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† Articles Editor, University of Pennsylvania Law Review Volume 172; J.D. Candidate University of Pennsylvania Carey Law School, Class of 2024; B.A. Emory University, 2018. Thank you first and foremost to Professor Vincent Buccola for academic guidance and personal friendship. I also thank Professors David Skeel, David Hoffman, and Kate Shaw for their feedback on my draft and support throughout the drafting process. Most importantly, thank you to my close friends in the Articles Office: Kirsten Hanlon, Carolyn Hartwick, Brian Tracz, Anna Statz, and Miles Gray. It is an honor to be published alongside the scholarship we selected together.
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INTRODUCTION

MyTheresa was particularly valuable to its parent company Neiman Marcus (“Neiman”). As an online retailer, it was immune from the decline of brick-and-mortar luxury retail that plagued Neiman itself. As a result, Neiman, which had been purchased in October 2013 by the private-equity firm Ares Management (“Ares”), was in dire financial straits. Indeed, Ares could see the writing on the wall—Neiman was headed for insolvency. So, concerned with salvaging its historic investment, Ares turned to its go-to law firm, Kirkland and Ellis (“Kirkland”), for help. Kirkland identified MyTheresa as a potential source of value and, understandably, Ares wanted it. More specifically, Ares wanted to maintain control of MyTheresa regardless of the fate of Neiman. Kirkland, eager to please an important client, devised a clever corporate structure and executed a deal that moved MyTheresa, Neiman’s most valuable asset, from the retailer to an Ares-controlled subsidiary. Importantly, that subsidiary “had no obligation to service or repay any of Neiman’s $5 billion in debt.”

1 See Daniel B. Kamensky, The Rise of The Sponsor-in-Possession and Implications for Sponsor (mis)Behavior, 171 U. PA. L. REV. ONLINE (forthcoming 2023) (manuscript at 17) (on file with author) (“In 2014, a year after the acquisition, Neiman Marcus acquired the fast-growing luxury online retailer MyTheresa for $239 million (including earn-outs).”).
2 Id. at 17-18 (“The acquisition of MyTheresa . . . represented a shrewd hedge by Ares against the risk that Neiman Marcus would turn out to be just another brick-and-mortar retailer about to be rendered obsolete by the internet.”).
3 Id. at 22 (referencing internal emails between co-founders of Ares management predicting Neiman’s insolvency).
4 Id. at 18-19 (detailing deterioration of Neiman’s cash flows).
5 Id. at 38 (noting that Ares retained Kirkland for the redesignation transaction).
Shortly thereafter, in May of 2020, Neiman Marcus filed for Chapter 11 bankruptcy.\(^7\) At their side to usher Neiman through the process was none other than Kirkland,\(^8\) serving as attorney to the estate, or more specifically, to Neiman itself as the debtor in possession ("DIP").\(^9\) Upon filing its petition for Chapter 11 bankruptcy, the Neiman estate was created as a legal entity.\(^10\) All of Neiman’s assets became part of that estate which would, upon confirmation of a plan of reorganization, either be transferred to the surviving corporation or liquidated.\(^11\) But, before a plan is proposed or liquidation is considered, the DIP and its counsel, Kirkland, have a duty to marshal assets and maximize the value of the estate.\(^12\) The Bankruptcy Code ("Code") provides several mechanisms to fulfill that duty, including rejecting executory contracts,\(^13\) repossessing assets,\(^14\) avoiding unperfected security interests,\(^15\) voiding preferential transfers to favored creditors,\(^16\) and unwinding both actual and constructive fraudulent transfers.\(^17\)

Upon filing, creditors of the estate scrutinize pre-petition transfers of assets to determine if any could be considered "constructively fraudulent."\(^18\)

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\(^9\) The Bankruptcy Code, via Section 1107, "provides that a debtor in possession stands in the shoes of a trustee in every way." Patti Williams, Bankruptcy Code Section 327(a)—New Interpretation Forces Attorneys to Waive Fees or Wave Good-Bye to Clients, 53 MO. L. REV. 309, 309-10 (1988). The debtor in possession is the formerly solvent company now operating under judicial guidance. This structure permits the company to continue operating as a going concern (with the benefits of bankruptcy code protections) while restructuring its debt. See id.

