

PROPERTY OF THE ESTATE PRE-PETITION OR POST-PETITION THAT IS THE QUESTION?

(Outline for Discussion)

Presenters:

Hon. Scott W. Dales, Moderator
Anthony J. Miller, Esq.
Charles J. Schneider, Esq.
Samuel D. Sweet, Esq.

1. Introduction of the Topic

- a) General statement of the problem of discovering claims that arguably straddle the petition date, e.g., debtor's prepetition exposure to harmful agents or medical devices
- b) Recent increase in cases being reopened to administer such assets
- c) General considerations from point of view of various constituents
- d) Some thoughts on ethical considerations

2. Practical Problems

- a) Reopening the Case
 - i) Former trustee probably lacks standing
- b) Cold Case Issues
 - i) Notice to Debtor of Reopening
 - (1) FRBP 7004(b)(9) (debtor has duty to keep address current *before case closing*)
 - (2) FRBP 9007 (court's general authority to regulate notice)
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- a) State law determines property interests
 - i) *Butner v. United States*, 440 U.S. 48 (1979)
 - ii) 28 U.S.C. § 1652 (rules of decision act)
- b) Variations according to state law
- c) What makes a cause of action "sufficiently rooted" in the prebankruptcy past?

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- a) Paid only if property distributed to creditors

- i) Protective proof of claim under FRBP 3004
 - ii) Role of FRBP 9011 in filing protective proof of claim
- b) Prompt liquidation and distribution
- c) Abandonment v. Administration
 - i) Evaluation of benefits and burdens of administration
 - ii) Amount of exemption
 - iii) Costs of litigation to liquidate claim and determine exemption rights
- d) FRBP 9019 Settlement concerns
 - i) Is the proposed settlement amount reasonably tied to the value of the cause of action:
 - (1) A confidential point system to access to a settlement fund - Take it or leave it we are not liable
 - (2) Is the settlement only to pay the filed POCs? Has the trustee couched the settlement solely in terms of "pain and suffering?" Does this impact the Debtor's (d)(11)(D) exemption? What about the release agreement to be signed by the Debtor to all manner of causes of action and associated damages

5. Debtor's Interests

- a) Exemption rights
 - i) FRBP 1009 and case closing
 - ii) Sec. 522(d)(5)
 - iii) Sec. 522(d)(11)(D)
 - iv) Sec. 522(d)(11)(E)
 - v) Non-Bankruptcy Exemption Possibilities
- b) Surplus
 - i) Sec. 726(a)(6) (surplus estate property goes to debtor)

6. Ethics (Special Counsel and Others)

- a) Sec. 327(e)
- b) State law professional responsibility concerns
 - i) Concurrent representation
 - (1) Disclosure to both clients
 - (2) Sec. 329 and FRBP 2017
 - (3) FRBP 2016(b)
 - ii) Hot Potato Rule
 - iii) Duty of loyalty
 - iv) Duty of confidentiality
- c) FRBP 9011
 - i) For protective proofs of claim
 - ii) For schedule amendments with absent debtors

**The Goose and the Golden Eggs:
Post-Bankruptcy Litigation and Conflicts Involving Injured Debtors**

By Hon. Scott W. Dales

INTRODUCTION

As Aesop tells the story, a farmer finds himself in possession of a goose that has the uncanny ability to lay golden eggs. Rather than carefully tending to the goose as it ploddingly lays the coveted eggs, the greedy farmer hastily kills it to get the gold, mistakenly believing that the goose must be filled with the precious metal. To his great regret, the farmer soon learns that the goose was not filled with gold and, with their relationship now at an end, can no longer lay the golden eggs for him. As it turns out, Aesop's farmer would have done well to keep tending to the goose, rather than taking a shortcut to recovery.

Personal injury attorneys representing former debtors with personal injury claims may not see the relevance of this fable at first, while they are helping their former-debtor clients monetize their claims. These personal injury cases generally proceed along a fairly-defined, orderly course of a well-oiled class action proceeding, with information exchanges and statistical formulae leading predictably to settlement, and the eventual liberation of a few golden eggs-- generally a third of which will land in counsel's basket as a contingency fee.

But sometimes, as settlement nears, the personal injury attorney eventually discovers that the client long ago filed a now-closed bankruptcy case, post-dating the debtor-plaintiff's exposure or other injury. As the day for finalizing or funding the settlement approaches, defense counsel suggests that the debtor-plaintiff lacks standing to pursue the cause of action,¹ the "judicial estoppel" alarm bell rings,² and the parties may come to realize that the settlement is going nowhere unless a bankruptcy trustee gets involved. Typically, defense counsel contacts the former trustee for direction.

The former trustee, equally interested in grabbing a golden egg or two, is nevertheless the *former* trustee and probably lacks standing unless and until the case is reopened and the UST reappoints the trustee.³ So, the former trustee contacts the UST, who files a perfunctory motion under 11 U.S.C. § 350(b)⁴ and Bankruptcy Rule 5010, reciting that the former trustee has discovered an unscheduled asset – a cause of action – that requires administration. The UST's

¹ 11 U.S.C. § 323 (trustee (not the debtor) is the representative of the estate); *Tyler v. DH Cap. Mgmt., Inc.*, 736 F.3d 455, 462 (6th Cir. 2013) (citing § 541(a)(1)'s definition of estate property as including debtor's prepetition causes of action).

² *In re Tennyson*, 313 B.R. 402, 407 (Bankr. W.D. Ky. 2004) (judicial estoppel may be used to bar recovery for would-be plaintiffs who failed to schedule causes of action in their prior bankruptcy cases).

³ *In re Trahan*, 460 B.R. 207, 210 (Bankr. C.D. Ill. 2011); *see also* Fed. R. Bank. P. 5010.

⁴ The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 *et seq.* Specific sections of the Bankruptcy Code are identified herein as "§ ____." The Federal Rules of Bankruptcy Procedure are set forth in Fed. R. Bankr. P. 1001 *et seq.* and are identified herein as "Bankruptcy Rule ____."

motion asks the court to direct the UST to appoint a trustee to administer the cause of action, and the court signs an order to that effect, usually without a hearing.

At this point, the personal injury lawyer must avoid the path of the fabled farmer and instead continue tending to the goose, if possible, not dropping it like a hot potato in favor of a seemingly more lucrative retention agreement with the newly-appointed trustee who may actually be the one entitled to the golden eggs. The golden goose's personal injury attorneys, now seeking to represent the bankruptcy trustee as special counsel under § 327(e), may suffer the same fate as the farmer in Aesop's story if counsel hastily dispatches the golden goose in order to win appointment as the trustee's special counsel.

The newly-appointed trustee (usually the original trustee who has been reappointed) makes a few phone calls and decides that the debtor's current lawyer, who has been prosecuting the debtor's claims for the last few years or more, is the person best-suited to assist the trustee in reducing the cause of action to money, as the trustee must do under § 704(a)(1). Counsel and the trustee talk, and this usually prompts the filing of an employment application under § 327(e). The theory, of course, is that the personal injury lawyer, who is familiar with the specifics of the debtor's case, is well-positioned to represent the trustee who, it now seems, is entitled to pursue the cause of action that originally appeared to belong to the debtor. The lawyer is so situated, of course, largely because of information the debtor provided during the course of their attorney-client relationship.

It is worth inquiring how the Bankruptcy Code and non-bankruptcy rules governing professional responsibility address the debtor's interests in this somewhat fluid situation, where a number of red flags of professional responsibility should be starting to wave. For example, can the attorney represent both the debtor and the trustee, consistent with state and federal law? What duties does the lawyer owe to the debtor, either as concurrent or former client? If the representation is concurrent, is counsel competent to serve as personal injury lawyer and consumer bankruptcy counsel if, for example, an issue arises with respect to the debtor's exemptions in the very asset counsel is pursuing? Counsel may encounter unanticipated conflicts of interest in this situation if the interests of the current client (the golden goose) and the future client (the trustee) diverge – conflicts that may not be resolved simply by “firing” the debtor as client. In other words, sacrificing the goose in pursuit of the golden eggs may, as the fable teaches, ultimately prove unprofitable.

ANALYSIS

Increasingly, the UST is filing motions to reopen bankruptcy cases under § 350(b) and Bankruptcy Rule 5010 to administer causes of action that, for one reason or another, the debtors failed to list on their bankruptcy schedules, but have since come to the UST's attention. In the typical scenario, the debtors have been exposed to harmful agents, either an herbicide, pesticide, or other chemical, or an implanted medical device, but they are not aware of any injury when they complete their bankruptcy schedules. Their bankruptcy cases usually proceed as “no asset” cases, with the chapter 7 trustee issuing a report of no distribution and the Clerk closing the case. Years later, however, after symptoms (or a law firm's television commercials) appear, the debtors retain

their own personal injury counsel and pursue relief in the non-bankruptcy courts. The cases proceed as any other similar tort or class action litigation, but eventually, after the defendants learn of the prior bankruptcy, they insist on dealing with the bankruptcy trustee, likely because a release from the debtor whose title to a claim is doubtful does not buy the defendants the peace they are seeking through settlement. They want to deal with the plaintiff-debtor's bankruptcy trustee, who now needs counsel to liquidate the late-discovered asset.

Because of the narrow scope of the assignment that the trustee may have in mind when a pre-petition claim lands on the desk as described above, a trustee may reflexively reach for § 327(e), which provides in relevant part as follows:

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

11 U.S.C. § 327(e). The careful practitioner or parser of statutes will note that, unlike § 327(a), § 327(e) omits the requirement of disinterestedness. *Compare* 11 U.S.C. § 327(a) *with* § 327(e). Instead, § 327(e) highlights the need to avoid concurrent conflicts between the estate and the debtor, or between counsel as the holder of any interest and either the debtor or the estate. This is a red flag, however, easily missed in the rush to finalize the imminent settlement.

Naturally, where the interests of the debtor and the estate are aligned, proposed special counsel should have no difficulty representing the debtor and the estate. *See, e.g., In re National Trade Corp.*, 28 B.R. 872, 875 (Bankr.N.D.Ill.1983) (denying motion to disqualify special counsel under precursor to § 327(e) because interest of the firm as special counsel was identical to interest of the estate); *In re RPC Corp.*, 114 B.R. 116 (M.D.N.C.1990) (approving retention because “the interests of the estate and the firm's clients are identical with respect to the firm's duties as special counsel”). A bankruptcy court in eastern Tennessee helpfully summarized the requirements that special counsel must meet:

By its terms, § 327(e) places three conditions on the attorney's employment. *See Buckley v. TransAmerica Inv. Corp. (In re Southern Kitchens, Inc.)*, 216 B.R. 819, 826 (Bankr.D.Minn.1998). First, the employment must be for a specified special purpose and not for the general management of the debtor's bankruptcy. *See id.* at 826 n. 13. Second, the employment must be in the best interests of the estate, meaning that pursuit of the claim is justified by its merit and value and that the proposed attorney has expertise and familiarity with the claim. *See id.* Third, the attorney to be employed must not “represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.” 11 U.S.C.A. § 327(e); *Southern Kitchens*, 216 B.R. at 826. The third requirement “prevents the employment of special counsel who, on any matter of substance, represent or have represented a client that is an actual or potential opponent of the estate in the dispute for which counsel would be engaged.” *Id.*

In re West Point Properties, 249 BR 273, 284-85 (Bankr. E.D. Tenn. 2000). The goal is to prevent a sense of rivalry so courts have given meaning to the phrase “interest adverse to the debtor or to the estate” within § 327(e) by looking to an influential decision of the Second Circuit. The phrase has been construed to mean:

(1) to possess ... an economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.

See Bank Brussels Lambert v. Coan (In re AroChem Corp.), 176 F.3d 610, 623 (2d Cir.1999). The standard for special counsel under § 327(e) is more flexible or forgiving than for general counsel under § 327(a), but it remains a standard nevertheless, and not a toothless one.

With these standards in mind, let’s return to our increasingly-less-hypothetical hypothetical. Assume that the debtor and her counsel have been participating in the post-bankruptcy litigation for some time and settlement negotiations are commencing when the defendants discover the debtor’s now-closed bankruptcy case. Recognizing that the debtor’s supposed cause of action probably belongs to the bankruptcy estate,⁵ the defendants contact the trustee who, as noted above, arranges with the UST to file a motion to reopen. The court grants the motion to reopen, and the UST reappoints the former trustee, who now finds herself in the driver’s seat with respect to the personal injury claim. It makes sense, says the trustee, to retain the debtor’s counsel, who eagerly agrees to the retention, keeping an eye on the golden eggs.

Many retention applications for special counsel in these circumstances make no mention of the current status of counsel’s relationship with the debtor, and that is a glaring omission against the backdrop of § 327(e). Most applications seem to imply that the lawyer represents the trustee who, as the person in charge of estate property, including the cause of action, has capacity to sue and be sued, and in whom Congress has vested the duty to reduce the cause of action to money. *See* 11 U.S.C. § 323 and 704(a)(1). Perhaps that is so, and that the attorney-client relationship with the debtor has ended. Perhaps, however, the parties have ignored that loose end in the rush to settlement. Imagine, further, that the trustee and the debtor have different views on the value of the claim or the merits of the proposed settlement. The trustee, for example, has a duty to close the estate “as expeditiously as is compatible with the best interests of parties in interest,” so does that include the debtor or just the creditors? With the bankruptcy courts’ broad construction of the phrase “party in interest,”⁶ it is certainly conceivable that the debtor may be a party in interest. What if there is a small universe of creditors who can be located many years after the commencement of the case? Should the trustee settle for an amount just enough to satisfy their claims (and administrative claims), or should the trustee be concerned about the debtor’s exemption claims (if any), or the possibility of a surplus for the debtor under § 726? Perhaps a

⁵ In fact, there may be a dispute between the debtor and the estate regarding ownership of the claim, either due to timing of the accrual or exemption claims or for some other reason. This very dispute could itself disqualify special counsel by making the trustee and the debtor rival claimants.

⁶ *See In re Morton*, 298 B.R. 301, 307 (B.A.P. 6th Cir. 2003) (“party in interest” is anyone with an actual pecuniary interest in, a practical stake in, or is significantly impacted by the case).

trustee can be forgiven for feeling less than motivated to maximize the settlement value for funds that may be paid to the Debtor (outside the trustee's fee calculation in § 326(a)) or only escheat to the U.S. Treasury under § 347 (depending on the proofs of claim that may have been filed in the case).

An issue may arise with respect to a debtor's exemption claim under, say, § 522(d)(11)(D) or (E), depending on how the parties agree to allocate the settlement funds. Sometimes, outside of bankruptcy, a plaintiff may have tax reasons to allocate more of a settlement to pain and suffering (not taxable) and away from lost earnings (taxable). The re-opening of the bankruptcy case (and renewed importance of exemption statutes) may change that calculation. For example, § 522(d)(11)(D), impenetrable as its text may be, seems to exclude from possible exemption a debtor's pain and suffering, sometimes a large (and tax advantaged) component of a personal injury claim. A debtor and her trustee may not agree on the allocation if allocation becomes an issue as it may in sorting out exemptions. It is worth remembering that under Bankruptcy Rule 1009, a debtor may amend exemptions from time to time, perhaps even in a reopened case, either as of right or perhaps with leave of court.⁷

More fundamentally, although we make take it for granted that a medical device implanted prepetition but later proving defective necessarily gives rise to a prepetition cause of action, in some cases the conclusion is far from clear. Certainly, a debtor in the situation described in this paper has every reason to argue that the claim arose after the order for relief, not before, with (say), the onset of symptoms, or some other less than pellucid event. That certainly looks like a situation fraught with conflicts for special counsel. Other conflicts loom on the horizon.

For example, perhaps the trustee's counsel, who wants to argue that the claim arose prepetition, may attempt to prove the point by resorting to the debtor's medical records or other confidential information derived from the prior representation. This is a situation fraught with peril and one that is not resolved simply by arguing that the cause of action now belongs to the trustee; we cannot simply ignore the history of the prior attorney-client relationship between the newly-appointed special counsel and the original debtor-plaintiff-client.

If the special counsel continues to represent the debtor, these controversies may preclude retention under § 327(e): the debtor and the estate become rival claimants for the settlement funds leaving counsel in a quandary. To resolve the conflict, special counsel (whose payment will likely come only from the settlement proceeds under one retainer agreement or the other) may be tempted to resolve the conflict by, in effect, firing the debtor as client, presumably on the grounds that the cause of action does not belong to her. But counsel would be wise to ask, is the trustee's role and

⁷ *In re Goswami*, 304 B.R. 386, 392 (B.A.P. 9th Cir. 2003) ("[t]here is no difference between a never-closed case and a reopened case with respect to amended exemption claims"); *In re Boyd*, 243 B.R. 756, 766 (N.D.Cal.2000) ("for the purposes of filing amendments, there is no difference between an open case and a reopened case, and [a debtor in a reopened case does] not need the court's permission to amend"); see also *In re Jordan*, 276 B.R. 434, 438 (Bankr.N.D.Miss.2000) (Rule 1009(a) applies in a reopened bankruptcy case).

standing to prosecute the cause of action enough for the special counsel to drop his debtor-client like a hot potato? Should the lawyer kill the goose that is laying the golden eggs? Probably not.

Courts “universally hold that a law firm will not be allowed to drop a client in order to resolve a direct conflict of interest, thereby turning a present client into a former client.” *Garland v. Ford Motor Co.*, No. 2:12-00121, 2015 WL 1401030, at *6 (M.D. Tenn. Mar. 26, 2015) (quoting *El Camino Res., Ltd. v. Huntington Nat'l Bank*, 623 F. Supp. 2d 863, 868 (W.D. Mich. 2007) (collecting cases)); see also *In re Curare Lab. LLC*, Case No. 21-31588, 2002 WL 1572059 (Bankr. W.D. Ky. May 18, 2022). This is commonly referred to as the “hot potato” doctrine or rule. See *Metro. Life Ins. Co. v. Guardian Life Ins. Co.*, No. 06-C-5812, 2009 WL 1439717, at *3 (N.D. Ill. May 18, 2009) (the doctrine prohibits an attorney from dropping a client “like a ‘hot potato’ when the more lucrative client [comes] along”).

Magistrate Judge Joseph Scoville, now retired from the Western District of Michigan, addressed the “hot potato” rule in a civil case with bankruptcy overtones: *El Camino Resources, Ltd. v. Huntington Nat. Bank*, 623 F.Supp.2d 863 (W.D. Mich. 2007). *El Camino* involved a national law firm’s concurrent representation of several financial institutions, two alleging that the third (and larger) client’s depository-customer committed a massive fraud, aided and abetted by the larger client. The law firm initially sought a broad conflict waiver from the prior two clients, but when the waivers were not forthcoming, the firm purported to ignore or discontinue the earlier representation in favor of the more lucrative later engagement of the third client. In refusing to permit the law firm to cut loose the smaller fish in order to catch a larger one, Judge Scoville relied, in part, on a Michigan ethics rule which provides, in relevant part, as follows:

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests unless:

(1) the lawyer reasonably believes the representation will not be adversely affected; and

(2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

M.R.P.C. 1.7(b). State ethics authorities, which federal courts frequently consult, have construed the rule to mean that “a law firm will not be allowed to drop a client in order to shift resolution of the conflicts question from Rule 1.7 dealing with current clients, to the more lenient standard in Rule 1.9 dealing with former clients.” State Ethics Opinion RI-139 (State Bar of Michigan) (attached to these materials).

