

Waiver of Dual Representation Insufficient to Cure Conflict in Bankruptcy Court
In re Lewis Road, LLC, 2011 Bankr. LEXIS 4827, at *4–5 (Dec. 9, 2011)

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Recently, the Bankruptcy Court of the Eastern District of Virginia contemplated the limitations of waiver to cure a conflict between clients. *In re Lewis Road, LLC, 2011 Bankr. LEXIS 4827 (Dec. 9, 2011)*, presented a situation in which the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. A Creditor held a promissory note in the amount of \$500,000 that was secured by a second priority deed of trust in the Debtor's sole assets consisting of two adjoining parcels of real estate. The Debtor employed the defendant's law firm as counsel—consisting of the defendant lawyer-father and lawyer-son. In the defendant's application for court approval of their engagement as Debtor's counsel, the defendant firm indicated it had "connections with a creditor" and "[t]his conflict of interest has been waived and proposed counsel has no connections with any other party in interest."¹ However, the application failed to attach the required verified statement or any information about the identity, nature, or scope of its "connections" with any creditor or any information about the waiver of potential conflicts.

At a hearing seeking court approval of a sale involving the Debtor's real estate, the United States Trustee informed the Court that the defendant law firm represented not only the Debtor, but also the Creditor in the same bankruptcy matter. Specifically, the lawyer-son represented the Debtor, and the lawyer-father represented the Creditor. The lawyer-son explained that at the time of the petition filing, his father had not yet been engaged to represent the Creditor and there was no obligation to disclose the relationship because "everyone was working together to achieve a positive resolution to this matter."² Another creditor stated the defendant law firm represented that it had received an opinion from the Virginia State Bar permitting the joint representation with the consent of all parties involved, but no such opinion surfaced in the proceedings.

Although the Bankruptcy Court approved the sale and directed that the sales proceeds remaining after satisfaction of a senior claim be held in escrow, a hearing was scheduled for the Debtor to show cause why the Court should not appoint a Chapter 11 Trustee. The lawyer-son objected to the show cause hearing because the Bankruptcy Court had approved the prior sale, but the Court—disappointed that the lawyer son had not immediately withdrawn as counsel when the conflict surfaced—appointed a Trustee anyway.

The Trustee filed a Rule 60(b) motion because of the conflict created by the defendant firm's dual representation of the Debtor and Creditor, arguing that payment of fees and expenses previously awarded to the firm under a settlement agreement were substantially for legal services unrelated to the settlement. At an evidentiary hearing on this motion, the Trustee raised numerous concerns indicating a conflict created by dual representation, including the facts that the settlement award was for prepetition collection work to enforce the Debtor's obligation to the Creditor and the defendant lawyers reconstructed their time records to justify the settlement award. The Bankruptcy Court noted that although the "connections" cited in the original

¹ *In re Lewis Road, LLC, 2011 Bankr. LEXIS 4827, at *4–5 (Dec. 9, 2011)*.

² *Id.* at *10.

application were unknown at the time it was filed, the disclosures were woefully inadequate and “[t]his lack of proper disclosure alone warrants the firm’s disqualification from the case.”³

The Court stated, “While [11 U.S.C.] § 327(c) creates an exception to § 327(a) and does not require the automatic disqualification of a party ‘solely because of such person’s employment by or representation of a creditor,’ the party may still be disqualified if a creditor or the United States Trustee objects and the Court determines that the representation creates an actual conflict of interest.”⁴ Because the United States Trustee objected, the Court held that the representation created an actual conflict. The court was unpersuaded by the defendants’ attempt to justify its dual representation because both clients waived the conflict. However, this was not merely a “potential” conflict under the Virginia Rules of Professional Conduct⁵ because this representation involved the assertion of a claim by one client against another client represented by the lawyer in the same litigation or proceeding. Thus any waiver was completely ineffective. Further, even if this was subject to waiver, the Bankruptcy Court found the waiver was ineffective because it was not in writing with notice to all parties in interest and approved by the Bankruptcy Court. Thus, under § 328(c), as professionals serving the Debtor’s bankruptcy estate who were found to have a conflict of interest in violation of § 327, the defendant firm and lawyers were not entitled to compensation for their work.

Practice Note: With all the moving parts and players in bankruptcy, this case serves as a reminder that actual conflicts can happen easily. When they occur, however, counsel must first determine whether waiver is even appropriate for the type of conflict at hand or run the risk of undermining their own work, despite their best intentions.

³ *Id.* at *30.

⁴ *Id.*

⁵ Va. R. Prof. Conduct 1.7(b).