Norton Bankruptcy Law Institutes
Bankruptcy Ethics Update
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1. Jackson Walker and Judge Jones

As has been extensively publicized, Bankruptcy Judge David R. Jones was in a romantic relationship with Elizabeth Freeman, one of his former clerks who was for several years a bankruptcy partner at Jackson Walker, including living and co-owning a house with her. Yet he did not recuse himself or disclose that relationship in public records or to parties in cases where Jackson Walker appeared, often as local counsel to Kirkland & Ellis in large, complex chapter 11 cases. Judge Jones approved some $13 million in fees for Jackson Walker during the period Ms. Freeman was both a Jackson Walker partner and living with him, including approximately $1 million billed by Freeman in 17 cases. He also mediated a case and entered an order where Ms. Freeman was appointed as a trustee to wind down an insurance services provider, compensated at a rate of $100,000 each month.

The Fifth Circuit filed a misconduct complaint against Judge Jones after the relationship came to light. Complaint Identified by the Chief Judge of the Fifth Circuit Court of Appeals Against United States Bankruptcy Judge David R. Jones, Southern District of Texas, Under the Judicial Improvements Act of 2002 at 1–4, No. 05-24-90002 (5th Cir. Oct. 13, 2023). It found probably cause to believe misconduct by Judge Jones occurred. The complaint says "on information and belief," Judge Isgur ruled on a motion to recuse Judge Jones while unaware of that relationship. The district court upheld the denial of recusal on the same basis. The Fifth Circuit complaint says if Judge Jones had disclosed the facts, the motion to recuse would have been granted. Judge Jones resigned, and the complaint was withdrawn.

Jackson Walker did not disclose the relationship in its Rule 2014 disclosures. Firm management advised that they learned of it in March 2021, after Judge Isgur denied the first recusal motion on grounds of lack of evidence. Freeman initially denied an ongoing intimate relationship, and the firm accepted that without further inquiry. Upon advice of an ethics expert, the firm informed Freeman that she could not work on any cases pending before Judge Jones and removed her share of partnership profits from those cases. Six months later, it obtained written confirmation from Freeman that she was not in an ongoing intimate relationship with Jones, and didn't live with him or own a house with him. In March 2022, Freeman admitted to the relationship, but she and Judge Jones refused to publicly acknowledge it. Judge Jones contended any disclosure obligation belonged to him alone. Freeman's counsel and Judge Jones wanted the firm to disclose only that Freeman and Jones had a "close personal relationship."

Freeman finally left the firm in December 2022 to start her solo practice (with referrals from Jackson Walker to firm clients to hire her in matters not before Jones and a confidentiality agreement). The Rule 2014 disclosures in pending cases were not supplemented nor were full

disclosures made during the 20 months of firm-acknowledged notice of at least some Jones-Freeman relationship, and the firm was awarded over $21 million in fees and expenses for its work in over 30 cases during that period, which included time billed by Freeman. Only after Freeman left the firm did Jackson Walker begin including local bankruptcy judges on its list of names to check for conflicts in its database and among its attorneys and make disclosures in future cases, although the judges were on the lists utilized by the primary DIP counsel firm, Kirkland and Ellis, all along.

The U.S. Trustee is pursuing claw-backs of fees in 35 cases, consolidated into a miscellaneous proceeding, Bankr. S.D. Tex. No. 23-645; *see In re Jackson Walker Law Firm*, 2023 WL 9316926 (Bankr. S.D. Tex. Dec. 21, 2023), 661 B.R. 217 (Bankr. S.D. Tex. 2024); 663 B.R. 335 (Bankr. S.D. Tex. 2024); 663 B.R. 480 (Bankr. S.D. Tex. 2024); *see also In re Professional Fee Matters Concerning the Jackson Walker Law Firm*, 2024 WL 4903762 (D. Or. Nov. 27, 2024). A motion by the U.S. Trustee to withdraw the reference to the Judge Alia Moses in the District Court for the Western District of Texas is pending. Judge Moses issued the most comprehensive reported description of the facts and issues to date in *Van Deelen v. Jones*, 2024 WL 3852349 (S.D. Tex. Aug. 16, 2024).

Judge Jones and the Judicial Code

"Any justice, judge, or magistrate judge of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned." 28 U.S.C. § 455(a). Under the Code of Judicial Conduct, "[a] judge shall disqualify himself or herself in a proceeding in which the judge's impartiality might reasonably be questioned, including but not limited to instances in which… (c) the judge knows that the … judge's spouse … residing in the judge's household, has a financial interest in the subject matter in controversy … or any other interest that could be affected substantially by the outcome of the proceeding; [or] (d) … the judge's spouse … is: … (ii) acting as a lawyer in the proceeding; (iii) known by the judge to have an interest that could be substantially affected by the outcome of the proceeding.… Code of Conduct for U.S. Judges ("Judicial Code") Canon 3(C) (Jud. Conf. 2019). Commentary to Canon 3(C) states that "[r]ecusal considerations applicable to a judge's spouse should also be considered with respect to a person other than a spouse with whom the judge maintains both a household and an intimate relationship." Disclosure of relationships and agreement of all parties to proceed will not excuse disqualification in these circumstances. Canon 3(D).

An advisory opinion on point "concludes that an equity partner in a law firm generally has 'an interest that could be substantially affected by the outcome of the proceeding' in all cases where the law firm represents a party before the court." Committee on Codes of Conduct ("CCC") Advisory Op. 58 (Guide Vol. 2B). It directs that recusal is mandatory in such cases, although not when the judge's relationship is with an associate or non-equity partner having no share in the firm's profits, client list or goodwill. A friendly relationship between a judge and an attorney alone is insufficient to require recusal, but the judge may not allow such relationships to influence judicial conduct or convey or allow others to convey the impression that another person is in a special position to influence the judge. Judicial Code Canon 2B, CCC Advisory Op. 11. In a bankruptcy case, the debtor, a trustee, and a party to an adversary proceeding or contested matter are deemed parties to the case for purposes of requiring recusal evaluation. CCC Advisory Op. 100.

The Fifth Circuit expressly agreed with Advisory Opinion 58 that partner status of a judge's relative and co-owned property is alone sufficient grounds to disqualify the judge, because

disqualification focuses on the appearance of impartiality. *Potashnick v. Port City Constr. Co.*, 609 F.2d 1101, 1113-14 (5th Cir. 1980) (disqualification mandatory where judge's father was partner in law firm representing plaintiff whose compensation was unrelated to firm income despite the father having no role in the case, and also because plaintiff's lawyer co-owned property with judge and represented judge in other matters; judgment after lengthy trial reversed despite no allegation of actual bias or prejudice and consent during trial to the judge). The Fifth Circuit noted in *Potashnick* that "[a]part from the potential financial interests at stake, a win or loss in any lawsuit could affect a partner's interest in his firm's reputation, its relationship with its clients, and its ability to attract new clients." *Id.* at 113; *See also Judges' Social or Close Personal Relationships with Lawyers or Parties as Grounds for Disqualification or Disclosure*, ABA Comm. On Ethics & Pro. Resp., Formal Op. 488 (Sept. 5, 2019) (judge must disqualify when in a romantic relationship with a lawyer or party in the proceeding); *see also Listecki v. Official Committee of Unsecured Creditors*, 780 F.3d 731, (7th Cir. 2015) (no party obligation to discover potentially disqualifying information; judge should make informed decisions and disclose any concerns he might have; when family members within the third degree are involved in the litigation, it should heighten the judge's awareness of potential bias and consideration whether to disclose information so parties can decide to proceed with full knowledge).

The Fifth Circuit complaint against Jones states there is a reasonable probability that as a Jackson Walker partner, Ms. Freeman obtained a financial benefit from, or had a financial interest in, fees approved by Judge Jones. Efforts to obtain discovery from Judge Jones in the Jackson Walker litigation are ongoing, overseen by Bankruptcy Judge Rodriguez. This includes disputes over deposition questions and subpoenaed documents. Discovery in the U.S. Trustee fee disgorgement proceeding includes a text from Freeman to a Jackson Walker partner before the J.C. Penney chapter 11 case was filed that Jones had participated with her in steering the impending case to Jones, instead of to "process hawk" Judge Isgur.