In addition, and again as a matter of state law, counsel may have obligations to the plaintiff-debtor beyond settlement negotiations. Another ethics opinion advises that counsel in such situations may have additional obligations, depending on the nature of the engagement. Michigan’s State Ethics Opinion RI-373 recites that an attorney who enters into a contingent-fee agreement

with a client in a personal injury case and charges the one-third fee permitted by law may not ethically charge an additional contingent fee for resolving a related medical lien. As it turns out, resolving a medical lien is part of the same "claim or action" as the underlying personal injury case under MRPC 1.5(c) and MCR 8.121 and is therefore covered by the original contingent fee. So, assuming the estate retains the Debtor's personal injury counsel under § 327(e), counsel should nevertheless be mindful of any lingering obligations to the Debtor.⁸

Because the duty of confidentiality continues after the client-lawyer relationship has terminated, special counsel may be limited in connection with the new representation of the trustee or estate. M.R.P.C. 1.6 and 1.9. The discussion of client confidences is beyond the scope of this paper, but counsel should proceed carefully.

If the proposed counsel will continue representing the debtor *while also representing the trustee*, counsel should do so, of course, only in consultation with the debtor. As the commentary to the M.R.P.C. 1.7 makes clear, "common representation of persons having similar interests is proper if the risk of adverse effect is minimal and the requirements of paragraph (b) are met." More specifically, if special counsel will be representing both clients, the rule provides the following guidance:

When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

M.R.P.C. 1.7(b)(2). Moreover, to the extent the continued representation of the debtor involves intersection with the client's exemption rights or surplus rights or other bankruptcy-specific matters, counsel must pay heed to the omnipresent duty of competence. M.R.P.C. 1.1 (competence). Given the expertise required to handle tort claims and class actions, on the one hand, and the distinct skills required to represent a debtor in bankruptcy, on the other, the duty of competence in a concurrent representation context may present a hardship, or at least a challenge, for counsel.

In addition to navigating through the wickets of state law governing the conduct of lawyers, special counsel, or proposed special counsel, must always be mindful of the federal overlays – not just § 327 governing the appoint of estate professionals but also § 329, which licenses the court to supervise the relationship between debtors and their counsel who represent them "in connection with the case." 11 U.S.C. § 329. If special counsel continues to represent both the debtor and the estate, it would be reasonable to regard the continued representation of the debtor as "in connection with the case," subjecting counsel to the reporting obligations under § 329(a) and Bankruptcy Rule 2016(b), and more generally, the bankruptcy court's scrutiny.

⁸ Other obligations may include a continuing duty of confidentiality, which may complicate counsel's representation of the trustee.

CONCLUSION

The transition from prosecuting a tort or class action claim on behalf of an individual who was a debtor in bankruptcy to prosecuting the very same claim on behalf of the first client's bankruptcy trustee is fraught with difficulties under state laws governing the attorney client relationship, as well as federal (bankruptcy) law governing the representation of trustees and, if the representation is concurrent, debtors.

The point of this paper, like a good law school exam answer, is simply to spot issues so that transition may go smoothly for all parties in interest. Special counsel may be unaware or unfamiliar with the notion that state and federal law may govern the relationship simultaneously and would be well-served to pay some attention to the hidden issues, rather than reflexively dropping the client like the hot potato debtor-plaintiff may have become. With consultation and sensitivity to the needs of both clients – the debtor-plaintiff and her newly-appointed trustee -- it may be possible to preserve a healthy relationship with the goose and the golden eggs. On the other hand, careless or hasty navigation may result in forfeiture, disappointment, or even grievance. In other words, counsel would do well to remember the fable of the goose and the golden eggs.

623 F.Supp.2d 863
United States District Court, W.D. Michigan,
Southern Division.

EL CAMINO RESOURCES, LTD., et al., Plaintiffs, v.
HUNTINGTON NATIONAL BANK, Defendant.

Case No. 1:07-cv-598.

|
Sept. 13, 2007.

Synopsis

Background: In action arising from bankruptcy and loan fraud, national banking association and computer leasing companies that engaged in commercial transactions with debtor brought action against debtor's principal financial institution and depository, alleging that financial institution aided and abetted debtor's fraud. Plaintiffs moved to disqualify defense counsel on ground that firm had conflict of interest.

Holdings: The District Court, [Joseph G. Scoville](#), United States Magistrate Judge, held that:

[1] firm's representation of financial institution was conflict of interest;

[2] computer leasing company did not waive conflict of interest; and

[3] violation of ethical rules warranted disqualification of law firm.

Motions granted.

West Headnotes (18)

[1] [Attorneys and Legal Services](#) 🔑 [Motions and proceedings for disqualification in general](#)

A motion to disqualify counsel is the proper method for a party to bring to the court's attention

an alleged conflict of interest or breach of ethical duty by opposing counsel.

[3 Cases that cite this headnote](#)

[2] [Attorneys and Legal Services](#) 🔑 [Power to Disqualify; Jurisdiction](#)

The power to disqualify an attorney from a case is incidental to all courts, and is necessary for the preservation of decorum, and for the respectability of the profession.

[2 Cases that cite this headnote](#)

[3] [Attorneys and Legal Services](#) 🔑 [Standards of professional conduct in general](#)

A violation of the rules of professional ethics does not automatically necessitate disqualification of an attorney; rather, the extreme sanction of disqualification should only be utilized when there is a reasonable possibility that some specifically identifiable impropriety actually occurred, and where the public interest in requiring professional conduct by an attorney outweighs the competing interest of allowing a party to retain counsel of his choice.

[9 Cases that cite this headnote](#)

[4] [Attorneys and Legal Services](#) 🔑 [Relation of remedy to client's right to counsel of choice](#)

While motions to disqualify are legitimate and necessary to protect the integrity of judicial proceedings and the ethics of the bar, courts must be vigilant in viewing motions to disqualify counsel, as the ability to deny one's opponent the services of capable counsel is a potent weapon; the court must therefore balance the interest of the court and the public in upholding the integrity of the legal profession against the right of a party to retain counsel of its choice.

[3 Cases that cite this headnote](#)

[5] [Attorneys and Legal Services](#) 🔑 [Findings and conclusions; determination](#)

A decision to disqualify counsel must be based on a factual inquiry conducted in a manner allowing appellate review.

[6] Federal Courts 🔑 **Counsel**

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

5 Cases that cite this headnote

[7] Attorneys and Legal Services 🔑 **Nature and Scope of Duty**

Attorneys and Legal Services 🔑 **Concurrent clients**

Under Michigan law, an attorney owes undivided allegiance to a client and usually may not represent parties on both sides of a dispute.

1 Cases that cite this headnote

[8] Attorneys and Legal Services 🔑 **Creation and Existence of Relationship**

Attorneys and Legal Services 🔑 **Particular Cases and Contexts**

Law firm had current attorney client relationship with computer leasing company, and thus law firm's appearance on behalf of financial institution in fraud action brought by computer leasing company represented direct conflict of interest in violation of Michigan Rules of Professional Conduct; firm was counsel of record for computer leasing company in forfeiture actions concerning third party pending before court, firm did not request leave to withdraw as computer leasing company's counsel until one month after leasing company filed motion to disqualify, and leave to withdraw was not granted. MRPC 1.7(a).

[9] Attorneys and Legal Services 🔑 **Creation and Existence of Relationship**

Attorneys and Legal Services 🔑 **Bankruptcy and debt collection**

Law firm had current attorney client relationship with computer leasing company, and thus law firm's appearance on behalf of financial institution in fraud action brought by computer leasing companies represented direct conflict of interest in violation of Michigan Rules of Professional Conduct; firm provided bankruptcy-related services to company on periodic basis for over six years and at time of action was acting as local counsel for company in another bankruptcy action. MRPC 1.7(a).

1 Cases that cite this headnote

[10] Attorneys and Legal Services 🔑 **Potential or prospective clients; consultations**

Attorneys and Legal Services 🔑 **Current and former clients**

Loyalty to a client prohibits undertaking representation directly adverse to that client without that client's consent even if the adverse representations are wholly unrelated.

[11] Attorneys and Legal Services 🔑 **Effect of Conflicts**

A law firm that knowingly undertakes adverse concurrent representation may not avoid disqualification by withdrawing from the representation of the less favored client before hearing.

1 Cases that cite this headnote

[12] Attorneys and Legal Services 🔑 **Effect of Conflicts**

Attorneys and Legal Services 🔑 **Motions and proceedings for disqualification in general**

The status of the attorney/client relationship is assessed at the time the conflict arises, not at the time the motion to disqualify is presented to the court; if this were not the case, the challenged attorney could always convert a present client into a "former client" by choosing when to cease to represent the disfavored client.

7 Cases that cite this headnote

[13] Attorneys and Legal Services 🔑 Conflicts as grounds for disqualification

Attorneys and Legal Services 🔑 Per se standard

To determine whether conflict of interest exists warranting disqualification, the more stringent per se rule, which prohibits a conflict between current clients, vindicates an entirely different ethical principle than does the substantial relationship test, which prohibits conflicts involving a current client and a former client; the propriety of representing interests adverse to a current client must be measured not so much against the similarities in litigation as against the duty of undivided loyalty which an attorney owes to each of his clients. [MRPC 1.7\(a\), 1.9](#).

6 Cases that cite this headnote

[14] Attorneys and Legal Services 🔑 Particular Cases and Contexts

Under Michigan law, computer leasing company did not waive law firm's conflict of interest in company's action against financial institution, alleging that financial institution aided and abetted fraud; firm asked for broad waiver of conflict which company refused, waiver letter referred only to two adversary proceedings commenced against financial institution by trustee in bankruptcy court, and firm failed to identify direct conflict or disclose possibility that firm would seek to take position adverse to company in representation of financial institution. [MRPC 1.7\(a\)](#).

1 Cases that cite this headnote

[15] Attorneys and Legal Services 🔑 Conflicts as grounds for disqualification

Attorneys and Legal Services 🔑 Disclosure, Waiver, or Consent

Attorneys and Legal Services 🔑 Presumptions, inferences, and burden of proof in general

An attorney bears the burden of establishing the fact and scope of consent to conflict of interest.

1 Cases that cite this headnote

[16] Attorneys and Legal Services 🔑 Disclosure, Waiver, or Consent

To be sufficient to waive attorney's conflict of interest, the disclosure of risks must be in such detail that the person can understand the reasons why it may be desirable to withhold consent.

[17] Attorneys and Legal Services 🔑 Current and former clients

Informed consent to attorney's conflict of interest requires that the client or former client had reasonably adequate information about the material risks of such representation to that client or former client.

6 Cases that cite this headnote

[18] Attorneys and Legal Services 🔑 Particular Cases and Contexts

Law firm's violation of Michigan Code of Professional Responsibility and breach of its duty of undivided loyalty to its computer leasing company clients warranted disqualification of firm from representing financial institution in computer leasing companies' fraud action against financial institution; at time representation of financial institution was undertaken, conflict was foreseeable, firm knew that company's waiver of conflict was limited to two specific actions, and firm was not deeply engaged in representation of financial institution as would outweigh gravity of ethical violation. [MRPC 1.7\(a\)](#);

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1 Cases that cite this headnote

Attorneys and Law Firms

***865** Duane Lee Coleman, Lewis Rice & Fingersh LC, St. Louis, MO, John E. Anding, Thomas Vincent Hubbard, Drew Cooper & Anding, Grand Rapids, MI, Raynor D.

Zillgitt, Jr., Willingham & Cote, PC, East Lansing, MI, John Albert Graham, Jeffer Mangels Butler & Marmaro LLP, Los Angeles, CA, for Plaintiff.

Charles Nedwin Ash, Jr., Dennis W. Archer, Dickinson Wright, PLLC, Matthew J. Lund, Robert Steven Hertzberg, Pepper Hamilton LLP, Detroit, MI, Laurence Z. Shiekman, Nicole G. Tell, Pepper Hamilton LLP, Philadelphia, PA, Jon R. Muth, Monica Cook Inhulsen, Miller Johnson PLC, Grand Rapids, MI, Robert P. Hurlbert, Dickinson Wright, PLLC, Bloomfield Hills, MI, for Defendant.

OPINION ON MOTION TO DISQUALIFY DEFENSE COUNSEL

JOSEPH G. SCOVILLE, United States Magistrate Judge. This

is a civil action falling within the district court's diversity jurisdiction. The *866 case is one of the many criminal, civil, and bankruptcy actions now pending in this court arising from the massive Cyberco fraud. Plaintiffs El Camino Resources, Ltd. and ePlus Group, Inc. are computer leasing companies that engaged in commercial transactions with Cyberco: El Camino purchased over \$11.5 million in computer equipment and ePlus Group over \$14.5 million in computer equipment for purposes of leasing the equipment to Cyberco. Plaintiff Bank Midwest is a national banking association that entered into a secured loan transaction with Cyberco in 2004 for \$4.925 million. All three plaintiffs allege that they were the victims of fraud by Cyberco and that defendant Huntington National Bank, Cyberco's principal financial institution and depository, aided and abetted Cyberco's fraud. They therefore seek judgment against Huntington National Bank in an amount exceeding \$30 million. Huntington is represented in this action by Pepper Hamilton, LLP.

Presently pending before the court are motions by plaintiffs ePlus Group and Bank Midwest to disqualify Pepper Hamilton as defense counsel, on the ground that the firm has a conflict of interest arising from its status as counsel for each of the two moving plaintiffs in other litigation. They assert that Pepper Hamilton's decision to defend Huntington National Bank in this case against the claims brought by plaintiffs is a breach of the firm's duty of undivided loyalty to them and that disqualification is required pursuant to Michigan Rule of Professional Conduct 1.7(a). In connection with the motion to disqualify, both Huntington National Bank and the Pepper Hamilton firm have retained special

counsel. Special counsel have argued that the conflict of interest was "thrust upon" Pepper Hamilton through no fault of its own and that the "flexible approach" adopted by some courts allows Pepper Hamilton to continue its representation of Huntington National Bank in this case while withdrawing from its admitted attorney/client relationship with the two moving plaintiffs. Additionally, they argue that Bank Midwest executed a written conflict of interest waiver broad enough to comprehend the present litigation.

On July 31, 2007, the district judge referred this motion to me

for decision pursuant to  28 U.S.C. § 636(b)(1)(A).

Pursuant to the reference, I conducted a hearing on September 6, 2007, at which plaintiffs' counsel of record presented their positions and special counsel (Dennis Archer, Esq. for Pepper Hamilton and Jon Muth, Esq. for Huntington National Bank) argued in opposition to the motion. Having considered the record and submissions of counsel, I conclude that (1) Pepper Hamilton violated its duty of loyalty to each moving defendant by taking a position in this case directly adverse to them; (2) Pepper Hamilton is ethically precluded from attempting to discharge the moving plaintiffs as clients in order to free itself of the conflict; (3) plaintiff Bank Midwest did not waive its right to object to the conflict of interest raised by this case; and (4) the "flexible approach" to conflicts of interest that are thrust upon an attorney does not apply in the circumstances of this case. Plaintiffs' motions to disqualify will therefore be granted.

Findings of Fact

In support of its motion, plaintiff Bank Midwest submitted the affidavit of Douglas Neeb, Senior Litigation Counsel for its parent company. (docket # 20). ePlus Group submitted the affidavit of Erica Stoeker, General Counsel. (docket # 33–2). In response, Huntington National Bank submitted the affidavit of Managing Counsel John Liebersbach. (docket # 61–2). Pepper Hamilton submitted the following affidavits, all filed under docket number *867 68: Attorneys Robert Hertzberg, Laurence Shiekman, David Fournier, David Murphy, and Jeremy Frey. All parties were given the opportunity to call any of their witnesses live, but declined to do so. The facts found in this opinion are gleaned from those affidavits and the exhibits thereto, as well as the record in this case and other related cases pending in this court and the Bankruptcy Court, proper subjects of judicial notice.

A. Parties

1. Plaintiff El Camino Resources, Ltd. is a California corporation with principal place of business located in the State of California. On or about May 27, 2004, El Camino executed a master equipment lease with Cyberco Holdings, Inc. Pursuant to the master equipment lease, during the remainder of 2004, Cyberco purported to lease equipment from El Camino in an aggregate amount exceeding \$11.5 million. El Camino alleges that Cyberco fraudulently converted the money earmarked for the leases.

2. Plaintiff ePlus Group is a Virginia corporation with principal place of business in the State of Virginia. ePlus Group entered into a master lease agreement with Cyberco effective March 3, 2004, pursuant to which Cyberco thereafter purported to lease computer equipment from ePlus valued in excess of \$14 million. ePlus alleges that Cyberco fraudulently converted the monies earmarked for the equipment.

3. Plaintiff Bank Midwest is a national banking association organized under federal law with branches in the States of Missouri and Kansas. In early November 2004, Bank Midwest entered into a secured loan transaction with Cyberco, pursuant to which Cyberco borrowed \$4.925 million for the ostensible purpose of acquiring equipment that would stand as security for the loan. Bank Midwest alleges that Cyberco fraudulently converted the proceeds of the loan.

4. Defendant Huntington National Bank is a national banking association organized under federal law with principal place of business in Columbus, Ohio. Plaintiffs allege that Huntington established a comprehensive banking relationship with Cyberco beginning in 2002 and ultimately extended loans to it exceeding \$19 million.

5. Pepper Hamilton, LLC is a national law firm with principal offices in Philadelphia, Pennsylvania, and a substantial presence in several other cities, including Detroit, Michigan. Pepper Hamilton is counsel of record for defendant Huntington National Bank in this matter, having filed its appearance on July 10, 2007. As chronicled below, at the time Pepper Hamilton agreed to represent Huntington National Bank in this case, it had an active attorney/client relationship with both ePlus Group and Bank Midwest.

6. Plaintiffs' complaint asserts four counts against Huntington National Bank: aiding and abetting Cyberco's fraud (count I); aiding and abetting Cyberco's conversion of plaintiffs' funds (count II); statutory conversion (count III); equitable recovery

of stolen property, unjust enrichment and constructive trust (count IV, brought by El Camino only). The gravamen of plaintiffs' claims against Huntington National Bank is that Huntington aided and abetted Cyberco in its fraud and that the bank accepted from Cyberco and its affiliate Teleservices Group "laundered money" that represented proceeds of the fraud worked by Cyberco on plaintiffs. For the sake of simplicity, this opinion refers to plaintiffs' claims as the "aiding and abetting claims."

