The Knotty Problem of Creeping Conflicts:
A Healthcare Plethora of Problems

Ethics Session

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The Healthcare Plethora of Problems

Bubba Hotep is a big-time executive in the hospital industry who has acquired 25 hospitals across the Midwest and Southeast. Bubba’s main company is Compliance Healthcare, a for-profit hospital company located in Nashville, Tennessee.

Each hospital is managed by Compliance, but Compliance does not own the hospitals. Instead, the real estate for each hospital is owned by a separate single purpose real estate entity (a “Propco”). Each Propco leases the real estate to a separate single purpose operating company (an “Opco”). There are 25 Propco’s, and 25 Opco’s. Each Opco contracts with Compliance for management services. All of the employees work for Compliance, and there are no separate employees at the Propco’s and Opco’s.

Bubba owns a controlling interest in Compliance, and has different levels of ownership in each of the Propco’s and Opco’s. The rest of the shares in Compliance and each of the Propco’s and Opco’s are owned by management-level employees at Compliance, some former employees of Compliance, and a number of outside private investors. The ownership varies from entity to entity, so that a majority of the investors in one company is not necessarily the same in the other companies. There is no holding company above Compliance, the Opco’s, or Propco’s; instead, they roll up into direct ownership by Bubba and numerous investors and investor-owned entities.

The Propco’s are financed by 9 different banks, with a few banks having pools of 3-4 hospitals, and several banks having only one property. Each bank has a lien on the pieces of real estate it financed, and in most cases, each bank also has a secured guaranty from the related Opco for that property, and an unsecured guaranty from Compliance. If the loan was against a pool of properties, then there is a single loan to all of the Propco’s in the pool, with a secured guaranty from all of the Opco’s operating those properties, and an unsecured guaranty from Compliance.

Some of the hospitals are profitable, but many are not and do not make enough cash to fund their operations. In other words, under Compliance’s management, the hospitals are not producing enough income for the Opco’s to fund their operations and to pay the rent owed to the Propco’s. Without the rent, many of the Propco’s are unable to pay the obligations to their lenders on time.

Bubba comes to you for help. Heller Financial has a loan against a pool of 4 hospitals (the “Heller Pool”) and is threatening to foreclose the 4 Propco’s. Market chatter is picking up, and it is possible that other banks will begin taking action on other pools as well. You decide to represent the Propco’s in the Heller Pool in a workout with Heller. After months of negotiation, the parties cannot reach agreement and the Propco’s have to file Chapter 11.
**Representing the PropCo’s:**

Question 1: Can you represent all of the Propco’s in that filing?

Question 2: Compliance is a current client of your firm -- does this prevent you from working for the Propco’s in the Chapter 11?

Question 3: The Propco’s do not have sufficient cash to pay retainers for your fees. Bubba offers to have the retainers funded by Compliance out of its cash collected from the operation of the 25 facilities. Is this a problem? What if Bubba agreed to pay you himself?

**Representing the OpCo’s:**

Question 4: Heller attempts to grab the cash located at the 4 Opco’s in the Heller Pool, and they need to file bankruptcy. Can you represent them as lead counsel in their bankruptcy filings? Can these cases be administratively consolidated?

**Representing a Separate Pool:**

Question 5: When news about the Compliance affiliate bankruptcies reaches Healthcare Business Credit Corp (“HBCC”), HBCC looks more closely at its own pool of 4 facilities (the “HBCC Pool”) and finds that the facilities have numerous covenant defaults. Bubba asks you to negotiate a forbearance deal on behalf of the PropCo’s in the HBCC Pool. Can you do it, and if so, are any disclosures necessary in the bankruptcy court?

Question 6: The negotiation with HBCC fails and Bubba asks you to file Chapter 11’s on behalf of the HBCC Pool Propco’s and Opco’s. Can you do this? If so, will they be administratively consolidated? Where is venue?

**Representing Compliance:**

Question 7: Both Heller and HBCC begin pursuing Compliance in state court, and Bubba asks you to file a Chapter 11 on behalf of Compliance. Can you do this? If so, will it be administratively consolidated? Where is venue?

Question 8: Would it make any difference if Compliance was also a partner in a partnership that owns part of some of the Heller or HBCC Propco’s?
**Lawyer Movement:**

Question 9: A group of 5 lawyers at the firm representing Heller in the bankruptcy cases moves to your firm. Does this prohibit you from continuing to represent the Compliance-related entities in their Chapter 11 cases? If not, what sort of disclosures do you need to make, and what do you need to do to protect against the conflict issue?