The Code of Judicial Conduct provides "A judge shall not initiate, permit, or consider *ex parte* communications, or consider other communications made to the judge outside the presence of the parties or their lawyers, concerning a pending or impending matter, except" for administrative, scheduling or emergency purpose which do not address substantive matters provided that the judge reasonably believes no party will gain an advantage and the judge promptly notifies all other parties of the substance of the communication and gives them an opportunity to respond. Code of Judicial Conduct Rule 2.9(A). Judicial Code Canon 2 provides in part that "A judge should … act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary…A judge should neither lend the prestige of the judicial office to advance the private interests of the judge or others nor convey or permit others to convey the impression that they are in a special position to influence the judge.… Judicial Code Canon 2(A)–(B).

Jackson Walker and Bankruptcy and Ethics Law

Bankruptcy Rule 5004 incorporates the judicial disqualification provisions of 28 U.S.C. §455, and subsection (b) specifically disqualifies a bankruptcy judge "from allowing compensation to a person who is a relative of the bankruptcy judge or with whom the judge is so connected as to render it improper for the judge to authorize such compensation." Rule 5002(a) prohibits the court

from approving employment of a professional "if the individual is a relative of the bankruptcy judge approving the employment." Jackson Walker argues that because Jones and Freeman never married, she was not a relative under the Bankruptcy Code §101(34) definition, and neither was the firm, so Rule 5002 did not apply.

As we all know, a professional for the debtor or trustee in a bankruptcy case must be "disinterested." 11 U.S.C. § 327(a). That's defined as a person who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." The U.S. Trustee's motions allege that Jackson Walker had a material financial interest in having a friendly judge in a relationship with a firm partner who might be less critical of its employment and compensation requests.

The primary focus of the U.S. Trustee's motions to claw back fees has been on disclosure deficiencies. Bankruptcy Rule 2014(a) requires disclosure of, "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." Connections with the judge are not specifically listed, and judges do not hold or represent an interest in a bankruptcy estate. The Advisory Committee notes to Bankruptcy Rule 5002, however, states that professionals should make "appropriate disclosure" under Rule 2014 of their connections with a judge if those connections might render their employment improper. Bankruptcy Rule 5002(b) (Advisory Committee Note – 1985).

On September 20, 2024, Judge Isgur sent District Court Chief Judge Crane a disciplinary complaint against Jackson Walker, alleging that Rule 11 sanctions should be imposed against the firm for failing to disclose the Jones-Freeman relationship to firm clients, to Judge Isgur, or in Rule 2014 disclosures in bankruptcy cases. The district court dismissed the complaint, concluding that the court can sanction individual attorneys who violate ethical codes, but lacks authority to financially punish an entire law firm, sanctioning many who had no involvement in or knowledge about any wrongdoing.

Filed briefs in the fee disgorgement proceedings do not cite any cases applying Rule 2014 to a lawyer's relationship with a judge. Courts have repeatedly held that the definition of disclosable "connections" is very broad, and that professionals "cannot pick and choose which connections are irrelevant or trivial." *In re EWC, Inc.*, 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992); *see In re Am. Int'l Refinery, Inc.*, 676 F.3d 455, 465-66 (5th Cir. 2012) (counsel must disclose all connections regardless of whether sufficient to rise to the level of a disqualifying interest); *In re BH&P Inc.*, 949 F.2d 1300, 1308 (3d Cir. 1991) (disclosure encompasses any professional with an "interest or relationship that would even faintly color the independence and impartial attitude required by the Code").

Jackson Walker has responded to the U.S. Trustee's Rule 60(b)(6) motions alleging lack of standing, and estate claims having been barred by releases in confirmed plans that have *res judicata* effect under Code § 1144. On the merits, the firm argues that the Jones-Freeman relationship does not fall within the bounds of Rule 2014. The firm also claims that before March 2022, it didn't know of the relationship, and thereafter Judge Jones and Ms. Freeman refused to make the full truth public. Jackson Walker argues that Ms. Freeman's knowledge and conduct

cannot be imputed to the firm under Texas LLC and agency law and *In re Cygnus Oil and Gas Corp.*, 2007 WL 1580111 (Bankr. S.D. Tex. May 29, 2007) (Isgur, J., rejecting a per se imputation rule). That case and Jackson Walker's response do not address applicable professional ethics rules.

Under the Texas ethics rules, prior to an amendment effective October 1, 2024, even personal interest conflicts were imputed to the entire firm. Tex. Disciplinary Rules of Pro. Conduct ("TDRPC") Rule 1.06(f) (Tex. Bar Ass'n 2022). Oklahoma, like most states, has adopted a form of Model Rules of Professional Conduct Rule 1.10, which applies in Texas after the amendment effective date:

> Rule 1.10 - Imputation of Conflicts of Interest: General Rule
>
> (a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless the prohibition is based on a personal interest of the prohibited lawyer and does not represent a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm.

See In re Essential Therapeutics, Inc., 295 B.R. 203 (Bankr. D. Del. 2003) (discussing conflicting lines of cases on imputation of conflicts).

In 2016, the Texas State Bar Professional Ethics Committee considered whether a disqualifying conflict exists where married attorneys are members of firms that represent opposing parties in the same civil matter. It determined that an individual lawyer's disqualifying conflict based on a personal interest is imputed to the entire firm in Texas, which until October 2024 included no exception to its Rule 1.06(f), which provided: "If a lawyer would be prohibited by this Rule from engaging in particular conduct, no other lawyer while a member or associated with that lawyer's firm may engage in that conduct." Tex. Pro. Ethics Comm., Formal Op. 666 (2016), quoting TDRPC 1.06(f); *see Unauthorized Practice of Law Comm. v. Am. Home Assurance Co., Inc.*, 261 S.W.3d 24, 40 (Tex. 2008) ("Texas law imputes knowledge of confidential information to counsel's lawyer-associates so that in a private law firm, all of the lawyers are irrebuttably presumed to have knowledge of the confidential information.").

Ethics Opinion 666 discussed a personal interest conflict as follows:

> A ... conflict of interest will usually exist when both spouses are personally involved in representing opposing parties in the same matter, *or when either spouse, for whatever reason, has a material personal interest in the outcome of the matter*. In other circumstances, resolution of the issue requires consideration of all the circumstances, including, without limitation, (1) the nature of the matter and the issues involved; (2) whether either spouse will be directly involved in the representation, and if so, the nature and extent of such involvement; (3) whether and to what extent the outcome of the representation may have a financial effect on either spouse; (4) the positions of the spouses within their firms; and (5) whether the lawyers handling the representation have a close working relationship with the lawyer-spouse in the same firm....

> If, under the circumstances, it reasonably appears that the lawyer's representation will not be adversely limited by the lawyer's interest arising from the marital relationship, the lawyer is free to undertake or continue with the representation. Even in that event, it may be wise (although not required) for the lawyer to disclose the spousal relationship to the client, notwithstanding the absence of a conflict of interest.

Id. (emphasis added). Jackson Walker has argued that there was no substantial risk that its representation of clients was materially and adversely affected by Freeman's personal interests, or by the firm's desire to generate revenues and avoid fee litigation like any firm. It says the firm would have performed the same services before another judge. Jackson Walker has not responded to the U.S. Trustee's point that if disclosures were made and Jackson Walker was disqualified from representing clients in his cases, the firm's bankruptcy practice would have been negatively impacted by not being able to appear before the judge with the most large chapter 11 cases in the country. The firm could argue that the relationship between Judge Jones and Freeman enhanced, rather than adversely affecting, their clients' interests. Some of the discovery in the U.S. Trustee claw-back litigation shows cases steered to Judge Jones through Freeman because of Jackson Walker's perception that he would benefit their clients' treatment in their cases.

Jackson Walker also argues that Rule 2014 and disclosure caselaw require actual "knowledge" of the firm, not "notice," so common law imputation of Freeman's knowledge does not apply. Discovery in the fee disgorgement proceeding has focused in part on knowledge of the Jones-Freeman relationship by other Jackson Walker partners, including those appearing in bankruptcy cases and signing Rule 2014 disclosures.