*868 B. Related Cyberco Litigation

7. The Cyberco scam came to a halt on November 17, 2004, when agents of the FBI executed search warrants on Cyberco's office and seizure warrants for the bank accounts and other assets of Cyberco and its affiliates. Through seizure warrants, the federal government sequestered millions of dollars in bank accounts held in the name of Cyberco or nominees. The United States began a series of *in rem* forfeiture actions to condemn these funds to the use and benefit of the United States under proceedings established by 18 U.S.C. §§ 981(a)(1)(A) and 981(a)(1)(C), on the theory that the proceeds of the bank accounts were traceable to violations of numerous federal criminal laws. Relevant to the present case, the United States initiated the following forfeiture actions in this court:

(a) *United States of America v. One J.P. Morgan Case Bank Account Number 026073870865 In the Amount of \$750,000.00*, case no. 1:05-cv-59 (filed 1/24/05);

(b) *United States of America v. One Comerica Bank Account Number 6811948139 In the Amount of \$700,000.00*, case no. 1:05-cv-60 (filed 1/24/05);

(c) *United States of America v. One Huntington National Bank Account Number 01159630935 In the Amount of \$705,168.60*, case no. 1:05-cv-61 (filed 1/24/05);

(d) *United States of America v. One Independence Community Bank Account Number 92043867 In The Amount of \$750,000.00*, case no. 1:05-cv-62 (filed 1/24/05);

(e) *United States of America v. One Chemical Bank Shoreline Account Number 5024019400 In The Amount of \$100,000.00*, case no. 1:05-cv-294 (filed 4/21/05);

(f) *United States of America v. One Silicon Valley Bank Account Number 3300355711 In The Amount of \$113,952.62*, case no. 1:05-cv-295 (filed 4/21/05);

(g) *United States of America v. One Fifth Third Bank Account Number 7680526741 In The Amount of \$20,291.27*, case no. 1:05-cv-296 (filed 4/21/05);

(h) *United States of America v. One Macatawa Bank Account Number 26002212 In The Amount of \$200,000.00*, case no. 1:05-cv-432 (filed 6/22/05); and

(i) *United States of America v. One Macatawa Bank Account Number 64010200 In The Amount of \$25,000.00*, case no. 1:05-cv-433 (filed 6/22/05).

(In this opinion, these nine civil actions, all of which are pending and unresolved in this court, are referred to as the “Forfeiture Cases.”)

8. In November 2004, Bank Midwest retained Pepper Hamilton to represent it in the proceedings that led up to the Forfeiture Cases. In each Forfeiture Case, Pepper Hamilton attorneys located in the firm's Philadelphia or Detroit offices have filed an appearance for Bank Midwest and an answer setting up a claim to the seized funds. In each case, Pepper Hamilton alleged on behalf of Bank Midwest that the seized property “represents the direct and actual proceeds of fraud, conversion and theft against Bank Midwest committed in violation of law.” (See, e.g., Answer of Claimant Bank Midwest, N.A., case no. 1:05-cv-61, docket # 21, Defense 1). Pepper Hamilton asserted the existence of a constructive trust arising on behalf of Bank Midwest in each of the disputed accounts. (*Id.*). According to the docket sheets of this court in each of the Forfeiture *869 Cases, Pepper Hamilton remains counsel of record for Bank Midwest in each case. Pepper Hamilton filed a motion for leave to withdraw in each case on August 24, 2007, but no such leave has yet been granted.

9. On December 9, 2004, El Camino and two other creditors filed an involuntary bankruptcy petition for Cyberco Holdings, Inc. in the United States Bankruptcy Court for the Western District of Michigan under Chapter 7 of the Bankruptcy Code (*In re Cyberco Holdings, Inc.*, no. 04-14905). The Bankruptcy Court appointed Thomas C. Richardson as Trustee. On January 21, 2005, Teleservices Group, Inc., a corporation under common ownership with Cyberco, filed a voluntary petition for bankruptcy under Chapter 7, and Mr. Richardson was appointed Trustee. (*In re Teleservices Group, Inc.*, no. 05-00690).

10. On January 6, 2005, the firm of Warner, Norcross & Judd filed its appearance on behalf of Huntington National

Bank in the Cyberco bankruptcy case. Thereafter, the Warner, Norcross firm represented Huntington National Bank in a protracted effort by the bank to avoid or substantially limit a Rule 2004 examination sought by El Camino and the Trustee. El Camino filed its motion for a Rule 2004 examination of Huntington National Bank on March 3, 2005, and the Trustee joined the motion on March 31, 2005; Huntington National Bank, through Warner, Norcross, objected on March 19, 2005. The parties then engaged in a long series of negotiations and motion practice before the Bankruptcy Court. The final hearing took place on February 8, 2007, nearly two years after El Camino and the Trustee had filed their original motions. Counsel for Huntington asked that the examination by El Camino be precluded or limited because the bank believed El Camino sought the examination “for prelitigation discovery in connection with its own possible claims against Huntington.” (Hearing Tr. of 2/8/07, *In re Cyberco Holdings, Inc.*, docket # 771, at 25). While not admitting that El Camino was planning such litigation, its counsel said that it was “possible.” (*Id.* at 17–19). Bankruptcy Judge Jeffrey Hughes allowed the examination to proceed, with limitations.

11. The Cyberco bankruptcy case has spawned numerous adversary proceedings. In one of the proceedings, *Bank Midwest, N.A. v. Cyberco Holdings, Inc., et al.*, Adversary Proceeding No. 05-80020, filed on January 14, 2005, Pepper Hamilton represented Bank Midwest and asserted a claim for constructive trust over the alleged proceeds of the \$4.925 million loan to Cyberco. In connection with that case, the firm conducted discovery on behalf of Bank Midwest, including the issuance of a subpoena *duces tecum* on Huntington National Bank. The proceeding led to the execution of a settlement agreement dated March 29, 2006. The agreement provided, among other things, that Huntington would receive \$705,168 in funds seized by the government, with Bank Midwest receiving a smaller share. The agreement provided that the settlement did not impair any rights of Bank Midwest “to raise or pursue claims against Huntington, except with respect to the \$705,168.60,” nor impair any defense of Huntington to such claim. (*Bank Midwest, N.A. v. Cyberco Holdings, Inc., et al.*, No. 05-80020, docket # 70).

12. Another in the constellation of Cyberco-related cases in this court was *Bank Midwest, N.A. v. Cyberco Holdings, Inc., et al.*, case no. 1:04-cv-795, in which Pepper Hamilton again represented Bank Midwest as plaintiff. The complaint in that case, signed by David Murphy of the Pepper Hamilton firm, sought judgment in *870 an amount approaching \$5 million against Cyberco and related persons on theories of

fraud, conversion, and constructive trust. The court granted plaintiff's motion for expedited discovery on December 14, 2004, allowing Pepper Hamilton, on behalf of Bank Midwest, to take immediate discovery of a number of banks, in an effort to trace proceeds of the alleged fraud. Approximately five months later, Pepper Hamilton filed a motion for leave to withdraw as counsel, in favor of the Willingham & Cote' firm. On March 13, 2005, the court entered its order granting Pepper Hamilton leave to withdraw as counsel for Bank Midwest in that case. By amended complaint filed August 24, 2005, Bank Midwest added Huntington National Bank as an additional defendant, alleging that its rights to a \$700,000.00 Cyberco account were superior to those of Huntington.

13. In all of the proceedings listed above, whether filed in this court or the Bankruptcy Court, the objective of Pepper Hamilton's efforts on behalf of Bank Midwest was to recover all or part of the \$4.925 million loaned by the bank to Cyberco. Pepper Hamilton collected fees and costs from Bank Midwest approaching \$300,000.00 for prosecution of these matters. (Neeb Aff., ¶ 6). In each case, Pepper Hamilton asserted that Bank Midwest had been defrauded by Cyberco and its affiliates and that it was entitled to the imposition of constructive trust on the proceeds of that fraud. Douglas Neeb, in-house counsel for Bank Midwest, avers in his affidavit that in the course of its representation of Bank Midwest on these matters, Pepper Hamilton attorneys participated in numerous confidential attorney/client conversations with the bank's chief lending officer and other bank officials and that the bank provided Pepper Hamilton with "nearly every internal document created by Bank Midwest during its consideration of whether to conduct business with Cyberco and every internal document regarding the Cyberco matters, including documents relating to legal claims against Huntington and Huntington's possible defenses thereto." (Neeb Aff., 7–

8). Jeremy Frey, the principal Pepper Hamilton attorney representing Bank Midwest in the Forfeiture Cases, does not deny any of these assertions. Indeed, it would be most unusual for an attorney handling cases of this magnitude not to assemble all relevant facts and engage in confidential communications with in-house counsel and witnesses with relevant knowledge. Mr. Frey does assert, however, that he was not requested to undertake "any detailed factual review or analysis of any direct claims Bank Midwest may have against Huntington National Bank." (Frey Aff., ¶ 13). David Murphy, the Pepper Hamilton attorney who represented Bank Midwest in both *Bank Midwest, N.A. v. Cyberco Holdings, Inc.*, case no. 1:04–cv–795, and the adversary proceeding in

the Bankruptcy Court does not deny the receipt of confidential information in connection with his representation of Bank Midwest in those matters. He does assert, however, that he "did not have any knowledge at that time [when he represented Bank Midwest] that Bank Midwest intended to pursue Huntington as one of the parties involved with the Cyberco fraud" and that there was no direction by the bank to develop a lawsuit against Huntington. (Murphy Aff., ¶ 8). He acknowledges that his service of a subpoena on Huntington National Bank (already a client of the firm) raised a "conflict of interest question" which the firm apparently decided to ignore after "due consideration." (*Id.*, ¶ 9). Mr. Murphy asserts that he had no knowledge that review of the subpoenaed documents caused Bank Midwest to suspect Huntington *871 as a participant of the fraud with Cyberco. (*Id.*).

C. Trustee's Action Against Huntington National Bank

14. On December 7 and 8, 2006, the Trustee initiated over fifty adversary proceedings, principally to recover allegedly voidable preferences from Cyberco creditors. One such proceeding was brought against Huntington National Bank. *Richardson, Trustee of Cyberco Holdings, Inc. v. The Huntington National Bank*, Adversary Proceeding No. 06–80989 (W.D.Mich.Bk.Ct.). The Trustee's complaint asserted ten counts against the bank. Counts IV through X alleged claims under the Bankruptcy Code to recover payments from the debtor to Huntington National Bank on the theory that such payments were either voidable preferences under

11 U.S.C. § 547(b) or were fraudulent transfers under

11 U.S.C. §§ 548(a), 544(b), and 550. These are "core" proceedings that the Trustee is clearly entitled to bring in the Bankruptcy Court on behalf of the bankrupt estate and over which the Bankruptcy Court clearly has dispositive jurisdiction. Counts I, II, and III, however, were of a different nature. These counts alleged that Huntington National Bank aided and abetted Cyberco's fraud and that "Cyberco's creditors were generally harmed by Cyberco's prolonged existence because the [Cyberco principals] were given the opportunity to perpetrate and expand the Ponzi scheme." (¶ 142). Unlike the core statutory claims in the remaining counts, the claims in counts I, II and III apparently arose under state law, and the complaint did not cite any source of authority for the Trustee to bring such actions on behalf of the estate. The Trustee also filed an adversary proceeding against Huntington National Bank in the Teleservices case to recover certain payments and transfers from Teleservices

to the bank, asserting only statutory claims arising under the Bankruptcy Act (or analogous state law) and clearly within the Bankruptcy Court's core jurisdiction. *Thomas C. Richardson, Trustee of Teleservices Group, Inc. v. The Huntington National Bank*, Adversary Proceeding No. 07–80037 (W.D.Mich.Bk.Ct.). These two proceedings are referred to collectively as the “Trustee's actions.” Warner, Norcross & Judd filed an appearance on behalf of Huntington Bank in both proceedings.

15. At the end of March 2007, John Liebersbach, Senior Vice–President and Managing Counsel of Huntington, contacted Robert S. Hertzberg, a Pepper Hamilton partner resident in its Detroit and New York offices. (Hertzberg Aff., ¶¶ 1, 4). Hertzberg, who had been a member of the Pepper Hamilton firm since March 2002, had a longstanding relationship with Huntington National Bank. Mr. Liebersbach asked Hertzberg to replace Warner, Norcross & Judd and to represent Huntington National Bank in both of the Trustee's actions. (*Id.*, ¶ 4).

16. At the time Huntington sought to engage Pepper Hamilton to represent it in the Trustee actions, both Mr. Liebersbach and Mr. Hertzberg anticipated that other creditors might join in the Trustee's actions or attempt to assert the same or similar claims on their own behalf. Mr. Hertzberg's affidavit establishes this fact beyond genuine issue:

I was also informed [by Mr. Liebersbach] that based upon Rule 2004 examinations in the Bankruptcy Court that provided pre-complaint discovery by Huntington to the Trustee and various creditors (including plaintiffs in this action), it was very likely that a number of Cyberco creditors would seek to intervene in the Trustee's Actions on the side of the Trustee or file “me too” suits with *872 allegations redundant to those by the Trustee in the Trustee's Actions.

(Hertzberg Aff., ¶ 6).

D. Midwest's Conflict Waiver in the Trustee's Actions

17. Mr. Hertzberg performed a conflict-of-interest check and learned that Pepper Hamilton actively represented Bank Midwest in the nine Forfeiture Actions identified in paragraph 7 above and that the firm had formerly represented Bank Midwest in the Cyberco-related federal court lawsuit and the bankruptcy adversary proceeding identified in paragraphs 11 and 12 above. (Hertzberg Aff., ¶ 8). Mr. Hertzberg, although unsure that this was a disabling conflict, discussed the issue with Huntington National Bank, who was willing to waive any potential conflict. Huntington requested that he attempt to secure a waiver from Bank Midwest. Mr. Hertzberg avers that the purpose of the requested waiver was to allow Pepper Hamilton to defend Huntington National Bank against both the Trustee's actions and actions “which likely would be asserted by other creditors.” (*Id.*).

18. Mr. Hertzberg recruited another Pepper Hamilton partner, Laurence Shiekman, to assist him in the Huntington representation. He asked Shiekman and Jeremy Frey, the Huntington partner handling the forfeiture actions for Bank Midwest, to attempt to procure a conflict-of-interest waiver from Bank Midwest.

19. Thereafter, Jeremy Frey (Pepper Hamilton counsel representing Bank Midwest) and Laurence Shiekman (Pepper Hamilton counsel on the “Huntington team”) spoke to Mr. Neeb, Bank Midwest's in-house counsel. It is significant to this court that Mr. Frey's affidavit is completely silent on the contents of the conversations with Mr. Neeb. Rather, only Mr. Shiekman, who was obviously pursuing the interests of Huntington, has provided an affidavit concerning his understanding of those conversations. In the circumstances of this case, and with all due respect to Mr. Shiekman, the court is skeptical of his understanding of those conversations, which tend to serve only Pepper Hamilton's and Huntington's interests and are at odds with the written waiver ultimately signed by Mr. Neeb. Even so, Mr. Shiekman acknowledges that Mr. Neeb did not wish to agree to a broad waiver. (Shiekman Aff., ¶ 4). The first conversation, apparently held on Friday, March 30, 2007, resulted in a draft conflict-of-interest waiver, prepared by Pepper Hamilton, transmitted by Mr. Shiekman by e-mail on Tuesday, April 3, 2007. (*See* Letter from Special Counsel, docket # 74, and attachments). The draft letter, dated April 3 and set up for Mr. Hertzberg's signature, mentioned only one of the nine Forfeiture Actions in which Huntington was acting as counsel for Bank Midwest, as well as its previous representations of the bank in related bankruptcy matters. The letter disclosed that Huntington Bank had asked Pepper Hamilton to represent it in the two

Trustee's Actions, identified by name, as well as “generally with regard to all matters related to or arising in the Cyberco Bankruptcy Case and the Teleservices Bankruptcy Case.” The letter referred to these three enumerated matters as the “Huntington Matters” and requested Bank Midwest's consent to Pepper Hamilton's representation of the Huntington Bank in the “Huntington Matters.”

20. The record is devoid of the disclosures, if any, given by Pepper Hamilton to Bank Midwest in support of the requested waiver. Specifically, the record does not disclose that Pepper Hamilton told Bank Midwest that Pepper Hamilton and its prospective client Huntington anticipated future creditor lawsuits and that Huntington *873 had asked Pepper Hamilton to procure a waiver broad enough to allow Pepper Hamilton to take a position adverse to Bank Midwest in any such anticipated lawsuit. Mr. Shiekman avers only that he told Neeb that in the adversarial actions brought by the Trustee, “it might be necessary to depose creditors or otherwise be adverse to them in order to aggressively litigate on behalf of Huntington Bank.” (Shiekman Aff., ¶ 3).

21. Mr. Neeb asserts that at his insistence the draft waiver was “carved back” to make clear that the waiver was only directed to the specifically enumerated adversary proceedings. (Pepper Hamilton (“PH”) Ex. F at 2). The documents clearly support this conclusion. On April 6, 2007, Jeremy Frey, on behalf of the Pepper Hamilton firm, sent Mr. Neeb a revised letter embodying a waiver of conflict of interest by Bank Midwest. (PH Ex. A(3)). In the first paragraph of the letter, Mr. Frey again alluded to one, but only one, of the nine pending cases in which Pepper Hamilton was counsel of record for Bank Midwest, as well as the two closed Cyberco and Teleservices bankruptcy matters. Mr. Frey identified the two adversary proceedings commenced by the Trustee against Huntington, which were defined as the “Huntington Matters.” Significantly, the third enumerated category (“all matters related to or arising in” the Cyberco bankruptcy) was eliminated. Mr. Frey's letter recited that “in its current posture” the single forfeiture case identified was not related to either of the Huntington Matters. The letter went on to acknowledge, however, that Pepper Hamilton's representation of Huntington and Bank Midwest “might give rise to a potential conflict of interest in the absence of a conflict waiver,” without identifying any specific conflict. Mr. Frey requested a waiver of conflicts of interest in the following words:

We, therefore, request that Midwest specifically waive any claim that our representation of Huntington in the Huntington Matters represents a conflict of interest and thereby consent to our representation of Huntington in the Huntington Matters.

(PH Ex. A3). The requested waiver was further qualified by the following language:

We further confirm that Midwest's consent, if given, would not be deemed to be a consent for our representation of Huntington as a party in any other litigation in which Midwest may be or become adverse.

(*Id.*). Mr. Neeb, on behalf of Bank Midwest, signed the letter under the legend “Consent, as requested, is hereby given.” (*Id.*). The only reasonable interpretation of the waiver letter, in its final form, is that the waiver was limited to the two identified “Huntington Matters” and did not extend to any other pending or future litigation.

22. After receiving the conflict-of-interest waiver, Pepper Hamilton attorneys represented Huntington National Bank in the Trustee's Actions. Six Pepper Hamilton attorneys, plus paralegals, expended considerable time and resources in representing the bank, including organization of thousands of documents. The firm prepared a motion to dismiss the Trustee's actions, which was filed on May 4, 2007. Huntington has paid Pepper Hamilton over \$440,000.00 to date in defending the Trustee's actions. (Hertzberg Aff., ¶ 24).

23. In response to Huntington's motion to dismiss the Trustee's actions, the Trustee conceded that it lacked standing to assert counts I, II and III and agreed to *874 dismiss those counts.¹ With regard to the Trustee's core claims for recovery of allegedly voidable preferences and fraudulent transfers, Bankruptcy Judge Jeffrey Hughes took Huntington National Bank's motion to dismiss under advisement.

