Limited scope representation is simply an engagement in which the scope of the representation is limited. It has become known as the "unbundling" of legal services. The Texas Equal Access to Justice Foundation has been focusing education on the concept over the past few years as a means of increasing access to needed legal services to indigent persons or persons with limited means on an affordable fee-for-service payment structure.

> "Ethical rules involving attorneys practicing in the federal courts are ultimately questions of federal law. The federal courts, however, are entitled to look to the state rules of professional conduct for guidance."

El Camino Res. Ltd. v. Huntington Nat'l Bank, 623 F. Supp. 2d 863, 876 (W.D. Mich. 2007) (citing *In re Snyder,* 472 U.S. 634, 645 n.6, 105 S. Ct. 2874, 86 L. Ed. 2d 504 (1985) and *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Alticor, Inc*., 466 F.3d 456, 457-58 (6th Cir. 2006), vacated in part on other grounds, 472 F.3d 436 (6th Cir. 2007)).[1]

I have taken this quote from the El Camino case out of the Western District of Michigan and provided you with a string cite to some cases that have come head to head with limited scope representation in the context of consumer bankruptcy cases. The concept is one that we often forget practicing in federal court. Although a federal court may look to the state rules of professional conduct, the law governing ethics in a federal court is federal law.

The Fifth Circuit recognizes the Texas Disciplinary Rules of Professional Conduct are applied in the Southern District of Texas under its Local Rules. Fifth Circuit also recognizes that the DRs are not the end of the discussion. *In re American Airlines, Inc.,* 972 F.2d 605 (5th Cir. 1992). Getting straight to the heart of the matter, in the Southern District of Texas, the Local Rules for the District control ethical rules that practitioners must follow. Local Rule 83.1(L) points to Appendix A of the Local Rules, which contain the rules of discipline that apply in the Southern District. Rule 1 of that Appendix states that the minimum standard of practice is the

[1] *See also In the Matter of Chidi Egwim*, 291 B.R. 559 (Bankr. N.D. Ga. 2003)(local bankruptcy rule applied local district court rules, which in turn applied Georgia Rules of Professional Conduct); See *In the Matter of Kenneth Robert Collmar*, 417 B.R. 920 (Bankr. N.D. Ind. 2009)(Court applying Indiana Rules of Conduct)

Texas DRs. Although a violation of those DRs "shall" be grounds for disciplinary action, the court is not limited by that code. This is critical to the analysis of limited scope representation in the Southern District, because although we will see that the DRs permit limited scope representation and guide what constitutes ethical limited scope, this is only the minimum standard in federal court in the Southern District. There may be situations in which the court finds that the practitioner's limited scope representation, although ethical under the DRs, was not ethical under Rule 1 of Appendix A of Local Rule 83.1(L). In addition, Appendix D to the Local Rules also contains guidelines for professional conduct. The first guideline requires the lawyer to "be ever conscious of the broader duty to the judicial system that serves both attorney and client. This may impact what a consumer bankruptcy attorney can and cannot do in limited scope as well.

So what is the starting place? I think under the Local Rules, we have to start at the minimum conduct, which is the Texas DRs. DR 1.02(b) states that a lawyer may limit the scope, objectives, and general methods of representation if the client consents after consultation. Although "consultation" is not defined in that rule, it is defined in the Terminology section of the DRs that precedes the DRs after the preamble. It states that "consultation" is the communication of information and advice reasonably sufficient to permit the client to appreciate the significance of the matter in question. What does that mean? It is not explained in the DRs. Suffice it to say that such communication should explain exactly what is being excluded from the representation, how that matter fits within the overall context of the other services the client needs, how it can impact the client if she does not have representation for that matter, and all of this should be in writing. Checklists and handwritten notes placed into the file to document the process of communicating the information can be helpful. Having a staff member in the office while the

communication is given in person can help. Explaining in person or over the phone allows the client to ask questions which further enhances the communication.

To summarize some of the key practice tips in any limited scope representation: (1) Have a clear agreement as to limitations on scope, (2) Discuss all aspects of the case with the client, (3) Discuss how the limitations may negatively impact the client, (4) Have a witness (secretary or associate) sit in on the client meeting, (5) Maintain notes of the meeting, (6) file an application to employ that discusses the limited scope and attach the engagement agreement, (7) confirm in writing the end of the representation when it is over, and (8) move to withdraw when the representation is over. Some have even mentioned the notion of tape recording the client meeting regarding scope. Although taping the conversation would be legal and ethical if the attorney obtains the client's permission to record the meeting, it may cast an unnecessarily formal and even paranoid air over the meeting.

Retaining Special Counsel

I. The Rules

A. 11. U.S.C. § 327

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

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.

(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

(f) The trustee may not employ a person that has served as an examiner in the case.

B. Federal Rule of Bankruptcy Procedure 2014

(a) Application for an order of employment

An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection,

the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

(b) Services rendered by member or associate of firm of attorneys or accountants

If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation or individual may act as attorney or accountant so employed, without further order of the court.

C. Local Rule 2014-1. Employment of Professionals.

(a) An application for employment by an attorney for the debtor or a motion for substitution of counsel for the debtor must have attached the statement required by FED. R. BANKR. P. 2016(b) and § 329 of the Bankruptcy Code.