Applicants for employment as court-approved professionals have been required to make reasonably diligent inquiry into and analyze the factual and legal elements of every document signed and filed. Bankruptcy Rule 9011; *In re Pierce*, 809 F.2d 1356, 1363 n. 21 (8th Cir. 1987) (applying Rule 9011 to erroneous application to employ counsel). That includes comparing a list of all parties in interest to a thorough client database encompassing firm clients and parties adverse to firm clients in represented matters. *See Jay Alix v. McKinsey & Co., Inc.*, 23 F. 4th 196 (2d Cir. 2022) (allegations of disclosure misconduct including choice not to include adverse parties in database of client engagements sufficiently alleged corruption of bankruptcy process to state RICO cause of action).

Required diligence for Rule 2014 disclosures also includes inquiries into potentially-disqualifying personal connections of firm attorneys, such as service as an officer or director of the debtor, owning an interest in the debtor or an asset acquirer that would not be shown on a database of firm clients. *See* Code §101(30) "insider" definition; *In re Matco Electronics Group, Inc.*, 383 B.R. 848 (Bankr. N.D.N.Y. 2008) (committee counsel's fees disgorged for inadequate disclosure of firm partner's relationship with CEO of petitioning creditor); *In re Essential Therapeutics, Inc.*, 295 B.R. 203 (Bankr. D. Del. 2003) (firm disqualified because partner held ministerial officer position in debtor within two years prepetition); *In re Olympia Office LLC*, 562 B.R. 8 (Bankr. E.D.N.Y. 2017) (disclosed family relationship of lawyer to equity holder of debtor not disqualifying because of consanguinity degree); *In re O'Connor*, 52 B.R. 892 (Bankr. W.D. Okla. 1985) (DIP counsel approved after full disclosure that firm members owned less than 1,000 shares of 12,969,626 outstanding

DIP stock). Bankruptcy Rule 2014 requires disclosure of all of the applicant's connections to the U.S. Trustee and any person employed in the office of the U.S. Trustee. A Rule Note explains this requirement as important to confidence in the bankruptcy system "especially since the United States Trustee monitors and may be heard on applications for compensation and reimbursement of professionals." Rule 2014 Advisory Committee Note (1991).

Jackson Walker also argues that the applicable Code of Professional Ethics does not support civil liability and Code provisions were not breached. The Code provisions cited by the U.S. Trustee do not specifically identify a relationship between a lawyer and the judge handling her case: Rule 3.03 (candor toward the tribunal), 3.04 (fairness in adjudicatory proceedings); 3.05 (maintaining impartiality of tribunal), 4.01 (truthfulness in statements to others); 5.01 (partner and supervising attorney duties not to knowingly permit ethical violations or knowingly fail to take reasonable remedial action). The spirit of these code provisions indicate that Jackson Walker should have at least disclosed the Jones-Freeman relationship, but the express language does not.

Texas has adopted a version of Model Rule 8.4 which provides, in part, that a lawyer shall not: "(a) violate these [ethics] rules, knowingly assist or induce another to do so, or do so through the acts of another; . . . (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation; (d) engage in conduct constituting obstruction of justice [Model Rules: "prejudicial to the administration of justice"]; . . . (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law . . .. TDRPC 8.04(a).

The U.S. Trustee also argues that Jackson Walker's disclosure duties as DIP counsel are based on the fiduciary duties of DIP counsel to the bankruptcy court (but not to any specific creditor). *In re Futuronics Corp.*, 655 F.2d 463, 470 (2d Cir. 1981); *ICM Notes Ltd. v. Andrews & Kurth, L.L.P.,* 278 B.R. 117, 123 (Bankr. S.D. Tex. 2002), *aff'd.* 324 F.3d 768 (5th Cir. 2003). Jackson Walker's response does not specifically address this point.

Kirkland & Ellis and Bankruptcy Law

No Rule 60 relief has been sought against Kirkland and Ellis by the U.S. Trustee. Kirkland routinely included Texas bankruptcy judges in the list of material parties it checked for conflicts and disclosed connections with in its bankruptcy cases filed in Texas (mostly former clerks), according to the U.S. Trustee's Rule 60 motions. Discovery may ultimately elicit whether any Kirkland lawyers knew about the Jones-Freeman relationship. If so, Professional Conduct Rule 8.4 may be raised for Kirkland as well as Jackson Walker. TDRPC 8.04(f) (a lawyer shall not "knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law . . ..). Texas also has a version of Model Rule 8.3. Its subsection (a) requires reporting of violations by other lawyers of applicable ethics rules when that violation "raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects." TDRPC 8.03(a). It also requires some reporting of misconduct by a judge: "Except [inapplicable], a lawyer having knowledge that a judge has committed a violation of applicable rules of judicial conduct that raises a substantial question as to the judge[']s fitness for office shall inform the appropriate authority. TDRPC 8.03(b). Recent filings have indicated a senior Kirkland partner, Joshua Sussberg, testified in a deposition that Jackson Walker's errors tarnished all cases which was a great concern to Kirkland.

Several courts have held that other professionals in a case have the right to raise the issue of an estate professional's conflict of interest under state professional conduct rules. In *In re Congoleum Corp.*, 426 F.3d 675, 686 (3d Cir. 2005), the Third Circuit explicitly did not decide if a noncreditor's (insurer's) lawyer had a duty to disclose a conflict of interest on the part of special counsel, but held counsel had standing, the right to raise the issue of a conflict under state Rules of Professional Conduct, and said that counsel has a responsibility, if not a duty, to alert the court to ethical conflicts on the part of other counsel. *See also Jay Alix v. McKinsey & Co., Inc.*, 23 F.4th 196 (2d Cir. 2022) (competing professional standing to pursue RICO claim based on failure to comply with professional disclosure obligations); *In re Black*, 116 B.R. 818, 821 (Bankr. W.D. Okla. 1990) (attorneys who know that others file false Rule 2014 disclosure statements have an ethical responsibility to inform the appropriate professional authority). In at least one case, lead bankruptcy counsel was sanctioned for failure to disclose lack of disinterestedness of another estate professional. *Matter of CF Holding Corp.*, 164 B.R. 799, 808 (Bankr. D. Conn. 1994). The court analogized DIP counsel to a trustee, whose fees may be disallowed under §326(d) if the trustee failed to make diligent inquiry into facts that would permit fee denial under §328(c) or employed a professional under §327 with knowledge of such facts.

Potential Consequences

If the court finds the firm was not disinterested during any portion of its DIP representation, its compensation may be disapproved and ordered disgorged under Code §328. *E.g. Gray v. English*, 30 F.3d 1319 (10th Cir. 1994). Disclosure rule violations may be sanctioned even if the estate did not suffer any actual financial loss because of the undisclosed relationship. *In re New River Dry Dock, Inc.*, 497 Fed.Appx. 882, 887 (11th Cir. 2012).

Where a judge should have recused but did not, orders entered thereafter may be vacated unless the failure to recuse was harmless error. *Liljeberg v. Health Servs. Acquisition Corp.*, 486 U.S. 847, 864 (1988) (consider risk of injustice to the parties, risk that denial of relief will produce injustice in other cases, and risk of undermining public confidence in the judicial process when determining whether to vacate a judgment for violation of 28 U.S.C. §455(a)); *Roberts v. Wal-Mart Louisiana, LLC*, 54 F.4th 852, 854 (5th Cir. 2022) (before a judgment by a judge who should have recused may be vacated under Rule 60(b)(6), the court must probe whether the alleged extraordinary circumstances undermine the targeted judgment's merits and render it "manifestly unjust", or harmless error); *see Tesco American, Inc. v. Strong Industries, Inc*., 221 S.W. 3d 550, 553 (Tex. 2006) (Texas Constitution provides for disqualification of judges connected by affinity or consanguinity; judgments by trial judge are void; by appellate judge are reversed for reconsideration by remaining panel members without disqualified judge). Jackson Walker argues there was no injustice to other parties in the bankruptcy cases, as Jackson Walker lawyers did quality work benefitting client estates that was not impacted by the Jones-Freeman relationship, and no parties nor the U.S. Trustee objected to firm fee applications.