E. Representation of ePlus Group

24. Since late 2001, Pepper Hamilton has represented ePlus Group in a number of bankruptcy matters. (Stoeker Aff., ¶ 3). This representation included acting as lead counsel in some matters and local counsel in others. (Fournier Aff., ¶ 2). At the time the present case was filed, Pepper Hamilton was actively representing plaintiff ePlus Group, Inc. in a bankruptcy case, *In re Cable & Wireless U.S.A.*, No. 03–13711 (Dist.Del.Bk.Ct.), an engagement that the firm accepted in 2003. At all times during 2007, the *Cable & Wireless* bankruptcy matter was active, and Attorney David Fournier of Pepper Hamilton served ePlus as local counsel. The firm billed 2.5 hours of professional time to ePlus during the first half of 2007.

F. The Present Case

25. On June 22, 2007, the same day on which the Bankruptcy Court heard the motion to dismiss, plaintiffs initiated the present action. In their complaint, plaintiffs allege that they were defrauded by Cyberco and its affiliates and that Huntington National Bank aided and abetted Cyberco in its fraud. The legal theories and many of the factual allegations in the present complaint mirror those made by the Trustee in the Trustee's actions.

26. As chronicled above, at the time this case was filed, Pepper Hamilton was actively representing plaintiff ePlus as local counsel in an unrelated bankruptcy case and plaintiff Bank Midwest in the nine Forfeiture Actions related to the Cyberco fraud. The firm had previously represented Bank Midwest in two related Cyberco matters. All of these cases were designed to recover for Bank Midwest the same \$4.925 million that is the subject matter of the present case, although from different parties.

27. Huntington National Bank asked Pepper Hamilton to represent it in the present case, because the case presents overlapping legal and factual issues already asserted in the Trustee Actions. (Liebersbach Aff., ¶ 12). Mr. Hertzberg again asked Mr. Frey (Bank Midwest's counsel in the nine Forfeiture Actions) and Mr. Shiekman (a member of the Pepper Hamilton team representing Huntington) to procure a supplemental waiver from Bank Midwest. Bank Midwest refused to do so, advising its counsel Pepper Hamilton that the refusal was based on “the highly confidential and privileged information previously given to Pepper Hamilton by Bank Midwest and the fact that Bank Midwest is a current client of Pepper Hamilton in the forfeiture actions.” (Neeb Aff., ¶

13). Mr. Neeb discussed the matter on July 2, 2007, with Mr. Shiekman, who promised to consider the firm's options and to get back to Mr. Neeb. (*Id.*). Pepper Hamilton first appeared in this lawsuit on behalf of Huntington by filing a motion for extension of time to answer on July 10, 2007. (docket # 6). Two days later, plaintiffs filed a response to the motion (docket # 8) asking that the motion be denied because Pepper Hamilton's representation of *875 Huntington was adverse to its clients ePlus and Bank Midwest and violated Rule 1.7(a) of the Michigan Rules of Professional Conduct. On July 16, 2007, Mr. Neeb again contacted Shiekman to inquire as to the status because two weeks had passed and Neeb had not been contacted by Shiekman. Neeb was advised by Shiekman that the firm was still considering its options and that Shiekman would be discussing the matter with Hertzberg. (*Id.*). Later on the same day, Pepper Hamilton filed an answer in the present case on behalf of Huntington (docket # 9), signed by Messrs. Hertzberg and Shiekman, among others. On the next day, Mr. Hertzberg informed Mr. Neeb that Pepper Hamilton had concluded that a conflict of interest waiver was not necessary after all, because the April 6 waiver was broad enough to encompass the present case. (Neeb Aff., ¶ 16). After further inconclusive discussions, the managing partner of Pepper Hamilton sent a letter to Mr. Neeb on July 23, 2007, informing the client that Pepper Hamilton had decided to move to withdraw from all pending matters on behalf of Bank Midwest and that in the circumstances the firm's conduct was consistent with the Rules of Professional Conduct. (PH Ex. G).

28. Shortly before appearing for defendant on this case, Pepper Hamilton contacted Ms. Stoeker, General Counsel for ePlus Group, to request a waiver of any conflict. Ms. Stoeker did not consent. (Stoeker Aff., ¶¶ 8, 9). By e-mail dated July 10, 2007, Pepper Hamilton unilaterally terminated its attorney/client relationship with ePlus. (*Id.*, ¶¶ 6, 7). Because the firm was only acting as local counsel, it did not believe that leave of the Bankruptcy Court was required as a prerequisite for withdrawal. (Fournier Aff., ¶¶ 6–7). In response, ePlus Group demanded that Pepper Hamilton immediately withdraw from its representation of Huntington National Bank (PH Ex. I at 2), but Pepper Hamilton refused. (PH Ex. J).


29. Plaintiff Bank Midwest promptly filed its motion to disqualify Pepper Hamilton as defense counsel on July 24, 2007, only two weeks after the firm first appeared for defendant. (Motion, docket # 18). Plaintiff ePlus Group filed its motion on July 30, 2007. (docket # 26). Both

Pepper Hamilton and Huntington National Bank retained special counsel to oppose the motions, which were heard on September 6, 2007.


Discussion


[1] [2] [3] [4] [5] A motion to disqualify counsel is the proper method for a party to bring to the court's attention an alleged conflict of interest or breach of ethical


duty by opposing counsel. See  *DeBiasi v. Charter County of Wayne*, 284 F.Supp.2d 760, 770 (E.D.Mich.2003) (citing


 *Musicus v. Westinghouse Elec. Corp.*, 621 F.2d 742 (5th Cir.1980)). The power to disqualify an attorney from a case is “incidental to all courts, and is necessary for the preservation of decorum, and for the respectability of


the profession.”  *S.D. Warren Co. v. Duff–Norton*, 302


F.Supp.2d 762, 766 (W.D.Mich.2004) (quoting  *Ex Parte Burr*, 22 U.S. (9 Wheat) 529, 531, 6 L.Ed. 152 (1824)). A violation of the rules of professional ethics, however, does not automatically necessitate disqualification of an

attorney.  *SST Castings, Inc. v. Amana Appliances, Inc.*, 250 F.Supp.2d 863, 865 (S.D.Ohio 2002). Rather, the extreme sanction of disqualification should only be utilized when there is a “reasonable possibility that some specifically identifiable impropriety” actually occurred, and where the public interest in requiring professional conduct by an attorney outweighs the competing interest of allowing a party to retain counsel

of his choice. *Id.* (quoting  *876 *Woods v. Covington County Bank*, 537 F.2d 804, 810 (5th Cir.1976)); accord, *Moses v. Sterling Commerce (Am.), Inc.*, 122 Fed.Appx. 177, 183 (6th Cir.2005). While motions to disqualify are legitimate and necessary to protect the integrity of judicial proceedings and the ethics of the bar, courts must be vigilant in viewing motions to disqualify counsel, as the “ability to deny one's opponent the services of capable counsel is a potent weapon.”

 *Manning v. Waring, Cox, James, Sklar & Allen*, 849 F.2d 222, 224 (6th Cir.1988). The court must therefore balance the interest of the court and the public in upholding the integrity of the legal profession against the right of a party to retain

counsel of its choice.  *Id.* at 225. A decision to disqualify counsel must be based on a factual inquiry conducted in a

manner allowing appellate review.  *General Mill Supply Co. v. SCA Servs.*, 697 F.2d 704, 710 (6th Cir.1982). The Sixth Circuit will review this court's decision on motion


to disqualify for an abuse of discretion. See *Moses*, 122 Fed.Appx. at 183.


Under the analysis set forth above, plaintiffs' motions to disqualify Pepper Hamilton as defense counsel raise two separate issues. First, the court must determine whether Pepper Hamilton's representation of Huntington National


Bank in this litigation is a violation of the firm's ethical duties. If so, the second question is the appropriate remedy. The court will consider each issue in turn.

I. Pepper Hamilton's Representation of Huntington National Bank in This Litigation is a Clear Breach of Its Ethical Duties

A. Violation of Rule 1.7(a)

[6] [7] Ethical rules involving attorneys practicing in the federal courts are ultimately questions of federal law. The federal courts, however, are entitled to look to the state rules of professional conduct for guidance.  *In re Snyder*, 472 U.S. 634, 645 n. 6, 105 S.Ct. 2874, 86 L.Ed.2d 504


(1985); see  *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Alticor, Inc.*, 466 F.3d 456, 457–58 (6th Cir.2006), vacated in part on other grounds, 472 F.3d 436 (6th Cir.2007) (applying Michigan Rules of Professional Conduct). The district judges of this court have determined that the ethical obligations of attorneys practicing before it will generally be governed by Michigan Rules of Professional Responsibility.

See W.D. MICH. LCIVR 83.1(j);  *City of Kalamazoo v. Michigan Disposal Serv. Corp.*, 125 F.Supp.2d 219, 231 (W.D.Mich.2000). The general prohibition against direct conflicts of interest is set forth in Rule 1.7(a) of those rules:

(a) A lawyer shall not represent a client if the representation will be directly adverse to another client, unless:

(1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and

(2) each client consents after consultation.

MICH.R.PROF.COND.1.7(A). This rule is founded upon an attorney's fundamental duty of undivided loyalty to clients. “It is a well established ethical principle that ‘an attorney owes undivided allegiance to a client and usually may not represent parties on both sides of a dispute.’ ”  *Evans &*

Luptak, PLC v. Lizza, 251 Mich.App. 187, 650 N.W.2d 364, 370 (2002) (quoting *Barkley v. Detroit*, 204 Mich.App. 194, 514 N.W.2d 242, 246 (1994)). “Thus, a lawyer ordinarily may not act as advocate against the person the lawyer represents in some other matter, even if it is wholly unrelated.”

MICH.R.PROF.COND.1.7 (comments); accord *Evans & Luptak*, 650 N.W.2d at 371. The duty of undivided loyalty is as old as the legal profession itself, see **877 Williams v. Reed*, 29 F.Cas. 1386, (3 Mason) 405, 418 (C.C.D. Maine 1824) (Story, J.), and reflects an ancient teaching of Western Civilization: “No man can serve two masters.” *Matthew* 6:24.

[8] Under the first sentence of *Rule 1.7(a)*, a lawyer is precluded from representing a client if the representation of that client will be directly adverse to another client. Application of this rule to the present case is essentially mechanical. There can be no question that the interests of plaintiffs on one hand and Huntington National Bank on the other hand are adverse. See *In re Ervin Test. Trust*, 2005 WL 433573 at *3 (Mich.Ct.App. Feb. 24, 2005) (when a law firm is representing two parties, especially where one is suing the other, it follows then that the representations are directly adverse). Consequently, Huntington National Bank has a conflict of interest if it is presently has an attorney/client relationship with any of the plaintiffs. With regard to Bank Midwest, the fact of current representation is established by the records of this very court. Pepper Hamilton is presently counsel of record for Bank Midwest in the nine Forfeiture Actions. Those actions have been pending in this court for over two years, and Pepper Hamilton has been the only counsel of record for Bank Midwest. Pepper Hamilton did not even request leave to withdraw from the forfeiture cases until August 24, 2007, one month after Bank Midwest filed the pending motion to disqualify. Under the clear requirements of the Local Rules of this court, Pepper Hamilton remains counsel of record unless and until the court grants leave to withdraw. See W.D. MICH. LCIVR 83.3(d) (“Withdrawal of appearance may be accomplished only by leave of court.”). No such leave has been granted.

[9] [10] Application of the rule to ePlus is only slightly more involved. The affidavit of David M. Fournier, a Pepper Hamilton attorney practicing in Philadelphia, establishes that the firm has provided bankruptcy-related services to ePlus Group on a periodic basis for over six years and that the firm at all times in 2007 was acting as local counsel for ePlus Group in the *Cable & Wireless* bankruptcy. Pepper Hamilton's brief and affidavits tend to downplay the


relative scope and importance of this representation, but the nature of the representation is completely irrelevant. See *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F.Supp. 1121, 1125 (N.D. Ohio 1990) (The law makes no distinction between “lead” and “local” counsel in assessing their ethical duties.). There are no small or unimportant clients. Pepper Hamilton cannot and does not deny that ePlus Group was an active client of the firm when Pepper Hamilton agreed to undertake the representation of Huntington National Bank to oppose the claims of ePlus in this case. “Loyalty to a client prohibits undertaking representation directly adverse to that client without that client's consent even if the adverse representations are wholly unrelated.” *Florida Ins. Guar. Ass'n., Inc. v. Carey Canada, Inc.*, 749 F.Supp. 255, 259 (S.D. Fla. 1990).

[11] The conflict of interest was not cured by Pepper Hamilton's purported termination of the attorney/client relationship with ePlus by e-mail sent January 10, 2007. The courts universally hold that a law firm will not be allowed to drop a client in order to resolve a direct conflict of interest, thereby turning a present client into a former client. See, e.g., *Picker Int'l, Inc. v. Varian Assoc., Inc.*, 869 F.2d 578, 583–84 (Fed. Cir. 1989); *Unified Sewerage Agency of Washington Co. Ore. v. Jelco*, 646 F.2d 1339, 1345 n. 4 (9th Cir. 1981); *Stratagem Dev. Corp. v. Heron Int'l, N.V.*, 756 F.Supp. 789, 794 (S.D.N.Y. 1991); *Florida Ins.*, 749 F.Supp. at 261; *Hartford *878 Acc. & Indem. Co. v. RJR Nabisco, Inc.*, 721 F.Supp. 534, 540 (S.D.N.Y. 1989); *Harte Biltmore Ltd. v. First Penn. Bank, N.A.*, 655 F.Supp. 419, 421 (S.D. Fla. 1987). As one state appellate court has summarized the rule:


Simply put, may the automatic disqualification rule applicable to concurrent representation be avoided by unilaterally converting a present client into a former client prior to hearing on the motion for disqualification? We answer each question in the negative and hold, consistent with all applicable authority, that a law firm that knowingly undertakes adverse concurrent representation may not

avoid disqualification by withdrawing from the representation of the less favored client before hearing.

 *Truck Ins. Exch. v. Fireman's Fund Ins. Co.*, 6 Cal.App.4th 1050, 1057, 8 Cal.Rptr.2d 228 (Cal.Ct.App.1992).

[12] Pursuant to this universal rule, the status of the attorney/client relationship is assessed at the time the conflict arises, not at the time the motion to disqualify is presented to the court. See *Ehrich v. Binghamton City Sch.*, 210 F.R.D. 17, 25 (N.D.N.Y.2002). “If this were not the case, the challenged attorney could always convert a present client into a ‘former client’ by choosing when to cease to represent the disfavored client.”  *Unified Sewerage Agency*, 646 F.2d at 1345 n. 4. This unilateral abrogation of the duty of loyalty cures nothing, but serves to make matters worse.


Indeed, the offense inherent in taking on the conflicting representation is compounded by seeking to “fire” the client in pursuit of the attorney's interest in taking on a new, more attractive representation. If, as one judge has written, “the act of suing one's client is a ‘dramatic form of disloyalty,’ what might be said of trying to drop the first client in an effort to free the attorney to pursue his or her self-interest in taking on a newer and more attractive professional engagement?”


Universal City Studios, Inc. v. Reimerdes, 98 F.Supp.2d 449, 453 (S.D.N.Y.2000) (quoting  *British Airways, PLC v. Port Authority*, 862 F.Supp. 889, 899 (E.D.N.Y.1994)). This ethical rule is not triggered only when the attorney's motives are selfish or otherwise suspect. The rule vindicates the attorney's fundamental duty of loyalty: the breach of ethics is not triggered by bad motive or excused by good motive.



The Michigan courts have not had occasion to apply this doctrine, which is colloquially referred to as the “hot potato rule.” The Ethics Committee of the State Bar of Michigan, however, has issued a formal ethics opinion that is directly on point. Opinion RI-139 (Aug. 7, 1992).² In formal opinion RI-139, the Committee applied the general rule that the existence of a conflict must be judged at the time the conflict arises. The Committee went on to rely on the “hot potato rule,” remarking that “courts that have considered the issue have held that a firm will not be allowed to drop a client in order to shift resolution of the conflicts question from Rule

1.7 dealing with current clients, to the more lenient standard in Rule 1.9 dealing with former clients.” (Op. at 3).

[13] In its briefing, Pepper Hamilton attempts to do just that, by relying not on *879 the strict rule of preclusion embodied in Rule 1.7(a), but on the more lenient standard set forth in Rule 1.9, which deals with former clients. The firm likewise invokes the three-part “Sixth Circuit

rule” set forth in cases such as  *Dana Corp. v. Blue Cross & Blue Shield Mut. of N. Ohio*, 900 F.2d 882, 889 (6th Cir.1990). Both Rule 1.9 of the Michigan Rules of Professional Conduct and the *Dana* rule expressly apply to

situations involving former clients. See  *SST Castings*, 250 F.Supp.2d at 867 (“The *Dana* substantially-related test is not applicable where an attorney undertakes employment against a current client.”). The federal courts have recognized that the stringent rule against advocating a position adverse to a current client is designed to vindicate the fundamental duty of loyalty, while the rule involving former clients focuses on the existence of confidential information and a substantial relationship between the present matter and

the former one. See  *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir.1976). “The more stringent *per se* rule vindicates an entirely different ethical principle than does the substantial relationship test. The propriety of representing interests adverse to a current client must be measured not so much against the similarities in litigation as against the duty of undivided loyalty which an attorney owes to each of his clients.” *Ehrich*, 210 F.R.D. at 24; accord  *Concat LP v. Unilever, PLC*, 350 F.Supp.2d 796, 822 (N.D.Cal.2004) (purpose of prohibition against concurrent adverse client relationships is to preserve duty of loyalty, not confidentiality). A law firm is not privileged to extinguish its duty of loyalty to a present client by unilaterally turning it into a former client.³

In summary, I find that plaintiffs Bank Midwest and ePlus Group have borne their burden of showing that Pepper Hamilton's appearance in this case on behalf of Huntington National Bank represents a direct conflict of interest. With regard to ePlus Group, this showing is sufficient to establish a violation of Rule 1.7(a) of the Michigan Rules of Professional Conduct. Regarding Bank Midwest, the court must continue its analysis under Rule 1.7(a), as Pepper Hamilton and Huntington National Bank contend that Bank Midwest waived the conflict, as allowed by the rule.

B. Waiver

[14] By the express terms of [Rule 1.7\(a\)](#), a direct conflict of interest may be waived by the client, after consultation, if the attorney reasonably believes the representation will not be adversely affected. In the present case, Pepper Hamilton and Huntington Bank argue that Bank Midwest waived any objection to Pepper Hamilton's conflict of interest in the present case by executing the April 6, 2007 conflict waiver.

Although the moving parties have the ultimate burden to show grounds for disqualification, Pepper Hamilton has the burden of proving full disclosure and of establishing the fact and scope of consent. Judge Quist has stated the rule as follows:

The law imposes certain obligations upon ... attorneys who seek to advance conflicting interests. They have the duty to make full disclosure and obtain clear and informed consent. If the transaction thereafter goes sour, theirs is the burden of proving full disclosure *880 and the fact and scope of consent. This burden is not met by arguing that the party to whom the duty was owed had constructive knowledge of the conflict. See [IBM Corp. v. Levin](#), 579 F.2d 271, 281 (3d Cir.1978). Such a position would shift the burden from the fiduciary to the

party to whom the duty is owed. [Id.](#) at 282. To satisfy the burden of full disclosure, it is not sufficient that both parties be informed of the fact that a lawyer is undertaking to represent both of them. Rather, there must be a disclosure of risks in such detail that the person can understand the reasons why it may be desirable to withhold

consent. [Unified Sewerage Agency v. Jelco Inc.](#), 646 F.2d 1339, 1345 (9th

Cir.1981); [Florida Ins. Guaranty Assoc., Inc. v. Carey Canada, Inc.](#), 749 F.Supp. 255, 258 (S.D.Fla.1990);

[Ransburg Corp. v. Champion Spark](#)


[Plug Co.](#), 648 F.Supp. 1040, 1046 (N.D.Ill.1986).