(b) Nunc Pro Tunc Application.

(1) If an application for approval of the employment of a professional is made within 30 days of the commencement of that professional's provision of services, it is deemed contemporaneous.

(2) If an application for the approval of the employment of a professional is made more than 30 days after that professional commences provision of services and the application seeks to make the authority retroactive to the commencement, the application must include:

(A) An explanation of why the application was not filed earlier;

(B) An explanation why the order authorizing employment is required nunc pro tunc;

(C) An explanation, to the best of the applicant's knowledge, how approval of the application may prejudice any parties-in-interest.

(3) Applications to approve the employment of professionals nunc pro tunc shall be approved only on notice and opportunity for hearing. All creditors in

the case must be served with notice of the application. The notice must include the negative notice language of BLR 9013-1(b).

(c) An ex parte application to employ accountant combined with application to pay compensation may be allowed without further application or notice and hearing, under this rule, when the compensation will not exceed $300 per annum and employment will not exceed three years.

(1) In chapter 7 cases, the trustee may make an ex parte application to employ combined with application to compensate an accountant for the estate for the purpose of tax preparation and accounting services, without further notice or hearing if it limits payment to less than $300 per year for each year's tax returns payable at the completion of a return, and which employment shall be for no longer than three years;

(2) This ex parte procedure is available only where no earlier application to employ an accountant has been made and no later applications are contemplated by the trustee;

(3) The trustee must indicate to the court that the administration of the estate is expected to be completed within three years; and

(4) Employment beyond tax preparation and attendant accounting services where compensation in excess of $300 per year or a duration longer than three years is sought requires separate applications to employ and for compensation with notice to all creditors and other parties in interest under FED. R. BANKR. P. 2016 and BLR 2016-1.

(d) Applications to retain special counsel in an individual chapter 7, 11, 12 or 13 case for the purpose of prosecuting a tort claim must be filed in a form as published on the Court's website. The proposed form of order must also be on a form as published on the Court's website. Leave from this BLR 2014-1(d) must be sought by a separate motion.

(e) Service of applications to employ professionals is governed by BLR 9003-1.

D. 11 U.S.C. § 329

(a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the 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 source of such compensation.

(b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to—

(1) the estate, if the property transferred—

(A) would have been property of the estate; or

(B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or

(2) the entity that made such payment.

E. Federal Rule of Bankruptcy Procedure 2016(b)

(b) Disclosure of compensation paid or promised to attorney for debtor
Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed.

II. Analysis

A. Two prongs to § 327 (a)

1. Must not hold an interest adverse to the Estate - courts look to Code of Professional Responsibility. *In re SBMC Healthcare, LLC*, 473 B.R. 871, 877 (Bankr. S.D. Tex. 2012); *see also In re American Avia Assocs.-SEA,* 150 B.R. 24, 27 (Bankr. S.D. Tex. 1992). Case law defines the term "adverse interest" as: (1) the broad commercial and economic meaning of "adverse interest," and (2) "possessing or asserting any economic interest that would tend to lessen the value of the estate or create either an actual or potential dispute in which the estate is a rival claimant." *In re Bechuck*, 427 B.R. 371, 375 (Bankr. S.D. Tex. 2012)(*quoting In re Red Lion, Inc.*, 166 B.R. 296, 298 (Bankr. S.D. Tex. 1994). "'Adverse interest also includes the attorney's economic and personal interests.'" *Id*

2. Attorney must be disinterested person under 11 U.S.C. § 101(14)(A). "Congress intended the second § 327(a) requirement—the disinterested person standard—'to prevent conflicts of interest without regard to the

integrity of the person under consideration for employment.'" *In re Bechuck*, 427 B.R. 371, 375 (Bankr. S.D. Tex. 2012)(*quoting In re Red Lion, Inc.*, 166 B.R. 296, 298 (Bankr. S.D. Tex. 1994).

B. **The court has broad discretion in determining whether to grant an application under § 327(a**). *In re Bigler, LP*, 422 B.R. 638, 643 (Bankr. S.D. Tex. 2010).

C. **Retaining prepetition creditor as a professional**.

1. 11 U.S.C. § 1107 provides flexibility: "Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor-in-possession solely because of such person's employment by or representation of the debtor before the commencement of the case." *In re SBMC Healthcare, LLC*, 473 B.R. 871, 878 (Bankr. S.D. Tex. 2012.

2. Totality of circumstances test when retaining a prepetition creditor as a professional – 14 factors in *In re SBMC Healthcare, LLC*, 473 B.R. 871, 880-81 (Bankr. S.D. Tex. 2012):
(1) Does the prepetition claim arise from an ordinary employment relationship with the debtor? An affirmative answer favors approval of allowing the debtor to retain the law attorney and his law firm.
(2) Is the attorney who has applied to represent the estate also an insider of the debtor? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(3) Does the attorney who has applied to represent the estate hold a mortgage or other type of lien on property of the debtor to secure the prepetition claim? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(4) Even if the attorney holds no lien on property of the estate, does the attorney hold any other type of interest, direct or indirect, on property of the estate? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(5) Does the attorney who has applied to represent the estate not only hold a prepetition claim against the debtor, but also represents a third party creditor of the estate? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(6) Does the attorney who has applied to represent the estate have a loan outstanding that is owed to the debtor? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(7) Does the attorney who has applied to represent the estate have a direct prepetition claim for services rendered prior to the filing of the petition? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.

