duties).

[59] *See* First Union Nat'l Bank v. Tenn-Fla Partners (*In re* Tenn-Fla Partners), 170 B.R. 946, 969 (Bankr. W.D. Tenn. 1994); *see also In re* BMW Group I, Ltd., 168 B.R. 731, 739 (Bankr. W.D. Okla. 1994); *see also In re* Microwave Prod. of Am., Inc., 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989).

[60] *See Schipper*, 109 B.R. at 836; *see also* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983); *In re* S.N.A. Nut Co., 186 B.R. 98, 104 (Bankr. N.D. Ill. 1995); *In re* After Six, Inc., 154 B.R. 876, 882 (Bankr. E.D. Pa. 1993).

[61] *See Tenn-Fla Partners*, 170 B.R. at 970; *S.N.A. Nut*, 186 B.R. at 104; *In re* Forster, 162 B.R. 478, 483 (Bankr. N.D. Ohio 1993); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 682 (Bankr. D.C. 1992).

[62] *See Fiduciary Obligations, supra* note 6, at 146-47.

[63] *See id.* at 146-49.

[64] *See Fiduciary Obligations, supra* note 6, at 146-49. Our opinion that there is little difference in how bankruptcy courts apply the "common-law trustee" standard and the "corporate fiduciary" standard should not be taken as criticism of this well-reasoned Note.

[65] Under either line of cases, the DIP is considered to be an officer of the court and, as such, owes fiduciary duties to the court. *See, e.g.*, Bank v. H & D Entertainment, Inc., 926 F. Supp. 226 (D. Mass. 1996); *In re* Tudor Associates Ltd. II, 52 B.R. 385 (D. Minn. 1985); *In re* St. Mary's Hosp., 155 B.R. 345 (Bankr. E.D. Pa. 1993); *see also supra* note 41 and accompanying text.

[66] 109 B.R. 832 (Bankr. N.D. Ill. 1989), *aff'd*, 112 B.R. 917 (N.D. Ill. 1990), *aff'd*, 933 F.2d 513 (7th Cir. 1991).

[67] *See id.* at 837 (stating that "[e]ven under the general standard of inherent fairness, which . . . applie[s] to transactions involving fiduciaries and the entities to which the fiduciary obligation runs, the debtor's conduct passes muster").

[68] *See* Fulton State Bank v. Schipper (*In re* Schipper), 112 B.R. 917, 919 (N.D. Ill. 1990), *aff'd*, 933 F.2d 513 (7th Cir. 1991) (stating that "[t]he bankruptcy court clearly held that a fiduciary duty did exist, noted the differences between the fiduciary duty in a bankruptcy case and that in a . . . corporate setting, and unequivocally held no breach of any fiduciary duty regardless of which standard applied").

[69] *See* Fulton State Bank v. Schipper (*In re* Schipper), 933 F.2d 513, 516 (7th Cir. 1991) (noting duties under

a section 363 sale using either the "corporate fiduciary" or "common-law trustee" standard. Further, the Bankruptcy Code's extreme concern over insider dealing[70] reduces even further any meaningful differences between the two standards.[71]

We conclude, then, that the duty of a DIP, like that of a chapter 11 trustee,[72] is a strictly enforced version of the "corporate fiduciary" standard. Although this standard isn't the highest available, it clearly requires DIPs to place the interests of the Bankruptcy Estate above their own interests,[73] and the Code has sufficient protective mechanisms to ensure compliance.[74]

C. *Duty of Debtors in Chapter 13*

The conduct of a Debtor[75] in chapter 13 cases is governed by a fairly comprehensive[76] set of statutory guidelines instead of the somewhat more strict and yet more nebulous concept of "fiduciary duty." In a chapter 13, the Debtor has no separate affirmative duty to the Bankruptcy Estate (such as recovering preferences, etc.) other than the general duties required of all Debtors under section 521.[77] But chapter 13 Debtors still have some obligation to creditors.[78] In a chapter 13 case, the Debtor can put her interests ahead of the interests of the creditors and other parties in interest so long as she complies with the provisions of chapter 13 in formulating a plan[79] and acts in "good faith."[80]

Chapter 13's good faith standard is really chapter 13's substitute for the DIP's fiduciary duties in chapter 11.[81] Put simply, good faith requires that, under the facts and

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Code are sufficiently demanding so as to not require "common law trustee" duties).

[70] *See* Gumport v. China Int'l Trust and Inv. Corp. (*In re* Intermagnetics Am., Inc.), 926 F.2d 912, 917 (9th Cir. 1991) (holding insider dealing to be fraudulent); *In re* Microwave Prods. of Am. Inc., 102 B.R. 666 (Bankr. W.D. Tenn 1989) (holding debtor cannot allow insider dealing to go on without prosecution).

[71] *See* First Union Nat'l Bank v. Tenn-Fla Partners (*In re* Tenn-Fla Partners), 170 B.R. 946, 970 (Bankr. W.D. Tenn. 1994); *see also In re* Sal Caruso Cheese, Inc., 107 B.R. 808 (Bankr. N.D.N.Y. 1989).

[72] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (stating "if a debtor remains in possession . . . the debtor's directors bear essentially the same fiduciary obligation . . . as would the trustee . . . ."); *see also* STN Enters. v. Noyes (*In re* STN Enters.), 73 B.R. 470 (Bankr. D. Vt. 1987).

[73] *See, e.g.*, Louisiana World Exposition v. Federal Ins. Co., 858 F.2d 233 (5th Cir. 1988); *In re* Bonneville Pac. Corp., 196 B.R. 868 (Bankr. D. Utah 1996).

[74] *See, e.g.*, 11 U.S.C. § 1104 (1994) ("Appointment of a Trustee or Examiner"); *id.* § 1112 ("Conversion or Dismissal"); *see also Fiduciary Duties*, *supra* note 4, at 559-567.

[75] Although defined separately for purposes of this Article, no one actually refers to individuals who have filed chapter 13 cases as DIPs. Indeed, in chapter 13 cases, the actual differences between the prepetition Debtor and the DIP are almost negligible.

[76] *See infra* notes 77-80 and accompanying text.

[77] *See* 11 U.S.C. § 521 (1994) (stating that "the first duty is to file . . . a list of creditors . . . ; second, the debtor is required to cooperate with the trustee . . . ; finally, the debtor must surrender to the trustee all property of the estate").

[78] *See* LUNDIN, CHAPTER 13 BANKRUPTCY § 3.25 (Wiley Law Pub. 2d ed. 1994) [hereinafter LUNDIN].

[79] For a detailed discussion of the requirements of filing a chapter 13 case and obtaining confirmation of a chapter 13 plan, *see* LUNDIN, *supra* note 78, *passim*.

[80] *See* LUNDIN, *supra* note 78, at §§ 5.16-5.26.

[81] *Compare* LUNDIN, *supra* note 78, at § 3.25 (discussing fiduciary nature of chapter 13 Debtor's role in her case

circumstances of a given chapter 13 case, the court can find that the Debtor's proposed treatment of her creditors is fair and equitable.[82] Indeed, given the mass of litigation surrounding the issue of good faith in chapter 13, it's impossible to devise a more meaningful definition.[83] For purposes of our discussion, however, it's clear that the chapter 13 Debtor's good faith hurdle is far lower than the chapter 11 DIP's fiduciary "high-jump bar."[84]

II. THE FIDUCIARY DUTIES OF ESTATE COUNSEL[85]

> It is not easy for a debtor in possession, corporate or individual, to serve two masters—juggling the personal needs and desires of the debtor itself, with its clear fiduciary responsibilities to unsecured creditors, other parties in interest and the court.
>
> *Nor is the role any easier for the attorney who represents the debtor in possession.*[86]

The above quotation, although an understatement of classic proportions, aptly illustrates the difficulties faced by Estate Counsel in all chapter 11 and 12 cases and, to a greatly reduced extent, by the Debtor's counsel in chapter 13 cases.[87] This difficulty

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and citing two cases), *with id.* §§ 5.16-5.26 (discussing chapter 13 DIP's "good faith" requirements and noting over 320 reported decisions on this issue, including more than 30 courts of appeal decisions); *see also In re* Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (addressing differences in duties between individual DIP in chapter 11 case and chapter 13 DIP). *But see In re* Oglesby, 161 B.R. 917 (Bankr. E.D. Pa. 1993) (holding that there is no good faith filing requirement in chapter 13).

[82] *See* LUNDIN, *supra* note 78, at § 5.16 for a discussion of the shifting nature of the chapter 13 good faith test.

[83] For an example of how a court of appeals has difficulty in formulating a simple and workable good faith analysis, see *In re* Love, 957 F.2d 1350, 1354 (7th Cir. 1992).

[84] *Compare* Society Nat'l Bank v. Barrett (*In re* Barrett), 964 F.2d 588 (6th Cir. 1992) (affirming confirmation of third chapter 13 case filed by debtors, even in light of their misconduct in earlier cases); *In re* LeMaire, 898 F.2d 1346 (8th Cir. 1990) (*en banc*) (reversing earlier decision that confirmed chapter 13 plan proposing to pay 62% of judgment debt that itself was based on debtor's attempted murder of creditor); *In re* Farley, 114 B.R. 711 (Bankr. S.D. Cal. 1990) (confirmation of 15% plan discharging drunk driving claim against debtor), *with supra* notes 27-51.

[85] And, to a lesser extent, Committee Counsel. *Cf. infra* note 256 and accompanying text.

[86] *In re* Harp, 166 B.R. 740, 747 (Bankr. N.D. Ala. 1993) (emphasis added); *see also In re* Delta Petroleum (P.R.) Ltd., 193 B.R. 99, 111 (D.P.R. 1996); *Inherent Conflicts*, *supra* note 4, at 303.

[87] *See infra* note 209 and accompanying text. The court in *Delta Petroleum* makes our point nicely:

> The situation is more complicated for trustee's counsel. On one hand, the attorney is retained at the trustee's request. On the other, the attorney's client is the estate, not the trustee. According to Model Rule 1.13(a), "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." Model Rules of Professional Conduct Rule 1.13(a) (1983). The Model Code provided similar guidance, in stating that "[a] lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity." Model Code of Professional Responsibility EC 5-18 (1981). By analogy, in the bankruptcy setting, trustee's counsel owes a higher fiduciary duty to the estate than to the trustee.

Delta Petroleum, 193 B.R. at 111 (citations omitted).

arises primarily from the unusual nature of bankruptcy cases.

In the vast majority of American civil litigation, there are generally only two sides to a dispute. Bankruptcy reorganizations, especially large business chapter 11s, can involve dozens, if not hundreds, of different players, all with different interests.[88] But most of the rules governing the ethical conduct of attorneys are still based on the "advocacy model,"[89] which is itself premised on the "two-sided" aspects of litigation.[90] As Professor John Ayer has observed, "[a]n oddity about bankruptcy is that it doesn't fit . . . the [litigation] model very well."[91] Although civil litigation has been (accurately) described as "warfare without guns and bombs," bankruptcy—with its lengthy negotiations, ever-shifting alliances among various parties,[92] and numerous administrative requirements—can best be described as "diplomacy without embassies or spies."[93] It is the sad lot of the Estate Counsel to attempt to represent the Bankruptcy Estate without either going too far and stepping into active control of the Estate's business operations[94] or doing too little and behaving as a "mere mouthpiece" of the DIP's management—the actual humans controlling the business operations.[95]

A. The Fiduciary Duty to the Bankruptcy Estate in Chapter 11 Cases

Estate Counsel is supposed to owe its allegiance to the Bankruptcy Estate[96] and not to the principals of the Estate.[97] In acting in this capacity, Estate Counsel's duties are "equivalent" to those of the DIP.[98] In particular, Estate Counsel can't close his eyes to

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[88] *See* Nancy B. Rapoport, *Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy*, 26 CONN. L. REV. 913, 917-40 (1994) [hereinafter *Turning*].

[89] *See* Bruce A. Green, *Conflicts of Interest in Litigation; The Judicial Role*, 65 FORDHAM L. REV. 71 (1996); *Bankruptcy Ethics*, *supra* note 4, at 392-98; Marvin E. Frankel, *The Search for Truth: An Empirical View*, 123 U. PA. L. REV. 1031 (1975); Monroe Freedman, *Judge Frankel's Search for Truth*, 123 U. PA. L. REV. 1060 (1975); H. Richard Uviller, *The Advocate, the Truth and Judicial Hackles: A Reaction to Judge Frankel's Idea*, 123 U. PA. L. REV. 1067 (1975); *see also Forest*, *supra* note 41, at 789-806.

[90] *See infra* notes 294-95, and accompanying text.

[91] *See Bankruptcy Ethics*, *supra* note 4, at 392; *see also Turning*, *supra* note 88, at 940-65.

[92] *See Turning*, *supra* note 88, at 917-26.

[93] We're willing to bet that we didn't come up with this turn of phrase.

[94] *See* DeVlieg-Bullard v. Natale (*In re* DeVlieg, Inc.), 174 B.R. 497 (N.D. Ill. 1994) (counsel filed unauthorized law suit against chapter 11 corporate Debtor's insiders).

[95] *See In re* Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991).

[96] *Cf. infra* notes 309-16 and accompanying text (noting that courts lack definition of "Estate" and this causes confusion as to duties of Estate Counsel); *see In re* Grabill Corp., 113 B.R. 966 (Bankr. N.D. Ill. 1990) (noting counsel for corporation owes duty to corporation and not principals). *But see* St. Angelo v. Sidco, Inc. (*In re* Sidco, 173 B.R. 194 (E.D. Cal. 1994) (finding only "weak" authority for finding any fiduciary duty of Estate Counsel to Bankruptcy Estate). *Sidco* may have been overruled by *In re* Perez, 30 F.3d 1209 (9th Cir. 1994). See discussion of *Perez*, *infra* notes 297-303 and accompanying text.

[97] *See In re* Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (individual chapter 11); *In re* Manguff, 147 B.R. 875, 879 (Bankr. D.C. Va. 1992) (chapter 7 trustee's counsel also has fiduciary duty to Bankruptcy Estate); *In re* Rusty Jones, Inc., 134 B.R. 321, 343 (Bankr. N.D. Ill. 1991) (corporate chapter 11); *In re* Storms, 101 B.R. 645, 648 (Bankr. S.D. Cal. 1989) (individual chapter 11).

[98] *See Harp*, 166 B.R. at 748; *In re* Consupak, Inc., 87 B.R. 529, 548 (Bankr. N.D. Ill. 1988).

matters having legal consequences to the Estate,[99] especially when the DIP may not be acting in the Estate's best interests.[100]

This fiduciary duty means that Estate Counsel *may not* act as a hired gun[101] for the DIP but instead must consider the instructions that he receives from his client to ensure "[t]hat he or she is receiving valid instructions from a competent fiduciary acting within the scope of the fiduciary's trust."[102] This charge to "double-check" the DIP's *bona fides* poses a number of practical problems, given that the interests of the *DIP controlling* the Estate are different from the interests of the *Estate itself*. Therefore, it's nearly impossible to draw the line as to the propriety of instructions.[103] It *is* possible, though, to review the existing case law and give some guidance as to what courts have required Estate Counsel, as fiduciaries, to do in certain discrete areas.

B. Special Issues

1. Duty of Estate Counsel to Investigate the DIP/Bankruptcy Estate

One of the first problems that Estate Counsel must address is how thoroughly it must investigate the Debtor in Possession's own affairs.[104] Although one court has held that "since . . . a debtor in possession has no duty to investigate his own financial affairs, it follows that his professionals have no such duty either,"[105] this view is clearly in the minority. The better reasoned majority view holds that Bankruptcy Rule of Procedure ("BRP") 9011 provides a baseline for an attorney's behavior.[106] BRP 9011 requires that the signature of an attorney on every "petition, pleading, motion, or other paper served or filed in a case under the Code"[107] constitutes a certification that the attorney has

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[99] *See Consupak*, 87 B.R. at 549.

[100] *See supra* Part I. and accompanying text. As the court noted in *Consupak*:

> In evaluating the performance of a trustee's attorney, then, it is necessary to determine the extent of duty to advise a trustee. The lower bounds of that duty are obvious: any attorney must, at a minimum, respond to client requests for legal advice. Because a trustee's attorney also has duties to the estate and to the court, however, the duty to advise requires a more active concern for the interests of the estate and of its beneficiaries, the unsecured creditors.
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> * * *
>
> A trustee's attorney cannot close his eyes to matters having legal consequences for the estate. Especially where legally adverse facts come to his attention, the attorney for a trustee must take the initiative to inform his client of the need for preventative or corrective action.

Id. at 549.

[101] *See Forest*, *supra* note 41, at 798-801; *In re* Whitney Place Partners, 147 B.R. 619 (Bankr. N.D. Ga. 1992) (noting attorney's fiduciary duties).

[102] *See In re* Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994).

[103] *See infra* Part II.B.4.

[104] Or the Debtor's (individual) affairs, for that matter. *See infra* Part II.G.2. (discussing *Bonneville* as case in which Estate Counsel simply didn't adequately investigate).

[105] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995).

[106] *See* Knepper v. Skekloff (*In re* Knepper), 154 B.R. 75 (N.D. Ind. 1993); *In re* Whitney Place Partners, 147 B.R. 619, 621 (Bankr. N.D. Ga. 1993) (discussing that attorney will not be liable for negligence).

[107] *See* FED. R. BANKR. P. 9011.

reviewed the document and:

> that to the best of the attorney's or party's knowledge, information, and belief formed after reasonable inquiry it is well-grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation or administration of the case.[108]

What constitutes "reasonable inquiry" is determined under the facts and circumstances of each case.[109] There is a split of authority as to whether reasonable inquiry should be judged from the point of view of a reasonable *bankruptcy* practitioner[110] or from a reasonable attorney who *doesn't* specialize in bankruptcy practice.[111]

2. Duty of Estate Counsel as to Fees, Retainers, and Applications for Employment

All counsel appointed by the bankruptcy court, both Committee Counsel and Estate Counsel,[112] need first to get hired and, later, get paid.[113] The duties associated with motions to appoint counsel and with fee applications arise from ancient[114] concerns that attorneys and other court professionals might loot Estates for their own benefit and the benefit of insiders.[115]

Under the provisions of 11 U.S.C. § 327 and BRP 2014, an attorney, before being employee as Estate Counsel or Committee Counsel, must file an application for employment[116] that makes full disclosure of that attorney's connections with the Debtor,

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[108] *See id.*

[109] *See* Mapother & Mapother v. Cooper (*In re* Downs), 103 F.3d 472, 480 (6th Cir. 1996) (noting attorney's actions were unreasonable but circumstances warranted no imposition of sanction).