[Glidden Co. v. Jandernoa](#), 173 F.R.D. 459, 480 (W.D.Mich.1997). I find that Pepper Hamilton has failed to carry its burden to establish either that Bank Midwest consented to the conflict in this case or that the firm made full disclosure sufficient to support such a waiver.

First, the record cannot support a finding that the April 6, 2007 waiver letter applies to the present lawsuit or that it was intended to. The waiver letter (*PH Ex. A(3)*) refers only to the two adversary proceedings commenced against Huntington by the Cyberco Trustee in the bankruptcy court, defining those proceedings as the "Huntington Matters." The letter, drafted by Pepper Hamilton, requested that Midwest "specifically waive any claim that our representation of Huntington in the Huntington Matters represents a conflict of interest and thereby consent to our representation of Huntington in the Huntington Matters." (*Id.* at 2). The letter reflects careful and lawyerlike draftsmanship, designed to limit the waiver to the two "Huntington Matters" then pending. That language, standing alone, is sufficient to support a finding that the waiver was limited to the two pending matters. Any possible ambiguity, however, was eliminated by the following sentence: "We further confirm that Midwest's consent, if given, would not be deemed to be a consent to our representation of Huntington as a party in any other litigation in which Midwest may be or become adverse." (*Id.*). This language unmistakably negates any reading of the document that would extend Midwest's waiver to the present case, or to any case beyond the two specific Trustee's Actions identified in the waiver letter.

Despite the clarity of the waiver letter, Pepper Hamilton advances an unreasonably broad interpretation that cannot withstand judicial scrutiny. Mr. Hertzberg, the Pepper Hamilton attorney with a longstanding relationship to Huntington National Bank, offers his "understanding" of the waiver, despite the fact that he never spoke to anyone at Bank Midwest. Mr. Hertzberg opines that the scope of the waiver reached the "subject matter of the Trustee's Actions regardless of how such action might be styled." (Hertzberg Aff., ¶ 9). Dismissing the broad reservation for "other" litigation, he opines that only "unrelated" litigation was excluded from the scope of the waiver. (*Id.*). This self-serving interpretation of the scope of the waiver, proffered by an attorney who never spoke to Bank Midwest, is obviously entitled to no


weight. Mr. Shiekman, the Huntington attorney who did speak to Bank Midwest's in-house counsel, avers that there was "no expectation that Bank Midwest would later attempt to render this consent illusory by seeking to take over any of the Trustee's claims against Huntington National Bank and then endeavoring to disqualify Pepper Hamilton," *881 without offering any factual basis, arising from his discussion with Mr. Neeb, to support this sweeping generalization. He also opines that the consent "would not apply to other or completely unrelated litigation ... which could not be deemed reasonably related to the Trustee's Actions." (Shiekman Aff., ¶ 6(b), (c)). Again, Mr. Shiekman presents his bare opinion, unadorned by support from either the waiver letter or his discussions with Mr. Neeb to support this unreasonably broad reading of the waiver letter.

[15] An attorney bears the burden of establishing the "fact and scope of consent."  *Glidden Co.*, 173 F.R.D. at 480.

If Pepper Hamilton truly intended that the waiver extend to the "subject matter" of the Trustee's Actions, no matter how styled, and that the reservation for "other" litigation really meant "completely unrelated litigation," it was the law firm's obligation to express this intent clearly in the proposed waiver letter. Expressing these concepts in a clear fashion would have been simple, had that been the intent of the parties. It has now come to light that Pepper Hamilton indeed tendered a draft letter to Bank Midwest that covered all matters related to or arising in the Cyberco or Teleservices Bankruptcies. This proffered language would have been broad enough to cover the present case, but Bank Midwest's counsel refused to agree to it. The existence of the April 3 draft renders Pepper Hamilton's reading of the April 6 waiver letter inarguable.⁴

The final waiver letter must be limited to the two matters specifically identified, as the language of the final letter will bear only that construction and a broad, subject-matter waiver had been specifically rejected by the client.



Perhaps cognizant of the plain import of the waiver letter, Pepper Hamilton's special counsel argues in this court that the waiver should be deemed to cover the present case because it is the "same case" brought by the Trustee in bankruptcy court. This is pure sophistry. As noted in the findings of fact, the Bankruptcy Trustee's complaints against Huntington National Bank contain several common-law counts that are similar, both factually and legally, to the aiding and abetting claims set forth by plaintiffs in this case. The Bankruptcy Trustee's claims, however, were not brought on behalf of any particular creditor or group of creditors, but were asserted on behalf of the bankruptcy estate itself. The ability of the Trustee to bring


such claims on behalf of the estate is dubious at best, and the Trustee has since agreed that he lacks standing to pursue these claims on behalf of the estate. When Bank Midwest consented to Pepper Hamilton's defense of Huntington National Bank against the Trustee's claims, it consented to just that. The interest of Bank Midwest in the Trustee's claims, if any, was limited to that of a general creditor. Indeed, at oral argument, special counsel for Pepper Hamilton represented to the court that no conflict of interest existed at all on April 6, 2007, indicating that the interest of Bank Midwest in the Trustee's Actions was tangential and indirect. By no stretch of construction can Bank Midwest's consent to its counsel's representation of Huntington National Bank in the Trustee's Actions, where Bank Midwest had only a remote interest, be deemed a prospective waiver of any conflict of interest *882 that would arise when Bank Midwest asserted claims, even identical claims, against Huntington National Bank in its own right. The criticism of Bank Midwest, contained in Pepper Hamilton's affidavits, that it somehow rendered its consent "illusory" by failing to disclose its intent to sue Huntington National Bank is preposterous. Pepper Hamilton's argument stands the law on its head. The law firm, and not the client, had a burden of full disclosure. See  *E.F. Hutton & Co. v. Brown*, 305 F.Supp. 371, 398 (S.D.Tex.1969) ("The rule [against representing conflicting interests] requires counsel—not clients—to search out and disclose potential conflicts between clients and the facts which causes them to arise."). Bank Midwest's violation of its nonexistent duty of disclosure did not, as suggested by Pepper Hamilton, render the waiver "illusory." Pepper Hamilton remains free to represent Huntington National Bank in the Trustee's Actions, the only subject of the written waiver.

In a related argument, Pepper Hamilton accuses Bank Midwest of some sort of duplicity arising from the client's choice to sue Huntington in Federal District Court, rather than the Bankruptcy Court. The suggestion is that Bank Midwest is unfairly trying to skirt the effect of the waiver. Again, this position is untenable. It is highly doubtful that the Bankruptcy Court would have jurisdiction to entertain the present case. More fundamentally, Pepper Hamilton has cited no authority that would impose upon a client the duty to maximize the effect of a conflict waiver for the benefit of its counsel.⁵

[16] [17] In order to sustain its argument that Bank Midwest somehow waived the actual conflict of interest posed in the present case, Pepper Hamilton has the burden of clearly establishing that the waiver applies to this case (which it has not), and of establishing the sufficiency of

its disclosures to the client to support such a waiver.

See  *Glidden*, 173 F.R.D. at 480;  *General Cigar Holdings, Inc. v. Altadis, S.A.*, 144 F.Supp.2d 1334, 1338 (S.D.Fla.2001). To be sufficient, the disclosure of risks must be “in such detail that the person can understand the reasons why it may be desirable to withhold consent.”

 *Glidden*, 173 F.R.D. at 480. As the Restatement puts it, “informed consent requires that the client or former client had reasonably adequate information about the material risks of such representation to that client or former client.” 2

RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 122(1) (2000).


Pepper Hamilton's disclosures in the present case are utterly insufficient to support a waiver of the direct conflict of interest presented in the present case. Pepper Hamilton's waiver letter identified no direct conflict but said only that continued representation of Bank Midwest “might give rise to a potential conflict of interest in the absence of a conflict waiver.” (PH Ex. A(3)). The firm's affidavits are similarly general. With regard to the nature of the conflict, they disclose only that Mr. Shiekman explained to Mr. Neeb that in the Trustee's Actions, “it might be necessary to depose creditors or otherwise be adverse to them in order to aggressively litigate on behalf of Huntington Bank.” (Shiekman Aff., ¶

3). Significantly, the record does not disclose that Pepper Hamilton ever directly discussed the possibility that the firm would seek to take a position *883 adverse to Bank Midwest if Bank Midwest ever decided to sue Huntington on similar claims, even though both Huntington and Pepper Hamilton considered such claims to be “very likely” (Hertzberg Aff., ¶ 6) and Huntington had asked Pepper Hamilton to secure a waiver from Bank Midwest broad enough to cover not only the Trustee's claims but claims “which likely would be asserted by other creditors.” (*Id.*, ¶ 8). The only inference possible on this record is that the law firm did not disclose to its client the likely possibility that undertaking the Huntington defense would lead to a direct conflict of interest in the future.

In summary, Pepper Hamilton's waiver argument is untenable. In order to undertake representation of Huntington National Bank in the Trustee's Actions, Pepper Hamilton realized that a broad waiver of conflict of interest from Bank Midwest was necessary, covering both the Trustee's Actions and all related matters, because of the likelihood that other creditors like Bank Midwest would bring similar claims against Huntington. The firm asked for a broad waiver, which Bank Midwest denied. The waiver as ultimately executed was

limited to the two pending Trustee's Actions and specifically excluded any other litigation. Pepper Hamilton failed to procure the necessary broad waiver, but undertook the defense of Huntington anyway. The creditor lawsuit that the firm knew was “very likely” came to fruition only months later. The firm, having failed to get a broad waiver, now tortures the language of the limited waiver in an effort to gain the benefit of the broad waiver refused by its client. Such conduct is unbecoming a great law firm.





II. Remedy

[18] This court has concluded that Pepper Hamilton's representation of Huntington National Bank in the present litigation is a violation of [Rule 1.7\(a\)](#) of the Michigan Code of Professional Responsibility and a breach of its duty of undivided loyalty to its clients Bank Midwest and ePlus Group. The finding of an ethical violation, however, does not automatically require disqualification. The court should order disqualification only where some “specifically identifiable impropriety” has actually occurred and the balance of relevant factors requires vindication of the integrity of the legal profession over defendant's interest in retaining counsel of its choice. See *Moses*, 122 Fed.Appx. at 183–84;  *SST Castings, Inc.*, 250 F.Supp.2d at 865.



In cases involving a direct conflict of interest involving current clients, most courts give decisive weight to vindication of the integrity of the bar.


An attorney who fails to observe his obligation of undivided loyalty to his client injures his profession and demeans it in the eyes of the public. The maintenance of the integrity of the legal profession and its high standing in the community are important additional factors to be considered in determining the appropriate sanction for a Code violation. The maintenance of public confidence in the propriety of the conduct of those associated with the administration of justice is so important a consideration that we have held that a court may disqualify an attorney for failing to avoid even the appearance of impropriety. Indeed, the courts have gone so far as to suggest

that doubts as to the existence of an asserted conflict of interest should be resolved in favor of disqualification.


 *Int'l Bus. Mach. Corp. v. Levin*, 579 F.2d 271, 283 (3d Cir.1978) (citations omitted); *accord*  *Hull v. Celanese Corp.*, 513 F.2d 568, 571 (2d Cir.1975) (Where clear conflict of interest exists, doubt should be “resolved in favor of disqualification.”); *Ehrlich*, *884 210 F.R.D. at 25;  *Harte Biltmore Ltd.*, 655 F.Supp. at 421. Some courts weigh the duty of loyalty so heavily that they apply a nearly *per se* rule in favor of disqualification. *See, e.g.*,  *Lemelson v. Apple Comp., Inc.*, 28 U.S.P.Q.2d 1412, 1418 (D.Nev.1993) (“Because the interest sought to be protected by Model Rule 1.7 is one of loyalty, a *per se* rule of disqualification should be applied when that rule is breached.”). In a recent case, the Sixth Circuit Court of Appeals disqualified a law firm with a direct conflict of interest, with little discussion of countervailing factors. *Nat'l Union Fire Ins. Co. of Pittsburgh v. Alticor, Inc.*, 472 F.3d 436 (6th Cir.2007).


Pepper Hamilton argues against the remedy of disqualification by relying on the “flexible approach” fashioned by some courts in situations in which a conflict of interest has been “thrust upon” a law firm through no fault of its own. Several courts have found that conflicts of interest arising during the course of representation and created by corporate mergers or acquisitions should be subject to a “flexible rule” pursuant to which the conflicted firm could withdraw from representation of one client to cure the conflict. Those few federal courts that have followed the “flexible approach” have done so only when the conflict of interest arises from an unforeseen merger that impacts a long-pending case, and have made it clear that the approach involves only remedy and not the question whether the


firm has a conflict of interest. *See e.g.*,  *SWS Fin. Fund A. v. Salomon Brothers, Inc.*, 790 F.Supp. 1392, 1399 (N.D.Ill.1992);  *Gould, Inc. v. Mitsui Mining & Smelting Co.*, 738 F.Supp. 1121 (N.D. Ohio 1990).


Contrary to Huntington's argument, the so-called “flexible approach” does not eliminate an ethical violation. It merely examines options available to courts in fashioning appropriate remedies where ethical standards have been violated. The limited nature of this approach is demonstrated by  *Gould,*


Inc. v. Mitsui Mining & Smelting Co., 738 F.Supp. 1121 (N.D. Ohio 1990), the seminal case in this area. In *Gould*, Jones, Day Reavis & Pogue (Jones, Day) represented Gould, Inc. (Gould) in a lawsuit filed in 1985 against Petchney and others alleging RICO and other claims based on Petchney's alleged misappropriations of Gould trade secrets concerning


the manufacture of electrolytic copper foil.  *Id.* at 1122. In 1989, Petchney acquired acquire IGT Technologies (IGT). Jones, Day had represented IGT in various matters prior to the acquisition and Jones Day continued to represent IGT in contractual and licensing matters through the date of the


court's decision.  *Id.* at 1123. Jones, Day never attempted to obtain Petchney's consent to Jones Day's continuing


representation of both IGT and Gould.  *Id.* In 1990, Petchney discovered that Jones, Day continued to represent both Gould and IGT. Jones, Day refused a request that they


withdraw as counsel for Gould.  *Id.* Judge Joiner, sitting by designation, initially determined that Jones, Day was in violation of DR 5–105 in its representation of current clients






Gould against Petchney's subsidiary IGT.  738 F.Supp. at 1125–26. Having determined that the firm had committed ethical violations, the court moved on to the question whether


disqualification was an appropriate remedy.  *Id.* at 1126. “In ruling on a motion to disqualify, and considering the possible sanctions available to punish unethical conduct, courts must remember that the court is not the only agency policing lawyers' conduct. Other agencies are established directly to deal with their conduct, and there may be times when the sanctions of those agencies may be more appropriate


than disqualification in the case before the court.”  *Id.* The court then examined what have since been referred to as the “*Gould factors*” in fashioning *885 an appropriate remedy. First, there was no evidence that Petchney had been prejudiced in any way by Jones, Day's representation of Gould. No confidential Petchney information had passed to Gould as a result of Jones, Day's representation of IGT on matters unrelated to the ongoing unfair competition


lawsuit that had been filed five years earlier.  *Id.* at 1126. “Second, disqualifying Jones, Day from representing Gould would not only cost Gould a great deal of time and money, in retaining new counsel, it would significantly delay the

progress of the case.”  *Id.* at 1127. The court found that this was a particularly weighty consideration given the complex technology and trade secrets at issue. Third, “the conflict was created by Petchney's acquisition of IGT several years

after the instant case was commenced, not by any affirmative act of Jones, Day.”  *Id.* The *Gould* court found that disqualification was not warranted, but also emphasized that “the conflict must not be allowed to endure.”  *Id.* at 1127. “Jones, Day can remain counsel for both Gould and IGT only if Petchney consents, and it is clear no consent will be given. Therefore, Jones, Day must discontinue its representation of either Gould or IGT.”  *Id.* The court left the choice, and its attendant ramifications to Jones, Day, giving “Jones, Day a chance to choose how to extricate itself from a conflict which it did not create, but to which it was unethically slow in responding.”  *Id.* The court reported the ethical violation to the state disciplinary counsel.  *Id.*

Similarly, in  *SWS Fin. Fund A. v. Salomon Brothers, Inc.*, 790 F.Supp. 1392, 1399 (N.D.Ill.1992), the court found that Salomon Brothers was a current client of Schiff, Hardin and Waite, that any attempted termination of Salomon as a client would have violated the “hot potato” rule, and that the law firm’s representation of Hickey violated Rule 1.7 of

the Rules of Professional Conduct.  *Id.* at 1397–99. The district court, in its discretion, found that disqualification was not an appropriate remedy. Disqualification was “one of three sanctions available to enforce prophylactic conflicts rules,” the other two being “[d]isciplinary proceedings and civil remedies (*i.e.*, malpractice suits and defenses for the non-



payment of legal fees).”  *Id.* at 1400. The court admitted that its refusal to disqualify the firm was a “departure from the norm,” but in this particular lawsuit, involving what the court labeled as “mega-firms (like Schiff) and mega-parties (like Salomon Brothers),” the court was concerned that “[w]ith simply a minor investment of some token business, such clients would in effect be buying an insurance policy against

that firm’s adverse representation.”  *Id.* at 1402.

At least one other court has rejected the *SWS* case’s reliance on the size of the client and size of the law firm as unprincipled and unworkable. The same ethics rules apply to all law firms and clients regardless of size:

This Court is fully aware of the “changes” in the “legal world” and attempts to stay abreast of them and deal with cases in an up-to-

date fashion. Keeping that in mind, however, does not somehow lead this Court to believe that “changes” also mean adopting a set of principles and ethics for “mega corporations” and “monster law firms” which is something less than that imposed on small companies and lesser-size law firms. Rule 1.7 stands as is for everyone. This Court notes that, if anything, large law firms have an even greater responsibility to incorporate satisfactory computer conflicts check systems simply because of their size and the fact the lawyers in these firms are not able to manually check their client lists for potential conflicts.

*886  *Lemelson v. Apple Computer, Inc.*, 28 U.S.P.Q.2d at 1419 (rejecting  *SWS*’s approach of a size-dependent application of ethical rules regarding disqualification).

Pepper Hamilton places great reliance on the opinion of the New York City Bar Association’s Ethics Committee (Opinion 2005–05), entitled “Unforeseeable Concurrent Client Conflicts.” This formal opinion attempts to set forth rules applicable to unforeseen conflicts that develop between clients in the course of ongoing representation of both, without fault of the lawyer. The opinion is not authoritative, and many of its conclusions are inapposite to the presentation, as the opinion was issued under New York Disciplinary Rule 5–105(A), which differs materially from Michigan’s Rule 1.7(a).⁶ Nevertheless, the opinion provides a useful synthesis of the few cases that directly apply the “flexible approach” in such unforeseen conflicts. The opinion defines “thrust upon” conflicts as conflicts between two clients that (1) did not exist at the time either representation commenced but arose only during the ongoing representation of both clients, where (2) the conflict was not reasonably foreseeable at the outset of the representation, (3) the conflict arose through no fault of the lawyer, and (4) the conflict is of a type that is capable of being waived under DR 5–105(C). Although not all aspects of the formal opinion are persuasive, its definition of “thrust upon” conflicts is an accurate reflection of those limited circumstances in which courts have seen fit to apply the flexible approach.