(8) Is the attorney who holds a prepetition claim and who has applied to represent the estate going to serve as general bankruptcy counsel? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(9) Is the attorney who holds a prepetition claim and who has applied to represent the estate going to serve as special bankruptcy counsel? An affirmative answer favors approval of allowing the debtor to retain the attorney and his law firm.
(10) Does the attorney now, or has he ever, served on the debtor's board? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(11) Is there an undisclosed relationship pursuant to Rule 2014? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(12) Has the attorney received potential preferential payments? An affirmative answer disfavors approval of allowing the debtor to retain the attorney and his law firm.
(13) Is some individual or entity, in addition to the debtor, liable to the attorney who has applied to represent the estate on the prepetition claim? If so, is this individual or entity an insider? Affirmative answers to both of these questions disfavor approval of allowing the debtor to retain the attorney and his law firm.
(14) How badly does the Debtor really need to employ the attorney who has applied to represent the estate?

D. **Applications under § 327 should include explanation as to why the proposed attorney is the best choice to represent the estate.** *In re Bechuck*, 472 B.R. 371, 376 (Bankr. S.D. Tex. 2012)

1. Rule 2014 requires:
   The application shall state the specific facts showing
   a. the necessity for the employment,
   b. the name of the person to be employed,
   c. the reasons for the selection,
   d. the professional services to be rendered,
   e. any proposed arrangement for compensation, and,
   f. to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee

2. *In re Bechuck* adds 2 other requirements:
   a. History of success and whether the attorney has been successful in achieving the tangible, identifiable, and material benefits for the estate. *In re Bechuck*, 472 B.R. 371, 376 (Bankr. S.D. Tex. 2012)(citing *In re Pro–Snax*, 157 F.3d 414, 426 (5th Cir.1998)).

b. A section itemizing the scope of the assignment, including a detailed description of the attorneys' assignment and duties, including how often the proposed attorneys have actually undertaken the tasks assigned (such as the number of adversaries filed, number of trials). *In re Bechuck*, 472 B.R. 371, 376-77 (Bankr. S.D. Tex. 2012).

E. **Personal relationships are not relevant.** *In re Bechuck*, 427 B.R. 371, 377 (Bankr. S.D. Tex. 2012).

F. **When Trustee seeks to hire own firm, must satisfy the "best interest of the estate" requirement under 11 U.S.C. § 327(d). The courts consider 9 factors under *In re Interamericas*, 321 B.R. 830, 834 (Bankr. S.D. Tex. 2005):**
(1) the qualifications of the members of the firm compared to the complexity of the case;
(2) whether the firm is regularly hired by others to handle similar litigation;
(3) whether the anticipated litigation predominantly involves issues of bankruptcy law with which the law firm has particularized expertise;
(4) whether the time commitment required to handle the case is consistent with the size of the firm and the balance of the firm's time commitments;
(5) whether only a nominal amount of work must be performed;
(6) the availability of other qualified firms to handle the case;
(7) the rates charged by the firm compared to the rates charged by other qualified firms;
(8) whether there will be material cost savings to the estate; and
(9) other case-specific factors.

G. **Negotiate Rates and contingency fees, and compare with other counsel.** *In re Lyons*, 439 B.R. 401, 405 (Bankr. S.D. Tex. 2010).

H. **Address *nunc pro tunc* factors with specificity.** *In re Lyons*, 439 B.R. 401, 406-08 (Bankr. S.D. Tex. 2010).

I. **Must perform thorough conflicts check against creditors as well as clients of the firm.** *In re Jackson*, 484 B.R. 141, 156 (Bankr. S.D. Tex. 2012).

III. Select cases

A. *In re American Airlines, Inc.*, 972 F.2d 605 (5th Cir. 1992).

June 8, 1992: American filed antitrust declaratory judgment action against Continental and Northwest.

June 9, 1992: American asked VE partner Alison Smith to represent it, and Smith accepted on June 10, 1992, not knowing that VE partner Harry Reasoner had promised Northwest's counsel, Joe Jamail that he would not consider representing another airline while they discussed joining forces. When Smith told Reasoner

about accepting the American representation, he said there "might be a problem with Northwest."

June 11, 1992: Reasoner accepted Northwest representation.

American filed a motion to disqualify VE.

VE had served as American's antitrust counsel since 1987 and had defended it against suits by Continental.

District court ruled that the initial acceptance was a "mixup" and that past matters were only tangentially related to the current litigation, and that any confidential information possessed by VE was not sufficient to cause any material prejudice to American. The court directed the parties to submit a plan for a "Chinese Wall" to safeguard against adverse use of confidential information.

American moved to disqualify on 3 grounds: (1) law firm may not switch sides in the same case; (2) VE had represented American in substantially related matters; (3) VE's representation will likely involve the use to American's disadvantage of confidential information.