[110] *See In re* DN Assocs., 144 B.R. 195, 201 (Bankr. D. Me. 1992) (stating fee of $125 per hour for bankruptcy attorney is permissible).

[111] *See In re* Whitney Place Partners, 147 B.R. 619, 622-23 (Bankr. N.D. Ga. 1992) (finding no violation of BRP 9011 due to lack of experience).

[112] *See, e.g., In re* National Liquidators, Inc., 182 B.R.186, 192 (S.D. Ohio 1995) (permitting dual representation for member and committee); *In re* Daido Steel Co., Ltd., 178 B.R. 129, 132 (N.D. Ohio 1995) (finding it unnecessary to prohibit representation of firm that represented committee and purchaser); *In re* Office Prods. of Am., Inc., 136 B.R. 983, 989 n.2 (Bankr. W.D. Tex. 1992) (explaining that one of the purposes of full disclosure is to prevent repeat of "sordid chapters" in history of corporate bankruptcy reorganizations); *see also* S. REP. NO. 95-989, at 40 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5826.

[113] *See Downs*, 103 F.3d at 472 (6th Cir. 1996); Neben & Starrett v. Chartwell Fin. Corp. (*In re* Park-Helena Corp.), 63 F.3d 877, 882 (9th Cir. 1993) (discussing denial of attorney compensation).

[114] *See supra* note 113 ; *see also In re* Arlan's Dept. Stores, Inc., 615 F.2d 925, 936 (2d Cir. 1979); Robert M. Lawless et al., *A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies*, 1994 U. ILL. L. REV. 847-88.

[115] *See In re* Wood & Henderson, 210 U.S. 246, 252 (1908) (stating that court can reduce fees if there is opportunity to contest charges).

[116] *See* C.R. Bowles, Jr., *The Problem of Retroactive or Nunc Pro Tunc Employment of Professionals in*

creditors, and other parties in interest.[117] The application, in the case of Estate Counsel, must also make full disclosure of any "compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the sources of such compensation."[118] Even a brief review of the disinterestedness standard and fee awards is beyond the scope of this Article, but we feel compelled to remind all Estate and Committee Counsel that they have a fiduciary duty[119] to make those full and complete disclosures required under 11 U.S.C. § 327[120] and 11 U.S.C. § 329.[121] If there is any question as to whether certain information is pertinent, attorneys should take the conservative approach and disclose.[122] Although later in this Article we discuss the various forms of sanctions that courts have imposed on Estate Counsel for violations of their fiduciary duties,[123] one mention here is particularly apt: two courts of appeal have held recently that the appropriate remedy for an attorney failing to disclose the source of his retainer is the denial of *all* requested fees.[124]

The attorney also has a duty not to require the Debtor to pay a retainer so large as to endanger ongoing operations.[125] In the infamous Bankruptcy Act case of *In re Arlan's Department Stores, Inc.*,[126] Estate Counsel demanded and received a retainer of $125,000. This fee was paid in cash by Arlan's officials, who collected the receipts of several Arlan's stores in the Detroit area and flew the money to Estate Counsel's office in New York City,[127] where a partner of the firm acting as Estate Counsel "counted out five, ten and twenty dollar bills and apparently quarters, dimes, nickels and pennies as well."[128] This retainer represented a significant amount of the Debtor's available cash and was not disclosed to the bankruptcy court until six months after the bankruptcy petition was filed. For a number of reasons,[129] including the nature of the retainer, the

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Bankruptcy Cases, 1996 ANNUAL SURVEY OF BANKRUPTCY LAW 219 (1996) (noting rare cases where counsel may try *nunc pro tunc* employment application when circumstances permit).

[117] *See In re* Bonneville Pac. Corp., 196 B.R. 868, 880-81 (Bankr. D. Utah 1996); *see also infra* Part II.G.2.; *see also In re* Rogers-Pyatt Shellac Co., 51 F.2d 988 (2d Cir. 1931).

[118] *See* 11 U.S.C. § 329 (1994); *see also Downs*, 103 F.3d at 477; *Park-Helena Corp.*, 63 F.3d at 877.

[119] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (stating professionals hired by Debtor in Possession have fiduciary duty to Estate); *In re* Rusty Jones, Inc., 134 B.R. 321, 343 (Bankr. N.D. Ill. 1991) (discussing attorney's fiduciary duty); *In re* Churchfield Management & Inv. Corp., 100 B.R. 389 (Bankr. N.D. Ill. 1989) (finding breach of fiduciary duty).

[120] *See supra* note 112.

[121] *See id.*

[122] *See* Nancy B. Rapoport, *Avoiding Judicial Wrath: The Ten Commandments for Bankruptcy Practitioners*, 5 J. BANKR. L. & P. 615, 619-22 (1996) [hereinafter *Commandments*].

[123] *See infra* notes 190-96, 209-19 and accompanying text.

[124] *See supra* note 112.

[125] *See In re* Arlan's Dep't Stores, Inc., 615 F.2d 925 (2d Cir. 1979); *In re* Burke, 147 B.R. 787 (Bankr. N.D. Okla. 1992) (chapter 12 case).

[126] *See Arlan's*, 615 F.2d at 925.

[127] *See id.* at 935.

[128] *Id.*.

[129] *See In re* Arlan's Dep't Stores, Inc., 615 F.2d at 925 (providing an excellent discussion of how *not* to handle

Estate Counsel was denied all compensation.[130] Overall, *Arlan's* stands for the principle that counsel, especially Estate Counsel, owes two duties in every case: one to the client, and one to the court.[131]

3. Duty to Address Motions Filed By Creditors

A related issue arises when the DIP instructs Estate Counsel to oppose a motion to convert, a motion for the appointment of a trustee,[132] or a plan of reorganization proposed by a party other than the Debtor.[133] Estate Counsel must take care, in opposing such motions, not to elevate the interests of the DIP (and its management) over the interests of the Estate.[134] Estate Counsel can't be compensated "for representing the interests of the debtor or the debtor's directors, officers and/or shareholders in a manner which is adverse to, or does not benefit, the estate or the creditors."[135]

On the other hand, *In re Office Products of America, Inc.*[136] addresses the flip side of this restriction: whether Estate Counsel could be compensated for proposing and attempting to obtain confirmation of a plan that could succeed only through the "cramdown" provisions of section 1129[137] but that was opposed by most of the creditors. In refusing to disallow all fees (under a theory that such actions were a breach of Estate Counsel's fiduciary duty), the court held:

> There are serious policy ramifications to such a holding, however, which argue against deciding the case on that basis. The cramdown provisions of the Code are an expression of congressional intent regarding the importance of reorganization values even in the face of considerable

fees and expenses in reorganizations); *see also In re* Midwestern Cos., 55 B.R. 856 (Bankr. W.D. Mo. 1985) (taking attorney fees without court authorization).

[130] *See Arlan's*, 615 F.2d at 944. *In re* Burke, 147 B.R. 787 (Bankr. N.D. Okla. 1992), tells of a smaller, but far worse, breach of an attorney's fiduciary duty regarding fees. In *Burke*, Estate's Counsel demanded and received payment of a nonrefundable retainer of $20,000.00. The $20,000.00 paid by the Debtors represented all of the Estate's cash. This payment left the chapter 12 Debtors with no way to buy feed for their herd of cattle, which was subsequently decimated by starvation. After an overwhelmingly unsuccessful attempt at reorganization, the chapter 12 case was converted to a proceeding under chapter 7, and the trustee filed a motion with the court to review the chapter 12 Estate Counsel's fees and transactions with the Debtor. *See id.* at 794 ("When last heard of by this Court, debtors were living in a state of demoralized squalor."). After a lengthy hearing on the fees, the court leniently allowed Estate Counsel to keep $10,000.00 of the nonrefundable retainer and required Estate Counsel to turn the remainder over to the trustee. *See id.*

[131] *See Arlan's*, 615 F.2d at 932-33 (failure to disclose pertinent information in application for appointment as Counsel was violation of Counsel's fiduciary duty to court). *Cf. Forest, supra* note 41, at 789 (stating that duty as officer of court trumps duty to client).

[132] *See In re* Office Prods. of Am., Inc., 136 B.R. 983 (Bankr. W.D. Tex. 1992); *In re* Davison, 79 B.R. 859 (Bankr. W.D. Mo. 1987).

[133] *DN Assocs.*, 144 B.R. at 195; *Storms*, 101 B.R. at 645; *Kendavis*, 91 B.R. at 742.

[134] *See In re* Reed, 890 F.2d 104, 105 (8th Cir. 1989).

[135] *Id.*

[136] 136 B.R. 983 (Bankr. W.D. Tex. 1992).

[137] *Id.* at 984-991.

> creditor opposition, provided those creditors' interests are appropriately protected. Were we to hold here that pursuing those goals over the objections of creditors in and of itself created a conflict of interest, lawyers would be discouraged from even representing debtors in the face of creditor opposition (even if the plan could pass muster under § 1129(b)), for fear of not being paid.
>
> Such a result is so antithetical to the structure of the reorganization chapters that we must retreat from such a harsh ruling. If there is a basis for the trustee's objections to the fees requested, this is not it (at least not under the facts of this case).[138]

The *Office Products* court, however, went on to disallow Estate Counsel's requested fees for time spent opposing conversion of the case to Chapter 7.

Although no court has articulated a comprehensive test of when Estate Counsel should follow the instructions of the DIP in these situations, one court has suggested:

> Counsel is charged with a "duty of diligence" and should be expected in every reorganization to make a "seasoned determination" whether the debtor is capable of achieving successful reorganization. Attorneys will not be compensated for vain attempts to resuscitate the debtor long after they should have given up the ghost.[139]

This test doesn't offer any bright lines, but it does suggest the absolute reaches of permissible conduct. When it becomes clear that Estate Counsel's efforts can't reasonably benefit the Estate, those efforts must be abandoned.

4. The Duty to "Rat"

One of the most troubling fiduciary duties that Estate Counsel has in a bankruptcy case is the duty to report improper conduct by the DIP to the Bankruptcy Court or other authorities.[140] In one of the earliest articles on Estate Counsel ethics under the

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[138] *Id.* at 986-87. The *Office Products* court also refused to find that the Estate Counsel in this case actually represented the officers and directors of the Debtor, stating that such findings should not be "lightly made." *Id.* at 988.

[139] *DN Assocs.*, 144 B.R. at 220 (Bankr D. Me. 1992), *aff'd*, 160 B.R. 20 (D. Me 1993). The court didn't agree with the applicant's novel argument that, because there was a confirmed plan in place, where Creditor was obliged to pay administrative claims, standards governing compensation by the Estate didn't pertain. *See id.* The applicants were never relieved from their obligation of fidelity to the Debtor in Possession. The context of Casco's plan obligation to pay administrative fees was the context that the Code provides, which authorizes compensation for "necessary and reasonable" expenses and fees based on, among other things, the value of those services. *Id* at 202 n.28.

[140] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (noting that professionals will be obligated to report Debtor's breach) ; *In re* Rivers, 167 B.R. 288, 301 (Bankr. N.D. Ga. 1994) (claiming that attorney, as fiduciary of Estate, must furtherEstate's interest); *In re* Barrie Reed Buick-GMC, Inc., 164 B.R. 378, 381 (Bankr.

Bankruptcy Code, Professor Ayer suggested that Estate Counsel might have a duty to report wrongdoing by the DIP even though, at the time Ayer's article, there was no clear case law on the issue.[141] Ayer's prescient statement of the law has been adopted by all courts that have considered this position.[142]

Perhaps the first case to discuss Estate Counsel's duty to report wrongdoing on the part of the DIP was *In re Rusty Jones, Inc.*,[143] where the court denied 60% of the requested fees of Estate Counsel due to numerous violations of Counsel's fiduciary duty,[144] including Counsel's failure to inform the court of clear insider misconduct relating to the postpetition operation of the Estate's business.[145] This is scary stuff. Courts want Estate Counsel to "rat" on the very people who are running the DIP.[146]

Since *Rusty Jones*, numerous opinions have considered this question and have held that Estate Counsel has breached, or would breach, the fiduciary duty by failure to disclose [147] misconduct by the DIP in a number of situations, including:

1. Undisclosed conflict of interest of another professional approved by the court;[148]
2. Unauthorized use of Estate funds by the DIP;[149]

S.D. Fla. 1984) (noting the duty of Debtor's counsel to bring breaches of fiduciary to attention of court). *See generally In re* Love, 163 B.R. 164 (Bankr. D. Mont. 1993); *In re* Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993); *In re* United Utensils Corp., 141 B.R. 306 (Bankr. W.D. Pa. 1992); *In re* Wilde Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991); *In re* Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992); *In re* Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D. Ill. 1991).

[141] *See Bankruptcy Ethics, supra* note 4, at 355.

[142] We've been unable to find any reported case where Estate Counsel was sanctioned for wrongly disclosing DIP misconduct.

[143] 134 B.R. 321 (Bankr. N.D. Ill. 1991).

[144] *See id.* at 343.

[145] *See id.*

[146] Of course, there is plenty of law regarding the duty of corporate counsel to "rat" on the misconduct of its management. *See, e.g.*, MODEL RULE OF PROFESSIONAL CONDUCT 1.13 (1983) [hereinafter MODEL RULE 1.13]; MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980); Ellen A. Pansky, *Between an Ethical Rock and a Hard Place: Balancing Duties to the Organizational Client and its Constituents*, 37 S. TEX. L. REV. 1167 (1996); Stanley Pietrusiak, Jr., *Changing the Nature of Corporate Representation: Attorney Liability Aiding and Abetting the Breach of Fiduciary Duty*, 28 ST. MARY'S L.J. 213 (1996).

[147] We haven't found any reported bankruptcy case law discussing how Estate Counsel should inform the bankruptcy court about DIP misconduct. The Estate Counsel could attempt what has become known as "noisy withdrawal," which requires the lawyer not only to withdraw but to disaffirm any documents that he prepared that related to the misconduct. *See* Hazard, *supra* note 3, at 727-288 (discussing ABA Professional Ethics Formal Opinion 93-366, which expressly permitted lawyer to disavow work to prevent its use by client perpetrating a fraud). In the "real world" of bankruptcy practice, Estate Counsel will actually do this in cases involving serious client misconduct. But is noisy withdrawal sufficient? What if the judge doesn't smile knowingly and sign the withdrawal papers? And what if she asks the horrible "Why?" question? Case law is silent. See *infra* Part IV (discussing our proposed solution).

[148] *See In re* Sky Valley, Inc., 135 B.R. 925, 937-38 (Bankr. N.D. Ga 1992) (stating Debtor's attorney has "duty" to inquire about all connections that may reveal adverse interest or render professional "not disinterested" under §§ 327(a) and 101(14)).

[149] *See id.* at 939 (discussing attorney's duty to monitor disposition of assets and to assure rights of creditors are protected).

3. Undisclosed insider relationship between the DIP and a prospective purchaser of the DIP's assets;[150]
4. Failure to disclose that the DIP was refusing to pursue claims against insiders;[151]
5. Failure to disclose that the DIP was putting its interests ahead of the interests of the Estate;[152]
6. Failure to disclose that the DIP was "incompetent";[153]
7. Failure to disclose conversion of Estate property by the DIP;[154] and
8. Failure to disclose concealment of Estate assets.[155]

But what acts by a DIP should Estate Counsel disclose? Ayer expressed frustration with that dilemma:

> Suppose the client is not engaged in active concealment but has nonetheless engaged in conduct that may be grounds for creditor action under the Bankruptcy Code: suppose, for example, he has made preferential transfers, or that he is running an insolvent administration. By definition here, creditors could act, but it may be that they are not acting. Does counsel, in her role as counsel for the DIP, have some obligation to mobilize them to action? I know of no case that so holds, and it may be that we simply expect less of a DIP in the exercise of his fiduciary obligation than we do of a trustee. But unless and until we define the status of the DIP in this situation, counsel's position is, at least, doubtful.[156]

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[150] *See* CPY Co. v. Ameriscribe Corp. (*In re* Chas. P. Young Co.), 145 B.R. 131, 136 (Bankr. S.D.N.Y. 1992) (stating transactions with insiders are subject to careful and vigorous scrutiny).

[151] Agresti v. RosenKranz (*In re* United Utensils Corp.), 141 B.R. 306, 309 (Bankr. W.D. Pa. 1992) (holding attorney has responsibility and duty to disclose Debtor's failure to fulfill fiduciary duty); *see also infra* Part II.B.5. (discussing attorney's duty to police DIP).

[152] *See In re* Barrie Reed Buick-GMC, 164 B.R. 378, 381 (Bankr. S.D. Fla 1994) (finding duty to detect DIP's failure to preserve assets of estate).

[153] *See* In re Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga 1994) (denying compensation for attorney's failure to disclose the DIP's legal incompetency due to his stroke).

[154] *See* In re Brennan, 187 B.R. 135 (Bankr. D. N.J. 1995) (stating, in dicta, which professionals are obligated to report Debtor's conversion of estate property).

[155] *See* Vining v. Ward (*In re* Ward), 894 F.2d 771, 776 (5th Cir. 1990) (stating attorney had ethical duty to disclose Debtor's concealment of assets if such concealment was known to attorney). There is at least one state court ethics decision that required even *former* counsel of the Debtors to disclose this type of fraud. *See* Columbus Bar Ass'n v. Wright, 568 N.E.2d 1218 (1991) (affirming suspension of attorney who failed to disclose his former clients' misrepresentations in their bankruptcy petition).

[156] *See Bankruptcy Ethics*, *supra* note 4, at 388-389 (footnotes omitted) (emphasis in original). Query whether Committee Counsel, acting as an advocate for all unsecured creditors, could take over the "distasteful" actions that Estate Counsel might be reluctant to file. *See infra* notes 328-31 and accompanying text (discussing available tools for monitoring Estate Counsel).

