

American Bankruptcy Institute
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Ethics Workshop 2007:
*Real-World Hypotheticals for Bankruptcy
Lawyers*

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HYPOTHETICAL 1:
“Alex, I’ll take ‘Conflicts Potpourri’ for \$100, please!”

Scene One: Your client, the lessor of several of the debtor’s retail stores in various states, tells you that the debtor’s law firm has sent documentation of a purported assumption and assignment of those leases to objectionable new tenants. Your client goes on to say that the law firm in fact represents it, the lessor, in pending matters in Florida. You look at the docket and find that the firm was approved as special counsel to sell “under-market” leases, and the firm represented that it had no conflicts of interest. Your client says, “That’s clearly a conflict, right? What should we do?”

QUESTIONS: Well, what do you say? Should you object to the special counsel’s engagement or fees? Should you report the conflict to the bar?

Scene Two: Your lessor client objected to the debtor’s proposed sale of a business division that includes assumption and assignment of its lease to the buyer, contending that the lease cannot legally be assigned. The creditors committee filed a blistering response, accusing the lessor of bad faith in raising its objection. The lessor tells you that a distant office of committee counsel’s law firm began representing it (the lessor) in a significant tax dispute relating to other property a year ago (but post-petition). The client calls up, furious, and says, “This is outrageous. I want to take that creep down a few notches. What can we do to her?”

QUESTION: Well, what do you recommend?

Scene Three: The unsecured creditors committee in a large Chapter 11 has filed an adversary proceeding against an accounting firm that represented the debtor, alleging malpractice and aiding and abetting of fraud. The creditors committee consists of the 15 largest creditors; there are approximately 11,000 unsecured creditors in all. You are contacted by an old adjuster friend at the accounting firm’s malpractice carrier about representing the defendant.

QUESTIONS: What kind of conflicts check do you need to run?

Suppose that one of your firm's clients is one of the members of the committee – can you still take the case? Suppose that none of the committee members are firm clients, but several other unsecureds are – can you still take the case?

Scene Four: Your client owns and operates a large farming operation. This year, they have suffered significant losses due to the FDA finding an E. coli contamination of its broccoli. While the situation was reasonably quickly remedied, the company lost substantial income and incurred a host of unexpected expenses associated with the problem. You conclude that Chapter 11 is the best way to deal with the one-time setback, addressing vendor claims, and allowing this overall very sound business to move forward. The client agrees, wants you to file for them, and gives you a list of its principal vendors, equity holders, and secured lender. The client is aware of some existing or likely tort claims due to the contamination, but expects there may be others of which it is not yet aware.

QUESTIONS: What kind of conflicts check do you need to run?

Suppose your firm represents several of the listed vendors – can you still take on the Chapter 11 representation? Suppose your firm represents a couple of significant customers of the company – can you still take the case?

HYPOTHETICAL 2:
Standby Financing

Michael Smith was retained as special counsel to a Chapter 11 debtor-in-possession, pursuant to 11 U.S.C. ' 327(e), for the purpose of opposing a motion to convert the case or to appoint a trustee and for other related issues.

After the debtor was unable to propose a plan of reorganization, it filed a plan of liquidation. Within a week, a competing plan of liquidation was filed. The debtor attempted to arrange financing to support its plan and negotiated with a bank for a line of credit that was to be secured by certificates of deposit. These CDs were to be pledged by a group of investors who would receive an interest in the debtor=s assets. This financing never materialized, however, and the debtor withdrew its plan. The bankruptcy court confirmed the competing plan of liquidation.

Attorney Smith filed an application for his fees as special counsel. The successful plan proponent objected to the allowance of Smith=s fee request after it learned that Smith himself was one of the potential investors for the debtor-in-possession=s proposed bank line of credit. At hearing, Smith testified that he had floated the idea of putting up money as a passive investor in order to help the debtor=s principal secure financing for its plan. No documents were ever signed, and he just wanted to be there as insurance, if needed. It was, he testified, all talk; the debtor never applied for a loan, and no deal was ever made.

You are the bankruptcy judge before whom the case is pending.

QUESTION: How do you rule?

HYPOTHETICAL 3:
Lawyers for the Situation?