\(^10\) See generally 11 U.S.C. § 541(a) (detailing the creation of an estate).

\(^11\) See generally id. § 1104(b) (noting that the confirmation of a plan vests all of the property of the estate in the debtor).


\(^13\) See id. § 543(a) ("[T]he trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.").

\(^14\) See id. § 542(a) ("[A]n entity . . . in custody . . . of property that the trustee may use, sell, or lease under section 363 of this title . . . shall deliver to the trustee . . . such property or the value of such property . . . .").

\(^15\) See id. § 544(a)(1) (detailing the rights of the trustee to avoid certain voidable transfers of property of the debtor).

\(^16\) See id. § 547(b) (outlining the right of the trustee to avoid any transfer of an interest of the debtor in certain property).

\(^17\) See id. §§ 548(a)(1)(A)-(B) (allowing the DIP to unwind both constructive and fraudulent transfers).

\(^18\) See id. § 548(a)(1)(B).
Any transfer can be unwound as constructively fraudulent if it took place on or within two years before the date of filing and if the debtor (i) received less than reasonably equivalent value in exchange, and (ii) was insolvent at the time of the transfer or was made insolvent as a result of the transfer. In the Neiman case, unsurprisingly, creditors zeroed in on the MyTheresa transaction. In their estimation, that transaction stripped significant value from Neiman just a few years before filing for bankruptcy and could be vulnerable to a fraudulent transfer claim. The investigation and if necessary, litigation, of that claim fell to the DIP and its counsel.

For Kirkland, finding itself in the driver seat of a major corporate restructuring was nothing new. In the world of corporate restructuring, Kirkland is king. So, in theory, creditors to the estate were in good hands, having retained the top of the top—the best attorneys that money can buy. But there was one problem. Kirkland was suffering from a serious conflict of interest—one that called into question their willingness to vigorously pursue redress for the potentially fraudulent transfer of MyTheresa.

Indeed, Kirkland’s conflict of interest was comically obvious. Kirkland had a legal and ethical obligation to try to unwind the MyTheresa transaction—the very transaction that Kirkland itself devised and facilitated. Not only did Kirkland have a responsibility to question the legality of a transaction it had consummated, but it also had a responsibility to work to strip a long-time and lucrative client, Ares, of a prized asset.

Creditors, cognizant of this conflict, objected to Kirkland’s appointment as counsel to the estate, requesting the judge deny Kirkland’s appointment, or at a minimum, prohibit the firm from participating in the investigation of the MyTheresa transaction. The creditors’ efforts were futile. The Bankruptcy judge, seemingly unfazed by the blatant conflict, approved Kirkland’s retention.

Kirkland’s conflict of interest in the Neiman case represents one of the more egregious examples of attorney conflicts of interest in bankruptcy. But

19 Id.
20 Kamensky, supra note 1, at 39-40 (providing an overview of the MyTheresa transaction during the bankruptcy proceeding).
21 Id.
23 What’s more, Kirkland advised both Neiman and Ares on that transaction. Kamensky, supra note 1, at 39-40 (“Not only had [Kirkland] structured the distribution of MyTheresa, but it had advised the Ares-led Board and operating company on the proprietary nature of the transaction.”).
24 Id.
25 Id.
that conflict and others like it are becoming increasingly likely due to the emergence of private equity as a dominant force in the American economy and, in particular, distressed investing.26 Furthermore, as private equity has grown in stature, its legal needs have exploded,27 and the country’s largest and most prestigious law firms eagerly filled the void. Consequently, law firms and private equity formed a symbiotic relationship. Each entity has grown in wealth and reputation with the assistance of the other. And yet, bankruptcy judges often refrain from scrutinizing that relationship.28 This Comment hypothesizes that judges refrain in part because they lack a cohesive understanding of the conflicts and their associated risks. The pages that follow constitute a modest attempt to bridge that gap. By highlighting the problem, categorizing the conflicts and risks, and pointing to key case law, this Comment serves as a jumping-off point for practitioners, judges, and scholars keen on restoring the ethical foundation of corporate restructuring.