In somewhat disturbing dicta in *In re* Whitney Place Partners, 147 B.R. 619 (Bankr. N.D. Ga. 1992), the Bankruptcy Court for the Northern District of Georgia indicated that Estate Counsel may have breached the "candor" required by its fiduciary duties by not making certain affirmative disclosures concerning the proposed

Bankruptcy attorneys' problems with the duty to disclose arise not from a fear of losing fees,[157] but rather from a misperception as to the identity of their client.[158] But even federal courts have difficulty with this issue.[159]

Practitioners and courts should focus on the fact that the Bankruptcy Estate, not the prepetition debtor (either the business entity[160] or an individual[161]) is the Estate Counsel's client.[162] Although this advice is an excellent abstract concept, it's difficult to follow in practice. As the Bankruptcy Court for New Jersey noted in *In re Brennan*:[163]

> Therefore, whether related parties controlled by the same individuals have the same professionals or different professionals, the positions asserted by such parties will tend to be the same. In such circumstances, requiring related parties to have different professionals is often nothing more than insisting on a deceiving appearance of separateness at great added expense.[164]

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chapter 11 reorganization plans. *Id.* at 621.

> However, in the courts' zeal to ensure such integrity, it is possible to overlook a simple, basic fact: no matter who the professionals are, it is the client who makes the ultimate decision as to the positions taken in the matters for which the professionals are employed. Where the same individuals control related parties, those parties will act in concert in their mutual interests. Subject to the fiduciary duty of estate professionals and the Rules of Professional Conduct, attorneys have a duty of loyalty to their clients.

Brennan, 187 B.R. at 150.

The court ultimately refused to sanction Estate Counsel under BRP 9011 due to Counsel's "lack of experience" in chapter 11 practice. *Id.* at 621. We note that there was apparently no disclosure in this case. *Whitney Place*, therefore, can't stand for the horrifying proposition that Estate Counsel must disclose the entire strategy in chapter 11 and chapter 12 proceedings.

[157] *See* DeVlieg-Bullard Inc. v. Natale, (*In re* DeVlieg Inc.), 174 B.R. 497, 502 (N.D. Ill. 1994) (finding that purpose behind disinterested requirement is not directly related to fees but rather is intended to ensure objective advice). *See also infra* notes 181-91 (discussing *DeVlieg*).

[158] *See In re* Love, 163 B.R. 164 (Bankr. D. Mont. 1993) (disallowing attorneys' fee for failure to disclose previous representation of DIP's partner in previous proceedings); *In re* DN Assocs., 144 B.R. 195, 199 (Bankr. D. Me 1992) (finding DIP's attorney cannot be compensated for representation of Debtor, Debtor's directors, officers, or shareholders in matters that did not benefit the estate); Agresti v. RosenKranz (*In re* United Utensils Corp.), 141 B.R. 306, 308 (Bankr. W.D. Pa 1992) (stating attorney employed by corporation owes allegiance to corporate entity, not shareholders, directors, officers, employees, or other related parties); *In re* Rusty Jones, 134 B.R. 321, 343 (Bankr. N.D. Ill 1991) (stating conflict of interest exists when attorney represents DIP and Debtor's shareholders); *In re* Kendavis Indus. Int'l. Inc., 91 B.R. 742, 751 (Bankr. N.D. Tex. 1988) (finding conflict of interest existed when attorney represented Debtor and Debtor affiliates).

[159] *See In re* Rivers, 167 B.R. 301 (Bankr N.D. Ga 1994) ("The unique circumstances . . . of a Chapter 11 case place the attorney for the debtor in possession in the unusual position of sometimes owing a higher duty to the estate and bankruptcy court than to his client") (citing *Whitney Place*, 146 B.R. 619, 620-21 (N.D. Ga 1992)).

[160] *See* Barrie Reed Buick-GMC, 164 B.R. 381, 378 (Bankr. S.D. Fla 1994) (disallowing accounting fee related to services provided to DIP's operation); *In re* Sky Valley, Inc., 135 B.R. 925 (Bankr. N.D. Ga. 1992) (denying fees to realtor who provided services to DIP).

[161] *See In re* Brennan, 187 B.R. 135, 150 (Bankr. D. N.J. 1995) (finding individual DIP owes fiduciary duty to estate); *Love*, 163 B.R. at 177 (denying attorney's fee where substantial work had been provided to DIP in his individual capacity).

[162] *See supra* note 158 and accompanying text (discussing confusion as to whom the attorney owes his duty).

[163] 187 B.R. 135.

[164] *Id.* at 150.

5. Duty to Police the DIP

Recently, several courts have begun to impose yet another fiduciary duty on Estate Counsel—that of actively overseeing or policing the conduct of the Debtor during the pendency of a chapter 11 case.[165] Even though there is both scholarly authority[166] and case law[167] rejecting this duty as being both unfair and unwise, the majority of courts that have considered this issue have found such a duty.

One of the first cases recognizing this duty was *In re Davison.*[168] In *Davison,* the Bankruptcy Court denied Estate Counsel all requested fees as a result of Counsel's failure to prevent the Estate from incurring nearly $800,000 in unpaid postpetition debt.[169] The court held "the manipulation of chapter 11 proceedings so as to dissipate assets which may otherwise be available to creditors is recognized as a species of misconduct which may justify the denial of attorneys' fees or other professional fees."[170] As harsh as this language was, at least the *Davison* court didn't *expressly* hold that there was an affirmative duty to police the DIP.[171]

The first case that found an affirmative duty to police was *In re Sky Valley, Inc.*[172] In *Sky Valley,* the DIP hired a consultant prepetition to manage the Estate's business, a ski and golf resort.[173] There was insufficient cash flow to pay the consultant, so the DIP decided to compensate the consultant[174] *by hiring a real estate firm in which the consultant had an ownership interest* to sell certain real estate that the Debtor owned.[175] Neither the DIP, nor its Estate Counsel, disclosed to the court that the "consultant" owned an interest in the real estate firm, and the court approved the employment of the firm.[176] Subsequently, the real estate firm sold some real estate and received sales commissions without making proper application to the court for compensation. To add

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[165] *See Rivers,* 167 B.R. at 288; *In re* Harp, 166 B.R. 740, 748 (Bankr. N.D. Ala. 1993) (imposing special duty on attorney for Debtor to ensure that Debtor is complying with Bankruptcy Code); *In re* Wilde Horse Enter's, Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (requiring attorney to take active role in protecting interests of Estate, beneficiaries, and unsecured creditors); *Sky Valley,* 135 B.R. at 937 (discussing attorneys' ongoing duty to investigate professionals hired by Debtor); *In re* Davison, 79 B.R. 859 (finding that attorney is not liable for Debtor's waste of assets unless attorney takes active role in Debtor's wrongful conduct). *But see* In re Derringer, 132 B.R. 34 (Bankr. N.D. Cal. 1991) (arguing that Debtor's counsel should not be "policeman; rather, that role should be left to creditors' committee").

[166] *Professional Responsibility, supra* note 4, at 23.

[167] Derringer,132 B.R. at 36(requiringactive participation in wrongful conduct by debtor's counsel for liability).

[168] *See Davison,* 79 B.R. at 859.

[169] *See id.* at 861.

[170] *Id.* at 864 (footnotes omitted).

[171] *Id.* (stating that court refuses to endorse, by awarding attorney fees, practices that virtually ensure unsuccessful chapter 11 proceeding).

[172] 135 B.R. 925 (Bankr. N.D. Ga. 1992).

[173] *See id.* at 928

[174] *See id.* at 929.

[175] *See id.*

[176] *See id.* The court's opinion provided that no compensation be paid without court approval.

insult to injury, the DIP distributed the proceeds of the sale of real estate without the required court approval.[177]

The court reduced Estate Counsel's attorneys' fees by approximately $40,000, citing Counsel's failure to properly "supervise" the DIP: "In the instant case, Debtor's attorney failed in his responsibility to supervise the auction process. Funds were expended for improvement of the property. Those expenditures were clearly outside the ordinary course of business."[178] The court reasoned that Estate Counsel failed to supervise the auction process and, as a result, funds left the Estate without the requisite court approval.[179] Since *Sky Valley* was decided, other cases have reached similar results. In those cases, DIPs were committing outrageous violations of the Bankruptcy Code and of their fiduciary duties with, at the very least, the quiet acquiescence of the Estate Counsel.[180] Though it would be tempting to dismiss these cases as precedent for sanctioning the attorneys for malpractice or incompetence, the cases unequivocally held that Counsel has a duty, not merely to advise, but to police the DIP.

So where does Estate Counsel cross the unmarked line between conceptual control of a reorganization case and actually "taking over" the Debtor? There's no case law directly on point, but *In re DeVlieg*[181] illustrates the strange course of action that Estate Counsel may be forced to take in fulfilling any duty to police the DIP. The *DeVlieg* case arose in the unusual context of the chapter 11 Trustee seeking to employ former Estate Counsel to act as special counsel in a lawsuit against various insiders of the Debtor (including the corporate officers and shareholders who hired the Estate Counsel).[182] The lawsuit involved allegations of fraudulent conveyances and breaches of fiduciary duty by insiders of the DIP (including the officer who had operated the Estate's business before the appointment of the Trustee).[183] This lawsuit was filed by Estate Counsel, without the authorization of the DIP.[184] Not surprisingly, the DIP and other insiders didn't like being sued, and they fired the Estate Counsel.[185] The U.S. Trustee's Office, upon learning of the reasons for the firing, moved to have a chapter 11 Trustee appointed to administer the Bankruptcy Estate.[186] The bankruptcy court granted that motion, and it also granted a later motion by the chapter 11 Trustee to employ the

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[177] *Sky Valley*, 135 B.R. at 933-34.

[178] *See id.* at 939-40. The court denied $19,299 in requested compensation for work on the auction and reduced other fees by $20,000. *Id.*

[179] *See id* at 939.

[180] *See, e.g.*, *In re* Wilde Horse Enters., Inc., 136 B.R. 830, 838 (Bankr C.D. Cal 1991) (finding Estate Counsel allowed DIP to attempt to sell Estate's assets to her boyfriend/landlord for below-market value); *In re* Harp, 166 B.R. 740, 744 (Bankr. N.D. Ala. 1993) (finding chapter 11 individual Debtors took postpetition vacation to Netherlands, Antilles, and hosted large pregame brunch for their friends before the 1992 Alabama-Auburn football game).

[181] DeVlieg-Bullard, Inc. v. Natale (*In re* DeVlieg, Inc.), 174 B.R. 497 (N.D. Ill 1994).

[182] *See id.* at 497.

[183] *See id.*

[184] *See id.* at 503-04.

[185] *See id.*

[186] *DeVlieg*, 174 B.R. at 499-500.

very same Estate Counsel as special counsel to prosecute the lawsuit.[187] The defendants in the lawsuit appealed.[188] The district court, in a careful and detailed opinion, affirmed the bankruptcy court's holding that there was no conflict of interest between the Estate Counsel and the DIP who operated the Estate's business.[189] But the district court voiced its discomfort with the entire situation:

> Indeed, the purpose behind the no-adverse-interest requirements of §§ 327(a) & (e) is to ensure objective advising of the bankruptcy trustee. The concern with former counsel for the debtor is that they will not be in a position to provide such advice.... In the present case, this concern does not appear to be implicated; as evidenced by the timing and apparent circumstances of the filing of the LBO Litigation, RS & W may actually have begun acting in the interest of the estate (and, in doing so, not necessarily following the direction of its then-client, the debtor) even before a chapter 11 trustee had been appointed. Thus, the usual concern with employment of former counsel for the debtor, residual loyalty to that client, would not appear to be a problem here. ... In so noting, however, the Court does not pass on whether such behavior would comply with applicable standards of professional responsibility.[190]

This case is distressing because it seems to indicate that, under some situations, Estate Counsel may be permitted (or even required) to "take over" the operations of a Debtor from those individuals who are acting as the DIP. We doubt that Estate Counsel's malpractice insurance covers the actual running of the client's affairs, and we think that it's bad policy in general.[191]

6. Special Issues in Individual Chapter 11 Cases

Representing a corporation can present numerous problems for Estate Counsel,[192] but representing individual Debtors in chapter 11 is even trickier: "The complex fiduciary duties of a chapter 11 debtor-in-possession and its counsel can become even more confused when the debtor(s)-in-possession are individuals."[193] Obviously, there is the metaphysical challenge of realizing that the human who hired you to file his

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[187] *See id.* at 503.
[188] *See id.* at 499.
[189] *See id.* at 503.
[190] *Id.* at 502 n.7 (citations omitted); *see also* In re Delta Petroleum (P.R.), Ltd., 193 B.R. 99, 110-11 (D. P.R. 1996) (awarding counsel fees to attorney for services rendered to trustee in bankruptcy proceeding even though attorney provided services to Debtor in criminal proceeding because of attorney's inability to withdraw from either case).
[191] *See, e.g., Forest, supra* n.41, at 823-826 (discussing repercussions of lawyers rendering nonlegal advice).
[192] *See, e.g.,* FDIC v. O'Melveny & Meyers, 969 F.2d 744 (9th Cir. 1992), *rev'd on other grounds*, 512 U.S. 79 (1994) (holding attorney has duty to avoid public harm when he discovers his client is engaging in fraud, and attorney has duty to investigate information supplied for inclusion into materials intended for public use).
[193] *See In re* Harp, 166 B.R. 740, 748 (Bankr. N.D. Ala. 1993).

chapter 11 petition is not your client in the bankruptcy case.[194] Even though it's fairly easy, at least in theory, to understand that the president of a corporation or the managing partner of a partnership is not your client when you are representing the business entity itself, it stretches the bounds of legal fiction to comprehend the difference between the *Bankruptcy Estate* of an individual (your client) and the *individual himself* (not your client).[195]

A second issue is whether counsel for the pre-Debtor can perform extensive "prebankruptcy planning" to enable the Debtor to shelter most of its assets from the Estate. Prebankruptcy planning is clearly at odds with the Estate Counsel's fiduciary duty to the Estate. At some point in the prebankruptcy planning process, the pre-Debtor's lawyer must fulfill his duty of zealousness to his client. On the other hand, once Estate Counsel *is* Estate Counsel, the "pre" in "pre-bankruptcy planning" is over, and hiding (sheltering?) assets is a no-no. There's no clear-cut, easy balance. NBR teaches the hoary old saw as a guiding principle: "pigs can be greedy, but hogs get slaughtered." (Not an original turn of phrase, by any means.) We do want to point out one case that gave Estate Counsel plenty of leeway on the prebankruptcy planning front.[196] *Brennan* permitted the lawyers to act as Estate Counsel even though, as part of the pre-Bankruptcy "probate" estate planning, the pre-Debtor, on the advice of counsel, placed millions of dollars out of the easy reach of creditors.

7. Fiduciary Duties of Counsel in "Global Settlement" Situations

An increasingly popular activity in bankruptcy cases in recent years has been participating in negotiations that will result in a global settlement of all issues among the Debtor, its creditors and shareholders, and other related parties.[197] Estate Counsel

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[194] *Id.* at 746 (discussing challenge of serving needs of debtor when attorney's duty is owed to others).

[195] *See In re* Philadelphia Athletic Club, Inc., 20 B.R. 328 (E.D. Pa. 1982) (discussing importance of attorneys avoiding any appearance of impropriety in bankruptcy context); *In re* Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bankr. S.D. Ill. 1993) (stating failure to disclose potential conflicts subjects attorney to risk of court denying compensation pursuant to § 328).

Perhaps the most difficult issues in individual chapter 11 cases are: (1) whether a Chapter 11 Debtor's postpetition income is property of the Estate, see *Harp*, 166 B.R. at 740; *In re* Herberman, 122 B.R. 273 (Bankr. W.D. Tex. 1990); and (2) for what purposes the individual who filed the Chapter 11 may use Estate assets and/or postpetition income. *See In re* Duque, 48 B.R. 965 (S.D. Fla. 1984) (retaining criminal counsel at Estate's expense); *In re* Engel, 190 B.R. 206 (Bankr. D. N.J. 1995) (retaining criminal counsel); In re Warner, 141 B.R. 762 (M.D. Fla. 1992) (retaining criminal counsel); *Harp*, 166 B.R. at 740 (personal expenditures). Detailed discussions of these issues are clearly beyond the scope of this Article, but we want to remind Estate Counsel that they must take care not to violate their fiduciary duty to the Estate in these areas. *See id.*, 166 B.R. at 740.

[196] *See In re* Brennan, 187 B.R. 135, 151-55 (Bankr. D.N.J. 1995) (allowing retention of Estate Counsel where Counsel's retainer and prepetition claim were paid by Debtor on eve of bankruptcy).

[197] *See In re* Central Ice Cream Co., 114 B.R. 956, 964 (N.D. Ill. 1989) (holding attorney did not engage in conflict of interest violation by negotiating settlement on behalf of debtor's president); *see also In re* Central Ice Cream Co., 836 F.2d 1068 (7th Cir. 1987) (finding trustee was entitled to reasonable attorney's fees incurred defending suits by creditors and shareholders).

must remember that the same fiduciary duties applicable to chapter 11 litigation extend to settlement negotiations.[198] Whenever Estate Counsel is striking a bargain on behalf of the Estate, Counsel mustn't "cave" on the Estate's interests simply out of an exhausted need to seal the deal.[199] This is especially true when Estate Counsel attempts to negotiate payments to parties other than the Bankruptcy Estate.

C. *Sanctions Against Estate Counsel for Breaching His Fiduciary Duties*

As a general rule, the sanctioning of an attorney lies within the sound discretion of the trial court.[200] Therefore, a wide range of possible penalties can be imposed on Estate Counsel.[201] We can't even begin to catalogue all of the types of punishment that a court can devise for a counsel who has failed to fulfill his fiduciary duties. We've noted, though, four broad categories of sanctions (three formal and one informal) that courts have imposed in these cases.

1. Disqualification

The first and most drastic[202] of the sanctions available to a court for abuses of an attorney's fiduciary duty is disqualification.[203] Courts will refrain from disqualifying Estate or Committee Counsel in certain limited situations where disqualification would work an undue hardship on the Estate,[204] but in most cases where disqualification was appropriate, courts haven't hesitated to impose that sanction.[205]

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[198] *See Central Ice Cream*, 59 B.R. 476, 489 (Bankr. N.D. Ill. 1985) (imposing fee sanction upon special counsel for negotiating settlement for debtor while attempting to obtain a release from a principal shareholder in exchange for certain direct payment to the shareholder). This section was later reversed by the 7th Circuit in *In re* Central Ice Cream Co., 836 F.2d 1968 (7th Cir. 1987).

[199] *Cf. Central Ice Cream*, 59 B.R. 476.