A & B Associates, a partnership consisting of two partners, A and B, owned a commercial office building.

A hired the law firm of Jones & Jones, which established a limited partnership to which A transferred several hundred thousand dollars of personal assets. The terms of the limited partnership agreement provided that A received a limited partnership interest in exchange for the transfer of assets. A was entitled to share only in partnership profits, which the general partner (a family member) was authorized to withhold in the event of an attachment of A=s interest. The law firm set up a similar limited partnership for B.

Subsequently, A & B Associates filed a Chapter 11 bankruptcy petition with the Jones & Jones law firm acting as Chapter 11 counsel. None of the retention documents filed with the court disclosed the law firm=s ongoing individual representations of A and B or the firm=s involvement with A and B=s limited partnerships.

The debtor-in-possession=s schedules valued its real property in excess of \$1,000,000. The schedules did not mention any contingent contribution claims debtor might have against its partners A and B. Within a year of filing, the Chapter 11 case is converted to Chapter 7 because of a decline in the real property=s value. Upon conversion, Jones & Jones furnished the partners= individual financial records to the Chapter 7 trustee, including disclosure of the limited partnerships. The law firm did not disclose its involvement in setting up the limited partnerships, and the trustee did not inquire into their nature. Administration of the Chapter 7 estate resulted in a deficit of unpaid debt and administrative expenses over asset recoveries of \$212,000.

You are hired as trustee and, upon inquiry, learn of Jones & Jones=s full involvement with the debtor and its partners.

QUESTIONS: What do you do? How do you evaluate the law firm=s conduct? Are there any remedies you should consider seeking?

HYPOTHETICAL 4:
Meta-What?

As you sit in the senior partner's office discussing a deal you are working on with him, he absent-mindedly opens and scans a new email.

You can tell he's distracted, and he mutters, "That doesn't look right."

Realizing that you don't know what he's talking about, he tells you that the email he just opened is from opposing counsel concerning a significant new transaction you will be helping him on. Last week, the client shook hands on the outline of the deal. The next task will be to work on a letter of intent and a term sheet.

The email the senior partner just got was a draft of a term sheet. From what he tells you, it seems to him, from a quick review, that there are several terms that he has not heard anything about from the client, and the listing of what security will be given appears a little different from what he thinks he heard from the client in a telephone call yesterday. He says, "I guess we need to call the client, since this looks a little different from what I expected."

Before really thinking about it, you say, half-joking, "Well, why don't you see what's in the meta-data?"

In response, you get a blank stare. "What did you say?"

QUESTION: What do you tell the senior partner?

After you explain meta-data to the senior partner (not being sure at all that he has a clue what you are talking about), you stand up to move toward his computer and you say, "Can I just show you?"

QUESTIONS: Is it OK for you to do this? Is it wise?

A couple of weeks later, you and the senior partner have finished the first complete draft of one of the more complicated deal documents. It has gone

through several drafts in your office, with you, the senior partner, and two other partners each making edits.

You and the senior partner are in his office. He has the document up on his screen, having just made one last change to the document himself and telling you about it as he did so. As he attaches the document to an email to send it to the other side for their review and comment, he says, “OK, I guess we can get this out? Are we sure it’s ready to go?”

QUESTION: Are you?

A few weeks later, the senior partner drops by your office.

He tells you he is attempting to negotiate the price on a real estate deal for another client. Opposing counsel is a complete techno-geek, he says. “She’s always showing off her new gadgets whenever I see her,” he says. (It doesn’t sound like he appreciates these displays.)

The senior partner goes on to say that the client has told him that they would take as little as \$50,000 for the property they’re selling, but the client has strongly encouraged the senior partner to do his absolute best to get more.

Finally, it becomes clear why the senior partner is telling you all this on a deal you have nothing to do with. Now savvy to all this meta-data stuff, he asks you, “Look, can you tinker with a document for me and put something in there that looks like a comment to me from the client on the price, maybe saying something like, ‘Our *absolute* bottom line is \$62,500’? You know, where the comment isn’t visible to the other side unless they know how to look at this meta-stuff?”

QUESTIONS: Is it OK for you to do this? Is it wise?