By Joseph J. McMahon, Jr.

Naming Names After *Brown*

Is There an Obligation under Rule 2014(a) to Identify Attorneys Who Staff Unrelated Creditor Representations?

Joseph J. McMahon, Jr.
Ciardi Ciardi & Astin PC
Wilmington, Del.

Joseph McMahon, Jr. is Of Counsel at Ciardi Ciardi & Astin PC in Wilmington, Del.

Professionals routinely employed by bankruptcy estates implement standard practices designed to satisfy their disclosure obligations to the court under Rule 2014(a) of the Federal Rule of Bankruptcy Procedure in connection with prospective engagements. The law is clear that the obligation to disclose "connections" under Bankruptcy Rule 2014(a) is distinct from the lack of disqualifying conflict/disinterestedness requirements contained in § 327(a) of the Bankruptcy Code.[1] The law is equally clear that a failure to disclose constitutes grounds that are independent from § 327(a) for sanctions (including disqualification and/or disgorgement of compensation/reimbursement).[2]

Unsurprisingly, litigation under Bankruptcy Rule 2014(a) focuses on the issue of how much information about a "connection" needs to be disclosed,[3] and if there was ever a gray area of the law, this is it. When a party in interest claims that disclosure under Bankruptcy Rule 2014(a) is insufficient, the bankruptcy court is initially called to decide whether there was, in fact, a failure to disclose. If there was a failure to disclose, the bankruptcy court determines what consequences, if any, should flow from the failure based on the facts and circumstances associated with the same.

The Case of *KLG Gates LLP v. Brown*

In the recent decision of *KLG Gates LLP v. Brown*,[4] the U.S. District Court for the Eastern District of New York affirmed the bankruptcy court's finding that the law firm failed to disclose that a firm partner staffing the debtor's chapter 11 engagement was the engagement partner on two representations of creditors in separate, unrelated bankruptcy cases.[5] At the time that its employment application was filed, the law firm disclosed the fact that it had represented a number of creditors in separate matters that were pending or had concluded.[6] The law firm disputed the creditor allegations that disclosure was insufficient.

Cases like *Brown* usually turn on whether a professional sufficiently discharged its disclosure obligations through what I will loosely label a "general" disclosure. So goes the push and pull of many challenges under Bankruptcy Rule 2014(a): The law firm says that general disclosure was sufficient to put parties in interest on inquiry notice with regard to the information that was allegedly required to be disclosed (but not specifically stated), and the objector responds that one should not have to ask the next question in order to extract the information that is allegedly required to be disclosed (meaning that it should have been in there in the first place).[7]

While the appeal in *Brown* involved a number of issues, this article will focus exclusively on the subject of nondisclosure and the pertinent facts. The debtors in *Brown* were 15 affiliated entities that were focused on the publication of periodicals and other media. Substantially all of the equity interests in the debtors were held, directly or indirectly, by members of the Brown family. The law firm was initially engaged to represent Brown Publishing Co. (a parent debtor) only via an engagement letter dated December 2008.[8] In August 2009, as the law firm's engagement began to shift toward bankruptcy, the law firm obtained an executed rider to the initial engagement letter, which provided that the law firm would represent the affiliated entities in connection with a bankruptcy filing.[9] In August 2009, the law firm sent the client a conflict waiver that contained the following language:

> As you know, the Firm currently represents [certain of the debtors' secured lienholders] in connection with various lending and other matters (the "Bank Matters"). Accordingly, if the Firm were to represent Brown in the Brown Matter [*i.e.*, the debtors' bankruptcies], the Firm would have ongoing duties of loyalty to both Brown with respect to the Brown Matter and the Banks with respect to the Bank Matters…. Because the Brown Matter and the Bank Matters are not related,