[200] Mapother & Mapother v. Cooper (*In re* Downs), 103 F.3d 472 (6th Cir. 1996) (stating that bankruptcy courts enjoy inherent power to sanction attorneys for improper behavior); Futuronics Corp v. Arutt, Nachamie & Benjamin (*In re* Futuronics Corp.), 655 F.2d 463, 469-70 (2d Cir. 1981) *cert. denied*, 455 U.S. 941 (1982) (finding bankruptcy court had power to deny compensation based upon violation of Bankruptcy Code provision).

[201] *See infra* Part II.F. (discussing third-party and criminal liability).

[202] Disqualification, at least from the Debtor's and the Bankruptcy Estate's point of view, is the most drastic. Fee reduction is probably a more painful sanction to the attorney involved, given that the attorney has expended uncompensated efforts.

[203] *See In re* Granite Sheet Metal Works, 159 B.R. 840, 846-47 (Bankr. S.D. Ill. 1993) (disqualifying attorney for failure to disclose prepetition representation of Debtor in employment application and affidavit); *In re* Rusty Jones, 134 B.R. 321, 341 (Bankr. N.D. Ill. 1991) (stating bankruptcy court can disqualify attorney after retention and before completion of assignment).

[204] *Rusty Jones*, 134 B.R. at 347 (refusing to disqualify attorney because of great hardship that would result).

[205] *Granite Sheet Metal Works*, 159 B.R. at 848 (finding that even, though disqualification after significant services were rendered was a harsh remedy, it was appropriate where attorney's actions reflected allegiance to Debtor's controlling shareholder rather than Debtor). We've noticed that, in most reported cases in this area, Estate Counsel have been relieved of their duties long before the court begins to consider imposing any sanctions.

2. Sanctions Under BRP 9011 and/or 28 U.S.C. § 1927

Both 28 U.S.C. § 1927[206] and BRP 9011[207] are designed to penalize attorneys who file either groundless or bad faith pleadings. Courts sometimes use these rules as a vehicle for punishing attorneys who violate their fiduciary obligations in bankruptcy cases. Because the standard of conduct for violating either 28 U.S.C. § 1927 or BRP 9011 is much lower than that required for breaching an Estate Counsel's fiduciary duty, though, neither of these rules is used with great frequency.[208]

3. Reduction or Denial of Fees

A long-forgotten comic once cynically remarked that "shooting an attorney in the heart wouldn't do much damage, because that organ in attorneys is usually made of stone. If you want to hurt a lawyer, shoot him in his hip pocket and get his wallet." This joke is in bad taste,[209] but it does reveal a long realized truth—taking someone's money *does* hurt.[210] In bankruptcy cases, it is also an easily applied sanction because all fees of Committee Counsel and Estate Counsel must be reviewed and approved before they're paid.[211] Courts have imposed a wide range of monetary sanctions, ranging from minor tweaking of fees[212] to outright denials of all requested compensation against Estate Counsel and Committee Counsel who have failed to meet their fiduciary obligations.[213] The exact deductions are generally fact-driven determinations.

The Sixth Circuit in *In re* Downs,[214] however, recently added a new twist to this issue. In *Downs*, under rather unusual facts, the bankruptcy court found that counsel for a chapter 7 Debtor had violated section 329 by failing to fully disclose the source of his $46,000 retainer.[215] The bankruptcy court originally denied all of the Counsel's

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[206] *See* 28 U.S.C. § 1927 (1994); *see* Knepper v. Skeloff (*In re* Knepper), 154 B.R. 75, 79 (N.D. Ill. 1993) (holding bankruptcy courts have sanctions power under § 1927 for unreasonably multiplying proceedings).

[207] *See* FED. R. BANKR. P. 9011; *see In re* Downs, 103 F.3d 472., 481 (6th Cir. 1996) (stating attorney is subject to sanction under Rule 9011 when motion is filed that is not "well grounded in fact or warranted by existing law or a good faith argument for extension or modification, or reversal of existing law").

[208] *See Downs*, 103 F.3d at 481-82, (affirming bankruptcy court's sanction of chapter 7 Debtor's counsel for violating 11 U.S.C. § 329 and denial of sanctions under Rule 9011).

[209] Well, not to *us*, really, but to *some* people, it might be offensive.

[210] *See, e.g.*, *In re* Sky Valley, Inc., 135 B.R. 925, 937-38 (Bankr. N.D. Ga. 1992) (punishing less than diligent attorney by denying portion of fees); *In re* Rusty Jones, Inc., 134 B.R. 321, 325 (Bankr. N.D. Ill. 1991) (describing attorney fee application as an "unhappy issue").

[211] *See* 11 U.S.C. § 330 (1994) (prescribing process of compensating officers).

[212] *See Sky Valley*, 135 B.R. at 925 (denying approximately $40,000 of $339,000 in requested fees); *In re* Consupak, Inc., 87 B.R.529, 552 (Bankr. N.D. Ill. 1988) (denying $11,309.50 in fees).

[213] *See, e.g.*, *In re* Wilde Horse Enters.Inc., 136 B.R. 830, 834 (Bankr. C.D. Cal. 1991) (denying attorney's fee and requiring disgorgement of retainer); *In re* Churchfield Management & Inv. Corp. 100 B.R. 389, 394-95 (Bankr. N.D. Ill. 1989) (noting unethical attorney not entitled to any fees).

[214] 103 F.3d 472 (6th Cir. 1996).

[215] *See id.* at 479-80 (noting failure to fully disclose retainer was "willful disregard" of fiduciary duties imposed by statute). The retainer was paid during a time when the Debtors were attempting to convert their case to a chapter 11 proceeding. The court ultimately denied the motion to convert. *See id.* at 479.

fees, but upon reconsideration, sanctioned the attorney $20,000 and permitted him to file a fee application for any fees under 11 U.S.C. § 330.[216] The district court affirmed, but the Sixth Circuit reversed, ruling that all fees had to be denied to an attorney "who exhibits a willful disregard of his fiduciary obligations under § 329."[217] Although this ruling was made in a case involving disclosure of fees under section 329, there is a possibility that it could be applied in all cases involving breaches of Estate (or Debtor's) Counsel's fiduciary duty,[218] which would make representing Bankruptcy Estates essentially an "all or nothing" venture.[219]

4. Judicial Distrust

Finally, there's one more form of punishment that deserves mention: the problem of judicial distrust. In bankruptcy cases, the *reputation* of an attorney, especially an attorney who regularly represents Debtors, is perhaps the most valuable asset that the lawyer owns. If a court believes that an attorney has failed to act properly in regard to his fiduciary duties as Estate Counsel, that belief will make the attorney's future bankruptcy practice that much more difficult.[220] We aren't saying that bankruptcy judges have favorite counsel or that they'll only work well with the "regular" bankruptcy practitioners, but we *are* saying that bankruptcy judges, like anyone else, will view an individual or firm with a good (or even unknown) reputation in a better light than they'll view someone who has previously committed serious fiduciary and/or ethical breaches.[221]

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[216] *Downs*, 103 F.3d at 476.

[217] *Id.* at 479; *see also* Neben & Starrett, Inc. v. Chartwell Fin. Corp. (*In re* Park-Helena Corp.), 63 F.3d 877, 882 (9th Cir. 1995) (holding attorney failure to disclose retainer was willful), *cert. denied*, 116 S.Ct. 712 (1996).

[218] Heaven forbid. In all seriousness, though, using the sledgehammer of wholesale denial of fees as the *sole* appropriate remedy undercuts some necessary judicial flexibility.

[219] *See, e.g.*, *In re* Office Prods., of Am., Inc. 136 B.R. 983, 988 (Bankr. W.D. Tex. 1992) (describing that under both chapters 7 and 11 reasonable fees may be awarded only for those services "actual, necessary, and/or beneficial to the estate").

[220] *See In re* Mangum, 147 B.R. 875, 880 (Bankr. E.D. Va. 1992) (removing counsel from present case and requiring future filings of petitions to be accompanied by his application to employ counsel).

[221] *See infra* Part II.G.2., and then ask yourself if you would want to be any of the counsel mentioned in *In re* Bonneville Pacific Corp., 196 B.R. 868 (Bankr. D. Utah 1996).

Judge William T. Bodoh visited NBR's Debtor-Creditor class on March 17, 1997, and concluded his remarks with a story about counsel who had misrepresented the law to him. He emphasized that any counsel who chooses to misstate *either* the law *or* the facts to him can count on the fact that he will *never*—repeat, never— believe that lawyer again. *See also Commandments, supra* note 120, at 619-23.

To beat a dead horse here (and we really mean to do that—this point is important), it's not just the distrust of the *individual* judge that should worry the practitioner. *Individual judges publish opinions*, which means that a lawyer's reputation can be tarnished far beyond the jurisdiction of the judge who observed the unethical behavior in the first place.

D. *Duty of Counsel for Chapter 13 Debtors*

As we've already observed,[222] the Debtor in a chapter 13 case owes a duty of good faith that is much less onerous than the duties imposed on a chapter 11 or chapter 12 DIP.[223] It's no surprise, then, that the duties of Counsel for the chapter 13 Estate are also less exacting than those required of Counsel for a chapter 11 or chapter 12 Bankruptcy Estate. Indeed, Judge Keith Lundin has observed[224] that a chapter 13 attorney's primary obligation, other than properly practicing the law, is to advise the chapter 13 Debtor of her rights and responsibilities.[225] If chapter 13 Counsel totally ignores this duty, he may lose his fees, just as he would by committing any other type of malpractice.[226]

E. *Duty as an Officer of the Court*

Of all the fiduciary duties that we've discussed, perhaps the oldest and least explored duty is that which all attorneys owe in their role as "officers of the court."[227]

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[222] *See supra* Part I.C.

[223] *See In re* Harp, 166 B.R.740, 754 (Bankr. N.D. Ala. 1993) (discussing differences between individual chapter 11 case and chapter 13 case).

[224] LUNDIN, *supra* note 78, at §1.86.

[225] *See id.* at §§ 1.86-1.134. For a complete discussion of the ethical obligations of counsel in all consumer bankruptcy cases, *see* Carol W. Gustavsen, *The Ethical Role of a Debtor's Attorney in a Consumer Bankruptcy Filing*, 6 GEO. J. LEGAL ETHICS 665 (1993). This Article clearly shows that the attorney's primary obligation to chapter 13 debtors is to keep them from defrauding the court either by concealing assets, improper bankruptcy planning, or simply disregarding their duties under the Code. *See id.*

[226] *See, e.g.*, Cohn v. United States Trustee (*In re* Ostas), 158 B.R. 312, 316 (N.D.N.Y. 1993) (mandating that attorney return certain fees due to failure to disclose); *In re* Damon, 40 B.R. 36, 378 (Bankr. S.D.N.Y. 1984) (precluding all fees where attorney failed to disclose fees to court and committed various ethical violations). The reduced nature of the fiduciary duties of Estate Counsel in a chapter 13 also reflects the reality of Chapter 13 practice: the level of direct supervision that the drafters of the Code might have contemplated is simply impossible, given the economics of the practice:

> Chapter 13 can be a deadly combination for lawyers: high speed, low fees, "small" cases, big emotions, complicated legal questions, unsophisticated clients, a judiciary intent on moving cases and impatient with variations and litigation. Substantial rights of debtors and creditors are at issue, but often the time available for an individual debtor or creditor is minimal. Sophisticated things happen very quickly, but the clients tend to be unsophisticated. Getting information from an unsophisticated client is hard work; giving effective instructions to an unsophisticated client is similarly difficult.
>
> The counsel fees in a Chapter 13 case are modest. Creditors' claims are relatively small, and the amount that a creditor is willing to spend to resolve a claim is usually small. Whatever is to be done on behalf of a debtor or creditor must be done quickly and efficiently. Lawyers must get it right the first time because the transaction costs of correcting mistakes may be prohibitive.

LUNDIN, *supra* note 78, at § 1.86.

[227] *See* Vining v. Ward (*In re* Ward), 894 F.2d 771, 776 (5th Cir. 1990) (noting law firm did not have duty to inform bankruptcy court of existence of judgment because attorneys had not been employed as Estate Counsel); *In re* Arlan's Dept. Stores, Inc., 615 F.2d 925, 941 (2d Cir. 1979) (stating that attorney seeking fee in bankruptcy matter has fiduciary obligation to court as officer as court); *In re* Philadelphia Athletic Club, Inc., 20 B.R. 328, 336 (E.D. Pa. 1982) (stating public and bar demand officers of the court and judiciary adhere to highest standards); *In re* Consupak, Inc., 87 B.R. 529, 548 (Bankr. N.D. Ill. 1988) (noting those performing duties in administration of bankruptcy estate are officers of the court and may be held to fiduciary standards); *In re* Damon, 40 B.R. 367, 376 (Bankr. S.D.N.Y. 1984) (mandating forfeiture of fees if attorney violates duty as officer of the court); *see also*

The leading description of that duty is found in the Supreme Court case of Baker v. Humphrey:[228]

> The legal profession is found wherever . . . civilization exists. Without it society could not well go on. But, like all other great instrumentalities, it may be potent for evil as well as good. Hence the importance of keeping it on the high plane it ought to occupy. Its character depends upon the conduct of its members. They are the officers of the law, as well as the agents of those by whom they are employed. Their fidelity is guaranteed by the highest considerations of honor and good faith, and to these is superadded the sanction of an oath.[229]

Although there is no clear or precise definition of this duty, the case law discussing it uses "duty" as almost a judicial "smell" test, under which—apparently—any honorable lawyer would be able to determine if his actions in a case were appropriate or not.[230] Ah, if only all lawyers had the same olfactory ability.

In what has to be the leading discussion of this fiduciary duty, *In re Ward*,[231] the Fifth Circuit indicated that, at a minimum, the duty as an officer of the court would require an attorney in a bankruptcy case to disclose to the court the existence of any concealed assets[232] and probably any criminal activity that the attorney knew might have taken place.[233] Although this duty is similar to the duty to "rat" discussed above,[234] it is different because the lawyer owes it based on his status as an attorney at law, rather than based on any court-approved appointment in a bankruptcy case. Further, this duty is owed directly to the court *qua* court, not indirectly through an Estate Counsel's fiduciary duties vis-a-vis the Bankruptcy Estate.[235]

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supra note 40 and accompanying text.

228 101 U.S. 494 (1879)

229 *Baker*, 101 U.S. at 502. It would be lovely if lawyers really aspired to behave this way, wouldn't it?

230 *See, e.g., Arlan's*, 615 F.2d at 925, 937 (refusing to accept that law firms' action was inadvertent); *Damon*, 40 B.R. at 377 (same).

231 894 F.2d 771 (5th Cir. 1990).

232 *See id.* at 776.

233 *See* Geoffery C. Hazard, Jr., *Lawyers and Client Fraud: They Still Don't Get It*, 6 GEO. J. LEGAL ETHICS 701, 721-31 (1993); Meyerhoffer v. Empire Fire & Marine Ins. Co., 497 F.2d 1190, 1195 (2d Cir. 1974) (noting that lawyers must strive to avoid even the appearance of impropriety). Counsel may need to report such crimes to the court in order to permit the court to fulfill *its* duty, under 18 U.S.C. § 3057, to report to the U.S. Attorney that reasonable grounds exist for believing that a bankruptcy crime has been committed. Only judges, receivers, and trustees have this duty to report. *See* 18 U.S.C. § 3057 (1994) (governing bankruptcy investigations).

234 *See supra* Part II.B.4.

235 It is this ancient duty that is probably, in our humble opinion, the progenitor of the duty to "rat" in bankruptcy cases.

F. Duty to the People: Bankruptcy Crimes and the Bankruptcy Attorney[236]

The ultimate "rules" of bankruptcy ethics can be found at 18 U.S.C. §§ 152 through 157,[237] which are the federal statutes directly relating to bankruptcy crimes. For example, section 157 deals explicitly with bankruptcy fraud and is a recent addition to the federal criminal statutes.[238] Understanding what constitutes a bankruptcy crime is a fairly simple task. It's also an important task—we've seen an increased emphasis in reviewing attorney conduct in bankruptcy cases for evidence of possible criminal activity.[239]

The problem of "criminal" bankruptcy attorneys[240] isn't a new issue.[241] Nor is it confined to inexperienced or "poor" practitioners.[242] Although there are few reported cases involving attorneys who have been convicted of "bankruptcy crimes," several instructive appellate court cases address this topic.[243]

By far the largest class of "bankruptcy crimes" for which attorneys have been convicted involve concealing assets of the Bankruptcy Estate.[244] In *United States v. Smithson*[245], *United States v. Center,*[246] *United States v. Knoll,*[247] and *United States v. Parkhill,*[248] attorneys were convicted of assisting their clients in concealing assets from the Bankruptcy Estate in a plethora of ways. A brief review of these cases shows that the attorneys in question were actively involved in the fraud, so their convictions were not unexpected.

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[236] For a *much* more comprehensive discussion of bankruptcy crimes, see 1 COLLIER ON BANKRUPTCY ¶¶ 7.01 - 7.LH (Lawrence P. King ed., 15th ed. rev. 1996) [hereinafter Crimes]. For a shorter summary, see Ned W. Waxman, *The Bankruptcy Reform Act of 1994*, 11 BANKR. DEV. L.J. 311, 341 (1995).

[237] *See* 18 U.S.C. §§ 152-157 (1994); *see also* Crimes, *supra* note 236, at ¶ 7.02.

[238] For a view of bankruptcy crimes involving attorneys, see Joan B. Safford, *The Slippery Slope: The Road From Ethical Practice to Attorney Negligence, Contempt or Fraud in Bankruptcy Cases*, 1996 Workshop for Bankruptcy Judges II 277 (1996) [hereinafter *Slippery Slope*]. For a discussion of 18 U.S.C. § 157, see Maureen A. Tighe, *Criminal Bankruptcy Fraud*, 1996 Workshop for Bankruptcy Judges II 297 (1996) [hereinafter *Criminal Fraud*]. 18 U.S.C. § 157 is especially broad, so all attorneys who plan to represent a Debtor or DIP should read it.

[239] *See Slippery Slope, supra* note 238, at 282-85. The facts of several unpublished criminal cases scared the heck out of us.

[240] Not bankruptcy attorneys who *represent* criminals, but attorneys who *are* crooks.

[241] *See* United States v. Switzer, 252 F.2d 139 (2d Cir. 1958) (convicting attorney of conspiracy to transfer property illegally); Coghlan v. United States, 147 F.2d 233, 235 (8th Cir. 1945) (convicting attorney of making false documents and concealing property of debtors).