One relevant case is *Clark v. Kapila*, 612 B.R. 808, 816-20 (S.D. Fla. 2019). The district court vacated final judgment in an adversary proceeding where the bankruptcy judge failed to recuse when his fiancé was contacted by and engaged in recruitment discussions with counsel for one of the parties, while a summary judgment was pending. This was held to be a thing of value added to the judge's household. The court cited legislative history of the Bankruptcy Code raising concerns about a "bankruptcy ring" of professionals with an "inside track on all bankruptcy matters,

including the judges' favoritism." *Id.* at 817. The court remanded for the summary judgment to be retried before a different judge.

The Fifth Circuit has explained that the same disqualifying circumstance, such as the judge's agreeing to join DIP counsel's law firm shortly after entering the challenged rulings, may result in harmless error with respect to one ruling and reversible error as to another. A summary judgment on allowability of damages was held to leave (1) little risk of injustice to the parties because it was reviewed *de novo*; (2) little injustice in other cases, especially given a caution to other judges contemplating retirement and the status of the plan; and (3) an appellate ruling of judicial violation of 28 U.S.C.A. §455 was deemed to restore some of any public confidence lost as a result of the violation. *In re Continental Airlines Corp.*, 901 F.2d 1259 (5th Cir. 1990). On the other hand, that court held that the risk of injustice to the parties was greater with respect to a claim estimation order, because it is reviewable on an abuse of discretion standard. Further, the risk of undermining public confidence in the legal system was deemed greater in such a discretionary matter, where the public should trust that the parties' welfare will take priority over convenience or ease of disposing of the parties' claims. Injustice to other estate creditors from delay at that point in the case would be minimal due to a plan, and the increased risk of injustice to the parties and undermining public confidence in the judicial process "far outweighs any decrease in the risk of injustice to other parties in denying relief from the bankruptcy court's estimation order." *Matter of Continental Airlines*, 981 F.2d 1450, 1463 (5th Cir. 1993). The court remanded an order estimating claims for determination by a new bankruptcy judge.

2. Disinterestedness

In re Enviva, Inc., 2024 WL 2795274 (Bankr. E.D.Va. May 30, 2024)
In re Enviva, Inc., 2024 WL 3285781 (Bankr. E.D.Va. July 2, 2024)

The court denied the application to employ Vinson & Elkins as DIP counsel in a group of large chapter 11 cases with $500 million of DIP financing. V&E also represented a member of a non-debtor affiliate of the debtor that would receive $4.6 million for taxes and other liabilities, proposed on the first day but withdrawn at the initial hearing. V&E represented officers and directors of the debtor in shareholder and derivative litigation (claiming indemnity from the debtors), who would be entitled to 5% of the equity in the reorganized entity with warrants for more under restructuring support agreements (RSAs) negotiated prepetition.

V&E also represented Riverstone entities holding 43% of the debtors' equity securities and two directors' seats. Riverstone was a $14 million-per-year firm client. Under the DIP facility, existing equity security holders could subscribe up to $100 million of that facility, with the entire $500 million backstopped by an ad hoc group of creditors that included V&E clients. It would benefit significantly from the 5% equity interest provided in the RSAs. The plan would have to be negotiated with the unsecured creditors committee and other constituents, where the allocation of equity will be a significant issue. V&E did not erect an ethical wall between lawyers advising Riverstone and those advising the debtors; they worked simultaneously for both clients. The court held V&E could not eliminate its lack of disinterestedness through conflicts counsel because such counsel cannot substitute for general counsel's duties to negotiate a reorganization plan. The court found an actual conflict in that V&E could not be expected to negotiate a plan that contravened Riverstone's interests.

The court denied a reconsideration motion that proposed breaking out firm lawyers who

had represented both the debtors and Riverstone into two groups, which did not resolve their role during negotiation of the RSAs, and was held an insufficient ethical wall. It proposed that no attorney working more than 10 hours on debtors' cases would participate in net profits from Riverstone representation, which did not eliminate the firm's extensive ties to Riverstone or perception of unfairness. It proposed a Plan Evaluation Committee of the debtors' board to act as a check on the board and V&E, but that committee would be dependent on the board's financial advisers, could be eliminated by the board at an time, and did not have primary responsibility to negotiate the plan.

V&E had also received prepetition payments potentially avoidable as Code §547 preferences. That was held not disqualifying because preference claims could be brought by the committee or a plan liquidation trust, and V&E waived any Code §502(h) claim. The court held V&E could be employed under Code §327(e) on discrete matters not involving other V&E clients, such as tax or securities law compliance matters.

In re Invitae Corp., 2024 WL 2230069 (Bankr. D.N.J. May 16, 2024)

The court found Kirkland & Ellis disinterested despite the firm's representation of the largest secured creditor holding 79% of the debt on unrelated matters. It noted that concurrent representation is not automatically disqualifying under Code §327(c), and held that form conflict waivers in engagement agreements and references to the creditor on the debtor's schedules was sufficient to constitute informed consent. K&E billed the creditor client over $1.8 million the previous year, but that was considered *de minimus* for K&E. And limiting K&E's representation to matters not affecting the creditor was found to be impracticable, given the size of the creditor's claim. The court required an ethical wall between lawyers working on the chapter 11 case and lawyers providing unrelated services to the lender. The court said the fact that the creditor as stalking-horse was outbid in a Code §363 asset sale showed K&E could and did zealously represent the estate.

In re Norwich Roman Catholic Diocesan Corp., 2024 WL 535120 (Bankr. D. Conn. Feb. 9, 2024)

Ford Elsaesser was held disqualified to serve as counsel for the Unknown Claims Representative in a chapter 11 case because of his record of service as lead counsel for debtors and parishes in prior and pending diocesan bankruptcies. His historical and current alignment and advocacy for Catholic leadership and institutions and inevitable adversity to holders of unknown claims is logically antithetical to the objectivity, advocacy and transparency needed to represent unknown claimants in this case. The court held this constituted a concurrent conflict of interest under Professional Conduct Rule 1.7 or at least a disqualifying potential material adverse interest under §§321(a), 101(14)(C) ("for any other reason").

In re WB Bridge Hotel, LLC, 656 B.R. 734 (Bankr. S.D.N.Y. 2024)

DIP counsel was allowed to withdraw as counsel post-confirmation but not allowed to represent the debtors' manager in an adversary proceeding by the post-confirmation liquidating trustee to recover alleged fraudulent transfers. Applying the conflict standards for successive representation in Professional Conduct Rule 1.9, the court held that the trustee qualified as a former client of the firm, and a substantial relationship existed between counsel's prior representation of the debtors and the trustee's post-confirmation adversary proceeding. The lawyer likely had access to confidential information. The court also found a significant risk of trial taint

from the attorney's understanding of the debtors' finances and prepetition transfers.

In re Doug Gross Construction, Inc., 2024 WL 2990298 (Bankr. W.D.N.Y. June 13, 2024)

Law firm met requirements of disinterestedness and no actual conflict of interest even though its predecessor firm previously represented the creditor who provided $40,000 funding for the bankruptcy case in an unrelated individual tax matter. The firm represented only the debtor in the chapter 11 subchapter V case. Its previous firm's previous representation of the creditor should have been disclosed initially, but was eventually disclosed.

In re Witchey Enterprises, Inc., 2024 WL 2827928 (3d Cir. June 4, 2024)

DIP counsel for a small corporation failed to initially apply for approval of employment. When he did seek *nunc pro tunc* approval, the court only authorized approval as of the date of his delinquent employment application. The lawyer represented that he was disinterested, but ultimately confirmed he performed legal services before and during the case for the debtor's president and sole shareholder. And the president had made unauthorized loans to and received unauthorized payment from the debtor during the case. The Third Circuit upheld bankruptcy court and district court rulings that the attorney's representation of both the debtor and its principal and creditor warranted denial of all fees, even if the failure to disclose was inadvertent. Failure to disclose the attorney's relationship with the principal was an independent ground for fee denial.

In re Cinch Wireline Services, LLC, 2024 WL 4161463 (Bankr. W.D.Tex. Sept. 11, 2024)

The court declined to address as moot Code §327 disinterestedness of the chapter 7 trustee's special counsel arising from contemporaneous representation of a creditor. The disqualification motion five months after commencement of litigation was untimely, the alleged conflict was not pleaded with sufficient specificity, and it would be difficult for the trustee to secure new counsel willing to work on a similar 40% contingency fee in the uniquely complex lawsuit.