Fifth Circuit found fact issues with first ground. As to the other arguments, the sole issue was whether the prior representations were substantially related to the present case. The inquiry may be narrowed to the single question of "substantially related" because there is an irrebuttable presumption that relevant confidential information was disclosed during former period of representation. In a footnote, the Fifth Circuit stated: "A second irrebuttable presumption is that confidences obtained by an individual lawyer will be shared with the other members of his firm. *See Corrugated*, 659 F.2d at 1346. This presumption is not at issue in this case, for all of the VE lawyers involved have previously represented American."

The Fifth Circuit found that the prior representations were substantially related to the current representation.

B. *Kennedy v. Mindprint (In re Proeducation Int'l, Inc.)*, 587 F.3d 296 (5th Cir. 2009).

Kennedy was an associate at JW while JW represented a creditor, Mindprint, against the debtor. Lawsuit involved a shareholder, D'Andrea, of the debtor who took positions adverse to Mindprint.

Associate did not work on the case and knew nothing about it.

Associate leaves JW.

Judgment entered in favor of Mindprint and D'Andrea against debtor. Kennedy then represents D'Andrea and Mindprint filed a motion to disqualify.

Bankruptcy Court granted motion based primarily on *In re American Airlines*' "irrebuttable presumption" that confidences obtained by an individual lawyer will be shared with other members of the firm. District Court affirmed.

Fifth Circuit reversed, stating that *American Airlines* did not actually involve or apply that presumption, so any statements regarding the presumption are dicta.

Fifth Circuit also pointed out that *American Airlines* cited to cases applying an earlier version of the Texas Disciplinary Rules of Professional Conduct. In 1990, comment 7 to Rule 1.09 was added: states that this imputation can be removed when an attorney leaves a firm, stating that "should ... other lawyers cease to be members of the same firm as the lawyer affected by paragraph (a) without personally coming within its restrictions, they thereafter may undertake the representation against the lawyer's former client unless prevented from doing so by some other of these Rules."

C. ***In re Gleason*, 492 Fed. Appx. 86 (11th Cir. 2012), *cert. denied*, ___U.S.____, 2013 WL 125334 (April 1, 2013).**

Attorney filed inappropriate and unprofessional pleadings:

> In your fourth published example of "Ready–Fire–Aim" against this attorney, it is obvious that you have not reviewed the record in this case which does not support the purported findings of fact. It is further quite obvious that you do not believe that the same respect mandated to be shown to you should also be shown to me. Your conclusion that [my client's] attempt to exempt his commissions as the head of a household is not supported by law is belied by the language of the actual statute. Your conduct in this case [h]as been without citation to any authority for the propositions that: your jurisdiction is never ending and without geographic bounds; your unconditional releases are meaningless; and pronouncements of the United States Supreme Court are mere suggestions.
>
> * * *
>
> It is sad when a man of your intellectual ability cannot get it right when your own record does not support your half-baked findings.

Then sent the judge a bottle of wine and an offer to "privately" settle their dispute: "Dear Judge Olson, a Donnybrook ends when someone buys the first drink. May we resolve our issues privately?"

The bankruptcy court sanctioned him by suspending him from practicing in the bankruptcy court for 60 days. The lawyer appealed, and the district court affirmed. The lawyer appealed to the 11th Circuit, arguing among other things that his Fifth Amendment right to due process was violated because there are no

rules that authorized the procedure and by suspending him from practice even though there is no "bankruptcy bar" to which lawyers are admitted.

The 11th Circuit cited 11 U.S.C. § 105 in stating that a bankruptcy court is authorized to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of Title 11." The 11th Circuit noted that the court may *sua sponte* take any action or make any determination "necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." *Id.* Under the bankruptcy court's local rules, a single judge had the authority to discipline an attorney, including the authority to suspend him, after notice and hearing. The court also invoked the court's inherent power to impose sanctions.

The 11th Circuit affirmed, and the U.S. Supreme Court denied certiorari.

Who is my Client?

A. **Conflicts of Interest in Bankruptcies**

1. Corporation vs. Sole/Major Shareholder
2. Corporation vs. Subsidiary/Affiliate
3. Corporation vs. Directors
4. Appointment of "Responsible Person"?
5. Retention of Special Counsel that may represent debtor and creditor

Special counsel could represent debtor and creditor in state court appeal against third party, despite their competing interests in the bankruptcy, because resulting judgment would have benefited both clients. *Kittay v. Kornstein*, 230 F.3d 531, 538 (5th Cir. 2000) ("[W]here the interest of special counsel and the interest of the estate are identical with respect to the matter for which special counsel is retained, there is no conflict and the representation can stand.") (citations omitted); *see also In re American Avia Assocs.*, 150 B.R. 24, 28 (Bankr.S.D. TX 1992) (approving continued retention of plaintiffs' counsel to act on debtors and its joint venture partners in state litigation). [Decision by Judge Brown]

B. **Precise Identification of Client.**

In situations where the lawyer will be dealing with multiple parties, a clear understand of who is, and who is not, a client is essential. Engagement letters must be precise when representation is of multiple corporate entities. *Avocent Redmond Corp. v. Rose Elecs.,* 491 F. Supp. 2d 1000, 1004 (W.D. Wash. 2007) (disqualifying firm from defending corporation in suit brought by defendant's former corporate affiliate because firm's engagement letter (for prior and arguably related matter) stated that it was "engaged to represent [corporation]. . . and *its affiliates*," which was read to include plaintiff).