Specifically, I define and examine three types of conflicts that have resulted from the dominance of private equity in Chapter 11. Type One conflicts occur where counsel to the estate is bound by the Code to attempt to unwind a transaction that they (or their firm) facilitated. Type Two conflicts exist where the firm, serving as counsel to the DIP, has a prior and significant relationship with a private equity investor of the company operating within Chapter 11. Finally, Type Three conflicts arise when a firm serves as counsel to a company and its private equity parent in the zone of insolvency.

For each of these types of conflicts I will do three things: First, I will provide a normative description of how the conflict arises and why the rise of private equity makes the conflict common and pervasive. Second, I will apply the relevant bankruptcy provisions and rules of professional conduct to the conflict situation. And third, I will examine relevant case law to provide judges with precedent to address the specific conflict of interest. Then, to conclude, I will provide three solutions for addressing attorney conflicts in Chapter 11.

26 See Vincent S.J. Buccola, Sponsor Control: A New Paradigm for Corporate Reorganization, 91 U. CHI. L. REV. 1, 21 (2023) (“Private equity sponsors now predominate as the owners of large, distressed businesses.”).
28 See, e.g., In re Neiman Marcus Grp., No. 20–35219 (Bankr. S.D. Tex. May 7, 2020) (holding that debtors were authorized to retain and employ Kirkland as their attorneys); In re Stearns Holdings, LLC, No. 19-12226 (Bankr. S.D.N.Y. Nov. 13, 2019) (rejecting objections to Skadden’s representation of the estate raised by the U.S. Trustee).
I. PRIVATE EQUITY’S CENTRAL ROLE IN INSOLVENCY

The dramatic rise of private equity has reshaped the American economy.29 Over a seven-year period between 2000 and 2017, the number of companies controlled by private equity sponsors increased nearly fivefold.30 What’s more, assets under management are set to reach 9.11 trillion by 2025, more than double the amount in 2020.31 The repercussions of private equity’s explosive growth on law and economics has not gone unnoticed. To be sure, the impact of coordinated, sophisticated funds of private money on the American financial system is as broad as the scholarship that examines it.32 That said, the private equity industry’s dominance is felt most acutely in distressed investing and bankruptcy.33

The relationship between private equity–owned companies and financial distress is, in large part, a function of industry practice and strategy. One specific mechanism, the leveraged buyout (LBO), is of particular

29 See William Magnuson, The Public Cost of Private Equity, 102 MINN. L. REV. 1847, 1852 (2018) (“The private equity industry has seen dramatic growth over the past decade. The number of active private equity firms has increased by 143% since 2000.”).
30 Buccola, supra note 26, at 21.
Private Equity, Conflicts, and Chapter 11

LBOs are commonly utilized by private equity funds and lead to increased use of Chapter 11 for private equity–backed portfolio companies. In short, an LBO is a mechanism whereby a private equity firm finances an acquisition by securing new debt against the target’s assets and making regular payments on the debt with the target’s future cash flows. This corporate finance maneuver leaves the target company with a debt-heavy capital structure that could, in some cases, reach into the ninety percent debt-to-equity ratio. As a result, from the outset, private equity–owned companies, purchased via LBOs, operate under significant financial strain.

The use of LBOs is even more popular during times of low interest rates, which has characterized most of the last decade. In fact, LBO volume reached nearly $1 trillion in dollar value in 2021, more than double the prior peak in the 2007-08 financial crisis. Viewed as a piece of the larger LBO market, private equity sponsor–backed leveraged loan issuances accounted for over sixty percent of the entire leveraged loan market every year since 2020. These leveraged loans are more likely to default because they make up a disproportionate amount of the riskiest tiers of high-yield debt. Unsurprisingly, in the second quarter of 2020, more than half of the companies that defaulted in the second quarter were owned by private equity firms.