In re Lodging Enterprises, LLC, 2024 WL 4229132 (Bankr. D. Kan. Sept. 17, 2024)

The court approved employment of a chief restructuring officer despite his service as the debtor's vice president and treasurer until just before the petition filing. The court held that a CRO is a professional under Code §327 and found he was an insider, as defined in Code §101(14)(a). But it held that the disinterestedness requirement is modified by §1107(b). And it found that while not all connections were set forth in the Rule 2014 statement and some contract terms, including for compensation, were unreasonable, these issues were not of sufficient import to warrant denial of the application.

In re RKO Services LLC, 2024 WL 4455859 (Bankr. S.D. Tex. Oct. 9, 2024)

The court held that proposed chapter 11 DIP counsel was not disinterested person at the petition date because the engagement agreement permitted the firm to obtain a lien on property of the Debtors' estates to secure payment of its fees, making the firm both a creditor of the Debtors and an entity with an interest materially adverse to the Debtors' estates. The firm also had a current or potential conflict of interest with the Debtors through contemplated representation of entities with potential adverse interests, and failed to properly disclose all connections required by Rule 2014. The firm resolved the disinterestedness concerns, including by striking lien provisions from the engagement agreement. The court held that disinterestedness might be cured after employment approval was denied, but counsel must file a new application with proper disclosures.

Then employment could be approved retroactively to the date when the improper language was stricken from the fee agreement.

In re East Coast Foods, Inc., 2024 WL 4648076 (9th Cir. Nov. 1, 2024)

The bankruptcy court has exclusive jurisdiction over a lawsuit claiming that a trustee knowingly employed a professional that was not disinterested.

In re MMA Law Firm, PLLC, 660 B.R. 128 (Bankr. S.D. Tex. 2024)

Proposed Committee counsel was held disqualified, because the attorneys held confidential information about the law firm debtor as their prepetition prospective client that chose not to retain the firm as its DIP counsel. Texas' ethics code did not impose a direct duty to maintain the confidences of a prospective client until that code was amended in 2024 after the communication at issue, but Fifth Circuit decisions hold that the Model Rules must be considered in the context of a disqualification motion. Thus, while not barred by state law, in federal bankruptcy court, representation under Model Rule 1.18 is only permitted if (i) reasonable measures were taken to avoid exposure to more disqualifying information than reasonably necessary to determine whether to represent the prospective client, (ii) the firm had screened the lawyer possessing the confidential information from participation in the case, (iii) apportioned him no share of attorneys' fees paid, and (iv) prompt notice was given to the prospective client.

No such criteria were met in this case, and the debtor had communicated litigation strategy against creditors to the lawyers now seeking employment as Committee counsel. The court found that the social interests of disqualification far outweigh the social interests of the lawyers' continued participation in the case.

In re MMA Law Firm, PLLC, 661 B.R. 548 (Bankr. S.D. Tex. 2024)

The failure to disclose the date of paying a flat fee to proposed chapter 11 DIP counsel in the fee application did not preclude approval, as the payment was disclosed in the schedules, and no prepetition amount was owed. The firm was held disinterested despite the provision for a 40% contingency fee in addition to a $60,000 flat fee, because the contingency fee would only be earned if the firm brought funds into the estate for distribution to creditors. That directly aligned the firm's interests with the estate's interests.

3. <u>Bifurcated Fee Arrangements – Disclosure and Factoring</u>

In re Chapter 7 Fees and Practices of My Arizona Lawyers, PLLC and Related Financing Agreements with EZLegalFees, LLC, 2025 WL 308746 (Bankr. D.Ariz. Feb. 3, 2025)

The law firm required clients to execute a promise to paya purported attorney flat fee of $3,000 to EZLegal along with a postpetition retention agreement to retain the firm postpetition. The clients were not told that the lawyer had agreed to accept $1,860 of that amount and that EZLegal would keep the balance. The promise included a 300% default interest rate. And the bankruptcy schedules often showed the debtors lacked the income to make required payments. Filed disclosures of compensation erroneously indicated the debtors were the source of payment, the attorney flat fee was the amount the firm agreed to accept, and that the lawyer had not agreed to share fees. They misrepresented the EZLegal arrangement as a recourse line of credit secured by accounts receivable that counsel must repay regardless of receipt of payments from the debtors.

Client retention agreements contained multiple other misrepresentations directly conflicting with testimony about the agreements. They also required debtor clients to consent to sharing any and all personal information with EZLegal and waive unwaivable conflicts, with no accurate disclosure of direct conflicts of interest.

The court found an intentional, or at least negligent, consistent, years-long pattern and practice of violating material provisions of the Bankruptcy Code and Rules and state Rules of Professional Conduct. It held all retention agreements in EZLegal financed cases to be void, and ordered the lawyer and financing company to disgorge all fees and costs paid by debtors over a two-year period, $1,644,566, payable to the clerk of court pending further court order. They were prohibited from engaging in any collection efforts or accepting any payments from debtors. The lawyer was barred from filing bankruptcy cases for two years, and required to seek approval from the court thereafter to resume any filings. EZLegal was permanently barred from providing any financing to any bankruptcy cases in bankruptcy courts in the District of Arizona. They were required to remove any negative credit notations on debtor credit reports.

In re Smith-Freeman, 2024 WL 270395 (Bankr. W.D. Pa. Jan. 24, 2024)

Chapter 7 debtor's counsel in multiple cases filed multiple amendments of his fee statement (Form B2030), each time certifying the filing was a complete statement of compensation arrangements. Read together, they show initial disclosures with an overview of available options and extensive disclosures about those options; a pre-filing agreement describing pre-bankruptcy services and flat fees, if any, to commence the cases (meeting with the client, advising on available relief, and preparation and filing of a bare bones petition); a post-bankruptcy filing agreement to actually prosecute the cases with exceptions for adversary proceedings and contested matters. If the client did not pay an upfront fee, a 19.9% financing was added to cover the administrative cost of factoring the fees payable over one year to Fresh Start Funding.

The court held that the minimum level of competent services can be provided in a combination of prepetition and postpetition agreements. But in some of the cases, there was no emergency warranting a bifurcated filing, and no reason for a petition filing at all where bankruptcy was not in the client's best interest. The court held that the total amount charged to the clients was reasonable. But it held that the factoring fee the lender charged counsel is overhead that cannot be passed on to the client. The attorney's multiple disclosures were riddled with mistakes. Most importantly, he failed to disclose that his source of compensation was Fresh Start Funding, not the debtors. The attorney was sanctioned in the amount of $1,000 for each case challenged by the U.S. Trustee.

In re Baur, 658 B.R. 930 (Bankr. E.D.Mo. 2024)

After an *en banc* hearing, the bankruptcy court held that the attorney's bifurcated fee agreements were not "clear" as required by Code §548, although described services were not misrepresented per Code §526(a). The court held post-filing agreements to be void and unenforceable by anyone other than the debtors. It held the firm's Code violations to be at least negligent, rendering the firm liable to the debtors to refund all fees paid.

In re Mudd, 2024 WL 3100778 (Bankr. W.D. Okl. June 21, 2024)

This *en banc* order holds that attorneys representing chapter 7 debtors in this district may no longer unbundle essential bankruptcy legal services (listed in the opinion), nor may they utilize bifurcated contracts. The court reiterated that disclosures must be accurate, not evasive, clear and

concise, and comply with court directives. Filing fees may not be paid in installments unless the client is legitimately unable to pay the fee except in installments, and attorneys' fees may not be paid until all such installments are paid. Attorneys may not advance filing fees to their clients.