Question 10: One of the lawyers in the group never did any work for Heller on the Compliance-related bankruptcy cases. Can that lawyer work with you on behalf of the debtors in the Compliance cases? If so, what sort of waivers are required?

**Lender Acquisitions:**

Question 11: One of your firm’s largest clients, NCFE Bank, is acquired by Heller. Can you continue to represent the Compliance-related entities in their Chapter 11’s? What sort of disclosures do you need to make?

Question 12: What if, instead of being acquired by Heller, your client NCFE Bank actually acquired Heller instead. Can you continue to represent the Compliance-related entities in their Chapter 11’s? What sort of disclosures do you need to make?

Question 13: Would a Chinese-Wall cure the issue?

**Additional Affiliates:**

Question 14: Bubba asks you to file Chapter 11’s for additional Propco’s being chased by their lenders. You have previously represented some of these Propco’s in workout negotiations, and you’re still owed $75,000 for the work. Is this a problem, and if so, is it curable?

Question 15: In addition, a month ago your balance had been $150,000 for these Propco’s, and you had not received payment in 2 months, but these Propco’s caught up part of your balance with a late payment of $75,000. Is this a problem, and if so, are there ways to cure it?

**Financial Advisor Retention:**

Question 16: Prior to the bankruptcies, you brought in Corporate Revitalization Partners (“CRP”) to provide CRO services to the 25 Propco’s and Opco’s. Walter Sobchak, a senior partner at CRP, is serving as CRO, and you want to continue to use him and CRP in the bankruptcies. Can you retain him/CRP, and if so, how?

Question 17: In a deal with some of the banks, Bubba agrees to resign from management and to give a proxy to Walter Sobchak to vote Bubba’s interests in all of the entities, and he appoints Walter as the chairman of the board for the entities. Does this create a problem? What if some additional Opco’s and Propco’s later have to file bankruptcy -- can Walter serve as their CRO?
APPLICABLE AUTHORITIES

Case Law Bibliography

1) Inter-company conflicts:

Joint representation allowed (no per se rule against it due to cost burden):
- *In re 7677 East Berry Ave. Assocs., L.P.*, 419 B.R. 833, 842 (Bankr. D. Colo. 2009) (definition of “adverse interest”; court allows law firm to represent debtor partnership, bankrupt LLC that is general partner, and bankrupt holding company that holds 100% membership interest in the LLC; disinterestedness not lost from representations of other related entities controlled by the debtors’ principal)
- *In re Adelphia Communs. Corp.*, 342 B.R. 122, 128 (S.D.N.Y. 2006)(firm can represent multiple affiliated debtors; court adopts “wait and see” approach)
- *In re Int’l Oil Co.*, 427 F.2d 186, 198 (2d Cir. 1970) (same)
- *In re Sumner Regional Health Systems, Inc.*, Case No. 3:10-bk-04766 (Bankr. M.D. Tenn.)(US Trustee objection to representation of multiple debtors withdrawn following filing of motion proposing future substantive consolidation in connection with plan to be filed later)

Joint representation not allowed:
- *In re JMK Const. Group, Ltd.*, 441 B.R. 222, 230 (Bankr. S.D.N.Y. 2010)(whether representation of multiple-affiliated debtors creates impermissible conflict to be evaluated on a case-by-case basis; separate counsel needed because law firm not allowed to represent debtor, its principal and other related individuals in separate chapter 11 cases, due to contribution claims on pre-petition damages award and existence of intercompany claims)
- *In re Interwest Bus Equip, Inc.*, 23 F.3d 311 (10th Cir. 1994) (law firm not allowed joint representation of debtors due to actual conflict arising from intercompany claims and intercompany contracts)
- *In re W.F. Dev. Corp.*, 905 F.2d 883, 884 (5th Cir. 1990) (general and limited partners cannot be jointly represented; “[w]hen one attorney represents both limited and general partners in bankruptcy, there will always be a potential for conflict, and disqualification is proper”)
• *Quarles & Brady, LLP v. Maxfield (In re Jennings)*, 199 Fed. Appx. 845 (11th Cir. 2006) (law firm cannot serve as counsel to 11 affiliated debtors where one depleted assets despite another affiliate’s secured claim against those assets)

**Standard for evaluation:**
• *In re eToys, Inc.*, 331 B.R. 176, 189 (Bankr. D. Del. 2005) (adverse interest is “any 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”)
• *In re Grabill Corp.*, 113 B.R. 966, 970 (Bankr. N.D. Ill 1990) (duties to each estate and each estate’s creditors; “[c]ounsel for Chapter 11 debtor owes a fiduciary duty to the corporation or partnership as an entity and represents its interests, not those of its principals”)