C. **Engagement Letters.** In corporate and other transactional practices, attorney malpractice claims history shows the particular importance of telling nonclients who are involved in a transaction, in writing, that the attorney/firm does not represent them. The engagement letter sometimes can be a good vehicle to do this. Depending upon what information is in the letter, the firm may, with the client's consent, copy the nonclients on the engagement letter. Regardless of how it is done, advising nonclients of their nonclient status in writing can avoid trouble.

> **Sample Language.** *The client for purposes of this engagement is [CLIENT NAME]. It is understood that this representation of the Company does not create an attorney-client relationship with any related persons or entities, such as parents, subsidiaries, affiliates, employees, officers, directors, shareholders, or partners, unless specifically agreed otherwise in writing. It also is understood that this engagement is specifically limited to the Transaction, unless expanded by written supplement to this letter, and will be terminated when we have completed the services specified in this letter and any written supplement. If the Company later engages us to perform other services, the attorney-client relationship will be revived in accordance with the terms agreed upon at that time.*

See Avocent, 491 F. Supp. 2d at 1004 (holding that in the absence of a specification as to which of client's affiliates law firm represented, the engagement letter for client "and its affiliates" included all affiliates).

D. Existence of Attorney Client Relationship is Question of Fact

See generally Helie v. McDermott, Will & Emery, 852 N.Y.S.2d 701 (Sup. Ct. 2007) (refusing to require defendant's client to comply with subpoena until issue of whether plaintiff principal of client also had lawyer-client relationship with firm).

1. Clients Subjective Belief

"The existence of the relationship 'turns largely on the client's subjective belief that it exists.'" *Avocent,* 491 F. Supp. 2d at 1003.

2. Client's subjective belief must be Reasonably Based

   a. Attorney's Words

   b. Attorney's Actions

   c. Engagement letter must be specific

E. Fee Forfeiture for Failure to Disclose all Relationships

Although concurrent conflicts may be waived by clients, the effect of a waiver, particularly a prospective waiver depends upon whether the clients have given truly informed consent. *In re Congoleum Corp. 426 F.3d 675; (3rd Cir 2005).*

...given the complexities of the bankruptcy proceeding and the "many hats" worn by the attorney throughout the pre-and post-petition process, it could not be concluded that the purported waivers constituted informed prospective consent. See ***Baldasarre v. Butler***, 132 N.J. 278, 625 A.2d 458 (N.J. 1993) (concluding that informed consent was not sufficient in a complex commercial real estate transaction); *In re Matter of Edward J. Dolan*, 76 N.J. 1, 384 A.2d 1076, 1082 (N.J. 1978) ("This Court will not tolerate consents which are less than knowing, intelligent and voluntary."); *In re Lanza*, 65 N.J. 347, 322 A.2d 445 (N.J. 1974) (concluding that attorney should have first explained...all the facts and indicated in specific detail all of the areas of potential conflict that foreseeably might arise.").

F. Disallowance of Fee Application due to Failure to Disclose Source of Retainer

A fee applicant must disclose "the precise nature of the fee arrangement," and not simply identify the ultimate owner of the funds. *See In re Glenn Elec. Sales Corp.*, 99 Bankr. 596, 600 (D.N.J. 1988); see also *In re Bob's Supermarket's Inc*., 146 Bankr. 20, 25 (Bankr. D. Mont. 1992).

...the attorney's failure to describe the transaction and indicated that the president paid the retainer out of his personal account constitutes a violation of ***11 U.S.C §329*** and ***Fed. R. Bankr. P. 2016. In re Park-Helena Corp. 63 F. 3d 877 (9th Cir. 1995)***

G. Disallowance of Fee Application due to Failure to Disclose Conflict

As soon as an attorney becomes aware of any facts that may give rise to possible conflicts, whether they exist at the time of the appointment or arise subsequently, he has the duty to make immediate, candid, and complete disclosure of them so that the court can determine whether the attorney is disqualified from representing the estate. ***Rome v. Braunstein 19 F3d 54 (1st Cir 1994).***

An attorney retained pursuant to section 327(a) assumes a fiduciary responsibility to refrain from rendering any unauthorized service in furtherance of an interest adverse to the client he serves by court appointment. See ***In re Kendavis***, 91 B.R. at 753 (citing Wolf v. Weinstein, 372 U.S. 633, 641, 83 S. Ct. **969 975, 10 L.Ed.2d 33 (1963). "A fiduciary....may not perfect his claim to compensation** by insisting that, although he had conflicting interests, he served his several masters equally well or that his primary loyalty **was not weakened by the pull of his secondary one."** *Woods v. City Nat'l Bank & Trust Co*., 312 U.S. 262, 269, 61 S. Ct. 493, 497, 85 L.Ed. 820 (1941***); In re Roger J Au***, 71 B.R. at 241. Especially where there has been a clear failure to make timely and spontaneous disclosure of all facts material to a disqualifying conflict of interest, counsel appointed pursuant to section 327(a) can lay no claim of right to a lesser sanction that the bankruptcy court authorized to impose pursuant to section 328(c).