4. Internet Law Firms

In re Gibson, 658 B.R. 706 (Bankr. S.D. Ga. 2024)

Like multiple other cases concerning national internet consumer bankruptcy law firms working with local attorneys, the court sanctioned the local contract attorney and Recovery Law Group. Recovery prepared all the filings, and the attorney agreed to act pursuant to its direction. The Rule 2016 statement did not reference payments to Recovery; its involvement came to light at the §341 meeting. The court found that the attorney and Recovery violated Code §329 and Rule 2016 disclosure requirements, made false statements in violation of Code §707(b)(4)(c) and Rule 9011, the retainer was void and unenforceable under Code §§ 528(a)(1) and 526(c), they engaged in unauthorized fee sharing in violation of Code §504(a), and Recovery engaged in the unauthorized practice of law in violation of state law and professional conduct rules. On reconsideration, the court found that the attorney wasn't a member or regular associate of Recovery. The only part of the original ruling the court revised was that they might not have violated the Code §504(a) fee sharing prohibition because it's unclear if that section applies in chapter 7 cases, but held sanctions still warranted. It reduced the sanction to the amount of attorneys' fees paid, without including the amount of the filing fee.

In re White, 659 B.R. 68 (Bankr. D.S.C. 2024)

The debtor's house was foreclosed four months after she paid her retainer to Recovery Law Group. Recovery filed her petition two months later, delayed because "there were some documents and things" that Recovery needed. Not only was the debtor's purpose in filing thwarted, but there were multiple errors and omissions in the services rendered to her. The court describes previous rulings by that court in cases sanctioning Recovery.

Recovery violated Code §526(a)(1), (3)(A) because the attorney who carried out the analysis of the debtor's financial situation and advised and assisted the debtor in preparing bankruptcy documents was not admitted to practice in the filing district. The retainer was cancelled and Recovery was barred from soliciting and filing new cases in the district.

In re Shastal, 2024 WL 3755573 (Bankr. E.D. Mich. Aug. 9, 2024)

The opinion recounts multiple errors and omissions by Recovery Law Group and its local attorney inadequately representing the debtors. The debtors ultimately received their discharge, but in addition to a sanctions order, the trustee and debtors jointly filed a lawsuit for malpractice and violations of Code §526 against Recovery Law Group and its attorneys handling the case. Pursuant to a settlement agreement with the secured creditor, any net recovery would be divided equally between the debtors and the bankruptcy estate. The bankruptcy court analyzed at length and denied Recovery's motion to dismiss the litigation.

In re Thomas, 657 B.R. 613 (Bankr. C.D. Ill. 2024)

Local counsel working with Recovery Law Group repeatedly mishandled the debtors' chapter 13 case. That included filing petitions showing their electronic signatures five days before

the petitions were sent to the debtors for review, and not disclosing a previous case that could easily have been discovered through a PACER search. Schedules and other documents were contradictory and inaccurate and included false representations without efforts to verify their accuracy. Only one of the debtors signed the retainer agreement provided by Recovery, in violation of Code §528.

The court denied all fees. It found that the quality of legal work fell so far below the standards of competent representation that any award of fees would be unreasonable. The court also concluded that the lawyer's fee application and response to the trustee's objections provided overwhelming evidence of her lack of understanding of her role as an attorney, and that she is personally subject to the Bankruptcy Code and Rules and professional conduct rules, and she is a debt relief agency. No circumstances ever justify filing a document showing the debtor's signature without the debtor first having signed it.

5. Sanctions Standards

In re Frantz, 655 B.R. 594 (9th Cir. BAP 2023)

After dismissal of chapter 13 case based on debtors' uncured default in direct mortgage payments, the court sanctioned debtor's counsel for declaring that they had completed their plan. The panel held her statement was not frivolous as a matter of law because some legal authority supported her position that direct mortgage payments are not payments under the plan. Conduct is not sanctionable under Rule 9011(b) if a competent attorney practicing in that court could believe his actions were legally and factually justified. And when the court imposes sanctions on its on initiative, as in that case, it must apply a higher standard akin to contempt because there is no "safe harbor" allowing lawyers to correct or withdraw challenged filings. It did not meet that standard because there was a reasonable legal basis for counsel's argument. For the same reason, the court could not sanction her under its inherent powers.

In re Eagan Avenatti, 659 B.R. 214 (Bankr. C.D.Cal. 2024)

The court imposed civil contempt sanctions against the IRS for refusal to comply with discovery orders. It held that sovereign immunity was waived under Code §106, and that the court was empowered to award monetary relief in the form of damages suffered by the estate and monetary fines to coerce compliance. It ordered the government to reimburse the trustee $37,599 for attorneys' fees and costs that would not have been expended but for the violated court order.

In re Fundamental Long Term Care, Inc., 2024 WL 1855776 (Bankr. M.D. Fla. Apr. 29, 2924)

A probate estate obtained $110 million wrongful death judgments against a defendant that then transferred its assets to one company and its now-valueless shares to another company. The probate estate filed an involuntary chapter 7 petition against the successor owner of the defendant. The chapter 7 trustee and his counsel pursued litigation and recovered $23.65 million for the estate, which was used to pay professional and other administrative expenses, with the remainder distributed to the probate estate (and other probate estate creditors with similar claims). When the chapter 7 trustee settled with another defendant, counsel for the probate estates objected because the recovery would not net an amount sufficient to cover his attorneys' fees. The attorney engaged in objections, recusal and reference withdrawal motions and appeals all the way to the U.S. Supreme Court to try and extract additional creditor recoveries that could be used to pay his

fees. The bankruptcy court held it lacked jurisdiction to sanction unreasonable and vexatious litigation that occurred in the appellate courts.

6. Imposition of Sanctions

In re Day v. Kakol, 2024 WL 1506751 (Bankr. N.D. Ga. Apr. 5, 2024)

Chapter 13 debtor's counsel violated state professional conduct rules by accepting his fee from a prospective home purchaser to file the skeletal chapter 13 petition for an elderly debtor to stop a foreclosure, then took no further action so the case could be dismissed, for the sole purpose of buying time for the purchaser to acquire the debtor's home – that he did not want to sell, at a fire sale price that would have cost the debtor her substantial home equity. The attorney was paid by the same buyer to represent debtors in 25 other bankruptcy cases that netted the buyer a profit exceeding $1 million. He also failed to comply with Rule 2016 requirements to disclose his fee agreement.

The attorney's payment from this buyer resulted in an ethics rules 1.7 and 1.8 conflict of interest, materially and adversely affecting his representation of the debtor, who did not give adequately-informed consent. The lawyer also took no steps to ensure protection of the debtor's confidential client information, and acted unreasonably under ethics rule 1.2 in limiting the scope of his representation to merely filing the chapter 13 petition, again without adequately-informed client consent. He did not meet Code §§527-528 disclosure and engagement requirements. He violated local bankruptcy rules requiring court permission to withdraw as counsel and violated his disclosure and performance obligations under his Rule 2016. In light of the attorney's lengthy record of previous discipline by state and bankruptcy authorities, he was prohibited from filing any new bankruptcy cases for one year and prohibited permanently from filing any bankruptcy cases in which fees would be paid by a third party.

In re Robertson, 2024 WL 3738155 (Bankr. N.D. Ga. Aug. 8, 2024)

The court sanctioned the same lawyer referenced in the previous case for filing the seventh bankruptcy case in eleven years, during which the debtor made only three payments to the bank holding a lien on his home. The attorney either knowingly understated, or willfully ignored, the true amount of the arrearage. He had no reasonable basis to believe the chapter 13 plan could be feasible or had any basis in fact. He failed to conduct a reasonable inquiry into the debtor's previous cases or obtain evidence from the debtor necessary to support positions taken by counsel. The lawyer and his firm were sanctioned by disgorging all fees paid by the debtor in the latest case and pay them to the bank, reimburse the bank its attorneys' fees, and attend CLE focused on consumer bankruptcy. They were also prohibited from using appearance counsel without adequate supervision to ensure familiarity with the cases to effectively represent the clients. And the lawyer and firm would be sanctioned $500 for each future case in which they or an appearance counsel on their behalf was unprepared or unable to properly handle a debtor's business before the court.

In re Highland Capital Management, L.P., 98 F. 4th 170 (5th Cir. 2024)

In a highly litigious case, the bankruptcy court entered a gatekeeping order: no suit could be filed against the new CEO/CFO without a prior court order authorizing it and determining it was a colorable claim of willful misconduct or gross negligence. Entities related to the former CEO filed a

suit against the debtor in district court and sought to add the CEO/CFO. The district court declined, and litigation ensued in bankruptcy court to hold the entities and the former CEO in contempt. After extensive discovery and a lengthy hearing, the court ordered contempt sanctions of over $300,000.