New York City Bar Formal Opinion 2005–05 emphasizes that the conflict “must truly be unforeseeable,” and that the conflict must “truly be no fault of the lawyer.” *Accord, Eastman Kodak Co. v. Sony Corp.*, 2004 WL 2984297, at *7–8 (W.D.N.Y. Dec. 27, 2004) (accepting the flexible approach “for disqualification issues generated by mergers and acquisitions” but disqualifying counsel because the conflict was foreseeable). Pepper Hamilton cannot qualify under either of these definitional requirements.

First, at the time Pepper Hamilton undertook to represent Huntington National Bank in the Trustee's Actions in early April 2007, the conflict was eminently foreseeable. The Cyberco fraud had generated losses approaching \$100 million, the bankruptcy assets were inadequate to pay all creditors, and Huntington National Bank was the “deep pocket” most closely associated with Cyberco. The Trustee alleged that Huntington National Bank had received payments of over \$17 million from Cyberco and Teleservices in the waning days of the fraud. Huntington National Bank had spent two years fending off the efforts of El Camino to conduct a Rule 2004 examination, the obvious purpose of which was to build a case against the bank. (*See Findings of Fact*, ¶ 10). Huntington National Bank and Bank Midwest had entered into a settlement agreement on a related Cyberco issue, in which Bank Midwest had specifically reserved its right to assert claims against Huntington in the future, and Huntington had preserved its defenses. (*See Findings of Fact*, ¶ 11). ***887** The proceedings in the Bankruptcy Court, and Huntington National Bank's deep involvement in those proceedings, fully support a finding that in April 2007 it was foreseeable that large creditors such as El Camino (claiming a loss of \$11.5 million), ePlus Group (claiming a loss of \$14.5 million), and Bank Midwest (claiming a loss of \$4.925 million) would assert claims against Huntington National Bank. The present record, however, supports a finding even stronger than mere foreseeability. The record shows that both Huntington National Bank and Pepper Hamilton *actually foresaw* the conflict. The affidavit of Robert Hertzberg, Huntington's principal counsel, establishes this beyond doubt.

I was also informed [by Mr. Liebersbach, Huntington's counsel] that based upon Rule 2004 examinations in the Bankruptcy Court that provided pre-complaint discovery by Huntington to the Trustee and various creditors (including plaintiffs

in this action) it was very likely that a number of Cyberco creditors would seek to intervene in the Trustee's Actions on the side of the Trustee or file “me too suits” with allegations redundant to those asserted by the Trustee in the Trustee's Actions.


(Hertzberg Aff., ¶ 6). As a consequence, Huntington asked Mr. Hertzberg to attempt to secure a waiver from Bank Midwest so that Pepper Hamilton could represent Huntington National Bank “against the variety of claims asserted in the pending Trustee's Actions and *which likely would be asserted by other creditors.*” (*Id.*, ¶ 8) (emphasis added). In light of these admissions, Pepper Hamilton cannot be heard to argue that the assertion of claims in this case by the firm's clients Bank Midwest and ePlus Group was unforeseeable when the firm agreed to represent Huntington National Bank. Both Huntington and Pepper Hamilton considered such creditor claims to be “very likely.”⁷

Nor can Pepper Hamilton prevail on the claim that the conflict was not its fault. Understanding that creditor claims were “very likely,” Pepper Hamilton proffered Bank Midwest a form of waiver that would have allowed the firm to represent Huntington National Bank not only in the Trustee's Actions but also “generally with regard to all matters related to or arising in the Cyberco bankruptcy case and the Teleservices bankruptcy case.” (Draft Conflict Letter of 4/3/07, docket # 74). Counsel for Bank Midwest refused to execute the proffered waiver and ultimately signed an amended letter that waived the conflict only with regard to the two enumerated Trustee's Actions. Consequently, on August 6, 2007, Pepper Hamilton knew of the limited nature of the waiver, knew that the waiver would be ineffective to cover any future lawsuit, knew that a future lawsuit was “very likely,” and undertook to represent Huntington National Bank anyway. In the circumstances of this case, its decision can only be deemed reckless.

Finally, Pepper Hamilton cannot succeed in its attempt to blame Bank Midwest and ePlus Group for thrusting the conflict upon it. The firm claims that “the conflict thrust upon Pepper Hamilton is due to Bank Midwest's and ePlus Group's decision to bring this action placing Pepper Hamilton in a current conflict of interest.” (Brief at 20, docket # 72). ePlus Group and Bank Midwest no more created the ***888** conflict by bringing the suit than Huntington National Bank did by

deciding to defend itself. If accepted, Pepper Hamilton's argument would always allow a law firm to favor its defendant client over its plaintiff client, on the theory that the conflict would have never arisen had the plaintiff not decided to sue.

Those few courts that have adopted the “flexible approach” have done so reluctantly, recognizing that it represents an erosion of the duty of loyalty and therefore should be applied in limited circumstances, when the conflict is truly unforeseeable. All the cases upon which Pepper Hamilton relies to justify its position arose in the context of a client merger or acquisition, in which the conflict truly was unforeseeable and blind-sided the lawyer. The single case cited by Pepper Hamilton that does not involve a merger

or acquisition,  *Ex parte AmSouth Bank, N.A.*, 589 So.2d 715, 722 (Ala.1991), is unpersuasive in its reasoning and inapposite on its facts. Without holding that the “flexible approach” is never appropriate outside of the merger and acquisition context, this court holds that it is patently inapplicable in this case.

Finally, the court holds that Huntington National Bank's interest in retaining a lawyer of its choice does not outweigh the gravity of the ethical violation that would be countenanced if Pepper Hamilton were allowed to continue in this case. Unlike many cases in which the “flexible approach” has been applied, the law firm has not been deeply engaged in representing its client for a period of years, nor have the wronged clients delayed in raising the issue. Pepper Hamilton's involvement in the present case is barely two months old, and its involvement in the entire Cyberco matter on behalf of Huntington National Bank is barely five months old. Both Huntington National Bank and Pepper Hamilton make much of the firm's intense involvement in the

bankruptcy case since April 2007. The record in that case, however, shows that the firm's overt involvement has been limited to filing a motion to dismiss addressed only to legal issues. The motion has already been partially successful, in that the Trustee has conceded its lack of standing to bring common-law claims against Huntington National Bank. No depositions or other discovery have taken place. Although the firm has spent considerable time organizing documents, there has been no showing that the value of this work is lost forever or that substitute counsel could not make use of it. By contrast, Bank Midwest has relied on the Pepper Hamilton firm to represent its interest in the Cyberco matters for three years and has paid the firm fees of the same magnitude as those paid by Huntington National Bank. Bank Midwest's investment in the services of the law firm at least stands on a par with that of Huntington National Bank. Although the firm's breach of its duty of loyalty to other clients will certainly impose some hardship on Huntington National Bank, that is not the fault of the court or the other clients, but the firm itself.

Conclusion

The Pepper Hamilton firm has conducted itself in a way that no court would ever condone. This is not a situation in which a law firm innocently finds itself in a conflict situation not of its own making. A law firm's duty of loyalty to its clients is paramount, and no court should lightly countenance such a patent breach of that duty. The motions to disqualify the Pepper Hamilton firm will be granted.

All Citations

623 F.Supp.2d 863

Footnotes

¹ At the September 6, 2007 hearing in this matter, special counsel for Huntington represented to the court that the Trustee has taken assignments of the claims of individual creditors and on this basis intends to refile counts I, II and III, limited to those creditors which have assigned their claims. It is therefore likely that the aiding and abetting theories will be litigated in some form in the Bankruptcy Court.

² The Supreme Court Rules concerning the State Bar of Michigan establish a Board of Commissioners, which appoints a standing committee regarding professional and judicial ethics. The Committee's ethics opinions

are not binding on the courts, but such formal and informal opinions are deemed instructive. See [City of Kalamazoo](#), 125 F.Supp.2d at 232 n. 4; [Barkley](#), 514 N.W.2d at 245–46.

3 Under some authorities, discussed in section II below, the dropping of a client might be allowed by the court as an alternative to disqualification for an actual conflict of interest in certain limited circumstances. None of these cases hold, however, that the conflict of interest between existing clients can be made to disappear by the dropping of one of the clients.

4 Pepper Hamilton's submissions to this court made no mention of the April 3 letter which, in the circumstances of this case, is a “smoking gun” demolishing the firm's litigation position concerning the meaning of the waiver. The document was produced by special counsel after the hearing, at the court's direction. A firm's duty of candor to the court demands more.

5 Pepper Hamilton's attacks on the integrity of a current client, for which the firm remains counsel of record in nine cases in this court, are unseemly, to say the least. This points up one of the many dangers of allowing a firm to drop a client unilaterally—the firm is motivated to characterize the client as the wrongdoer in order to justify its own conduct.

6 New York is one of the few jurisdictions that has not adopted the ABA Model Rules of Professional Conduct.

Model [Rule 1.7\(a\)](#), in the form adopted in Michigan, strictly forbids a lawyer from undertaking representation of a client directly adverse to another client, in the absence of consent. The New York disciplinary rules are much more lenient. DR 5–105(A) forbids an attorney from taking a position adverse to a client only “if the exercise of professional judgment on behalf of a client will be or is likely to be adversely affected,” a far looser standard. Therefore, some of the conclusions set forth in Formal Opinion 2005–05 are overly favorable to the conflicted lawyer and would not apply in Michigan.

7 Pepper Hamilton appears to assert that although creditor suits were likely, a suit by Bank Midwest or ePlus Group in particular was unforeseen. It is simply not believable that lawyers of Pepper Hamilton's caliber could be so obtuse. If the firm deemed “me-too” creditor actions as “very likely,” the most likely creditors to bring such actions were those, such as plaintiffs, who had sustained the greatest losses.

RI-139

August 7, 1992

SYLLABUS

A lawyer who has unknowingly undertaken representation of a client directly adverse to a client represented by another member of the lawyer's firm, which representation a disinterested lawyer could not reasonably believe would not adversely affect the relationship with the firm's other client, must immediately withdraw from the representation once the conflict is discovered.

A lawyer may not avoid withdrawal from the representation by attempting to screen the lawyer colleague from the conflicting representation matter.

A lawyer may not avoid or delay withdrawal from the representation, or if the matter is before a tribunal may not avoid or delay seeking permission for withdrawal, on grounds that the client is unable to find substitute counsel.

A lawyer may not avoid withdrawal from the representation even if one of the conflicting matters is subsequently concluded.

References: MRPC 1.0(b), 1.7(a), 1.9(a) and (c), 1.10(b), 1.11(a), 1.16(c); R-4; RI-46, RI-66, RI-80, RI-97; CI-1140; *Dewey v. R. J. Reynolds Tobacco Co*, 536 A2d 243 (1988); *Harte Biltmore Ltd v. First Pennsylvania Bank*, 655 F Supp 419 (DC SFla 1987); *Picker International Inc v. Varian Associates Inc*, 869 F2d 578 (CA FC 1989); *Ransberg Corp v. Champion Spark Plug Co*, 648 F Supp 1040, 1044 (DC NIll 1986); *Strategem Development Corp v. Heron International NV*, 756 F Supp 789 (DC SNY 1991); *Truck Insurance Exchange v. Fireman's Fund Insurance Co*, 8 Cal Rptr 2d 228 (Cal Ct App 1992).

TEXT

In 1990, a lawyer defended a corporate client in a law suit brought by a former employee for wrongful termination. In August of 1991, another member of the law firm began representing a plaintiff against the same corporate client in the damages portion of a civil suit after appeal. The law firm became aware of the conflict in November, 1991. At that time the law firm requested the corporate client to consent to the second representation. When the corporate client refused, the law firm agreed to withdraw from the damage suit. In December, 1991, the court entered a Stipulation and Order extending discovery in the damages case, after being advised that the law firm had a conflict which precluded the law firm's continued representation of the damages client and to allow the client to secure new counsel. In April, 1992, the law firm again requested the corporate client to waive the conflict, as a settlement had been reached in the prior litigation. The corporate client again refused and requested the law firm to file a motion to withdraw. The law firm refused and the corporate client filed a motion to disqualify the law firm based on the ethical questions.

The presiding judge in the damages action asks whether the law firm may represent a client in a matter in which the client's interests are substantially adverse to the interests of a second client at the inception of the representation, but by the time the issue of disqualification for the conflict of interest is presented to the court for decision the representation of the second client is concluded, and where the lawyer for the law firm handling the new matter is adequately screened.

MRPC 1.7 states:

"(a) A lawyer shall not represent a client if the representation will be directly adverse to another client, unless:

"(1) the lawyer reasonably believes the representation will not adversely affect the other client; and

"(2) each client consents after consultation."

The representation of the client in the damages case was directly adverse to the corporate client which the firm represented in the employment litigation. MRPC 1.7 prohibits the representation of the client in the damages case unless a disinterested lawyer would reasonably believe the representation would not adversely affect the relationship with the corporate client, *and* both clients consent.

Under these facts, a disinterested lawyer could not reasonably believe that representing the client in the damages case against the corporate client would not adversely affect the lawyer's relationship with the corporate client. We have noted in prior opinions that when a disinterested lawyer cannot reasonably believe that the representation of the former or initial client would not adversely affect the relationship with the corporate client and MRPC 1.7(a)(1) cannot be satisfied, client consent does not cure the conflict. See, for example, RI-66, RI-80.

Even if MRPC 1.7(a)(1) were satisfied, MRPC 1.7(a)(2) requires that both clients consent to the adverse representation. Since the conflict was not discovered at the time the adverse representation was undertaken, clearly neither client consented. Thus the lawyer could not ethically undertake the representation. We assume that the damages client subsequently agreed to the representation, since counsel has now asked to proceed in the matter despite the original conflict. The corporate client, however, refused to consent on two separate occasions. Therefore, none of the conditions of MRPC 1.7(a) have been met.

Having failed to detect the conflict before undertaking the adverse representation, could the lawyer belatedly cure the conflict? We are told that the lawyer for the corporate client was "screened" from participation in the damages action. This is irrelevant. Screening is allowed under ethics rules in only two circumstances: MRPC 1.10(b) allows screening to avoid imputed disqualification of a firm in certain instances when a new lawyer joins the firm and MRPC 1.11(a) allows screening when a lawyer moves to and from public office and private practice. The rules allow screening in no other circumstances. Even if screening were considered a "cure" of the law firm's failure to detect the adverse relationship between its existing clients, the screening in this instance could not have been timely implemented, since the law firm represented both clients from August through November without being aware of the conflict. Screening not timely implemented is ineffective. R-4.

The law firm argues that since time has removed the conflict, *i.e.*, the employment litigation is settled, no further impediment to representation in the damages case exists. This argument misses the rationale underlying the prohibited representation.

First, it is still improper for the law firm to have *undertaken* the conflicting representation; the conclusion of the conflicting matter does not remove the ethical violation. Nor is the law firm excused from complying with ethical duties under the guise that the client cannot find substitute counsel; a situation resulting from a violation of ethics rules cannot be used to justify future conduct. If the law firm had promptly detected the conflict of interest and had never agreed to the representation, the client would be in the same position of seeking other counsel.

Second, courts that have considered the issue have held that a law firm will not be allowed to drop a client in

order to shift resolution of the conflicts question from Rule 1.7 dealing with current clients, to the more lenient standard in Rule 1.9 dealing with former clients. See, *Picker International Inc v. Varian Associates Inc*, 869 F2d 578 (CA FC 1989); *Strategem Development Corp v. Heron International NV*, 756 F Supp 789 (DC SNY 1991); *Harte Biltmore Ltd v. First Pennsylvania Bank*, 655 F Supp 419 (DC SFla 1987); *Truck Insurance Exchange v. Fireman's Fund Insurance Co*, 8 Cal Rptr 2d 228 (Cal Ct App 1992). "To hold otherwise would allow such unethical behavior to continue unrestricted because a law firm could always convert a present client into a former client merely by seeking to withdraw after suing a present client." *Ransberg Corp v. Champion Spark Plug Co*, 648 F Supp 1040, 1044 (DC NIII 1986).

Third, when a conflict arises after representation has been undertaken, or, as in this case, the pre-existing conflict is discovered after representation has been undertaken, the lawyer must withdraw and in some situations must withdraw from representing both clients. In this case the law firm took no definitive action to extricate itself from the impermissible conflict from November, 1991, when the conflict was discovered, to April, 1992, when one representation was concluded. Even if the damages client was unable to find substitute counsel, there is no evidence that the law firm sought to ameliorate the conflict by withdrawing from the employment litigation. Thus for several months after discovering the impermissible conflict, the law firm continued to act for both clients.

Fourth, in representing the corporate client in the employment litigation the law firm obtained information protected by MRPC 1.6 which is relevant to the damages case; if there had not been a possibility that relevant information would be forthcoming, the law firm would not have recognized a need to establish screening. MRPC 1.9(c) states in part:

"(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents after consultation.

". . .

"(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

"(1) use information relating to the representation to the disadvantage of the former client except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client, or when the information has become generally known; or

"(2) reveal information relating to the representation except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client."

MRPC 1.9(c) prohibits the use or revelation of information concerning the corporate client which is protected by MRPC 1.6. The lawyer's duties of loyalty, communication and confidentiality are the underpinnings of conflict of interest prohibitions. When client interests are directly adverse, doing the best possible job for one will virtually ensure a less than equal performance on behalf of the other. When client interests are adverse, the opportunities to put to use information pertaining to one client for the benefit of another multiply, and conversely, efforts to protect confidences of one client will result in less than adequate communication with, or less than whole-hearted dedication to the interests of, another client. If the information is relevant to the damages case, then the two representations are "substantially related," and MRPC 1.9(a) prohibits the representation. RI-46; CI-1140; *Dewey v. R. J. Reynolds Tobacco Co*, 536 A2d 243 (1988).

We note that violations of ethics rules are within the jurisdiction of the Attorney Grievance Commission and do

not give rise to a cause of action for enforcement of the rules, MRPC 1.0(b). We also note that whether a lawyer may withdraw from a matter pending before a tribunal is a question for the adjudicator, MRPC 1.16(c); RI-97.

RI-373

May 8, 2015

SYLLABUS

Where a lawyer enters into a contingent-fee agreement with a client in a personal injury case—and charges the maximum one-third fee permitted by law—the lawyer may not ethically charge an additional contingent fee for resolving a related medical lien. Resolving a medical lien is part of the same "claim or action" as the underlying personal injury case under MRPC 1.5(c) and MCR 8.121 and is therefore covered by the original contingent fee.