[242] *See* United States v. Goodstein, 883 F.2d 1326 (7th Cir. 1989) (convicting attorney who'd had over 40 years of bankruptcy experience).

[243] *See supra* note 226.

[244] For an excellent discussion of issues related to the unusual crime committed when "officers of the court" purchase Estate property (18 U.S.C. § 154), see Bernard Shapiro and Neil Wyland, *Ethical Quandaries of Professionals in Bankruptcy Cases*, 402 PLI/REAL 313, 360 (1994).

[245] 49 F.3d 138 (5th Cir. 1995).

[246] 853 F.2d 568 (7th Cir. 1988).

[247] 16 F.3d 1313 (2d Cir. 1994).

[248] 775 F.2d 612 (5th Cir. 1985).

Far more troubling is the case of *United States v. Zimmerman*.[249] This case is one chapter of a trilogy of cases[250] involving the ill-fated bankruptcies of Gary and Maree Levine and their furniture business, Sofa Gallery, Inc. In *Zimmerman*, an attorney was charged, along with his law firm,[251] his law partner, one of his associate attorneys,[252] and certain clients of his law firm—with conspiracy to commit criminal fraud in connection with the hiding of a client's assets from its creditors via the law firm's trust account. The attorney in this case apparently had only minimal connections with the Debtor or the Debtor's counsel but was nevertheless indicted and ultimately convicted on the strength of two Bankruptcy Court opinions that found that the attorney's law firm was probably conspiring with the Debtor to hide assets.[253] The attorney's conviction was overturned, and the case was remanded for a new trial. But the case still emphasizes the danger in this area even for lawyers who don't directly oversee bankruptcy cases for their firm.[254]

G. *The Good, the Bad and the Ugly:*[255] *Three Bankruptcy Cases That Shook the World*[256]

So far, our review of the case law on duties toward the Estate has convinced us of two things. First, in the universe of permissible Estate Counsel conduct, courts have been able to isolate individual examples of good and bad behavior, but they haven't been able to articulate a coherent, overall standard for attorneys to follow. Second, the

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[249] 943 F.2d 1204 (10th Cir. 1991); *see also* Crimes, *supra* note 239 at ¶ 7.08.

[250] *See* United States v. Levine, 970 F.2d 681 (10th Cir. 1992); United States v. Brown, 943 F.2d 1246 (10th Cir. 1991).

[251] *See Levine*, 970 F.2d at 683-684.

[252] *See Brown*, 943 F.2d at 1248-49; *see also* Crimes, *supra* note 239 at ¶ 7.02. *Note to all associates in law firms:* This case illustrates the sad but true principle that a defense based on a theory of "just following orders" does not work any better in criminal prosecutions of bankruptcy crimes than it does in war crime trials.

[253] *See Zimmerman* 943 F.2d at 1208, 1211(discussing strength of evidence against Zimmerman).

[254] We believe that the most blatant case of defrauding a bankruptcy estate of its assets is *United States v. Edgar*, 971 F.2d 89 (8th Cir. 1992). In that case, the attorney for the owner of a corporation in a chapter 11 proceeding negotiated the sale of the Debtor's business, drew up the paperwork concerning the transfer of the business, and structured the sale so the assets of the Debtor and the proceeds of the sale paid to the Debtor's owner would be difficult to trace. *See id.* at 91. Needless to say, the bankruptcy court was not informed of the Debtor's president's excellent sales ability until seven months after the completion of the sale. The Court of Appeals for the Eight Circuit upheld the conviction but remanded the case for resentencing. *See id* at 96.

The strangest bankruptcy-related crime to result in an attorney's conviction is undoubtedly the crime of circumventing the blind case—draw system of assigning judges to bankruptcy cases. *See* United States v. August, 745 F.2d 400 (6th Cir. 1984). In *August*, the attorney was having an affair with a Bankruptcy Court "intake" clerk. The attorney conspired with the intake clerk to ensure that his cases were not assigned to a bankruptcy judge who was conservative in awarding attorneys' fees. Even though the crime in *August* is unlikely to be repeated, it does illustrate that any attempt to manipulate the bankruptcy system in a questionable manner could lead to federal criminal charges. This is especially true given the new Justice Department emphasis on bankruptcy crimes. *See Slippery Slope*, *supra* note 238, for a general discussion of the "new" attitude toward bankruptcy crimes involving attorneys.

[255] You didn't think that we'd let you off without a Clint Eastwood reference, did you? THE GOOD, THE BAD, AND THE UGLY (Metro-Goldwyn-Mayer 1966)).

[256] *Cf.* JOHN REED, TEN DAYS THAT SHOOK THE WORLD (Penguin Books ed., 1966).

semantic gymnastics that courts have used to justify the imposition of a fiduciary duty going beyond the Estate to individual creditors have been based on the following false syllogism: *It is simply not true that*

> *Major premise 1 (correct)*: The DIP owes fiduciary duties to the Estate.
>
> *Major premise 2 (correct):* The Estate Counsel owes fiduciary duties to his/her/its client, the Estate.
>
> *Minor premise (questionable at best):* If the Estate is insolvent, it's "owned" by its creditors because there is no value left in the Estate for its shareholders or other equity owners.
>
> *Conclusion (false):* Therefore, the Estate Counsel owes fiduciary duties *directly* to each creditor.

We think that the best way to separate the correct assumptions from the unfounded ones requires a review of three cases: our "good," our "bad," and our "ugly."

1. The Good: *Louisiana Bank & Trust v. Anderson.*[257]

Every so often, bankruptcy issues wander into the "real world" of law. In this case, the issue of whether Estate Counsel was liable for alleged violations of its fiduciary duty to the creditors of the Bankruptcy Estate managed to come before the Louisiana Court of Appeals. The facts of the case were fairly straightforward. In May 1982, Underwater Completion Team, Inc. ("UCT") granted Louisiana Bank & Trust a security interest[258] in its accounts receivables. On November 1, 1982, UCT filed a Chapter 11 case.[259] In approving the firm of Anderson Anderson Hausey Rainack & Stakelum as Estate Counsel, the Bankruptcy Court ordered the law firm to: (1) "exercise general supervision" of the operation of the Estate's business by the DIP; (2) take responsibility for the DIP's "strict compliance with the terms of the Court's orders authorizing" the DIP to operate the Estate's business and the provisions of the Bankruptcy Code; and (3) "take all steps necessary to prevent any depletion of the assets of the [Estate] . . . and . . . notify the Court of any actual or threatened depletion . . . ."[260] Further, the Court ordered the DIP not to use cash collateral[261] without prior Court approval.[262]

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[257] 526 So. 2d 1386, 1387 (La. Ct. App. 1988). Please note that neither of us is familiar with Louisiana law, so our terminology may be somewhat imprecise.

[258] *See id* at 1387.

[259] *See id.* Not surprisingly, given its stellar performance in lending, the bank was taken over by the FDIC during the pendency of this appeal.

[260] *See id.* at 1387-88. The language of the bankruptcy court's order was so specific about what the law firm was supposed to do that it clarified, beyond cavil, the extent of the law firm's fiduciary duty to the Bankruptcy Estate in this case.

Unfortunately for the bank, the law firm advised UCT that the accounts receivable were not cash collateral because the bank's security interest was unperfected under Louisiana law. Acting on that advice, UCT used $400,000 of these receivables for daily operating expenses without first seeking the bank's permission or the court's approval.[263] Unfortunately for the law firm, the Louisiana Supreme Court changed the law on perfection during the chapter 11 case, which rendered the law firm's previous advice absolutely wrong.[264] The bank then sued the law firm and others to recover the improperly used receivables.[265]

The basis of the suit against the law firm was that it breached the duties (imposed upon it by the bankruptcy court) to the bank by advising the DIP that it could use funds collected from UCT receivables without court approval. After reviewing the pleadings, the trial court granted the law firm's motion for summary judgment, ruling that the DIP's law firm didn't owe the bank any fiduciary duty at all.[266] Like the trial court before it, the Louisiana Court of Appeals found, as a matter of law, that the law firm didn't owe a fiduciary duty directly to the bank:

> We are convinced that should we adopt the construction advocated by Louisiana Bank & Trust, it would turn the established concept of an attorney obligation to his client on its head. Most particularly, as we appreciate Louisiana Bank & Trust's argument, should we find that defendants owed an extended duty to it, we would be allowing Louisiana Bank & Trust to seek damages from an attorney, not its attorney, for the attorney's giving of correct advice to UCT, at least correct at the time the advice was given. We agree with the findings of the trial judge that the Bankruptcy Court order did not deviate to this extent from the concept of duty established in the Rules of Professional Conduct for the relationship between an attorney and his client. Therefore, we conclude that the trial court's dismissal of Louisiana Bank & Trust's claim on a motion for summary judgement was properly entered since there was no duty on defendants' part which extended to the protection of its client's creditor.[267]

This case and another one, *In re Derringer*,[268] together stand for the proposition that Estate Counsel generally owes no duties *directly* to third-party creditors.[269] Although the

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[261] *See* 11 U.S.C. § 363(a) (1994).
[262] *See Louisiana Bank & Trust*, 526 So. 2d at 1388.
[263] *See id.* at 1387.
[264] *See id; see also* Agrico Chem. Co. v. E.K. Paintings, Inc., 432 So. 2d 253, 255 (La. 1983) (reversing rule of law relied upon by Debtors).
[265] *See Louisiana Bank & Trust*, 526 So. 2d at 1388.
[266] Compare the Louisiana State trial court judge's understanding of this problem with the Ninth Circuit's decision in *In re* Perez, 30 F.3d 1209 (9th Cir. 1994), discussed *infra* notes 297-303.
[267] *Louisiana Bank & Trust*, 526 So. 2d at 1389-90.
[268] Scheftner v. Foster (*In re* Derringer), 132 B.R. 34 (Bankr. N.D. Cal. 1991).
[269] State law is all over the map when it comes to bootstrapping the duties of a lawyer *representing* a fiduciary to create a duty of the lawyer *directly to the beneficiary*. *Compare* Arpadi v. First MSP Corp., 68 Ohio St. 3d 453,

fiduciary duty to creditors *generally* is still an open question,[270] there shouldn't be any duty to a *particular* creditor. But we also must point out that the law firm in this case ran a real risk by advising its client that the collateral in question was definitely not cash collateral.

2. The Bad: *In re Bonneville Pacific Corp.*[271]

A frequent nightmare for attorneys who represent Estates is discovering that the client for whom they have worked so hard is being run by a bunch of crooks. The *Bonneville*[272] case is the ultimate example of that nightmare: the prepetition debtor was not only operated by a group of criminals,[273] but these same criminals were assisted in some respects by the Debtor's prebankruptcy counsel,[274] and some of the same questionable practices may have occurred not just before, but during, the case.[275] The court roundly criticized both Estate Counsel and Committee Counsel for their failure to properly investigate the activities of the Debtor and bring that information to the court.[276]

The prebankruptcy Debtor in *Bonneville* seems to have been simply playing a large con game, which created most of its value by engaging in creative trades of either exaggerated or nonexistent assets.[277] On December 5, 1991, it filed a voluntary chapter 11 petition. The Estate at first attempted to hire its prebankruptcy attorneys as primary Estate Counsel, but that application was refused by the bankruptcy and district courts and by the court of appeals,[278] although those attorneys were ultimately employed as special counsel. The Debtor's local bankruptcy counsel was given the task of acting as Estate Counsel. The case then proceeded normally until a series of hearings started

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458 (1994) (attorney for a general partnership owed a fiduciary duty to limited partners of general partnership); Johnson v. Superior Court, 38 Cal. App. 4th 463, 477-79 (1995) (same), *with* Rose v. Summers, Compton, Wells & Hamburg, P.C. 887 S.W.2d 683, 686-87 (Mo. Ct. App. 1994) (rejecting *Arpadi*'s reasoning and holding that there was no duty extending from partnership's attorney to individual partners).

[270] *See infra*, notes 298-308 and accompanying text. The better-reasoned cases refrain from blindly applying any hard-and-fast rule, preferring instead to consider the totality of the circumstances. *See, e.g.*, McClure v. Tremaine, 77 Wash. App. 312 (1995) (holding whether attorney-client relationship exists as a matter of substantive law is to be addressed by tribunal); Brennan v. Ruffner, 640 So. 2d 143 (Fla. Dist. Ct. App. 1994) (considering facts as whole as prelude to decision).

[271] *In re* Bonneville Pac. Corp., 196 B.R. 868 (Bankr. D. Utah 1996); *see also In re* Bonneville Pac. Corp., 147 B.R. 803 (Bankr. D. Utah 1992) (using authority to disgorge attorney of fees), *motion to amend denied*, 196 B.R. 868.

[272] *Bonneville*, 196 B.R. 868.

[273] We're not kidding. *See id.* at 870 n.3 (discussing various convictions, indictments, and guilty pleas entered by debtor's officers and directors to numerous federal felony counts).

[274] *See id.* at 874 n.11 (discussing $30,000,000 Debtor's prebankruptcy counsel paid to Bankruptcy Estate in settlement of Estate's claims against counsel).

[275] *See id.* at 875. Most of the debtor's principals—who later had criminal problems—were managing the DIP postpetition.

[276] *See id.* at 878.

[277] *See Bonneville*, 196 B.R. 868, 871 n.6. (Bankr. D. Utah 1996).

[278] *See id.* at 873.

to paint the picture of a very troubled Debtor.[279] The court believed that all of these events, taken together, should have signaled Estate and Committee Counsel that something was amiss.[280]

In spite of these "warnings," the Estate and Committee Counsel still took no action to investigate, even in a minimal way, the actions of the Debtor.[281] On May 14, 1992, the unsecured Creditors' Committee and the Estate filed a joint motion for extension of the exclusivity period.[282] Relying in part on information obtained from the examiner[283] that there was no great problem with current management, the committee and the Estate urged the extension in the hope that a plan could be proposed to "meet everyone's needs."[284] No one opposed the proposed extension, yet the court refused to grant it and warned Estate Counsel about filing an incomplete or unconfirmable plan just to preserve exclusivity.[285] Four days after this hearing, the Debtor *did* file an incomplete and unconfirmable plan.[286] Shortly thereafter, what can politely be described as "the poop hitting the air circulation device"[287] occurred.

On June 10, 1992, Committee Counsel filed an application to withdraw as counsel, which the bankruptcy court granted that same day.[288] The reason for withdrawal was the discovery that an attorney who was "of counsel" with the Committee's Counsel was married to an insider of Bonneville's numerous subsidiaries, who in turn had participated in a few of Bonneville's questionable transactions.[289] On June 11, 1992, after fully reviewing the examiner's report, the court *sua sponte* ordered the appointment of a trustee. At that point, all of the Debtor's problems came to light.

This appointment might have ended matters except that the Estate Counsel then filed an application for fees. In an earlier opinion in the case,[290] the court had denied Estate Counsel all fees due to its failure to investigate the Debtor, its misrepresentation

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[279] The hearings included: (1) a lift-stay motion on a questionable asset, (2) a motion by the debtor for an injunction to protect the principals of Bonneville from a suit by one of their largest creditors (denied by the bankruptcy court); and (3) a *sua sponte* appointment by the bankruptcy court of an examiner to investigate numerous charges of wrongdoing alleged by various creditors. *Id.* at 875-77.

[280] *See id.* at 878.

[281] *See Bonneville*, 196 B.R. 887. In fact, Estate Counsel informed the court that he was concentrating on "present tense, . . . not dwelling on historical events which . . . weren't going to change." *Id.* We read this as evidence that Estate Counsel was afraid to investigate his client.

[282] *See id.* at 878.

[283] Even the examiner did not escape the Court's displeasure. *See id.* at 878-81.

[284] Given the advantage of 20/20 hindsight, it's clear that the parties controlling the bankruptcy were merely playing for time. We can't tell, though, whether the Committee Counsel knew of the extent of the fraud at that point.

[285] *See Bonneville*, 196 B.R. at 879.

[286] *See id.*

[287] One of us is currently serving as a Brownie troop co-leader. That's why we chose this particular version of the well-known phrase. It gets by *them*.

[288] *See Bonneville*, 196 B.R. at 879.

[289] *See id.* at 881 n.20.

[290] *See In re* Bonneville Pac. Corp., 147 B.R. 803 (Bankr. D. Utah 1992) (regarding application for interim compensation).

of facts to the court, and its "dereliction of duty."[291] Some four years later, this matter came before the court on a motion for reconsideration filed by former Committee Counsel.[292] The result was a twenty-one page opinion that reaffirmed and expanded upon the court's previous ruling.[293]

What is unusual about the last *Bonneville* opinion is that the court was critical of the Committee Counsel for its failure to disclose the DIP's fraud and its "vigorous [] participation in and support of many of the efforts to protect the insiders"[294] in violation of the Committee Counsel's duty to its own client, the unsecured creditors.[295]

We admit that we're not experts on the facts underlying this case. Nonetheless, we believe that, from a review of other case law in this area, the court's criticism of Committee Counsel was undeservedly harsh. It appears that any comfort given by Committee Counsel to the Bonneville insiders was part of an effort to gain confirmation of a plan that would have given the unsecured creditors some distribution, and that the Debtor's collapse would result in a negligiable return to the unsecured creditors. Unless Committee Counsel had known that its clients' interests were being harmed by the insiders or unless its knowledge of the fraud was so substantial and direct that it had a duty, as an officer of the court, to report the fraud, the court's comments concerning Committee Counsel are probably unwarranted.[296]

3. The Ugly: *In re Perez*[297]

In re Perez involved a chapter 11 case filed by an individual, Gary Ronald Perez. In reversing the confirmation of his third amended plan of reorganization, which had been confirmed by the bankruptcy court and affirmed by the BAP, the majority opinion of the Ninth Circuit demonstrated a basic misunderstanding of the absolute priority rule and dabbled in just enough bankruptcy theory to be dangerous.

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[291] *Id.* at 806.

[292] There is no indication as to why there was a four-year lapse between the entry of the original opinion and the opinion on reconsideration.

[293] *See In re* Bonneville Pac. Corp., 196 B.R. 868, 868 (Bankr. D. Utah 1996).

[294] *See id.* at 882.