A bankruptcy court has authority to issue a civil, but not a criminal, contempt citation, so it must be coercive or compensatory and may not be punitive. It must be limited to the damages caused by the bad faith acts, here, the filing in district court instead of bankruptcy court with bankruptcy court permission, regardless of motive. The sanctions based upon the debtor's expenses were large because of the discovery and hearing about the plaintiffs' motives and the award of fees for that activity was punitive. Compensatory damages would have been limited only to the work required to obtain dismissal of the district court action, less the amount that would have been spent opposing the motion to join the CEO/CFO if filed in bankruptcy court.

In re Highland Capital Management, L.P., 2024 WL 959335 (Bankr. N.D. Tex. March 5, 2024)

The court imposed sanctions against a creditor who filed a proof of claim, litigated it for over three years, then sought to withdraw it on the eve of depositions of its principals and shortly before trial on the merits. The claim was denied on the merits in a lengthy decision. The court found the sanctions motion and notice complied with due process requirements. It found by clear and convincing evidence the creditor acted in bad faith and willful abuse of the judicial process. The creditor was required to pay over $825,000 for the attorneys' fees incurred by the debtor.

In re Vistam, Inc., 2024 WL 2037846 (Bankr. C.D. Cal. May 7, 2024)

Proposed DIP counsel in a Subchapter V case made inconsistent and incomplete disclosures about the source of a $25,000 retainer in her initial fee disclosures. It was said to be from the debtor, but was from an officer of the debtor (and brother of its president and CEO) individually, as an undocumented loan. After months of delay, the court denied counsel's employment application, making it clear the retainer would need to be turned over to the estate. Instead, immediately after the hearing the lawyer transferred the money back to the funder. The court held that the money belonged to the estate or the estate at least had an interest in the money. It held proposed DIP counsel and the retainer funder jointly and severally liable for civil compensatory contempt in the amount of the loan plus the trustee's attorneys' fees vindicating the estate's rights in the funds. The bankruptcy case was dismissed with a 180-day bar to refiling, and it is unclear from the decision how the money is to be used.

In re Kelley-Gershon, 2024 WL 3912192 (Bankr. E.D.N.Y. Aug. 22, 2024)

Debtor filed a chapter 7 case as a litigation strategy in a contentious, long-running divorce case. Her scheduled assets exceeded her debts by over $6.6 million. The court dismissed the case with prejudice to filing another within two years. It also allowed over $50,000 of trustee's attorneys' fees. The court noted the absence of any case law determining whether a court may award fees to a trustee's professionals in a dismissed chapter 7 case where no distributions were made. And case law is divided on whether a chapter 7 trustee herself may be compensated in a case in which she does not make any distributions. It found that not compensating a chapter 7 trustee's professionals in these circumstances would conflict with Congress's intent to oust bad-faith filers from chapter 7 and to promote use of chapter 13 by debtors who can afford to make meaningful payments to creditors.

In re Reeves, 2024 WL 1549300 (Bankr. S.D.N.Y. Apr. 8, 2024)

Counsel for the wife in a protracted and contentious divorce case filed a chapter 7 case for her, listing on Schedules over $150 million of property that had already been determined in the divorce case to be the husband's separate property. Counsel for the husband obtained a default judgment and was awarded attorneys' fees against the wife's attorney for fraud on the court after the wife's counsel refused to correct the Schedules.

In re Embler, 2024 WL 3765480 (Bankr. D. Conn. Aug. 12, 2024)

Chapter 7 debtor's counsel did not attend the debtor's §341 meeting, told the debtor not to attend, and said he would not provide the chapter 7 trustee with requested documents. The debtor appeared *pro se* at a continued meeting and received a discharge. The court held the attorney violated professional conduct rules 1.1, 1.3, 3.3 and his obligations under Code §329 and Rule 2016 to provide reasonable services. It sanctioned the attorney not only by requiring disgorgement of the fee paid by the debtor, but also requiring him to compensate the debtor for damages in the form of his vacation day to attend the continued §341 meeting and travel time and costs. The court also ordered the attorney to pay $250 to the state bar pro bono fund, suspended his privileges to practice bankruptcy for a year with specific details including notations of the order in all pending cases and suspension of his CM/ECF privileges, and transmittal of a copy of the order to the state bar and federal bar grievance committees.

In re Haynes, 662 B.R. 139 (Bankr. D.S.C. Aug. 9, 2024)

Following confirmation of an amended chapter 13 plan providing for surrender of the debtor's house, the debtor sought rehearing and claimed she never agreed to the plan. It was filed by her counsel with typed signatures for counsel and the debtor. She said she was current on her mortgage payments when she consulted the attorney, and he advised her to default for three months so she could seek mortgage modification in light of the full balance coming due in 2024. She did so, but testified she would not have stopped paying or filed bankruptcy if she had been told she might have to surrender her house. The mortgage company refused to modify. The attorney and debtor disputed what she was told about the amended plan. But the attorney had no documentary evidence of the debtor's approval and said she provided only verbal consent. This violated a local rule under Bankruptcy Rule 9011 that required a wet signature or such documented approval when filing a document on behalf of a represented party with an electronic signature. The court ordered the attorney to refund all money the debtor paid to him.

In the Matter of Roman Catholic Church of the Archdiocese of New Orleans, 101 F.4th 400 (5th Cir. 2024)

There have been multiple proceedings concerning sanctions imposed against a lawyer for committee members who violated a protective order and disclosed confidential information about an allegedly abusive priest to the media and the priest's school employer. The bankruptcy court concluded it could not trust the lawyer not to violate subsequent orders and could not force the committee members to terminate the lawyer, so it terminated the committee members' positions on the committee. The lawyer appealed the sanctions ruling and the committee members appealed their removal from the committee. After the district judge dismissed the committee members' appeal, he disclosed that while not required to recuse because of his donations to and service on the board of non-party Catholic charities, he was recusing anyway. The appeals were transferred to a new district judge, who declined to vacate any orders. On further appeal, the Fifth

Circuit held that the initial judge's failure to recuse was harmless and the committee members lacked standing to appeal their removal from the committee. A creditor has no protected right to serve on a committee. They were not sanctioned, and lost nothing.

In re Roman Catholic Church of Archdiocese of New Orleans, 2024 WL 3446910 (Bankr. E.D. La. July 16, 2024)

This is the latest of multiple cases concerning the same sanctionable lawyer misconduct in disclosing confidential information. A year after the court imposed $400,000 sanctions, the attorney sued DIP professionals in state court, alleging abuse of process and intentional and negligent infliction of emotional distress in connection with their service of the sanctions order on the entire mailing matrix. The lawsuit was removed to federal court and remanded to the bankruptcy court. Because the DIP professionals had served the order on behalf of the court under Bankruptcy Rule 2002 and pursuant to express court instructions what to serve and on whom, the court held the defendants derivatively entitled to the judge's absolute immunity. The court granted summary judgment for the defendants.

In re Dacosta, 2024 WL 422779 (Bankr. N.D. Ga. Feb. 25, 2024)

When a chapter 13 debtor complained to the bankruptcy court that his attorney failed to adequately communicate with him, failed to properly represent him including by refusing to object to a claim, and disputing the flat fee he was charged, the lawyer responded by disparaging his client and aggressively attacking his character and mental health. The court held such egregious behavior to warrant sanctions independent of any other event in the case.

7. Professional Fees Generally

In re Teter, 90 F.4th 493 (6th Cir. 2024)

The U.S. Trustee withdrew a motion to dismiss a debtor's chapter 7 case for abuse and the debtor received a discharge. The bankruptcy court properly denied the debtor's request for attorneys' fees under the Equal Access to Justice Act, 28 U.S.C. §2412. The court of appeals held that a motion to dismiss is not a "civil action" under the EAJA. The court also noted the undeveloped argument that Code §707(b)(5)(A) might also prohibit a fee award against a trustee or U.S. Trustee.

In re Golesis, 659 B.R. 767 (Bankr. D. Utah 2024)

Counsel did not demonstrate extraordinary circumstances warranting retroactive employment of counsel.