References: MRPC 1.1; MRPC 1.4(b); MRPC 1.5(a), (c), & cmt.; MRPC 1.15(b)(3) & (c); MRPC 7.1(b); MCR 8.121; RI-11; RI-73; RI-114; RI-184; Illinois Opinion 97-08; NYCLA Ethics Opinion 739; Ohio Opinion 2009-9; *Reed v. Breton*, 279 Mich App 239 (2008); *Doucette v. Kwiatt*, 467 NE2d 1374 (Mass 1984); MCL 400.106(3), (4); 42 USC § 1395y(b)(2)(B)(ii); 42 CFR §§ 411.23, 411.24(g), & 411.37.

TEXT

A lawyer entered into a written contingent-fee agreement with a client in a personal injury case, providing that the lawyer would receive one-third of any net recoveries. During the litigation, the State of Michigan asserted a lien to recoup Medicaid payments that the State had paid toward the client's medical expenses. Those medical expenses—and thus the State's medical lien—resulted from the same injuries at issue in the personal injury case.

When the personal injury case settled, the lawyer took his one-third fee (calculated without deduction of the lien amount). The lawyer then deposited the remaining money into a trust account to be applied to the medical lien. The lawyer disbursed the rest of the money to the client.

The lawyer and the client then entered into a second contingent-fee agreement, in which the lawyer agreed to negotiate a reduction in the medical lien. This second contingent-fee agreement provided that the lawyer would receive one-third of any reduction in the lien amount. Soon after signing the agreement, the lawyer contacted the State of Michigan, which agreed to reduce the medical lien. The lawyer paid the reduced medical lien from the money held in the trust account, disbursed two-thirds of the remaining amount to the client, and deposited the remaining one-third—the lawyer's contingent fee—into an interest-bearing trust

account. The lawyer now asks whether he is ethically permitted to receive that additional one-third fee.

I.

The Michigan Rules of Professional Conduct prohibit a lawyer from charging a "clearly excessive fee." MRPC 1.5(a). The rules further specify that for a contingent-fee agreement "in any claim or action for personal injury," a fee that exceeds "one-third of the amount recovered" is "deemed to be the charging of a 'clearly excessive fee' in violation of MRPC 1.5(a)." MCR 8.121(A)–(C); MRPC 1.5(c) (cross-referencing MCR 8.121).

The lawyer's inquiry here turns on whether resolving the client's medical lien is part of the same "claim or action" as the underlying personal injury case. MCR 8.121(A). If it is, then the lawyer's two contingent fees would violate MCR 8.121, because the lawyer's total fees would exceed one-third of the net settlement amount, as illustrated, by example, in the calculations below:

Gross Settlement Amount	\$900,000
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Costs	<u>- 300,000</u>
Net Settlement Amount	\$600,000
Client's Share	<u>- 400,000</u>
Lawyer's Initial 1/3 Fee	\$200,000

Client's Share	\$400,000
Disbursed to Client	<u>- 300,000</u>
Held in Trust for Medical Lien	\$100,000
Payment to State for Reduced Lien	<u>- 60,000</u>
Savings to Client	\$ 40,000
Disbursed to Client	<u>- 26,666</u>
Lawyer's Second 1/3 Fee	\$ 13,333

Lawyer's Total Fees = \$213,333

On the other hand, if resolution of the medical lien is not part of the same "claim or action" as the personal injury case, then the two fees would satisfy MCR 8.121.

II.

The Committee believes that resolving the medical lien is part of the same "claim or action" as the personal injury case, thus prohibiting the lawyer from charging an additional fee to resolve the medical lien. The Committee reaches that conclusion for three reasons.

First, the traditional understanding has been that a lawyer's obligations in a personal injury case include the resolution of any related medical liens. As other jurisdictions have explained, "the resolution of liens on recoveries" has long been "considered a routine part of case management." NYCLA1 Ethics Opinion 739 (July 10, 2008). Resolving medical liens has, therefore, customarily "been included in the legal services performed by a personal injury attorney and covered by the contingency fee." Ohio Opinion 2009-9. For that reason, at least one state ethics body has prohibited the very type of fee arrangement contemplated here, refusing to permit an additional contingent fee to resolve a lien related to the underlying litigation. Illinois Opinion 97-08; *see also Doucette v. Kwiatt*, 467 NE2d 1374, 1376 (Mass 1984) ("In the normal course, in the absence of a special agreement on the point, discharge of unchallenged liens and other such claims against a tort claim is part of the services an attorney would perform in return for his contingent fee.").

Second, because a health insurer typically asserts its medical lien at the outset of any personal injury case, a lawyer cannot effectively represent the client without simultaneously accounting for the lien. As one court has explained, "the better time to discuss settlement of a claim with a lien holder or a subrogated insurer is before rather than after settlement of the tort action, because before settlement the lien holder or subrogated insurer will have to face the possibility of receiving no recovery at all." *Doucette*, 467 NE2d at 1377 n.5.

Contemporaneous negotiations with the lienholder may also benefit the client because the lienholder may be more cooperative—and thus more willing to negotiate—if kept apprised of the personal injury case while the

case is ongoing. A lawyer's failure to account for the lien during litigation could therefore result in harm to the client—solely because of the delay in negotiating with the lienholder. Further, if the medical lien is larger than the client's expected recovery from the personal injury case, it is difficult to imagine how a lawyer could ethically agree to go forward with the case without advising the client about the lien or taking the lien into account during litigation. See MRPC 1.1, 1.4(b), 7.1(b).

In many instances, the law requires the lawyer to work with the lienholder while litigating the personal injury case. When the lienholder is Medicaid or Medicare, for example, the lawyer must notify and cooperate with the lienholder so that the lienholder can assert its rights to any recovery. See MCL 400.106(3); 42 CFR § 411.23. The lawyer can be held personally liable for the client's medical expenses if the lawyer fails to ensure that the lien is paid. See MCL 400.106(4); 42 USC § 1395y(b)(2)(B)(ii); 42 CFR § 411.24(g); *see also* NYCLA Ethics Opinion 739 (July 10, 2008) (noting that the lawyer "faces . . . risks of liability associated with the lien resolution"). The Michigan Rules of Professional Conduct impose a similar obligation, requiring the lawyer to pay a valid third-party claim from the proceeds of a case before disbursing any remaining amounts to the client. MRPC 1.15(b)(3) and (c).

1 New York County Lawyers' Association

Moreover, after the personal injury litigation has concluded, a reduction in the medical lien often occurs automatically—with little additional effort from the lawyer. Medicare, for example, is required by regulation to subtract a patient's "procurement costs" from the medical lien amount where the patient is only able to pay the lien because of a judgment or settlement. 42 CFR § 411.37. It would be odd indeed if a lawyer were permitted to charge an additional fee—and exceed the one-third ceiling in MCR 8.121—for something that happened as a matter of course.

Third, in analogous circumstances, this Committee has construed a "claim or action" under MCR 8.121 to include similarly common or reasonably foreseeable components of the client's case. In RI-114, for instance, we held that a lawyer who was already charging a one-third contingent fee in a wrongful death case could not charge an additional fee for presenting the wrongful death proceeds to the probate court. In RI-184, we held that a lawyer's representation of a **bankruptcy** debtor under a contingent-fee arrangement encompassed a related adversary proceeding. And in R-11, we held that a lawyer could not charge an additional fee for pursuing an appeal if the lawyer was already charging the maximum one-third contingent fee for the underlying personal injury case. See also *Reed v. Breton*, 279 Mich App 239, 242–44 (2008) (citing R-11 with approval).

In contrast, we have opined that a lawyer may charge an additional fee where the client has retained the lawyer for a matter that is truly "new and different." RI-73. In RI-73, for example, we explained that the lawyer could ethically charge an additional fee for services such as "financial counseling, tax advice, or estate planning." RI-73. Each of those services, however, differs from a medical lien, because a medical lien integrally affects whether—and to what extent—the client receives any recovery or faces any additional litigation from the personal injury case. As the commentary to MRPC 1.5 explains, a lawyer may not enter into a fee agreement "whose terms might induce the lawyer improperly to curtail services for the client," such as where the agreement limits the lawyer's services "when it is foreseeable that more extensive services probably will be required." MRPC 1.5 cmt. A lawyer's failure to account for a medical lien creates precisely this problem—leaving the client with a foreseeable need for more extensive legal services that are intertwined with the underlying litigation.

In summary, where a lawyer enters into a contingent-fee agreement with a client in a personal injury case—

and charges the maximum one-third fee permitted by law—the lawyer may not ethically charge an additional contingent fee for resolving a related medical lien. Resolving a medical lien is part of the same "claim or action" as the underlying personal injury case under MRPC 1.5(c) and MCR 8.121 and is therefore covered by the original contingent fee.

PUTTING A PRICE ON PAIN:
11 U.S.C § 522(d)(11)(D) EXEMPTION PERSONAL INJURY PROCEEDS

By Anthony J. Miller

INTRODUCTION

“Size matters! The bigger the better! I hammer insurance companies!”

“When stingy insurance companies don’t pay up, I get meaner than a junkyard dog!”

“A free 15-minute call can get you compensation for your injuries! Call 1-800-VICTIM!”

“Get the money you deserve!”

Everyone has seen the commercials. Legions of lawyers are ready, willing, and able to fight to obtain just compensation for people that have been injured, whether by auto accident, slip-and-fall, or some form of egregious corporate misconduct. And these lawyers are not shy about promising big returns.

Notwithstanding the sometimes cringe-worthy television spots, these attorneys provide a much-needed service. An injury can cause serious, life-altering, or even fatal consequences. They will almost certainly cause an adverse economic impact. Without competent, aggressive, and knowledgeable assistance, the injured parties are unlikely to receive compensation rightly due to them, to offset the negative changes to their lives brought about by the injury. Consumer protection, personal injury, and insurance law, ostensibly designed to protect and compensate the injured, can be labyrinthian and frustrating.

Things get even more complicated when the injured party then files for bankruptcy. The bankruptcy raises new questions, most of which will be completely foreign to the debtor, and probably to their personal injury counsel. What happens to the claim now? Is it property of the estate? Who has authority to litigate the claim? Who has the authority to author and accept a settlement? What can the debtor exempt? And just what is the debtor’s role in all this?

PERSONAL INJURY CLAIMS AS PROPERTY OF THE ESTATE

A fundamental tenant of bankruptcy, the debtor’s bankruptcy estate casts a wide net, and consists of “all legal or equitable interests of the debtor in property as of the commencement of the case” (with limited exceptions not applicable to this discussion). 11 U.S.C. § 541(a)(1). While this provision is simple enough on its face, consider a situation where a *pre-petition* act gives rise to a debtor’s *post-petition* injury. Did the debtor hold an interest in the claim “as of the commencement of the case?”

This may not be an easy question for the bankruptcy practitioner to answer. State law generally governs the property rights of the debtor. “The ‘basic federal rule’ in bankruptcy is that state law governs the substance of claims, *Butner, supra*, at 57, Congress having ‘generally left the determination of property rights in the assets of a bankrupt’s estate to state law,’ 440 U.S. at 54 (footnote omitted).” *Raleigh v. Ill. Dep’t of Revenue*, 530 U.S. 15, 20, (2000). Debtor’s counsel may not be well-versed in the state-law particularities of personal injury litigation, may therefore find it wise to consult with a personal injury attorney, or someone more expert in the state-law particulars of debtor’s claim.

The 6th Circuit has provided some guidance. “First, pre-petition conduct or facts alone will not ‘root’ a claim in the past; there must be a pre-petition *violation*.” *Tyler v. DH Capital*

Mgmt., 736 F.3d 455, 462 (6th Cir. 2013) (emphasis added). See e.g., *In re Davis*, 589 B.R. 146 (Bankr. E.D. Tenn. 2018) (A faulty medical device was installed in the debtor's body pre-petition, but it did not begin to deteriorate and cause her injury until *after* her bankruptcy petition. The court held that the debtor's products liability claim was not property of the estate, as it was not "sufficiently rooted" in the debtor's pre-bankruptcy past).

This does not mean, however, that a cause of action is only property of the estate if the debtor *knew of* the injury at the time the case was filed: "Second, all causes of action that hypothetically could have been brought pre-petition are property of the estate. This is the case even if the debtor was unaware of the claim." *Tyler*, 736 F.3d at 462 (internal citations and quotation marks omitted).

While 11 U.S.C. § 541(a)(1) appears straightforward at first glance, its application can become tricky when dealing with causes of action that appear to straddle the petition date. Accurate determination of the date the claim accrued is essential to protection of the debtor's interests and proper administration of the debtor's bankruptcy estate.

TRUSTEE'S ADMINISTRATION OF PERSONAL INJURY CLAIMS

Assuming that the debtor's personal injury claim is property of the bankruptcy estate under 11 U.S.C. § 541(a)(1), the trustee will likely seek to administer the claim for the estate's benefit. To that end, the trustee will hire special counsel to assist in the matter (likely the same counsel that had consulted with or been employed by the debtor pre-petition).

Assuming the claim proceeds to litigation, the trustee must substitute in as the real party in interest to the claim. A real party in interest is "the person who is entitled to enforce the right asserted under the governing substantive law." *Certain Interested Underwriters at Lloyd's, London, Eng. v. Layne*, 26 F.3d 39, 43 (6th Cir. 1994). "[The] [b]ankruptcy trustee, as the representative of the estate, 11 U.S.C. § 323(a), is responsible for 'collect[ing] and reduc[ing] to money the property of the estate,' 11 U.S.C. § 704(a)(1), and has the capacity to sue and be sued, 11 U.S.C. § 323(b). Therefore, [the] bankruptcy trustee is the real party in interest in the present case, as she has the capacity to sue on behalf of the estate to recover the property of the estate." *Toledo v. CSX Transp., Inc.*, 2018 U.S. Dist. LEXIS 174265, at *12 (E.D. Tenn. Oct. 10, 2018).

The trustee, as the real party in interest to the claim, then necessarily controls the litigation and the major decisions involved, including potential settlements. This can be a peculiar situation. The debtor is the injured party and is almost certainly the most informed person concerning the facts relevant to the claim. The debtor may also retain a pecuniary interest in the claims' outcome, by virtue of any asserted exemptions, or the right to any surplus under 11 U.S.C. § 726. Given the sensitive and personal nature of injury claims, the debtor may feel a very strong personal connection to the justice or righteousness of their claim. However, the decision-making authority has now been given over to the trustee, whose motivations differ substantially from the debtor's. While a debtor in such a situation might be forgiven for feeling disinclined to help a trustee litigate the debtor's claim for the benefit of the debtor's creditors, the debtor is nevertheless required to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title." 11 U.S.C. § 521(a)(3). Failure to cooperate as required may result in adverse consequences, potentially including a complaint to deny the debtor's bankruptcy discharge.

EXEMPTIONS

The debtor may not find himself *completely* unmotivated to cooperate with the trustee, as the debtor may retain some financial interest by asserting that some or all of the claim is exempt.

11 U.S.C. § 522(d)(11)(D) permits a debtor to exempt “a payment, not to exceed \$27,900, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent.”

This statute also appears straightforward on its face, but it can run into problems in application. Finders of fact determining awards in personal injury actions do not typically make any allocation between (exempt) “personal bodily injury” and (non-exempt) “pain and suffering.” Settlement agreements concerning such claims are typically equally reticent concerning allocation. The Bankruptcy Code offers little guidance here, and courts have had to make seemingly arbitrary distinctions between the bodily injury and the associated pain and suffering:

The Bankruptcy Code provision regarding exemptions is clear in its intent. In the legislative history, it is stated that since the personal injury exemption mentioned in section 522(d)(11)(D) does not cover pain and suffering or compensation for actual pecuniary loss, the exemption is designed to cover only payments covering actual bodily injury, e.g., the loss of a limb. In other words, the only exemption available for a debtor in a bankruptcy proceeding is for the payment covering actual bodily injury.

Actual bodily injury or personal injury is not defined by the Bankruptcy Code. In one case, it was stated that injuries to a plaintiff's back, spine, neck, hips, pelvis, left leg and foot constituted personal injury. . . . The parties have agreed that [the debtor] suffered a bodily injury which was serious and in the absence of a clear definition under the Bankruptcy Code this court will accept that the injury was both personal and serious.

In re Territo, 32 B.R. 377, 381 (Bankr. E.D.N.Y. 1983) (internal citations omitted).

Though there appears to be no consensus on what constitutes a “personal bodily injury” as opposed to “pain and suffering,” most courts addressing the issue have agreed on one thing – the allocation is a question of fact. It therefore behooves a party asserting (or challenging) an § 522(d)(11)(D) exemption to not merely recite that the finder of fact or the settlement agreement failed to allocate the claim proceeds, but to offer *something* - some concrete evidence to tangibly demonstrate that the lawsuit or settlement proceeds are (or aren't) on account of “personal bodily injury.” See *In re Harris*, 1985 Bankr. LEXIS 5985 (Bankr. E.D. Wis. 1985) (objection to exemption overruled where no evidence was presented that indicated all or part of proceeds were awarded for pain and suffering, and thus not subject to exemption); *In re Russell*, 148 B.R. 564, (E.D. Ark. 1992) (exemption allowed where personal injury judgment does not differentiate among damages for wages, bodily injury, or pain and suffering, and there is no offered proof that judgment was for pain and suffering); *In re Territo*, 32 B.R. 377 (Bankr. E.D.N.Y. 1983) (even though claim had settled, bankruptcy court required further factfinding, as it was not clear from the settlement whether some or all of the settlement proceeds were on account of pain and suffering).

11 U.S.C. § 522(d)(11)(D) necessitates a fact-specific inquiry, particularly when a judgment or settlement agreement is silent on the matter. Parties attempting to litigate such exemption claims should be prepared with facts and evidence, (affidavits, doctor's reports, medical records, etc.) to offer as proof in support of their position.

TRUSTEE'S CONSIDERATIONS IN SETTLING CLAIMS

As discussed above, the trustee is the proper party in interest in post-petition litigation of pre-petition claims. The trustee is therefore the party who may negotiate settlement of such claims. Given the potential ambiguities in allocation of the claim between "personal bodily injury" and "pain and suffering," an assiduous trustee, aware that evidence concerning the allocation of the claim would be difficult for either side to obtain, might decide to draft a settlement agreement (or even a compromise order) stating that *all* of the settlement proceeds are allocated to pain and suffering. After all, (non-debtor) personal injury plaintiffs often make the same allocation, as "pain and suffering" compensation is not typically subject to federal income tax. Of course, a plaintiff who also happens to be a debtor in bankruptcy would object to such allocation, as it would circumvent their § 522(d)(11)(D) exemption claim. Would such debtor be bound by the trustee's unilaterally imposed allocation? On the other hand, if the debtor's Schedule C had asserted a § 522(d)(11)(D) exemption, and the trustee had failed to timely object, would the trustee be bound by the debtor's characterization of the claim?