[295] *See id.* at 883. Although the court clearly stated that its findings as to the former Committee Counsel were mere dicta, we doubt that they'd get much from a fee request in the future. *See id.*

[296] We have some sympathy for Committee Counsel, but it appears that the language of the opinion and sanctions were justified as to the Estate Counsel. Other courts have also been wary of the relationship between Estate Counsel and Committee Counsel. *See, e.g.*, Pierson & Gaylen v. Creel & Atwood (*In re* Consol. Bankshares, Inc.), 785 F.2d 1249 (5th Cir. 1986):

> Too frequently, court-appointed counsel for debtor and the official creditor committees' interests in a case, sharing the mutual goal of securing approval for their fees, enter into a conspiracy of silence with regard to contesting each other's fee applications. (One bankruptcy judge characterized this process as a "massive backscratching exercise.") This is a violation of their duties as fiduciaries not only to their specific clients but to the interests of the debtor's estate.

Id. at 1255 (citing *In re* Arlan's Dept. Stores, 615 F.2d 925, 941 (2d Cir. 1979)).

[297] Everett v. Perez (*In re* Perez), 30 F.3d 1209 (9th Cir. 1994).

Along the meandering road to its conclusion reversing confirmation, the *Perez* majority tarried at what can best be termed a mirage. The court, after a rather short discussion, held that the Debtor in Possession owed a fiduciary duty, not to the Estate, or even to the creditors as a whole, but to "*a* creditor."[298] The majority opinion, betraying a surprising naivete regarding the workings of bankruptcy cases, expressed shock at the idea that the payment of a creditor's prepetition claim might be delayed during the pendency of the case.[299] Making a cognitive leap backwards, the court then implied that the delay wasn't due to the regular progression of reorganizations. Instead, the court attributed the delay to the tendency of many Debtors to capitalize on the fact that creditors have to expend funds on their own counsel to protect their interests in the case, thereby "prolong[ing] and complicat[ing] bankruptcy proceedings" and running up the creditors' costs.[300]

After this grandstanding, the court set forth its normative vision of how counsel for the Debtor in Possession should behave:

> Counsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually. Counsel has an independent responsibility to determine whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor. While he must always take his directions from his client, where counsel for the estate develops material doubts about whether a proposed course of action in fact serves the estate's interests, he must seek to persuade his client to take a different course or, failing that, resign. Under no circumstances, however, may the lawyer for a bankruptcy estate pursue a course of action, unless he has determined in good faith and as an exercise of his professional judgment that the course complies with the Bankruptcy Code and serves the best interests of the estate.
>
> We make no finding of wrongdoing here. *[!!!]* We simply remind counsel that his responsibility is to help lead the estate on a just, speedy, inexpensive and lawful path out of bankruptcy. Failure to live up to this responsibility may result in a reduction in allowable fees and other sanctions.[301]

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[298] *Id.* at 1215. For other cases linking corporate counsel's duty to third parties, see Willner's Fuel Distribs. Inc. v. Noreen, 882 P.2d 399, 406 (Alaska 1994) (noting corporate counsel owes fiduciary duty to creditors). *But cf.* Skarbrevik v. Cohen, England & Whitfield, 231 Cal. App. 3d 692, 700-04 (1991) (stating no such duty to individual shareholders).

[299] *See Perez*, 30 F.3d at 1218; *cf.* CASABLANCA (Warner Bros. 1943) (in which Claude Rains's character exclaims something on the order of: "I'm shocked, *shocked*, that gambling is going on here.")

[300] *See Perez*, 30 F.3d at 1218. The authors are puzzled by the court's implication that this type of behavior is somehow different from that usually attributed to wealthy parties in non-bankruptcy cases.

[301] *Id.* at 1219 (emphasis added).

Because the majority opinion never reached the much more important issue of what "duty to the Estate" means,[302] *Perez* manages to achieve the impossible. It is both a tautology (counsel representing the DIP must make sure that the DIP fulfills its duty to the Estate)[303] and a fiction (the court isn't making a finding of wrongdoing, but it is excoriating counsel for the DIP anyway). Moreover, *Perez* leaves unresolved the question of whether it should be read to overrule the rather more sensible, if more cynical, holding in *In re Sidco, Inc.*[304] In a variety of respects, *Perez* certainly is the "ugly" in our trilogy of cases.

III. THE TENSION BETWEEN THE "NEW" BURDENS OF FIDUCIARY DUTIES FOR ESTATE COUNSEL AND THE ETHICS RULES

One of us (NBR) has already gone on record in claiming that the duty of counsel to "official entities"[305] includes a duty to determine whether the adversary system

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[302] Of course, the *Perez* majority isn't alone in its confusion. *See In re* Bonneville Pac. Corp., 196 B.R. 868, 883 (Bankr. D. Utah 1996) (perpetuating bootstrapping of the duty of counsel to DIP—now a "fiduciary duty to the estate"—to DIP's own fiduciary duty to estate). At least the court in *In re* Brennan, 187 B.R. 135, 149-50 (Bankr. D. N.J. 1995), recognized that it *was* bootstrapping: "[T]he fiduciary duty of the debtor's professionals is derivative of the debtor's fiduciary duty." *Id.* at 149-50. *Perez* didn't involve unconscionable attorney conduct but, unlike *Brennan*, *Perez* is a problem for the average bankruptcy practitioner. The estate counsel in *Perez* wasn't trying to destroy the estate in a "scorched earth" war as in *In re* Kendavis Indus. Int'l, Inc., 91 B.R. 742 (Bankr. N.D. Tex. 1988), and wasn't manipulating a mentally impaired Debtor-attorney as in *In re Rivers*, 167 B.R. 288 (Bankr. N.D. Ga. 1994). Here, Debtor's counsel attempted, with some success, to get confirmation of an individual's chapter 11 plan that paid 100% on the claims of all creditors, even though it didn't pay interest on the claims. Unless Mr. Perez was hopelessly solvent (i.e., "rich"), this strategy hardly smacks of bad faith or unfair dealings. If counsel's conduct in *Perez* is sanctionable or otherwise improper, then it is almost impossible for Estate Counsel to ethically fulfill its duties in a chapter 11 or chapter 12 case other than by filing plans that call for payments in full with interest to all creditors.

[303] *See* Perez, 30 F.3d at 1218-19.

[304] St. Angelo v. Sidco, Inc. (*In re* Sidco, Inc.), 173 B.R. 194 (E.D. Cal. 1994) (affirming bankruptcy judge's holding that "the notion of a duty by debtor-in-possession's counsel to the debtor-in-possession's creditors [was] a 'flight into the absurd'"). As the district court in *Sidco* explained:

> [T]he authorities cited by appellant to create a fiduciary duty of counsel to the estate [are] very weak. These nonbinding cases speak of the attorney's fiduciary duty to the estate in unusual contexts, and not as a general principle. These cases do not overthrow [the bankruptcy judge's] basic tenet that attorneys for debtors-in-possession have a fiduciary duty to their *client*, the debtor-in-possession, not to the creditors and shareholders whose interests may be adverse to the debtor. In fact, 11 U.S.C. § 327 guards against concurrent representation of both the creditor and a debtor-in-possession.
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> * * *
>
> Furthermore, it is the debtor-in-possession who ultimately manages the creditors' and shareholders' interests, while the attorney only advises the debtor. The debtor-in-possession, not the attorney, acts as the trustee to the estate.

Id. at 196-97 (emphasis added) (citations omitted). The bankruptcy judge in *Sidco* also wryly observed that, because any attorney for the DIP was likely to be carrying out the wishes of the DIP's 90% owner, any lawyer for the DIP would be as good as any other, and the only way to avoid that type of owner control would be to appoint a trustee instead of permitting the Debtor to remain in possession. *See id.* at 195.

[305] *See Turning*, *supra* note 88, at 927 (defining "official entities" to include Debtors, creditors' committees, and parties that are paid by Estate funds).

protects everyone with an interest in the bankruptcy case.[306] There's a tension between a lawyer's duty of zealousness and the duty as an officer of the court. When the duty of zealousness would require the lawyer to mislead the court, NBR argues that the lawyer's duty as an officer of the court should be paramount.[307]

The adversary system presumes that each interested party is represented by competent, zealous counsel. When that presumption is true, then the "official entities" can feel free to represent their clients without worrying that they may be compromising their concomitant duty as officers of the court. When, however, the presumption fails—e.g., someone's interest isn't being represented by counsel, or the counsel isn't competent—NBR has suggested that lawyers have a duty to compensate for the presumption's failure and, thus, have a duty to consider the interests of those whom the adversary model doesn't protect.[308]

What complicates matters in bankruptcy cases is that counsel for the DIP is said to represent the "Estate," and there's no consensus on exactly what representing the Estate means. The Estate wants to reorganize, but for whose benefit? The managers? The shareholders? The creditors? Depending on which case or article you read, you get different answers.[309] Moreover, the interests of the Estate's constituents[310] will vary during the case, making the determination of appropriate interests a moving target.[311]

As our Parts I and II have shown, several cases have mentioned, without developing the concept, the DIP's "obligation to the court."[312] Other cases have spent time

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[306] *See Forest, supra* note 41, at 789-906 (discussing various possibilities of how much lawyer can advise her client on extra-legal issues); *In re* Consupak, Inc., 87 B.R. 529, 550-51 (Bankr. N.D. Ill. 1988) (discussing whether attorney must *volunteer* legal advice or must simply wait for client to ask for her opinion) (emphasis added).

[307] *See Forest, supra* note 41, at 789; *see also* discussion of *Arlan's, supra* note 126-31 and accompanying text. In addition, lawyers are subject to ethical rules that imply a duty to the court. *See, e.g.*, MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3 (1983) (stating that lawyer must disclose, to tribunal, criminal or fraudulent acts).

[308] The theory behind NBR's "tie-breaker" is that making the duty to the court superior to the duty to the client would best preserve the integrity of the entire system. *See Forest, supra* note 41, at 789.

[309] *Compare In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) (explaining that "[c]hapter 11 debtor in possession administers the assets of the estate and any business conducted therein as a fiduciary for both the equity interests and the creditors[;] . . . [c]ounsel for a Chapter 11 debtor owes a fiduciary duty to the corporation or partnership as an entity, and represents its interests, not those of its principals."); *with In re* Harp, 166 B.R. 740, 746-47 (Bankr. N.D. Ala. 1993) (noting fiduciary responsibilities of DIP require DIP to ensure that resources benefit "*the unsecured creditors and other parties in interest.*") (emphasis added).

[310] We're using "Estate constituents" to mean parties with an interest in the outcome of the case (e.g., parties in interest under 11 U.S.C. § 1109(b) (1994)) as well as those with outlying interests, such as employees. *Cf.* Karen Gross, *Taking Community Interests Into Account in Bankruptcy: An Essay*, 72 WASH. U. L.Q. 1031 (1994); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987); Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. Rev. 815, 815 (1987) ("On what in my view is a different front, Warren and I also think existing laws do not adequately protect many, such as workers who are affected when a firm fails."). *But see, e.g.*, Hon. Barry S. Schermer, *Response to Professor Gross: Taking the Interests of the Community Into Account in Bankruptcy—A Modern-Day Tale of Belling the Cat*, 72 WASH. U. L.Q. 1031 (1994).

[311] *See Turning, supra* note 88, at 919 (parties in interest may change allegiance several times during case).

[312] *See, e.g.*, Mapother & Mapother v. Cooper (*In re* Downs), 103 F.3d 472, 479 (6th Cir. 1996) (discussing possible sanctions for attorney's breach of "his fiduciary obligations to the court") (quoting Futuronics Corp. v.

discussing the DIP's duty to the Estate, without ever defining exactly what that means.[313] Still others have focused on the DIP's duty to the unsecured creditors.[314] And some

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Arutt, Nachamie & Benjamin (*In re* Futuronics Corp.), 655 F.2d 463, 471 (2d Cir. 1981)).

[313] *See* Knepper v. Skekloff (*In re* Knepper), 154 B.R. 75, 78-79 (N.D. Ind. 1993) (denying fees to DIP's counsel on the grounds that DIP's counsel should have recognized that reorganization was impossible and thus should have converted case to one under chapter 7); *see also* Everett v. Perez (*In re* Perez), 30 F.3d 1209, 1219 (9th Cir. 1994) (stating "[c]ounsel for the estate must keep firmly in mind that his client is the estate and not the debtor individually"). *Perez* reflects the consistent cognitive leap that courts make when they discuss counsel's "independent responsibility to determine whether a proposed course of action is likely to benefit the estate or will merely cause delay or produce some other procedural advantage to the debtor." *Id.* at 1219. Until we know which interests comprise the interests of the *Estate*, Judge Kozinski's majority opinion sheds no light on these duties. *Cf.* Jonathan M. Landers & Kathryn A. Coleman, *Unexpected Allies: The Bankruptcy Judge and Debtor's Counsel*, 112 BANKING L.J. 997, 1002-03 (1995) (noting that *Perez* and others hold Debtor as fiduciary to creditors, but "[t]he interests of different creditor constituencies are vastly different . . . [y]et the debtor has an obligation to maximize the overall return to creditors on a more or less utilitarian principle—that is, the greatest good for the greatest number.").

[314] *See In re* Wilde Horse Enters., Inc., 136 B.R. 830, 840 (Bankr. C.D. Cal. 1991) (stating that "[b]ecause the attorney for the debtor in possession is a fiduciary of the estate and an officer of the Court, the duty to advise the client goes beyond responding to the client's request for advice. . . . [and the] attorney has the duty to remind the debtor in possession, and its principals, of its duties under the Code, and to assist the debtor in fulfilling those duties."); *see also In re* Sky Valley, Inc., 135 B.R. 925, 929 (Bankr. N.D. Ga. 1992) ("Debtor's attorney's duty as fiduciary of the estate requires an active concern for the interests of the estate and its beneficiaries.") (citing *In re* Consupak, Inc., 87 B.R. 529 (Bankr. M.D. Ill. 1988), *In re* Whitney Place Partners, 147 B.R. 619, 620 (Bankr. N.D. Ga. 1992) ("The attorney for the debtor in possession is also a fiduciary to the estate.") (citing *In re* Doors & More, Inc., 126 B.R. 43 (Bankr. E.D. Mich. 1991)); *In re* Adam Furniture Indus., Inc., 158 B.R. 291, 301 (Bankr. S.D. Ga. 1993) ("Even though the law firm acts as attorney for the debtor in possession, it also has certain fiduciary duties to the estate, including insuring that the rights of the creditors are protected.")

In re Doors & More has the misfortune of perpetually being miscited by sloppy judicial clerks. In fact, *In re Doors & More* states the basic principles correctly, observing that the Estate encompasses the interests of creditors and shareholders. *In re* Doors & More, Inc., 126 B.R. 43, 46 (Bankr. E.D. Mich. 1991) (citing Commodity FuturesTrading Comm'n v. Weintraub, 471 U.S. 343 (1985)). It also correctly observes that Estate Counsel is a fiduciary for the Estate. *Id.* (citing Shaw & Levine v. Gulf & W. Indus., Inc. (*In re* Bohack Corp.), 607 F.2d 258 (2d Cir. 1979) and *In re* Consupak, Inc., 87 B.R. 529, 548-49 (Bankr. N.D. Ill. 1988)). What *In re Doors & More* avoids (but what some judicial clerks have misconstrued) is the transitive reasoning linking the Estate Counsel's fiduciary duty to its client (the Estate) with any duty to *particular* interests related to the Estate. It's unfortunate that this mistake in citing has been perpetuated by those who haven't read *Doors & More*. On the other hand, those mistakes have enabled us to write this Article.

Let's discuss some courts who have tried, at least, to "get it right." The bankruptcy court in *In re* Rivers, 167 B.R. 288 (Bankr. N.D. Ga. 1994), attempted to spell out the concept of the DIP's attorney's fiduciary duty to the Estate:

> The role of a court-approved professional employed in a bankruptcy case is to "advise" and "assist" the fiduciary. The professional's duties run not merely to the person or persons holding the office of the fiduciary but to the trust to which the fiduciary owes allegiance. Thus in a Chapter 11 case, an attorney for a debtor in possession must balance a role as counselor to the debtor with the role of officer of the court and fiduciary to the bankruptcy estate. When the interests of the former conflict with those of the latter, it is the estate and the court to which the attorney owes his highest allegiance.

Id. at 301. The *Brennan* court's view on the scope of the fiduciary duties of the DIP's counsel is different: "The fiduciary duty of the debtor's professionals is essentially to assist the debtor in fulfilling his fiduciary duty and to take action if the debtor fails to do so in a manner which is detrimental to the estate." *In re* Brennan, 187 B.R. 135, 150 (Bankr. D.N.J. 1995).

The analytical misstep of *Wilde Horse* and cases similar to it stems from superimposing the duty of the DIP courts (the most well-reasoned ones) reject a unitary definition of a DIP's duty to the Estate as being amorphous.[315] But until we know what the DIP's duty to the Estate is, it's difficult to relate the DIP's duty to the duty of Estate Counsel.[316]

We're not surprised by the reluctance to spell out exactly what the "Estate" is—such hesitance is natural. Defining the Estate as any of the possibilities mentioned brings with it serious consequences:

DEFINITION OPTIONS	CONSEQUENCES
1. "Estate" encompasses the interests of the creditors and the equity owners.	Estate Counsel has to reconcile vastly differing interests without being accused of conflicts of interest.
2. "Estate" encompasses the interests of creditors and shareholders if it's solvent but only the interests of creditors if it's insolvent.	How do we determine solvency—and as of what point? Solvency becomes a factor that leaves Estate Counsel liable based on 20/20 hindsight.[317]
3. "Estate" encompasses only the interests of creditors.	Ignores *Weintraub*; still creates unavoidable conflicts between secured and unsecured creditors.

(which *is* a fiduciary of the Estate) to the duty of the DIP's counsel to *represent* the DIP in all of its fiduciary splendor. We believe that these courts are confusing the counsel's legitimate duty as officer of the court with the DIP's fiduciary duty to the Estate. Such a cognitive leap in terms of duties puts too much pressure on the DIP's counsel and creates infinite loops of conflict. Still, there are those who insist on such a scenario:

> A Chapter 11 debtor in possession acts in a fiduciary capacity for the benefit of creditors and other parties in interest. *Counsel for the debtor in possession, therefore, not only has an obligation to the debtor, but also has an obligation to the debtor's creditors as well.* It may be difficult for counsel to satisfy these two roles in a small business case. . . . [But] counsel is responsible for seeing that the requirements and obligations imposed on the debtor in possession by the Code, Rules, and bankruptcy courts are strictly observed. *Failure of counsel to fulfill that obligation can have severe repercussions.*

Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305, 326-27 (1993) (citations omitted and emphasis added). If Judge Small can write so forebodingly about the precarious position of DIP's counsel, how likely is it that firms will continue to be willing to represent DIPs in the future? *See Folly, supra* note 44.