Individual Chapter 11

I. Key differences with individual chapter 7 and standard chapter 11

Property of the estate includes post petition and post confirmation income and any new property acquired after the petition is filed

11 U.S.C. § 1115 Property of the Estate

(a) In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541 –
    (1) All property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first; and

    (2) Earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13, whichever occurs first.

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

Plan is subject to modification based on future income

11 U.S.C. §1127 (e) [Modification of Plan]

(e) If the debtor is an individual, the plan may be modified at any time after confirmation of the plan but before the completion of payments under the plan, whether or not the plan has been substantially consummated, upon request of the debtor, the trustee, the United States trustee, or the holder of an allowed unsecured claim, to-

    (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
    (2) extend or reduce the time period for such payments; or
    (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim made other than under the plan.

No discharge until plan is completed

11 U.S.C. § 1141 (d) (5) [Effect of confirmation]

(d)(5) In a case in which the debtor is an individual –

(A) unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan;

II. Planning issues

(A) Source of income

You must understand the source of income for the debtor.

Is it?

Paycheck
Distributions
Dividends
Proceeds
Rents

Is the debtor an employee, a member of an LLC, a partner, a shareholder or an owner of incoming producing property?

While a paycheck cannot be pledged, other sources of income may be pledged as security for indebtedness, so there may be cash collateral issues with distributions, dividends, proceeds or rents.

Are there any domestic support obligations due or that must be paid?

(B) Exempt property and non-exempt property

The debtor is still entitled to claim exempt property, although property acquired after the case, including income is all property of the estate.

(C) Budget

Application of 11 U.S.C. § 1325 (b)(2) to individual chapter 11 by 11 U.S.C. § 1129 (a) (15). Technically, this is only supposed to apply if the holder of an allowed secured claim files an objection to the debtor's plan; however, Bankruptcy Rule 1007

(b) (5) requires individual chapter 11 debtors to file a Statement of Current Income (Official Form B22B)

Form B22B tracks only income, and does not include a means test element or the commitment and expense calculations in Form B22C for chapter 13, but schedules I and J will be scrutinized for the reasonableness and necessity of the budgeted expenses, and eventually come into play under §1129 (a) (15) if an unsecured claimant objects.

11 U.S.C. §1325 (b) (2) defines "disposable income"

The caveat for allowed deductions from income is "less amounts reasonable necessary to be expended" for "maintenance or support of the debtor or dependents;" certain charitable contributions. If the debtor is in business, it provides "for the payment of expenditures necessary for the continuation, preservation, and operation of such business." Subsection (3) then provides a formula for determining "reasonably necessary" expenses.

As a result, debtor should segregate funds between income needed for expenses and income needed to fund plan and pay administrative expenses

(D) Other Issues to consider prior to filing

Debtor has to file Monthly Financial Reports and pay quarterly US Trustee fees

Debtor may have a committee of unsecured creditors, another administrative expense [There is an option to opt out for small business cases, but no similar provision for individual chapter 11, unless the Debtor attempts to file as such, 11 U.S.C. § 101 51 (C) and 51 (D)]

Expense of a disclosure statement and plan

Executory contracts, issues of assumption and rejection and deadlines related to same

Insurance – United States trustee will require property of the estate to be insured

Status of tax returns and taxes

Professionals needed

III. The case

Same issues and deadlines as normal chapter 11

Relief from stay and cash collateral issues

Meetings with US Trustee and with creditors

Motions to Sell

Motions to Assume/Reject

Exclusivity

Conversion or Dismissal

Appointment of a trustee

If Debtor is a wage earner, can a trustee effectively be appointed? Can a trustee's plan based on receipt of future wages be confirmed if the trustee has no control on whether and/or how much a debtor will work? Arguably, a chapter 11 trustee cannot file a plan of reorganization for a wage earner unless it is a joint plan with the debtor, since the trustee cannot commit the wage earner's future wages to a plan with the debtor's consent. A trustee cannot force the debtor to be employed during the term of the plan.

Just as in a regular chapter 11 case when a trustee is appointed, Debtor's counsel cannot be compensated from the estate. Since all of an individual chapter 11 debtor's assets are property of the estate, there is no source of compensation for a chapter 11 debtor's counsel post trustee appointment. Counsel can attempt to withdraw or continue in the case, and hope that counsel will get paid by the Debtor after the bankruptcy case is completed. Claims for substantial contribution in chapter 11 are limited to "creditor" claims. Creditor does not appear to be defined broadly enough to cover the holder of a post petition claim for services. Should individual chapter 11 counsel incur time and/or expense that is unpaid as of the filing of a case so as to have standing as a creditor to file a claim for substantial contribution in the event a trustee is appointed?

IV. Dilemma as to how to conduct the case

The Debtor is a fiduciary for his/her creditors, therefore, where is the line between a Debtor and Debtor's counsel representing Debtor's position and breaching the duties of a fiduciary?