1 *See In re eToys Inc.*, 331 B.R. 176, 190 (Bankr. D. Del. 2005) ("Bankruptcy Rule 2014 requires that the attorney seeking employment disclose to the Court all connections with parties in interest in the case, rather than furnishing only those [that] appear to implicate 'disinterestedness' or 'adverse interest' concerns under section 327(a).") (citation omitted).
2 *Id.* ("So important is the duty of disclosure that the failure to disclose relevant connections is an independent [**25] basis for the disallowance of fees.").
3 *See In re Filene's Basement Inc.*, 239 B.R. 850, 856 ("Coy or incomplete disclosures [that] leave the court to ferret out pertinent information from other sources are not sufficient.").
4 No. 13-cv-4972 (ADS), 2014 U.S. Dist. Lexis 19998 (E.D.N.Y. Feb. 18, 2014).
5 *Id.* at *41 ("KLG failed to advise the Court that Fox, its lead billing partner, personally represented PNC in the *Enron* bankruptcy case and Wilmington Trust in the *Delphi* bankruptcy case.").
6 *Id.* at *40-41 ("KLG filed a Rule 2014 Statement disclosing all of its 483 former and current clients, in alphabetical order, who may have had conflicts with the Debtors.").
7 *Cf. eToys*, 331 B.R. at 191 ("While the disclosure requirements 'may not be so onerous as to require the party to raise with the court every imaginable conflict [that] may occur in a bankruptcy, it certainly compels disclosure where ... the party had contemplated and discussed a specific situation involving a potentiality for conflict.'") (quoting *In re BH & P Inc.*, 119 B.R. 35, 44 (D.N.J. 1990), *aff'd*, 949 F.2d 1300 (3d Cir. 1991)).
8 *See KLG Gates*, 2014 U.S. Dist. Lexis 19998 at *5.
9 *Id.* at *7-9.

> we believe that we would be able to provide appropriate representation of both Brown in the Brown Matter and the Banks in the Bank Matters and that our representation of each client will not be materially limited by our responsibilities to the other. Moreover, except for [two firm attorneys], who represent certain of the Banks in certain corporate trust matters, the Firm lawyers working for the Banks in the Bank Matters will not be involved in the representation of Brown in the Brown Matter.[10]

At the time that the *Brown* bankruptcy cases were initiated, the law firm represented a bank in its capacity as indenture trustee in the *Enron* bankruptcy cases. In addition, at the time that the *Brown* bankruptcy cases were initiated, the law firm represented a bank in its capacity as indenture trustee in the *Delphi* bankruptcy cases. Two of the law firm's attorneys who were the primary counsel for the debtors were counsel for the banks in those respective engagements.[11]

KLG Gates' Retention Application

After the debtors filed for bankruptcy protection, they applied to employ the law firm in connection with the matter. The lead partner, acting for the law firm, filed a Bankruptcy Rule 2014(a) affidavit, which stated that the debtors had 1,250 creditors, about 483 of which were being, or had been, represented by the law firm in unrelated matters. An annexed exhibit alphabetically listed all 483 creditors, and among the creditors listed were PNC and Wilmington Trust. The list specified that PNC and Wilmington Trust were the agents for the first- and second-lien lenders, respectively. However, nothing in the Bankruptcy Rule 2014(a) affidavit set forth how the two law firm attorneys primarily staffing the bankruptcy engagement had roles in the law firm's representations of PNC in the *Enron* case and Wilmington Trust in the *Delphi* case, or any other connection of it to any of the other 483 creditors. The bankruptcy court approved the law firm's employment.[12]

After the bankruptcy court confirmed the chapter 11 plan, the trust formed pursuant to the plan signaled its intention to sue one of the debtors' insiders. In turn, the insider filed a motion to disqualify the law firm on several grounds and raised the nondisclosure issue.[13]

The bankruptcy court concluded that the law firm's Bankruptcy Rule 2014(a) statement failed to abide by the "spirit and intent" of the rule. The bankruptcy court observed that the law firm had filed a "general statement indicating that the firm "may or may not have been retained by certain creditors of the debtor and, to the best of [its] knowledge, it did not know of any conflict." The statement was "incomplete" per the bankruptcy court, because the statement "did not point out which of the 483 creditors, attorneys or parties in this case [the firm] had had specific dealings with or which ones the firm had a continued legal relationship with at or about the time of the filing of this debtor's case." Also, per the bankruptcy court, the fact that the primary lawyer working the debtor's engagement for the law firm knew that he needed to obtain a waiver from the debtor with regard to his unrelated representations of the banks underscored the need for the law firm to specifically disclose its connections with those creditors.[14] The district court addressed — and rejected — four separate arguments by the law firm on appeal.

Rulings on Appeal

First, the law firm argued that the bankruptcy court's decision raised a due-process issue. The district court rejected that argument, noting that the word "connections" in Bankruptcy Rule 2014(a) was sufficiently broad to cover both individual attorneys and their law firms.

Second, the law firm argued that under precedent authored by the same bankruptcy judge assigned to its case, the disclosures made by the law firm, coupled with the debtors' petition and schedules, provided sufficient information for the court to evaluate whether the law firm could be employed under § 327. The district court disagreed, concluding that no disclosure was made of the lead attorney's representation of the bank creditors in unrelated matters.