[315] *See* St. Angelo v. Sidco, Inc. (*In re* Sidco, Inc.), 173 B.R. 194, 196 (E.D. Cal. 1994) (rejecting overall theory of DIP's counsel's duty to estate in favor of DIP's counsel's fiduciary duty to DIP itself, and approving bankruptcy judge's "basic tenet that attorneys for debtors-in-possession have a fiduciary duty to their client, the debtor-in-possession, not to the creditors and shareholders whose interests may be adverse to the debtor"). For a more thorough discussion of the status of *Sidco* in the Ninth Circuit today, see *supra* note 288 and accompanying text.

[316] How can Estate Counsel give legal advice in the best interests of the Estate if we can't pinpoint what the Estate is?

[317] *See Folly, supra* note 44. If we really wanted to complicate things, we'd throw in all of the different ways to determine "solvency," ranging from the balance-sheet test to the "generally not paying debts as they become due" standard. Let's face it: solvency is one of the most fluid concepts around.

4. "Estate" encompasses only the interests of unsecured creditors.	Ignores *Weintraub*; still creates conflicts based on (1) differing interests among unsecured creditors and (2) valuation declines that make unsecured creditors out of secured creditors.
5. "Estate" is too vague a concept to be defined.	What guidance is that? Is that really a viable construct?

All of these options pose problems. But until we figure out just what the "Estate" is, courts are going to be confused about the duties of Estate Counsel. Consequently, any increased risk that Estate Counsel will be held liable in some courts but not in others will tend to make attorneys squeamish about taking on Estate representation.[318]

We've therefore decided to adopt a combination of Options #1 and #5. We believe that, at least until facts clearly establish otherwise, the Estate has to include the interests of creditors *and* owners. Lynn LoPucki and William Whitford have made a good case for the proposition that the interests of the Estate are not limited to the interests of its creditors.[319] After several groundbreaking studies in this area, they "conclude[d] that the

[318] *See Inherent Conflicts, supra* note 4, at 288 (discussing superior talents of Debtor's counsel and how dangerous it would be to lose talented lawyers to justified fear of lawsuits); *Folly, supra* note 44 (questioning whether ethical and rational lawyers would ever want to represent insolvent corporations).

As usual, Jack Ayer puts it succinctly and accurately:

> "We" (meaning: the sovereign, the polity, the system) haven't really made up our mind how far the trustee/DIP should be able to go in protecting the debtor, at the creditors' expense. It would be possible to design a system of bankruptcy that served the interest of creditors only. Up to now, we have been unwilling to go that far. But we seem to have a bit of a bad conscience about it. We'll let the debtor go a ways, but not too far. And we have a way of changing the rules from case to case—sometimes even mid-case.

Brenda Hacker Osborne, Note, *Attorneys' Fees in Chapter 11 Reorganizations: A Case for Modified Procedures*, 69 IND. L.J. 581, 589 (1994) [hereinafter Osborne] (quoting John D. Ayer, *Professional Responsibility in Bankruptcy Cases*, in BANKRUPTCY ETHICS REVISITED 2-5 to 2-6 (1992)). For an interesting comparison of the "broad fiduciary duty" and the "no fiduciary duty" views, see Stephen McJohn, *Claims & Opinions: Person or Property? On the Legal Nature of the Bankruptcy Estate*, 10 BANKR. DEV. J. 465, 506-11 n.211 (1994) (citing, as support for the "no fiduciary duty" approach, Thomas G. Kelch, *The Phantom Fiduciary: The Debtor in Possession in Chapter 11*, 38 WAYNE L. REV. 1323 (1992), and citing, for the "broad fiduciary duty" approach, John T. Roache, Note, *The Fiduciary Obligations of a Debtor in Possession*, 1993 U. ILL. L. REV. 133 (1993)).

[319] *See* Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 680-83 (1993) [hereinafter *Corporate Governance*] (noting in large reorganizations creditors and shareholders are parties in interest); *Equity's Share, supra* note 52, at 143 (noting other interests besides creditors share in distribution); Osborne, *supra* note 318, at 589 n.49 (one of many manuscripts citing LoPucki & Whitford for the proposition that shareholders also have interest in estate). Osborne observes that:

> Many cases . . . [state] that the DIP's role in bankruptcy is to maximize the value of the estate for the benefit of creditors. . . . The DIP does have a duty to [do so,] but this does not mean that creditors must be served to the detriment of equity. No courts have held that the DIP must select a mode of maximization that harms equity in order to satisfy creditors *faster*, when another alternative exists which serves creditors' as well as equity's interests.

Id. at 588 n.47 (emphasis added and citations omitted). *But see In re* Perez, 30 F.3d 1209 (9th Cir. 1994), discussed in more detail *supra* at notes 297-303 and accompanying text.

better view is that management 'owes' fiduciary duties to both the creditors and the shareholders of an insolvent company, until their claims or interests are extinguished as part of the reorganization case."[320]

Using Option #1 increases the risk that the Estate Counsel will be pulled in several directions at once. Insolvency (or even borderline solvency) tends to create more risk-tolerance for junior interests than for senior interests. If the only possibility of gain for the junior interests stems from having the management go to the racetrack and gamble the company's cash, then the junior interests will be the ones handing management the

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Jay Westbrook's thoughtful piece on special conflicts issues for the DIP focused on the DIP's "conflicting obligations" to its creditors and, possibly, its owners. *See Inherent Conflicts, supra* note 4, at 289-90. "The Bankruptcy Code never specifies to whom the trustee owes duties, except perhaps in its references to 'parties in interest,' an undefined term. If the DIP represents owners, along with creditors, then it has an inherent and recurring conflict of interest, one that its attorneys must inevitably share." *Id.* at 290 (footnotes omitted).

In *Inherent Conflicts*, Westbrook discusses three cases—Diamond Lumber, Inc. v. Unsecured Creditors' Committee of Diamond Lumber, Inc., 88 B.R. 773 (N.D. Tex 1988), *In re* Kendavis Indus. Int'l, Inc., 91 B.R. 742 (Bankr. N.D. Tex 1988), and *In re* Chapel Gate Apts., Ltd., 64 B.R. 569 (Bankr. N.D. Tex. 1986)— that add support for the proposition that creditors' interests are paramount in a bankruptcy case. *See Inherent Conflicts, supra* note 4 at 290 & n.10. The structure of the argument bootstraps the duty that the DIP might owe to creditors and creates a duty of the DIP's *attorney* to those selfsame creditors. *Id.* at 290-91 & note 14 (discussing the debate, and citing LoPucki & Whitford, *Equity's Share, supra* note 52, about whether an insolvent DIP owes a duty to the owners or only to the creditors). But Westbrook correctly rejects this simple analysis:

> Indeed, for that reason a decision that DIPs should regard only the interests of creditors by no means resolves the problem of inherent conflict for the DIP and its counsel. But the existence of cramdown does highlight the statutory role of the debtor, just as the provisions relating to interest holders demonstrate that owners have legitimate interests in Chapter 11 proceedings.

Inherent Conflicts, supra note 4, at 293 n.23 (citing to 11 U.S.C. §§ 1129(a)(7), (b)(2)(c) (1994)).

[320] *Corporate Governance, supra* note 319, at 709-10. In a valiant attempt to clarify the muddled law in this area, they explain:

> [T]he cases are unclear as to whom management "owes" fiduciary duties. Most authorities agree that once insolvency intervenes, creditors can sue for breach of fiduciary duties by directors and officers. There is considerable wisdom in this point of view. Once insolvency intervenes, it is creditors who will bear the bulk of the company's losses, so they should be able to initiate legal action when losses result from inappropriate management behavior. The case for a fiduciary duty to creditors is especially strong in bankruptcy, where creditors' contractual rights are suspended by the automatic stay. There is a growing number of statements, however, that post-insolvency fiduciary duties run only to creditors. If that were an accepted statement of current law, it would be possible to argue that when a conflict of interest arises between creditors and shareholders, management of an insolvent corporation has a legal obligation to serve the creditors' interests.
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> We do not believe, however, that these statements should be viewed as establishing current law. First, contrary statements appear in both the cases and the law reviews. Second, the view that managers of insolvent companies owe fiduciary duties only to creditors fails to recognize the very real interest that shareholders can have in the management of those companies. For many insolvent companies a substantial possibility exists for a return to solvency prior to the confirmation of the plan. Even if the company never returned to solvency, shareholders might be able to win a share of the distribution under the plan. If the value of those possibilities is reduced by the wrongful acts of management, shareholders should have a remedy.

Id. at 707-09. In fact, LoPucki and Whitford concluded that "management does not consistently favor or represent either creditor or shareholder interests [and] the alignment of management is clearly a function of solvency." *Id.* at 745. According to their study, managers of solvent companies didn't tend to align with creditors, but managers of insolvent companies tended to align more with creditors than with shareholders. *Id.* at 745-46.

racing forms and the senior interests will be the ones blocking management's access to the betting window.[321]

But Option #1, by itself, may be too cumbersome for Estate Counsel to use on a daily basis. Estate Counsel can't each ask each day, "Is my client still arguably solvent, or have my duties switched over to creditors?" Option #5 provides us with a nice finesse. It's not as good as spelling out the Estate's exact interests, but as long as we can be clear that the DIP's duty is to the Estate, *period*, we can start to resolve the problem of fiduciaries that don't behave as fiduciaries.

We've experimented with other solutions. One of these involved applying Geoffrey Hazard's analysis of "triangular lawyer relationships" to the duties of Estate Counsel vis-a-vis the DIP and other parties in interest.[322] Hazard drew a distinction between the relationship that ensues when a lawyer represents a *client* who owes a fiduciary duty to a third party (the "lawyer⇒guardian⇒ward" relationship) and the relationship that ensues when *both a third party and the lawyer* owe fiduciary duties to the lawyer's

[321] *See, e.g.*, Dwyer v. Jones (*In re* Tri-State Paving Inc.), 32 B.R. 2 (Bankr. W.D. Pa. 1982) (involving managements use of Estate funds to gamble in Las Vegas); *Corporate Governance, supra* note 319, at 683 ("Senior interests are often in sharp conflict with juniors as to the level of risk an insolvent company should accept in its investment policy."). Not surprisingly, junior interests are much less risk-adverse than are senior interests. *See id.* at 684-86. Risk-tolerance, thus, may disproportionately harm creditors in favor of shareholders. *See id.* at 768-69. For this reason, LoPucki and Whitford suggested transfers of wealth in the form of "risk compensation payments." *See* Lynn M. LoPucki and William C. Whitford, *Compensating Unsecured Creditors for Extraordinary Bankruptcy Reorganization Risks*, 72 WASH. U. L.Q. 1133 (1994). *But see* Charles W. Mooney, Jr. *Hosing Down Senior Claims With a Quicker and Dirtier Chapter 11*, 72 WASH. U. L.Q. 1133 (1994); *see also* Lynn M. LoPucki & William C. Whitford, *Compensating Unsecured Creditors for Extraordinary Bankruptcy Reorganization Risks*, 72 WASH. U. L.Q. 1133 (1995). *But see* Charles W. Mooney, Jr., *Hosing Down Senior Claims With a Quicker and Dirtier Chapter 11*, 72 WASH. U. L.Q. 1153 (1994). Those who were more willing to have management engage in riskier decisions would pay those affected by any downside from the risk. *Corporate Governance, supra* note 319, at 788-800. We'll have to set aside for now this intriguing Coasian possibility, as our inquiry in this Article is different from their focus. What we do draw from LoPucki and Whitford is that we can't simply say that the DIP owes its duty merely to the creditors. The LoPucki and Whitford studies have done a marvelous job of dispelling that simplistic notion. *See also In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) ("A Chapter 11 debtor-in-possession administers the assets of the estate and any business conducted therein, as a fiduciary for both the equity interests and the creditors.")

For other good descriptions of the relationship between risk-tolerance and insolvency, see, e.g., Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439 (1992); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 357-59 (1993).

NBR's personal, Jiminy Cricket-type approach to risk tolerance as it applies to fiduciaries is that everyone is underemphasizing how a voluntary fiduciary will behave towards its beneficiary. Of course, everyone has his own personal interests that will pose at least potential conflicts with the interests of the beneficiary itself. *Cf. Inherent Conflicts, supra* note 4(discussing compensation as example of conflicts between attorneys own interests and interests of client). Voluntary fiduciaries, by definition, *understand* that they are obligated to put the interests of their beneficiaries first. They *agree* to that. And, for the most part, they abide by it. It's those few bad actors who make being a voluntary fiduciary seem difficult.

[322] *See generally* Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 GEO. J. LEGAL ETHICS 15 (1987) (examining "the nature of a lawyer's responsibilities where the lawyer's client has a special legal relationship with another party that modifies the lawyer's 'normal' professional responsibilities.") [hereinafter *Triangular Relationships*]. A special thanks goes to Ray Warner for pointing us in this direction.

client, but the lawyer deals primarily with the third party (the "lawyer⇨corporation ⇦officer" relationship).[323] As Hazard explains,

> The difference in the vectors of obligation in these two triangular relationships is important. In the lawyer⇨guardian⇨ward triangular relationship, the ward is the dependent person and the obligee of the guardian, but the guardian is the dependent person and the primary obligee of the lawyer. In the lawyer⇨corporation⇦officer relationship, the corporation is the dependent entity and the obligee of both the lawyer and the corporate officer. This structural difference in obligations can help identify and define the lawyer's role in the two triangular relationships.[324]

Hazard fleshes out his innovative theory by contrasting it with the traditional way in which a lawyer's relationships with others are characterized. He characterizes the three traditional relationships that a lawyer may have as: (1) the lawyer's relationship to the client (the client as "friend"); (2) the lawyer's relationship to the court (the court as "father"); and (3) the lawyer's relationship to a third party (the third party as "foe").[325] Deconstructing these characterizations,[326] Hazard rejects these "simplistic normative premise[s]"[327] in favor of a "normal"-"antagonistic" dichotomy:

> The difference between a "normal" triangular relationship and one contaminated by antagonism does not lie in the *structure* of the relationship. Until finally resolved or dissolved, the structure is ambiguously triangular, with the nonlawyer parties being fellow clients, or antipodal, with the nonlawyer parties being antagonists. The proper interpretation depends not on structure but on process—what has happened within the relationship. The relevant set of happenings include, above all, what the lawyer has done in the relationship.
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> * * *
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> The critical problem the lawyer faces in triangular relationships is that his or her professional responsibilities depend unavoidably on what the other two parties do for and to each other. The lawyer's duty cannot adequately be defined, as it normally is, by specifying *ex ante* the identity of "the client." Neither of the "relevant others" is a legally freestanding person in the standard conceptual sense of "client." . . . The corporation is not an individual at all, but exists only in law and through personification by others who act ex officio. If

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[323] *See id.* at 15-16.

[324] *See id.* at 16.

[325] *See id.* at 21-26 (defining three possible relationships lawyer may have).

[326] *See id.* at 26-31 (finding established three-tiered conceptual system inadequate where traditionally disparate relationships overlap, thereby giving rise to "very serious practical and conceptual difficulties").

[327] *See Triangular Relationships supra* note 322, at 30 (finding established conceptual system rendered simplistic by "complex interdependencies in the lawyer-guardian-ward and lawyer-corporation-corporate officer situations").

> the other parties to the relationship conduct themselves as the law contemplates they should, then all the "relevant others" collectively can be considered "the client." That principle is already well established for corporations, and there seems to be no reason not to think of guardianships and other triangular relationships in the same way. On the other hand, if the dominant party is guilty of misconduct toward the dependent one and if the lawyer behaves as though everything were still normal, the lawyer would then have at least an ethical problem and quite possibly legal liability.[328]

So how could we use Hazard's triangular relationship approach in analyzing the duties of counsel to the DIP or trustee? In some sense, the courts that have struggled to find a fiduciary duty to creditors have instinctively applied Hazard's analysis, which changes the lawyer's duty depending on "whether the dominant party [the DIP] is guilty of misconduct toward the dependent one [the Estate]."[329] But those courts have just made the same cognitive leap that we've been discussing: equating the *Estate's* interests with those of the Estate's *constituents*. Even if we wanted to use Hazard's theory, we'd have to form more than a triangle. We'd have to form some sort of a pentagon.[330]

IV. BACK TO BASICS: DECONSTRUCTING THE MYTH OF THE ESTATE COUNSEL'S FIDUCIARY DUTIES TO CREDITORS

Remember the false syllogism that some courts have created:

Major premise 1 (correct): The DIP owes fiduciary duties to the Estate.

Major premise 2 (correct): The Estate Counsel owes fiduciary duties to his/her/its client, the Estate.

Minor premise (questionable at best): If the Estate is insolvent, it's "owned" by its creditors because there's no value left in the Estate for its shareholders (or other equity owners).

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[328] *See id.* at 40-41 (emphasis in original and footnotes omitted).

[329] *See id.* at 41.

[330] Bruce Markell has suggested that Hazard's triangulation theory *can't* work here because the "triangle" is actually more of a "pentagon": "The lawyer (1) represents the DIP (2), but is hired by the DIP's management (3), which itself dut[i]es to the DIP's equity holders (4) and likely the DIP's creditors (5)." Markell Mail, *supra* note 10, at 2. We could *try* to sketch this concept as:

Court → Lawyer → Estate ← DIP ← DIP's management
↓
Creditors
↓
Shareholders

It's clear that this sketch doesn't clarify matters much, but it's more accurate than a simple triangle. Still, Hazard's triangulation theory gives us a good starting point.

Conclusion (false): Therefore, the Estate Counsel owes fiduciary duties *directly* to each creditor.[331]

A correct (if still incomplete) syllogism might be:

Major premise (correct): The Estate's decisions are made by the DIP or, if a trustee is appointed, by the trustee.

Minor premise (correct): Estate Counsel represents the Estate.

Conclusion (correct): Estate Counsel owes a fiduciary duty to the Estate directly, and not to any particular constituents of the Estate.

If we're right—that the concept of "Estate" includes a multitude of interests and that we need to finesse the concept of "Estate" as being a single entity for purposes of functioning on a daily basis—then our syllogism makes the right choices.

1. How "Specifying" and "Finessing" May Break the Transitive Relationship That Courts Are Establishing Among the Estate, Constituent Interests of the Estate, and Estate Counsel.