2) **Payment source conflicts:**

**Fee payments from third-party determined under “totality of circumstances” test (majority view):**
• *See Waldron v. Adams & Reese, LLP (In re Am. Int’l Refinery, Inc.)*, 676 F.3d 455, 462-63 (5th Cir. 2012) (totality of circumstances; sanction, but not disqualification, for failure to disclose)

**Fee payments from non-debtor are prohibited and per se conflict (minority view):**

**Disqualification for failure to disclose:**
• *In re Glenn Elec. Sales Corp.*, 99 B.R. 596, 601-602 (D.N.J. 1988)(failure to disclose that affiliate of the debtor’s secured creditor paid counsel’s retainer)
• *In re Nashville Senior Living*, Case No. 08-07254 (Bankr. M.D. Tenn.)(disqualification opinion entered on docket in 2009) (disqualification of committee counsel for failure to disclose pre- and post-petition payments from certain committee members prior to committee formation)

3) **Lender and third-party conflicts:**

**Active litigation or large revenue client creates disqualifying conflict:**
• *In re Project Orange Assocs., LLC*, 431 B.R. 363, 367 (Bankr. S.D.N.Y. 2010)(DLA prohibiting from representing debtor because representing creditor against debtor in active litigation involving contract dispute; conflicts counsel not sufficient to cure)
• *In re Am. Print & Lithographers, Inc.*, 148 B.R. 862 (Bankr. N.D. Ill. 1992) (law firm cannot represent debtor where 10% of law firm’s yearly revenue is from secured creditor firm represents on unrelated matters)
• *In re Amdura Corp.*, 121 B.R. 862 (Bankr. D. Col. 1990) (conflict prohibiting ability to be adverse to primary creditor means disqualification despite potential for conflicts counsel)
• *In re Status Game Corp.*, 102 B.R. 19 (Bankr. D. Conn. 1989) (similar)
• *In re Git-N-Go, Inc.*, 321 B.R. 54 (Bankr. N.D. Okla. 2004) (debtor counsel disqualification where counsel represented major creditor and shareholder in the case and unable to be adverse)

**Representation of lender in unrelated matters generally does not create disqualifying conflict:**
• *In re Rockaway Bedding, Inc.*, 2007 WL 1461319 (Bankr. D.N.J. May 14, 2007) (no ongoing litigation so no conflict; matters unrelated, so only potential conflict)

4) **Pre-petition claim conflicts:**

**Pre-petition claim creates prohibition on engagement (majority rule):**
• *In re Pierce*, 8089 F.2d 1356, 1362-63 (8th Cir. 1987)

**Pre-petition claim does not disqualify from employment (minority rule, except in 327(e) representations):**

5) **Preference conflicts:**

• *In re Pillowtex, Inc.*, 304 F. 3d 246 (3d Cir. 2002) (potential preference is disqualifying conflict for Section 327(a) counsel unless counsel returns preference and waives unsecured claim)
• *Diamond Lumber, Inc. v. Unsecured Creditors’ Committee of Diamond Lumber, Inc. (In re Diamond Lumber, Inc.)*, 88 B.R. 773, 777 (N.D. Tex. 1988) (disqualification and partial disgorgement due to potential preferences and failure to disclose)
• *In re SBMC Healthcare*, 473 B.R. 871 (Bankr. S.D. Tex. 2012) (preference and pre-petition claim disqualify firm from acting as lead counsel, but can act as special counsel if waive claim against company while retaining against insider)
Statutes and Forms (with emphasis supplied)

The Bankruptcy Code:

11 USC § 327 – Employment of professional persons
(a) Except as otherwise provided in this section, the trustee, with the court’s approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee’s duties under this title.
(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.
(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person’s employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.
(e) 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.
(f) The trustee may not employ a person that has served as an examiner in the case.


(14) The term “disinterested person” means a person that—
(A) is not a creditor, an equity security holder, or an insider;
(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
I does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.
The ABA Model Rules:

Client-Lawyer Relationship

Rule 1.7 Conflict Of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.
Client-Lawyer Relationship

Rule 1.8 Conflict Of Interest: Current Clients: Specific Rules

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:
(1) the client gives informed consent;
(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

Client-Lawyer Relationship
Rule 1.9 Duties To Former Clients

(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 gives informed consent, confirmed in writing.
(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter;

unless the former client gives informed consent, confirmed in writing.

(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 these Rules 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 these Rules would permit or require with respect to a client.