As a practical matter, the issue would likely come to a head if and when the trustee seeks bankruptcy court approval of his settlement, which he must do pursuant to Fed. R. Bankr. P. 9019. For a settlement to be approved by the court, it must be "fair and equitable," and "[t]he court must weigh the conflicting interests of *all relevant parties*." *In re McInerney*, 499 B.R. 574, 581-83 (2013) (emphasis added). "All relevant parties must necessarily include the debtor, whose exemption claim is on the line. While one judge in this district has suggested that a debtor's exemption might not be curtailed - regardless of how the trustee drafts a settlement (*see In re Carlisle*, Case No. 21-48153), debtors should nevertheless closely monitor the language the trustee utilizes in any proposed settlement. The trustee's unilateral disregard for the "personal bodily injury" portion of the debtor's claim might mean that the proposed settlement is not "fair and equitable," as it concerns the debtor and the debtor's exemption. Has the trustee put forth evidence to demonstrate that the proceeds are solely (or even partly) on account of "pain and suffering" and not "personal bodily injury?" If not, an attentive debtor may be wise to object the proposed settlement. Of course, such debtor should be prepared to offer his own evidence concerning the nature of the claim, and mindful of the burden of proof under Fed. R. Bankr. P. 4003(c).

CONCLUSION

The intersection of bankruptcy and personal injury can lead to some unforeseen interactions. An injury may have seriously upended a debtor's life, possibly playing a role in the debtor's financial hardship and, directly or indirectly, precipitating the bankruptcy filing itself. Bankruptcy then necessarily adds another layer of complexity to the personal injury litigation. The bankruptcy administration of personal injury claims can be fraught with potential traps, for the

unwary trustee and debtor alike. All parties involved should be mindful of such issues, ready to take proper steps to protect and preserve their rights and interests.

Going For It All

(Debtor Keeps the Golden Egg)

By Charles J. Schneider

INTRODUCTION

You receive an electronic notice that the UST has filed an *Ex parte* motion to reopen a bankruptcy case you had filed in 1999. What's this all about? Apparently, this debtor had been watching TV when a commercial ran from a personal injury law firm that encouraged viewers to participate in a mega settlement fund created by Bayer/Monsanto if they have contracted Non-Hodgkin's Lymphoma and believe it may have been caused by their use of the Roundup product.

It is apparent that the law firm has done a national search on PACER and found that your debtor had previously filed a bankruptcy case. The personal injury law firm working on behalf of the debtor knows enough bankruptcy law to determine that they may not get paid without Bankruptcy Court approval and that they should be working for the Trustee to do so. There is, of course, always the question of a defense of judicial estoppel if lawsuit should later be filed by the law firm.

You know that it is unlikely that the debtor has received notice of the reopening of the case as they may have moved. Contacting either the UST or the chapter 7 Trustee for the debtor's address may be an option but unlikely to be fruitful as they are relying upon the address the debtor had when the case was open more than twenty years ago. However, it is very likely that the debtor's personal injury law firm is very likely to have the latest address as they are a current client for them.

My experience informs me that the personal injury law firm working for the debtor has not informed their client of the consequence of the prior filing of bankruptcy on their settlement, that they no longer work for the debtor, that they have jumped ship and are now working for their adversary, the Chapter 7 Trustee. Luckily, you are alive and still practicing bankruptcy law. The debtor's interest in the matter of the settlement money might otherwise be disregarded by the bankruptcy system. You should be aware that the debtor may have passed away and that you need someone with proper authority (such as letters of authority) to represent the debtor in the case even if you are the attorney of record. You file a motion to amend the schedules to list and fully exempt the Roundup claim by using any remaining (d)(5) exemption as well as (d) (11) (D) and (E). You then follow-up the motion to amend by filing a motion to compel abandonment as the asset is not property of the estate and/or wholly exempt. If you decide to go all in for the debtor, you may wish to consider the following when embarking on this course.

Can a Trustee administer assets of the estate when they have been fully exempted?

It has been stated in *Law v Siegel*, 571 US 415, 417-18; 134 S Ct 1188; 188 L Ed 2d 146, 150-51 (2014), that:

“Chapter 7 of the Bankruptcy Code gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors. 11 U. S. C. §§ 704(a)(1), 726, 727. The filing of a bankruptcy petition under Chapter 7 creates a bankruptcy "estate" generally comprising all of the debtor's property. § 541(a)(1). The estate is placed under the control of a trustee, who is responsible for managing liquidation of the estate's assets and distribution of the proceeds. § 704(a)(1). The Code authorizes the debtor to "exempt," however, certain kinds of property from the estate, enabling him to retain those assets post bankruptcy. §522(b)(1). Except in particular situations specified in the Code, exempt property "is not liable" for the payment of "any [prepetition] debt" or "any administrative expense." § 522(c), (k).”

It was decided in *In re Fontana*, BR ; 2015 Bankr LEXIS 3771, at *4 (Bankr WDNC, Nov. 4, 2015) that:

As for whether a Chapter 7 trustee may administer these otherwise exempt assets, the Bankruptcy Code directs trustees to "collect and reduce to money the property of the estate for which such trustee serves" 11 U.S.C. § 704(a)(1). "On the filing date of a bankruptcy case, property of the estate includes exempt property." *Quezada*, 368 B.R. at 48. However, "[w]hen a debtor exempts property, it is effectively removed from the estate." *Covington*, 368 B.R. at 40 (citing *In re Szekey*, 936 F.2d 897 (7th Cir. 1991)). **Therefore, upon the exemption claim and assuming the property is wholly exempt, the related property is no longer available for a Chapter 7 trustee to administer. Id. This result is consistent with the longstanding principle that Chapter 7 trustees are not to pursue claims for individual creditors. *In re Miller*, 197 B.R. 810, 814-15 (W.D.N.C. 1996).** For these reasons, the trustee's request to administer this otherwise exempt property for the benefit of individual creditors is denied. (Emphasis added)

Does the Debtor have a right to amend exemptions as a matter of course in a reopened case?

Federal Rule of Bankruptcy Procedure 1009

(a) General right to amend. A voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time **before the case is closed**. The debtor shall give notice of the amendment to the trustee and to any entity affected thereby. On motion of a party in interest, after notice and a hearing, the court may order any voluntary petition, list, schedule, or statement to be amended and the clerk shall give notice of the amendment to entities designated by the court.

It may be concluded by the Court that any amendment to the exemption schedule may require that it be accomplished by a motion rather than just amending the schedule as it implies that after the case is closed you do not have a right to amend as a matter of course. In the case of *Ellmann v Baker (In re Baker)*, 791 F3d 677, 683 (CA 6, 2015), the Court applied the Supreme Court decision, *Law v Siegel*, 571 US 415; 134 S Ct 1188; 188 L Ed 2d 146 (2014), which held that under *Siegel*, bankruptcy courts do not have authority to use their equitable powers to disallow exemptions or amendments to exemptions due to bad faith or misconduct. However, it is arguable that the *Siegel* opinion did not abrogate all existing limitations on the right of a debtor to make an amended claim of exemption in a re-opened case. *Siegel* can be distinguished as in that case the debtor had not amended his exemptions and the case had never been closed. He made the claim of exemption at the time that the case was filed and still open. It may follow that the standard set forth in the Sixth Circuit line of cases led by *Lucius v. McLemore*, 741 F.2d. 125 (61h Cir. 1984) are applicable to a previously closed case despite *Law v. Siegel*.

In any event, there is usually no such bad faith or misconduct in the reopening of bankruptcy cases to administer the Roundup claim as the case is being reopened by the UST not the debtor. The debtor appears only to defend the Roundup claim asset. The debtor usually does not know that he had a claim as the science of the claim had not been developed at the time the asset was discovered. The conclusion ought to be that there is no bad faith in amending the exemptions if a judge imposes such a condition to amending.

Use of exemptions to protect the Bayer/Mansanto Roundup claim under 11 USC § (d) (5), (d) (11) (D) and (E)

The objecting party bears the burden of proof.

In *In re Lebourdais*, ___BR___; 2014 Bankr LEXIS 1098, at *3 (Bankr ED Mich, Mar. 19, 2014), it is stated that in the case of a claim of an exemption under 11 U.S.C. § 522 (d)(11)(E) that the:

Trustee bears the burden of proof by a preponderance. *In re Stanley*, 494 B.R. 287, 289 (Bankr. E.D. Mich. 2013). An exemption should

be liberally construed in favor of the debtor and in light of the purpose for which it was created

A Trustee cannot, therefore, shift the burden of proof. The Trustee in the Roundup claim is already informed whether the Roundup claim is for a loss of future earnings as the settlement agreement is in the possession of the special counsel. It is a settlement agreement must be revealed if it is to be approved by this Court pursuant to Bankruptcy Rule 9019. If the settlement agreement contains a general release or waiver of all claims by the debtor especially for serious bodily injury or loss of future earnings, then it cannot just be compensation for “pain and suffering”.

What does “future earnings” mean?

Future” in 11 USCS § 522(d)(11)(E) is properly interpreted as looking forward from date of bankruptcy filing, not from some prior point in time, and hence “loss of future earnings” in § 522(d)(11)(E) is correctly interpreted as referring to lost earnings for post-petition periods and not for periods prior to filing of bankruptcy petition. *Jackson v. Novak (In re Jackson)*, Bankr. L. Rep. (CCH) ¶ 1676, 593 F.3d 171, Bankr. L. Rep. (CCH) P81676, 2010 U.S. App. LEXIS 1418 (2d Cir. 2010).

Although it is established that the debtor cannot claim a loss of future earnings that occurred prior to the filing of the bankruptcy case, if the case is reopened years after the filing of the case, the debtor may establish a loss of future earnings due to the personal injury prior to the reopening even if the debtor is now deceased. The loss of future earnings may have been income to the debtor that would have been necessary to both the debtor and dependents while he was living. The debtor’s death would remain a loss of a source of income to dependents.

The accrual standard based on the appearance of a personal injury

In *Hanawalt v Hardesty (In re Hanawalt)*, 627 BR 352, 364-65 (Bankr SD Ohio, 2017) a product liability case was brought against the manufacturers of a vaginal mesh that was implanted in the debtor prior to filing bankruptcy. Over time, the vaginal mesh implant eroded inside the Debtor’s body causing a personal bodily injury. The Court would rule that:

...a strict liability claim based on a defective product does not accrue until there is a "cognizable physical manifestation" of injury caused by the defect.

in order to recover on a theory of strict liability, the plaintiff must establish each of the following: "(1) that plaintiff was injured, (2) that the injury was caused by defendant's product, (3) that the injury occurred because defendant's product was defective, and (4) that the defect was present in the product when it was sold by defendant"). Yet, Whittaker repeatedly references *Hanawalt's* strict liability claim as though it might through some talismanic effect

establish that she suffered a prepetition injury. The flaw in this logic is clear: **Because defectiveness does not equal injury, Hanawalt's allegation that the TVM was defective at the time it was implanted is not tantamount to an assertion that she suffered an injury at that time.** Thus, it does not follow from Hanawalt's allegation that the TVM was defective at the time of implantation that she must have been asserting that she suffered an injury at that time or at any other time before the Petition Date—and thus holds a prepetition claim against the manufacturer.

In *In re Underhill*, 579 F App'x 480, 482 (CA 6, 2014), it was recognized that:

[p]re-petition conduct or facts alone will not 'root' a claim in the past; there must be a pre-petition violation." *Id.* at 462. That is, **a cause of action qualifies as bankruptcy estate property only if the claimant suffered a pre-petition injury.** See *id.*; *In re Witko*, 374 F.3d 1040, 1044 (11th Cir. 2004) (concluding that legal-malpractice claim belonged to the debtor because he "did not suffer any harm from the alleged legal malpractice prior to or contemporaneous with filing his bankruptcy petition"); *Cook v. Baca*, 512 F. App'x 810, 820 (10th Cir. 2013) ("Though . . . the alleged conspiracies involved property that was the subject of dispute between the parties prior to the bankruptcy filing, the alleged constitutional injuries did not exist prior to the filing."); *In re Pettibone Corp.*, 90 B.R. 918, 932 (Bankr. N.D. Ill. 1988) ("[I]f a tort claimant whose employer had purchased a defective product pre-petition is exposed only post-petition to that product and sustains bodily injury only after filing of the manufacturer's bankruptcy, the claimant's bankruptcy claim arises post-petition.").

In re Davis, 589 BR 146, 152 (Bankr ED Tenn, 2018) involved a product liability case against the manufacturers of a vaginal mesh implant. Over time, the vaginal mesh implant eroded inside the debtor's body causing a personal bodily injury. The Court stated:

Likewise, the debtor in this case credibly testified that she suffered **no adverse effects from or related to the mesh device until four years post-petition.** In fact, the parties stipulated that the debtor "experienced no obvious physical complications involving the mesh implantation before the petition date." (Stipulation of Certain Facts ¶ 9.) The trustee presented no expert testimony or other evidence — if such evidence even exists — that the debtor actually suffered any physical injury caused by the implant prior to the petition date. There is no evidence that erosion of the implant

began prepetition. In fact, while the debtor is entitled to participate in the settlement because she received the mesh implant, there is insufficient evidence that the urinary tract problems she experienced post-petition were even caused by the mesh implant.

The non-accrual standard where the personal injury has not yet appeared

In *In re Richards*, 249 BR 859, 861-62 (Bankr ED Mich, 2000), the Court decided that the debtor's asbestos injury claim was sufficiently rooted in the pre-bankruptcy past for the claim to be property of the bankruptcy estate. It appears to reject the accrual of a personal injury claim. The Court stated that:

All of the allegedly wrongful conduct giving rise to the debtor's claim occurred prepetition, and indeed more than twenty-five years prepetition. Further, although the diagnosis was made seven months after the petition was filed, that timing appears to have been more a result of happenstance than of medical necessity. It appears likely that both the onset of the debtor's disease and a greater portion of its progress occurred before he filed his petition. The debtor's prepetition asbestos exposure led directly and inevitably to the post-petition accrual of his claim. These facts tip the balance in favor of finding that the debtor's claim for asbestos injuries is property of the estate even though his diagnosis and therefore his legal ability to sue were post-petition.

Can the same be said of diagnosis that occurs a decade or more after the filing of the bankruptcy case. What about the injury component of the claim? Were there any symptoms arising prior to the filing to say whether there was an injury? Did the injury actually occur prepetition?

Tomaiolo v Rodolakis (In re Tomaiolo), ___F Supp 2d___; 2002 U.S. Dist. LEXIS 2038, at *9 (D Mass, Feb. 6, 2002) is a legal malpractice claim rejecting the notion that the claim must accrue prior to filing the bankruptcy case. The Court in *Tomaiolo* states that:

These conclusions are also supported by several recent decisions by other courts. See e.g., *Johnson v. Alvarez (In re Alvarez)*, 224 F.3d 1273, 1276 (11th Cir. 2000) (holding that the debtor's malpractice claim was "rooted in the pre-bankruptcy past"); *Wheeler v. Magdovitz (In re Wheeler)*, 137 F.3d 299, 301 (5th Cir. 1998) (when the debtor could easily tell that his attorneys were not properly filling out bankruptcy schedules, the debtor's malpractice claim is estate property); *In re Richards*, 249 B.R. 859, 861 (Bankr. E.D. Mich. 2000) ("in determining whether a claim is property of the bankruptcy estate, the test is not the date that the

claim accrues under state law [,] . . . the appropriate inquiry is whether the claim is 'sufficiently rooted in the prebankruptcy past'.")

THE FILING OF CLAIMS AS A CHAPTER 7 BANKRUPTCY TRUSTEE

By Samuel D. Sweet

Pursuant to Bankruptcy Rule 3004, a Bankruptcy Trustee is allowed to file Proofs of Claims for the Benefit of each creditor listed by the Debtor within thirty (30) days of the deadline to file such claims. These claims are considered protective claims and are based upon the Debtor's bankruptcy schedules. The debtor is sworn that the bankruptcy schedules are a true and accurate reflection of their financial condition.

The United States Trustee's office while promulgating a policy in the "Trustee's Handbook" specifically provides as follows:

If the trustee determines that the funds to be distributed exceed the filed claims and anticipated administrative expenses, the trustee may contact creditors who have not filed claims. While section 501(c) and Fed. R. Bankr. P. 3004 give the trustee the ability to file proofs of claim on behalf of creditors, the trustee should exercise caution in doing so. In contacting creditors or filing claims, the trustee should exercise caution to treat similarly situated creditors equally.

See Handbook for Chapter 7 Trustees, at Section 4.F.3. (pg. 4-27).

Further, the Trustee's signature on a Proof of Claim is subject to the same issues related to Bankruptcy Rule 9011. Reliance on the Debtor's bankruptcy schedules alone is not sufficient. As such the filing of Proofs of Claims for the benefit of creditors is at a minimum dicey.

Case law on this matter is sparse to say the least. One such opinion is identified *In re Davis*, 538 B.R. 368, (Bankr.S.D.Ohio 2015) in which the court specifically provided that in footnote 13 that trustee's should be cautious related to the filing of bankruptcy creditor claims given that the trustee would generally have no specific knowledge as to any of the specifics as to that creditors claim or the amounts thereof.

One can only imagine that if a trustee files a Proof of Claim should the Trustee object to his own filed Proof of Claim if he determines that perhaps the claim is not valid. The United States Trustee's office specifically provides that the Trustee should utilize his own business judgment in determining whether claims should be filed or whether action should be taken to assist these creditors in the filing of proofs of claims.

Unfortunately, a Trustee is paid based upon the distributions made to parties other than the Debtor. So as a result, if creditors don't file a Proof of Claim in cases the money is to be returned to the Debtor and a Trustee is not compensated pursuant to Section 326 and 330 of the Bankruptcy code. While as a Trustee this can certainly become tragic, unfortunately, I am not sure that the Trustee has any ability given the best practices enumerated by the United States Trustee's Office to correct this on cases that are substantially old and reopened.

REOPENING OF CASES PURSUANT TO §350(b) OF THE BANKRUPTCY CODE

Bankruptcy Cases are routinely reopened by the Court. Generally, they are reopened for the Debtor to list an omitted Creditor or for the Case Trustee to administer an asset not originally listed. *Stark v. St. Mary's Hospital (In re Stark)* 717 F.2d 322 (7th Cir. 1983), *Hawkins v. Landmark Finance Co.*, 727 F.2d 324 (4th Cir. 1984), *In re Madaj*, 149 F.3d 467 (6th Cir. 1998)

As a Case Trustee, I receive emails, phone calls and letters advising of potential assets. The first item of business is to determine whether the asset is property of the estate or not. To determine whether a potential asset is property of the estate, an analysis must be taken whether the asset is a "pre – petition" asset or grounded in the Debtors post-petition life. (See Sec 541 (a) of the Bankruptcy Code)

Upon a determination that the potential asset is property of the estate a Motion to Reopen may be filed under Sec 350(b) of the Bankruptcy Code and Bankruptcy Rules 2002 and 5010. After a review of the Code and Rules it is clear that a notice to Creditors or the Debtor is not required. Throughout my tenure as a Bankruptcy Trustee, I have reopened many cases and this is done by *ex-parte* motion and order.

Understand that reopening a case doesn't mean that assets that the Trustee claims to be assets constitute property of the estate, that would require further action by the Trustee, however, simply reopening the case allows a Trustee to pursue assets and make determinations relative to those assets as property of the estate.

Pursuant to Bankruptcy Rule 5010, the reopening of a case may be done by simple motion by the Debtor or other parties in interest pursuant to §350(b) of the Bankruptcy Code. The Bankruptcy Trustee originally appointed to the case is not reappointed unless the court determines that such a reappointment is required to protect the interest of both creditors and the Debtor.

As a result, no notice is required, although, in every reopened case that I have been a party to notice is always sent to both the Debtor and Debtor's counsel at their last known address.