Think of this possible restatement of the DIP's role: the DIP is the inchoate embodiment of the Estate, in much the same way that corporate management is the inchoate embodiment of the fictional corporation. We acknowledge that we're already getting a bit fuzzy here, since we're finessing what that definition will mean on a day-to-day basis.[332] If the DIP is the embodiment of the Estate, then Estate Counsel must actually represent the Estate and not just the "ordinary" conception of the DIP.[333]

Defining Estate Counsel's client as the Estate itself, and not just the management of the Estate, solves some thorny problems.[334] For one thing, Estate Counsel can apply ethics rules relating to the "organization as client" to deal with recalcitrant or downright dishonest management.[335] For another thing, thanks to *Weintraub*,[336] Estate Counsel can

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[331] *See supra* II.G.

[332] *See supra* note 310 and accompanying text (discussing need for definitions to be used on day-to-day basis).

[333] Another way to say the same thing is: Estate Counsel represents the DIP, which is the entity running the Estate. Because the Estate itself can't hire attorneys or give orders (the Estate is a *concept*, not a real *physical being*), the "management" of the Estate has to do those things. Usually, "management" is the DIP. Sometimes, circumstances call for the appointment of a TIB. But, in either event, the DIP is to the Estate what the management is to a corporation. Therefore, the Estate itself is the ultimate client of the DIP counsel.

[334] *See* Robert R. Summerhays, *The Problematic Expansion of the Garner v. Wolfinbarger Exception to the Corporate Attorney-Client Privilege*, 31 TULSA L.J. 275, 284 (1995) (stating corporate managers and directors owe a fiduciary duty to the corporation as a whole); *see, e.g., Fiduciary Duties*, *supra* note 4, at 543 (restating issue of DIP's financing duty).

[335] *See supra* note 146 and accompanying text; *see also* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13

argue that the attorney-client privilege runs to the Estate and not to its managers. That way, in those relatively few instances in which a bankruptcy court supplants the DIP with a trustee, Estate Counsel can fulfill the fiduciary duty to the client (remember: the client is the Estate) by revealing to the trustee the communications that Counsel has had with the management of the DIP. Those communications are still privileged because the *Estate*, and not the DIP's management, holds the privilege. Acknowledging that the Estate holds the privilege allows the newly appointed trustee to root out mismanagement and fraud without requiring Estate Counsel to "rat" on its client directly to the court in every circumstance.[337]

And what of the Estate Counsel's duty to "rat"? Ratting on misbehaving management isn't ratting on the client when the Estate itself *is* the client. Estate Counsel could follow the normal procedure for cajoling corporate management to toe the line.[338]

(1983) (considering duty owed by lawyer to organization as client); MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980) (considering allegiance owed by "lawyer employed or retained by a corporation or similar entity"). Of course, that suggestion is by no means a cure-all. Corporate managers and corporate counsel are understandably perplexed about their fiduciary duties. *See* Lawrence E. Mitchell, *Cooperation and Constraint in the Modern Corporation: An Inquiry into the Causes of Corporate Immorality*, 73 TEX. L. REV. 477, 508-09 (1995) ("Jay Lorsch . . . concludes that corporate directors believe that their legal duty is to the stockholders, but feel moral obligations to a much broader range of constituents, including employees, creditors, customers, and sometimes the public.") (citing JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS 37-50 (1989)) (footnote omitted); Summerhays, *supra* note 335, at 289-90 (noting ambiguous nature of fiduciary duties owed within corporations).

But using the Model Rules's "entity" approach only goes so far: "[T]he Model Rules . . . provide that the organization, rather than the owners or managers, is the client. Nonetheless, some have suggested that the attorney who represents a person in a fiduciary capacity to another *may owe duties to the beneficiary of the client's duties.*" Robert R. Keatinge, *The Implications of Fiduciary Relationships in Representing Limited Liability Companies and Other Unincorporated Associations and their Partners or Members*, 25 STETSON. L. REV. 389, 401-02 (1995) (citations omitted); *see also supra* notes 298-308 and accompanying text (noting existence of varying opinions whether attorney's fiduciary duty to entity runs to human manifestations of corporation).

[336] *See supra* notes 47-50 and accompanying text.

[337] Here's one way to phrase your argument if you're trying to remind recalcitrant Estate Counsel or Committee Counsel of certain of their fiduciary duties:

1. Dicta in *Weintraub* permits an analogy from corporate counsel *outside* bankruptcy to Estate Counsel in a chapter 11 case. *See supra* notes 47-50 and accompanying text.

2. Not only would the Estate hold the privilege in the chapter 11 case, but the duty of Estate Counsel to the Estate would be analogous to the duty of corporate counsel toward the organization as client. *See, e.g., supra* notes 298-308.

3. The duties of Estate Counsel to the Estate can be monitored by asking whether Estate Counsel's behavior is in the Estate's interests (or, at least, whether the behavior was reasonably intended to be in the Estate's interest). Any outrageous behavior is probably sanctionable under BRP 9011. *See supra* Part.II.C.2.

Of course, if you're trying to invent *new* fiduciary duties for Estate Counsel and Committee Counsel to follow, you can always cite to *Perez*, *supra* Part.II.G.3.

[338] *See* Griva v. Davison, 637 A.2d 830, 841-42 (D.C. Cir. 1994) (discussing Model Rule 1.13 and reasoning that, where lawyer represents both partnership and constituents whose interest lawyer finds adverse to organization, lawyer may not represent constituents further because lawyer's loyalty to partnership is paramount); *see also* Crandon v. State, 257 Kan, 727, 741-42 (1995) (noting organization's attorney has responsibility to give advice; and when necessary to prevent or rectify unlawful or improper acts of organization or employers); MODEL RULES Rule 1.13 (describing options available to corporate counsel); MODEL RULES Rule 1.16 (describing lawyer's option to resign); *see generally* Geoffrey C. Hazard, Jr., *Rectification of Client Fraud: Death and Revival of the*

If no one's listening at the Estate level, then Estate Counsel could attempt to persuade the court to appoint a trustee or could try for a "noisy withdrawal" if the attempt to appoint a trustee is met with deaf ears.[339] At the least, freeing up Estate Counsel from its intimate ties with management will more easily reconcile Estate Counsel's duty to the client[340] with the attorney's duty as an officer of the court.

We have a couple of tools to help us monitor Estate Counsel. For one thing, we could assume that most of the Estate constituents' interests are being represented, for the most part, by somebody.[341] Committee Counsel is supposed to be looking out for the interests of the unsecured creditors.[342] If there's an Equity Security Holders' Committee,[343] counsel for that Committee can look after those interests. Secured creditors with large claims are likely to have their own counsel. What we need to do is to treat Estate Counsel as a conductor, blending all of the different melodies (interests) in the best interests of the entire opus. If Estate Counsel isn't blending those melodies, bankruptcy courts have ways of making their displeasure known.[344]

Professional Norm, 33 EMORY L.J. 271 (1984) [hereinafter *Rectification*] (discussing lawyer's obligations "when he discovers that a transaction he is handling for a client is tainted with fraud"); *see also* Richard W. Painter & Jennifer E. Duggan, *Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation*, 50 SMU L. REV. 225, 263-64 (1996) (discussing attorney's options of resignation or "waving the red flag" (noisy withdrawal)).

[339] *See Rectification*, *supra* note 339, at 286 (noting attorney's obligations to withdraw if client persists with fraudulent conduct and if there is a possibility of attorney being adverse witness); Jeffrey Pennelly, *Proceedings of the Conference on Ethical Issues in Representing Older Clients: Report of Working Group on Representing Fiduciaries*, 62 FORDHAM L. REV. 1045, 1051 (1994) (noting traditional view that lawyer who becomes aware of breach of responsibility has option to effect "noisy withdrawal""); Mark A. Riekhof, *Fraud, Withdrawal & Disclosure: What to Tell the Lawyer Who Steps Into My Shoes*, 34 SANTA CLARA L. REV. 1235, 1261 (1994) (stating Model Rule 1.16, comment 15, allows lawyer to send "signals" to third parties regarding his former client's fraudulent acts); *cf.* David B. Wilkins, *Making Context Count: Regulating Lawyers After Kaye, Scholer*, 66 S. CAL. L. REV. 1145, 1164 (1993) (noting that, where lawyer learns client intends to engage in prohibited conduct, attorney must choose between "gatekeeper" strategy, withholding support and thereby making client's accomplishment of prohibited purpose more difficult, and "whistleblower" strategy, reporting client's wrongful intentions to regulators); Brian W. Smith & M. Lindsay Childress, *Avoiding Lawyer Liability in the Wake of Kaye, Scholer*, 8 ST. JOHN'S J.L. COMM. 385, 391 (1993) (noting that, although attorney might have duty to report misconduct to third parties, duty does not extend to reporting to regulators absent special circumstances); Fred C. Zacharias, *Reconciling Professionalism and Client Interests*, 36 WM. & MARY L. REV. 1303, 1377 (1995) (calling for reeducation of lawyers to be more objective).

[340] Once it's clear beyond cavil that the Estate is (or isn't) insolvent, then Estate Counsel can fine-tune her duty, in much the same way that counsel for the corporation originally answers to the Board of Directors until and unless it's clear that the board wants to do something contrary to the interests of shareholders. Of course, corporate law is easier here, too. In corporate law, it's not so much a problem of knowing *to whom* counsel's ultimate duty is owed. The (solvent) corporation, and thus corporate counsel, owes its duty to the shareholders. The problem for corporate counsel is isolating exactly what is in the shareholders' best interests. *See Folly*, *supra* note 44.

[341] *But see Forest*, *supra* note 44, at 832-37 (giving examples of when advocacy model breaks down).

[342] *But see supra* note 281 (describing tendency of Committee Counsel and Estate Counsel not to contest each other's fee applications, apparently in violation of their respective fiduciary duties).

[343] *See* 11 U.S.C. § 1102 (1994) (allowing for foundation of equity security holders' committee).

[344] We like Westbrook's approach.

> The "quantum" cases seem removed from the de facto conflict cases, but they're really not. They focus on "what's at stake," and that issue in turn depends on the perspective from which the case is viewed, namely, whom the lawyer represents. To put it the other way around, if the lawyer spends time on "x" matter and "x" matter is only of value to the owners of the firm, the court may

For truly recalcitrant Estate Counsel, we also have BRP 9011[345] as a possible sanction.[346] If Estate Counsel is behaving badly, chances are that Counsel is lying on some of the pleadings. BRP 9011 gives the bankruptcy court the ability to punish counsel for those lies.[347]

2. How "Specifying" and "Finessing" Improve on a Bad Lot But Don't Fix It Entirely

Our solution isn't perfect. Far from from it. By finessing the concept of the "Estate," we're avoiding the hard questions that still must be resolved. By specifying the concept of the "Estate," we're making the management of the DIP very nervous about communicating with counsel, given that the Estate, and not the management, owns the privilege.[348]

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hold that the lawyer's time was of little actual benefit to the creditors, the only real parties in interest, or it may hold the lawyer must really have been representing the owners and must lose the entire fee, disqualified for conflict of interest. The first approach is the "benefit" analysis used by Judge Clark in OPA, while the second is the "adverse interest" approach followed by Judge Jones in Humble Place.

Any per se rule for inherent DIP conflicts has the potential to reduce substantially the pool of debtor-qualified lawyers willing to represent Chapter 11 debtors. Not only does it threaten counsel's livelihood, but it puts the reputations of lawyers at an unreasonable risk. The latter factor will discourage the very lawyers, conscientious and respectable, whom we would want to have making the tough decisions in the conflict-ridden context of Chapter 11 DIP representation. While the prevention of abuse is important, it cannot justify the cost. The cases just discussed offer a more sensible and balanced approach. First, where there is no actual representation of ownership interests, the courts should analyze the performance of DIP counsel on a benefit basis, rather than disqualifying counsel and denying all compensation. That course is more fair and less likely to chill DIP representation. Second, benefit must be understood to include the process benefits of competent and effective representation of the DIP. As long as Congress chooses to keep a debtor-driven system, that sort of advocacy is essential to its success. On that basis, a finding of no benefit to the estate should be because of over-litigation of futile or hopeless positions, rather than because the positions taken would benefit the ownership interest as such.

Inherent Conflicts, *supra* note 4, at 295.

345 FED. R. BANKR. P. 9011 (1994) (providing sanctions including payment of reasonable fees, where it is found attorney signed document absent factually supported, legally tenable good faith argument).

346 Along with the other sanctions mentioned in *supra* notes 190-196, 209-219.

347 *See In re* Palumbo Family Ltd. Partnership, 182 B.R. 447, 472 (Bankr. E.D. Va. 1995) (noting Bankruptcy Rule 9011 requires court impose "appropriate sanction" where document filed under frivolous or improper purpose); *see also In re* Poterek & Sons, Inc., 169 B.R. 896, 909 (Bankr. N.D. Ill. 1994) (stating bad faith "certainly warrants" sanctions under Rule 9011; however, bad faith not required); *In re* Food Workshop, Inc., 70 B.R. 962, 966 (Bankr. S.D.N.Y. 1987) (stating Rule 9011 provides for attorney sanctions if attorney "sign[s] and file[s] pleadings, motions and other papers . . . without making reasonable inquiry as to whether they are factually and legally well-grounded").

348 Of course, that problem didn't trouble the Supreme Court overmuch in *Weintraub*. *See supra* notes 47-50 and accompanying text.

There are two main jobs for the Estate in a reorganization: "pie-dividing" issues (who gets what and by what mechanisms) and "pie-enhancing" issues (how to get more, period). Markell Mail, *supra* note 52, at 2; *see also* e/mail from Edward Janger to Nancy B. Rapoport (March 26, 1997) (on file with author) (discussing the difference between "size" and "equality"). Our solution doesn't do a thing for "pie-dividing" issues, except to the limited extent that it keeps Estate Counsel from inappropriately dividing the pie in favor of particular constituents' interests.

Courts and academics have struggled with the concept of "specifying" and "finessing" the Estate.[349] Jay Westbrook has already published one of the best analyses of this struggle.[350] He's divided cases that review the behavior of Estate Counsel into two groups of standards: the "benefit" standard and the "adverse interest" standard.[351] Under the "benefit" standard, courts analyze Estate Counsel's conduct by asking whether Estate Counsel's actions provided a benefit to the Estate, rather than to factions with a personal interest in the outcome of the action. Under the "adverse interest" standard, courts review Estate Counsel's behavior to see if choices made during the case favored the Estate or an interested party to whom the Counsel might also owe some loyalty. If Estate Counsel's actions betray a conflict of interest, then Counsel runs the risk of total disqualification.[352]

We're sympathetic with Westbrook's distrust of per se rules as being both too facile and downright threatening to successful chapter 11 cases. Certainly his "benefit" approach makes sense. Of all of the alternatives out there, it's by far the best option. The problem, however, lies in the infinite loop that the "benefit" test creates. Until we pin down how to measure the benefit to the Estate, which still requires us to pinpoint

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But, to the extent that our solution enables the bankruptcy court to watch over Estate Counsel more closely, it's likely to enhance the pie. Our solution makes it tricky for Estate Counsel to represent the Estate and the prepetition Debtor, to the extent that those interest may conflict. We leave the implications of that statement for another day and another article.

Our solution, though, does seem to produce the correct result in our good/bad/ugly trilogy of cases. *See* Part II. G., *supra*. In Louisiana Bank & Trust v. Anderson, 526 So. 2d 1386 (La. Ct. App. 1988), Estate Counsel clearly represented the Estate and not the DIP's own interests. Recall that the advice that Estate Counsel gave regarding the use of purported cash collateral was wrong, at least after Louisiana changed its rules on perfection of the collateral. Nonetheless, the "wrong" advice didn't rise to the level of a BRP 9011 violation. It didn't even come close to a violation. So, under our solution, the Estate Counsel would have been safe.

If we applied our solution to the facts in *In re* Bonneville Pacific Corp., 196 B.R. 868 (Bankr. D. Utah 1996), we would have reached the same result that the bankruptcy court did. In *Bonneville*, it seems clear that the Estate Counsel was representing the DIP's interests and not the Estate's interests. Why else would Estate Counsel have submitted several unconfirmable plans or refused to investigate the Debtor's prepetition activities? Moreover, Estate Counsel seems to have filed several meritless pleadings, which would have violated BRP 9011. Our solution would sanction Estate Counsel for violating the duty to the Estate.

And then we come to *In re* Perez, 30 F.2d 1209 (9th Cir. 1994). Here, our solution would diverge from the majority's decision. As we read the facts in *Perez*, Estate Counsel was at least *trying* to represent the Estate by proposing a reasonable (if legally impermissible) plan of reorganization. (In fact, the plan could have been confirmed in some other jurisdictions). Therefore, Estate Counsel was attempting to fulfill his duty to the Estate and shouldn't have been punished so harshly. Even if we wanted to punish Estate Counsel slightly for failing to present a confirmable plan, our solution, at the very worst, would result only in a small reduction in fees (if the appeal were truly frivolous)— not the wholesale denial of fees presented in *Perez*.

[349] *See generally Inherent Conflicts*, *supra* note 4 (considering ethical questions and compensation issues in bankruptcy).

[350] *See id.*

[351] *See id.* at 295.

[352] *See* 11 U.S.C. § 328(c) (1994) (denying compensation for services and reimbursement of expenses where professional found "not disinterested"); *see also Inherent Conflicts*, *supra* note 4, at 295.

exactly whose interests comprise the Estate, we haven't finished the analysis. We admit that. But we've come closer than most.

CONCLUSION

We're not claiming to have found the perfect solution to the problem of exactly what duties Estate Counsel owes to individual Estate constituents. But we think that we've found a better one than the hodgepodge of answers currently out there. To get talented Estate Counsel, we can't greet each potential attorney with:

> Hi, there. We want you to represent the Estate, because we think that you have the talent to turn this company around. We need your expertise to preserve jobs and the general economy of the community. But we need you to agree to serve the interests of each and every constituent of this bankruptcy case, and somehow we need you to overcome the overwhelming conflicts of interest that ensue from considering all of these individual interests. Sign here.

We doubt that many Estate Counsel would want to "sign there." Furthermore, we doubt that many of them realize that they already have. If the goal of reorganization is, in fact, to turn an ailing business into a healthy one,[353] we need the best brains in the business. Let's let them do their job.

[353] *See Inherent Conflicts*, *supra* note 4, at 303 (stating reorganization bankruptcy is "financial hospital for sick companies"); *see also Folly*, *supra* note 44.