Client-Lawyer Relationship
Rule 1.10 Imputation Of Conflicts Of Interest: General Rule

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless

(1) the prohibition is based on a personal interest of the disqualified lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm; or

(2) the prohibition is based upon Rule 1.9(a) or (b) and arises out of the disqualified lawyer’s association with a prior firm, and

(i) the disqualified lawyer is timely screened from any participation in the matter and is apportioned no part of the fee therefrom;

(ii) written notice is promptly given to any affected former client to enable the former client to ascertain compliance with the provisions of this Rule, which shall include a description of the screening procedures employed; a statement of the firm's and of the screened lawyer's compliance with these Rules; a statement that review may be available before a tribunal; and an agreement by the firm to respond promptly to any written inquiries or objections by the former client about the screening procedures; and
(iii) certifications of compliance with these Rules and with the screening procedures are provided to the former client by the screened lawyer and by a partner of the firm, at reasonable intervals upon the former client's written request and upon termination of the screening procedures.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(c) A disqualification prescribed by this rule may be waived by the affected client under the conditions stated in Rule 1.7.

(d) The disqualification of lawyers associated in a firm with former or current government lawyers is governed by Rule 1.11.
ORDER GRANTING DEBTOR(‘S)(S’) MOTION FOR AN ORDER [insert title]

Upon consideration of the Debtor(‘s)(s’) motion for an order [insert title] (the “Motion”) and any response(s) to the Motion, after due and proper notice of the motion was given and a hearing was held on the Motion, it is ORDERED that:

1. The Motion is GRANTED as modified herein.
2. The Debtor(s) is/are authorized to engage [insert name of temporary personnel firm] on the terms described in the Motion, subject to the following terms, which apply notwithstanding anything in the Motion or any exhibit(s) related thereto to the contrary:

   (a.) [Insert name of temporary personnel firm] and its affiliates shall not act in any other capacity (for example, and without limitation, as a financial advisor, claims agent/claims administrator, or investor/acquirer) in connection with the above-captioned cases.

   (b.) In the event the Debtor(s) seek(s) to have [insert name of temporary personnel firm] personnel assume executive officer positions that are different than the position(s) disclosed in the Motion, or to materially change the terms of the engagement by either (i) modifying the functions of personnel, (ii) adding new personnel, or (iii) altering or expanding the scope of the engagement, a motion to modify the retention shall be filed.
(c.) [Insert name of temporary personnel firm] shall file with the Court with copies to the United States Trustee (“U.S. Trustee”) and all official committees a report of staffing on the engagement for the previous month. Such report shall include the names and functions filled of the individuals assigned. All staffing shall be subject to review by the Court in the event an objection is filed.

(d.) No principal, employee or independent contractor of [insert name of temporary personnel firm] and its affiliates shall serve as a director of any of the above-captioned Debtor(s) during the pendency of the above-captioned cases.

(e.) [Insert name of temporary personnel firm] shall file with the Court, and provide notice to the UST and all official committees, reports of compensation earned and expenses incurred on a monthly basis. Such reports shall contain summary charts which describe the services provided, identify the compensation earned by each executive officer and staff employee provided, and itemize the expenses incurred. Time records shall (i) be appended to the reports, (ii) contain detailed time entries describing the task(s) performed, and (iii) be organized by project category. Where personnel are providing services at an hourly rate, the time entries shall identify the time spent completing each task in 1/10/hour increments and the corresponding charge (time multiplied by hourly rate) for each task; where personnel are providing services at a “flat” rate, the time entries shall be kept in hourly increments. All compensation shall be subject to review by the Court in the event an objection is filed.

(f.) Success fees, transaction fees, or other back-end fees shall be approved by the Court at the conclusion of the case on a reasonableness standard and are not being pre-approved by entry of this Order. No success fee,
transaction fee or back-end fee shall be sought upon conversion of the case, dismissal of the case for cause, or appointment of a trustee.

(g.) The Debtor(s) is/are permitted to indemnify those persons serving as executive officers on the same terms as provided to the Debtor(‘s)(s’) other officers and directors under the corporate bylaws and applicable state law, along with insurance coverage under the Debtor(‘s)(s’) D&O policy.

(h.) There shall be no indemnification of [insert name of temporary personnel firm] or its affiliates.

(i.) For a period of three years after the conclusion of the engagement, neither [insert name of temporary personnel firm] nor any of its affiliates shall make any investments in the Debtor(s) or the Reorganized Debtor(s).

(j.) [Insert name of temporary personnel firm] shall disclose any and all facts that may have a bearing on whether the firm, its affiliates, and/or any individuals working on the engagement hold or represent any interest adverse to the Debtor(s), its/their creditors, or other parties in interest. The obligation to disclose identified in this subparagraph is a continuing obligation.

BY THE COURT:

The Honorable [insert name]
United States Bankruptcy Judge