Third, the law firm argued that the individual attorney's conflicts are ordinarily imputed to the firm, apparently in support of the notion that disclosure at the individual attorney's level was unnecessary in light of the firm's disclosure of the unrelated representations. The district court disagreed, stating that the mere fact that conflicts may be imputed to the firm does not mean that the conflict no longer applies to the individual attorney.

Finally, the law firm contended that it did not have to disclose the lead partner's involvement in the bank creditor engagements because they were unrelated to the bankruptcy case. The district court disagreed, noting that "boilerplate" disclosure was insufficient in circumstances where there were known connections presenting a significant risk of adversity.[15]

Implications of the *Brown* Ruling

The *Brown* ruling opens the door to some interesting questions regarding how specific Bankruptcy Rule 2014 disclosures must be with respect to representations of creditors in matters unrelated to the bankruptcy proceeding. Is *Brown*'s bottom line that names have to be named, meaning that whenever a law firm makes disclosures under Bankruptcy Rule 2014, it has to disclose whether one or more individual attorneys who are proposed to staff the engagement are also staffing (or previously staffed) the firm's representation of a creditor or other party in interest in an unrelated matter? In general, "unrelated" representation disclosures under Bankruptcy Rule 2014(a) do not include statements as to whether specific attorneys at the firm are staffing (or previously staffed) the unrelated representation.

Law firms typically append two lists of unrelated matters — one with pending engagements, one with concluded engagements — to their Bankruptcy Rule 2014(a) declarations. The declaration typically does not specify whether individual attorneys working on the bankruptcy case(s) are representing (or have represented) one or more creditors

10 *Id.* at *8-9.
11 *Id.* at *9.
12 *Id.* at *15-16.
13 *See KLG Gates*, 2014 U.S. Dist. Lexis 19998 at *17-18.
14 *Id.* at *24-27.
15 *Id.* at *39-47.

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on the lists. Accordingly, the line drawn in *Brown* regarding the scope of required disclosure represents a substantial deviation from current practice. If someone were to pull 10 employment applications from different randomly selected chapter 11 cases on the U.S. Bankruptcy Court for the Eastern District of New York's docket, you would be shocked if you found one that had the attorney-specific disclosures regarding unrelated matters that were required in *Brown*. If one were to guess as to why the attorney-specific disclosures regarding unrelated matters were not there, it might be that all 10 firms resolved the "why does it matter?" question in the same way.

Attorney-specific disclosures are undoubtedly necessary in certain circumstances. By way of a nonexclusive example, when a law firm partner is a corporate officer of the debtor or holds equity in the debtor, the attorney-specific connection has to be disclosed. Similarly, if the law firm proposes to cure a conflict of interest by means of an "ethical wall," it must specifically disclose what attorneys will reside on either side of the proposed wall.

The *Brown* decision could be viewed differently if the ruling was limited to the law firm's failure to disclose that it had sought/obtained a conflict waiver from the creditor/client in connection with the unrelated, concurrent bank representations. If that were the alleged nondisclosure, the ruling becomes understandable, as waiver-related information bears directly on the professional's qualification to serve. The decision could also be viewed differently if a point was being made about the need to disclose sufficient information to evaluate the economic significance of the creditor/client relationship (*e.g.*, whether the creditor/client represented more than 1 percent of the firm's gross receipts during a given year, which is a disclosure that courts typically see). That's not what the *Brown* court was focused on.

The decisions in the nondisclosure sphere that resonate with the private bar are the ones where the regulated body understands why the information that was not disclosed arguably could have made a difference in the court's evaluation of the professional's employment. Rulings like *Brown* raise more questions than they answer because the court does not connect the alleged nondisclosure with the level of notice that is necessary for the court and parties in interest in a bankruptcy case to adequately perform the fitness evaluation under § 327 of the Bankruptcy Code. Truly "unrelated" representations do not present the risk of one client's confidences being compromised to the advantage of another of the firm's client; accordingly, when we are talking about connections held by specific attorneys, isn't it fair to ask why disclosure at the attorney level matters when reviewing alleged conflicts? The *Brown* ruling effectively created a *per se* rule requiring disclosure of whether an attorney for the estate worked on unrelated representations of creditors and other parties in interest and, if so, any specific identification of such representations. But to what end? abi