It can be argued that the key fiduciary duty is no self dealing. As a fiduciary, you act for the interest of the beneficiary without regard to personal interest. In chapter 7 and chapter 13, a trustee is automatically appointed. In all other chapter 11 cases, there is no issue of exempt property and the absolute priority rule addresses what equity can retain under a plan. In individual chapter 11, a debtor can claim property as exempt, however, many courts have held that the concept of absolute priority applies in individual chapter 11. Further, the debtor has to set his/her own budget keeping in mind that §1325 (b)(2) may be applicable if an unsecured creditor objects. And how is absolute priority measured in an individual case?

Is there an inherent conflict of interest for an individual chapter 11 debtor that the Code does not address?

V. Dilemma as to how to address case post confirmation

The Code and Rules are silent as to how the case will be monitored post confirmation. While it is clear that the case has to remain open until all payments are made, other than filing MFR's whose responsibility is it to monitor the case for changes in income and/or property that could potentially expedite and/or increase payout to creditors. In the Southern District of Texas, the policy is to administratively close the case after confirmation so that the Debtor is not burdened with U.S. Trustee fees during the term of the plan. Once the plan is completed, the Debtor files a motion to reopen the case and to issue the order of discharge.

<u>Avoiding Train Wrecks in Chapter 11 (Ethical Dilemmas)</u>
The Arthur L. Moller-David B. Foltz Inn of Court, April 30, 2013 Team 6

***Pro-Snax* Portion of Presentation**

In re Pro–Snax Distribs., Inc., 157 F.3d 414 (5th Cir.1998)

<u>Issue:</u>

May debtor's counsel receive compensation (or may a Court compensate debtor's counsel) for work after the Court assigns a trustee under 11 U.S.C.§ 330 (a)?

<u>Holding:</u>

1. 11 U.S.C. § 330 (a) bars a Court "from compensating a debtor's counsel for work performed after a trustee is appointed."

2. Fees claimed for work performed before a trustee is appointed must pass a two-part test to be approved: (a) work performed and attorneys' fees charged must be reasonable on a prospective basis; and (b) work performed must also have produced tangible benefits based upon a retrospective view.

<u>Summary:</u>

Creditors argue that the appointment of the Trustee bars the Court from compensating the debtor's counsel A & K. Compensation requested for Counsel for debtor that began as an involuntary Chapter 7 converted to a Chapter 11 and later converted back to a Chapter 7. On September 13, 1995, the Debtor converted its case to a Chapter 11.

On or about August 10, 1995, Creditors filed a Chapter 7 involuntary bankruptcy for Pro-Snax Distributors, Inc. ("Pro-Snax" or Debtor) On August 31, 1995, the Court appointed a trustee. On October 16, 1995, the Court appointed a Chapter 11 Trustee when it also denied the creditors motion to convert the case to Chapter 7. At that same time, Debtor filed its Disclosure Statement and Plan of Reorganization. The Court entertained hearings on the plan on February 13, 1996. However, in light of objections the Court denied confirmation of the plan. The creditors renewed their motions to convert and on February 20, 1996, the Court converted the case to Chapter 7. The Bankruptcy Court authorized the employment of debtor's counsel Andrews Kurth, L.L.P. ("A &K") *nunc pro tunc* on the date of the fee application, July 1, 1996. A & K sought compensation from September 13, 1995 through May 31, 1996. Over the creditors' objections, the Court granted the fee application. On October 1996, the creditors filed a Motion to Reconsider. Nonetheless, the Bankruptcy Court denied the creditors motion and the trustee paid A& K. The creditors appealed. The District Court reversed the ruling and remanded the case back to the Bankruptcy Court. The District Court found that the Court could not compensate Debtors' counsel for fees after the appointment of the trustee. A & K appealed the decision.

Rule:

11 U.S.C. § 330 (a)

> [a]fter notice to the parties in interest and the United States Trustee and a hearing, ... the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103—
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney ...; and
>
> (B) reimbursement for actual, necessary expenses. 11 U.S.C. § 330 (a)

Note: Prior 1994, 11 U.S.C. § 330 (a)(1) explicitly awarded fees to the debtor's counsel.

Analysis:

The language is not ambiguous and the statute must be reviewed upon what it states not what it should state. Statute fails to state debtor's attorney when it lists attorney. Thus the legislature did not intend to include debtors' counsel. In addition, there are few tasks to complete after the Trustee is appointed.

Court specifically emphasized that counsel did not obtain any benefit for the debtor and it should have known that it would not. The Court further found that counsel should have realized that an involuntary filing by the Court deters a confirmable plan if not bars it.

In MSB Energy, Inc.; 450 B.R. 659 (Bankr. S.D. Tex. 2011)

Holding:
Even though unsecured creditors may not be paid, does not mean that professional services have not conveyed a tangible, material and beneficial result to the estate.

Summary:
Creditors objected to the fee application of Debtor's counsel on the grounds that Debtor's counsel failed to provide a tangible benefit to the estate.