In re Sunergy California, LLC, 651 B.R. 781 (Bankr. E.D. Cal. 2023)

Court-appointed counsel can only litigate disputes over its fees in prosecuting its fee application. It was preempted from filing an adversary proceeding against parties that objected to its fee application.

In re Wisconsin & Milwaukee Hotel LLC, 2024 WL 4896265 (Bankr. E.D. Wis. Nov. 26, 2024)

A law firm authorized to serve as Code §327(e) special counsel performed services not included in the scope of the authorized engagement. The court refused to allow the firm to recover fees and costs as an administrative expense under Code §503(b). The only avenue available for a

professional who fails to get its scope of employment approved is to seek retroactive approval upon a showing of excusable neglect.

In re Feilitech US, LLC, 2023 WL 8855666 (Bankr. N.D. Miss. Dec. 21, 2023)

The court evaluated various tests for determining whether professional fees in excess of local rates have been preapproved under Code §328, including factors such as specific descriptions of hourly rates and justifications for them in the application for approval of the professional's employment. The court also addressed standards for determining whether fees are reasonable.

In re MP PPH LLC, 2024 L 1023113 (Bankr. D.D.C. Mar. 8, 2024)

Proposed committee counsel sought preapproval of their hourly billing rates as reasonable under Code §328(a), which the court found more complex in the context of hourly billing than in the context of a flat fee or contingency fee. It held that the court must determine (i) whether the parties engaged in arms-length negotiations with equal bargaining power to derive the rates; (ii) whether the retention as proposed is in the best interest of the estate or necessary to its administration; (iii) whether there is any opposition to the retention terms; (iv) whether the projected fee amount is reasonable given the size, circumstances, and posture of the case; and (v) whether the proposed terms reflect the marketplace for the proposed services. The court found insufficient evidence to support such a §328(a) order.

In re Mehr Grp. Of Cos. Holding, Inc., 2024 WL 3876299 (9th Cir. BAP Aug. 20, 2024)

DIP counsel sought attorneys' fees and costs exceeding $93,000. The court awarded $5,000. The BAP upheld the award as within the court's discretion. Not only was counsel's performance deficient, "troubling," and "mishandled." But the attorney failed to verify the insurance certificate and bank records provided by the debtor, which were fraudulently created by the debtor's management. He failed to adequately represent the debtor such that his services provided little benefit to the estate. The Panel rejected the attorney's argument that he had no duty beyond accepting documents provided by debtor's principal.

The court entered sanctions against the debtor and its principal for their fraud upon the court and contempt of court. DIP counsel was not sanctioned, however, so he was held to lack standing to appeal the sanctions order. He had appealed solely on his own behalf, not as counsel for the debtor.

In re PM Management - Killeen I NC LLC, 2024 WL 4834630 (Bankr. N.D. Tex. Nov. 19, 2024)

The court evaluated Subchapter V DIP counsel's conflicts of interest in representing both affiliated debtors and their non-debtor parent company, sharing the same CRO and with the parent inappropriately draining money from the debtors. It did not disqualify the attorneys, but did significantly reduce their compensation on grounds the case was overworked and apparently prioritizing the interests of the parent over that of the debtors.

In re Figueroa, 2023 WL 8780705 (9th Cir. BAP Dec. 19, 2023)
In re Rivera, 2023 WL 8776750 (9th Cir. BAP Dec. 19, 2023)

A chapter 7 trustee seeking attorneys' fees must provide evidence that particular services

actually rendered went beyond the scope of the trustee's statutory duties and involved unique difficulties that required the expertise of counsel. The trustee may not rely on a general assertion that attorney assistance was needed.

In re Harrington, 2024 WL 2890080 (Bankr. D. Mont. June 7, 2024)

The court noted that in this case and others, it was being asked to review and approve fees in chapter 13 cases two to three times the "no look" fee. The court revisited applicable standards and surveyed prior fee awards, then offered renewed guidance on reasonable debtor's counsel fees in chapter 13 cases in that district. For a similar case evaluating chapter 13 fees, *see In re Martinez*, 2024 L l1059078 (Bankr. D.N.M Mar. 11, 2024)

8. Fee Collection

Reyes-Colon v. Banco Popular De Puerto Rico, 110 F.4th 54 (1st Cir. 2024)

After dismissal of an involuntary chapter 11 petition, the bankruptcy court retains jurisdiction to award attorneys' fees under Code §303(i), without the need for a provision retaining jurisdiction in the dismissal order. But a fee application must be timely filed. Fee requests are covered by Federal Rule of Civil Procedure 54(d)(2), which provides a 14-day limit for such requests. Bankruptcy Rule 7054 (applying Rule 54(d) to adversary proceedings); Rule 1018 (Rule 7054 applies to involuntary petitions). The fee application in this case, a year after the mandate issued in an appeal of the bankruptcy court's dismissal order, was untimely.

In re USA Dawgs, Inc., 657 B.R. 98 (9th Cir. BAP 2024)

The debtor's affiliate guaranteed and initially paid the chapter 11 corporate debtor's fees. Counsel disclosed and the court approved that the affiliate and debtor would be jointly and severally liable for approved fees. The law firm pursued enforcement of its allowed claim against the affiliate. The BAP upheld the bankruptcy court's refusal to reopen the debtor's bankruptcy case for the affiliate to challenge the fee approval order under Rule 60(b). It held the bankruptcy court had jurisdiction to enter an order determining the affiliate's liability for the fees.

SIPC v. Bernard L. Madoff Investment Securities LLC, 657 B.R. 382 (Bankr. S.D.N.Y. 2024)

Counsel who represented an investor for 13 years in the *Madoff* case was not allowed to withdraw from that representation despite not having been paid over $70,000 in fees more than six months, and potentially being unable to collect future fees, in light of the risk of disrupting litigation at a critical stage. The attorney had long-represented the investor defendant at a significant billing rate discount, and presented no evidence to evaluate the unpaid fees as a percentage of the total fees generated.

In re Aquilino, 600 B.R. 197 (D.N.J. 2024)

The bankruptcy court entered an order barring former chapter 7 bankruptcy counsel from pursuing fee collection in state court because the firm had not updated its fee disclosure statements in violation of Code §329 and Rule 2016. The fees had dramatically increased postpetition when counsel had to deal with alleged concealment of the existence of valuable assets, ultimately exceeding $200,000. Under a postpetition letter agreement, the debtors agreed to sell a non-estate residence and used $100,000 of the proceeds to pay their counsel. Instead, they secretly sold the residence and another non-estate property for almost $2 million, and used

the proceeds for other purposes. When the debtor sought a bankruptcy court order enjoining the firm's collection action, the court ordered disgorgement of all collected fees as a nondisclosure sanction.

The law firm appealed, arguing lack of bankruptcy court jurisdiction and deprivation of its right to a jury trial. The district court agreed, holding that the law firm could pursue collection of postpetition fees from non-estate assets without waiving its jury trial rights.

In re Allegiance Coal USA Ltd., 661 B.R. 874 (Bankr. D. Del.2024)

In administratively insolvent case, court-approved professional fees within the scope of a DIP loan carve-out have priority over the fees of the secured creditor's counsel.

In re Carpenter, 2024 WL 4355533 (Bankr. M.D. Pa. Sept. 30, 2024)

The court reduced by half the $40,000 fee that chapter 13 debtor's counsel sought to have approved for payment from non-estate assets after the debtor completed his 5-year plan. The court held the fees were excessive, and deprived the debtor of a fresh start. Once the court enters the debtor's discharge, the remaining fees will likely be held discharged as well. The plan cannot be modified to provide that attorneys' fees survive the discharge.

In re DynoTec, 2024 WL 2003065 (Bankr. D. Minn. Apr. 5, 2024)

Under the plan confirmation order, the Subchapter V trustee was only required to perform statutory duties until the earlier of the case closing or termination of the trustee's appointment. Under §1183(b)(1), such duties were limited to filing a final report. He did not have a general Code duty to "facilitate completion of a case," and in retrospect, his appointment should have been terminated in this case to reduce post-confirmation expenses. A year after confirmation, the trustee filed a status report describing actions with respect to liquidation of accounts receivable for the benefit of the secured creditor and recommendations for ensuring completion of the debtor's plan obligations. The court denied the trustee's request for compensation through surcharging the final plan distribution to the secured creditor.