In re Cyrus II Partnership, 2009 WL 2855725, at 3 (Bankr. S.D. Tex. Sept. 1, 2009)*

Holding:
Attorney's fees must meet both prospective (reasonableness) and retroactive (tangible results) tests (i.e., the "hybrid view". Court required counsel's services were "necessary to the administration of, or beneficial at the time at which services were rendered toward the completion of, a case" under 11 USC §330 (a)(3)(C). The Court will also require on a retrospective basis that the services resulted in "identifiable, tangible and material benefit to the estate."

Summary:
Creditor disputed the Special Counsel for Trustee's fees regarding its Petition to Annul Judgment. The Creditor disputing the fee application obtained the Judgment that the Special Counsel attempted to annul. The Petition to Annul was based upon the allegation that an exhibit was not turned over during the underlying case. The Creditor notified the Special Counsel that the exhibit had been entered into evidence by the party attempting to obtain the annulment. The Court found that the Special Counsel could have an adequate amount of time to determine the truth after receiving that information from the Creditor. The Court also found that after that amount of adequate time, the rest of the time should not be compensable.

In re Broughton Ltd. Partnership, 474 B.R. 206 (Bankr. N.D. Tex. 2012)

Holding:

"Success cannot be a requisite to compensation outside of a contingency arrangement."
Pro-Snax's requirement "that, in order for professional's services to be compensable from bankruptcy estate, they must result in "identifiable, tangible, and material benefit" to estate does not equate success. Pro-Snax does not require that counsel must succeed, or that its services must accrue value to the estate."

The Court could compensate special counsel to Chapter 11 debtor-in-possession for work that it performed at debtor's request. Special counsel negotiated sale of debtor's real estate to an interested and financially capable buyer in attempt to generate source of funding that would be essential to debtor's proposed reorganization.

Summary:

Debtor originally filed under Chapter 7. Later, Debtor converted the case to Chapter 11. Debtor's Counsel. After Counsel negotiated deals for 22 high end residential lots with a possible purchaser, the deal unraveled. Subsequently, the Court converted the case to Chapter 7. The Court held that Counsel's services were necessary to the administration of the estate or beneficial at the time that Counsel rendered such services.

In re NC12, Inc., 2013 WL 753540 (Bankr. S.D. Tex. Feb. 27, 2013)

Holding:
Hybrid approach: Consider both the "the services must be beneficial toward completion of the case at the time they are rendered and they must produce an identifiable, tangible, and material benefit to the estate." In re Cyrus II Partnership, 2009 *2009 WL 2855725,* at 5. In addition, the Court should not compensate Debtor's Counsel for work after the case was converted to Chapter 7. The Court found that Counsel provided some material, tangible benefit to the estate. The Court also considered the fact that the Trustee filed a No Opposition to the Fee Application.

Summary:
Debtor's counsel sought fees for before and after the case was converted to Chapter 7. The Court inquired if Counsel could be compensated when considering *Pro-Snax.* Counsel abated its fee application to wait on a 5th Circuit opinion enlightening its view of *Pro-Snax.* To date the 5th Circuit has failed to issue an order.

In re Yazoo Pipeline Co., L.P. et al, 2012 WL 6682025, at 8*(S.D. Tex. Dec. 21, 2012)

Holding:
Court reversed in part and affirmed in part. The Court reversed in part for failure of an adequate explanation. The Court found that Debtor's counsel failed to provide a material benefit to the estate. The Court also affirmed the Bankruptcy Court that held that even under a prospective basis Debtor's Counsel failed to provide value.

The Yazoo Court noted that most other circuits have not followed the retrospective approach.

Summary:
Charles Cheatam owned and managed several oil and gas companies. These companies filed Chapter 11 cases. The Court converted the cases to Chapter 7 a year later. The Court converted the case due to unauthorized administrative expenses by Mr. Cheatam and the lack success in reorganization. Debtor's Counsel requested a large amount of attorneys' fees. The Bankruptcy Court granted less than half of the requested expenses.

Status:
On appeal to the 5th Circuit. The date has yet to be determined.

Other Circuits-

In re Ames Dep't Stores Inc., 76 F.3d 66, 72 (2d Cir. 1996); abrogated on other grounds by *Lamie v. U.S. Trustee*, 540 U.S. 526, 531, 124 S.Ct. 1023, 157 L.Ed2d 1024 (2004)

Holding/Test: "If the services of a debtor's attorney are reasonably likely to benefit the debtor's estate, they should be compensable."

In re Veltri Metal Prods. Inc., 189 Fed. Appx. 385, 389-90 (6th Cir. 2006)

Holding/Test: The Court used the test that debtor's services would reasonably benefit the estate.

Roberts, Sheridan & Kotel PC v. Bergen Brunswick Drug Co. (In re Mednet). 251 B.R. 103, 107 (9th Cir. BAP. 2000)

Holding/Test: The Court adopted the reasonableness standard. It also noted that the 5th Circuit's holding that required a material benefit failed to comply with the statute.

In re Top Grade Sausage Inc., 227 F.3d 123, 131-32 (3d Cir. 2000);

Holding/Test: The Court adopted the reasonableness test.

In re Taxman Clothing Co., 49 F.3d 310 (7th Cir. 1995)

Holding/Test: The Court did not compensate Debtor's counsel *after* it became evident that the preference action would not succeed.