36 Femino, supra note 34, at 1834.
37 Id.
38 See Rodriguez Valladares, supra note 35 (observing credit rating downgrades and defaults in private equity-owned companies).
41 Kamensky, supra note 1, at 7.
42 See Research Announcement: B3 Negative and Lower Corporate Ratings List Declines Again in Q1 2021, Supports Moderating Default Forecast, MOODY’S (Apr. 20, 2021), https://www.moodys.com/research/Moodys-B3-Negative-and-Lower-Corporate-Ratings-List-declines-again—PBC_1279162 [https://perma.cc/D8YE-FBS2] (demonstrating that approximately 70% of all companies rated B3 or lower in the second quarter of 2021 were owned by private equity).
43 Idzelis, supra note 33 (noting that more than half of the companies that defaulted in the second quarter of 2020 were owned by private equity firms).
This phenomenon and the increase of private equity's power in bankruptcy is itself a paradigm shift in the field.\textsuperscript{44} The traditional understanding of bankruptcy is that creditors' interests drove the proverbial bus.\textsuperscript{45} Those in the field will recall the phrase "Creditor-in-Possession," which was first introduced by practitioner Harvey Miller as a means to explain the dominant position of creditors in Chapter 11.\textsuperscript{46} This traditional understanding is being challenged. Most recently, Professor Vince Buccola concluded that the recent trends described herein reflect a new paradigm for corporate reorganization,\textsuperscript{47} because "[p]rivate equity sponsors now predominate as the owners of large, distressed businesses."\textsuperscript{48} Indeed, "[s]ince the global financial crisis, the share of companies on Moody's B3 Negative and Lower Corporate Ratings List owned by a private equity sponsor has increased by 25%."\textsuperscript{49} In total, approximately 70\% of those companies were sponsor owned.\textsuperscript{50}

In some ways, the fact that private equity has begun to dominate corporate restructuring is entirely foreseeable. Private equity firms invest in assets most others eschew, providing much-needed capital to salvageable yet risky businesses.\textsuperscript{51} The economic costs and benefits of this strategy are well outside the scope of this Comment, but for present purposes, it suffices to note that private equity firms now have a central and powerful role in Chapter 11 restructuring.

A. The Relevance of Attorney Conflicts Has Increased with the Power of Private Equity

Corporate legal practices in New York and Delaware have grown alongside private equity to meet its insatiable legal needs.\textsuperscript{52} The intimate relationship

\textsuperscript{44} See, Buccola, supra note 26, at 4 ("The central observation is that financial sponsors, not lenders, now frequently shape the path by which financially troubled companies resolve distress.").

\textsuperscript{45} See id. ("The lender-control paradigm thus joined theory with practice, and it has dominated scholarship and set the terms of policy debates ever since.").

\textsuperscript{46} See generally Harvey R. Miller & Shai Y. Waisman, The Creditor in Possession, BANKR. STRATEGIST, Nov. 2003.

\textsuperscript{47} Buccola, supra note 26.

\textsuperscript{48} Id. at 21.

\textsuperscript{49} Id.

\textsuperscript{50} Id.


that has evolved between the two industries is important yet straightforward. Private equity managers have strong working relationships with attorneys they trust, using select firms for due diligence, acquisitions, sales, mergers, and other corporate work, racking up significant bills in the process.\(^\text{53}\) In the case of an acquisition, the preferred law firm builds a relationship with the management team. Or, as is often the case, the private equity firm replaces old management with a new hand-picked group.\(^\text{54}\) In that case, the private equity firm’s preferred team of lawyers will come highly recommended and will have the opportunity to pitch the new management team on future work before any of its rivals.

From the law firm side, these relationships are a core part of the economic model. As Daniel Kamensky notes, “[p]rivate equity has become an important growth engine for law firms. Not only does the initial LBO assignment result in hefty M&A fees, but the subsequent corporate work for the newly acquired portfolio company can be extremely lucrative.”\(^\text{55}\) Indeed, portfolio companies will often opt to utilize outside counsel for the vast majority of their legal needs.\(^\text{56}\)

In sum, the incentives are strong on both sides for the portfolio company to utilize the same law firm as their private equity sponsors. It will come as no surprise, then, that it is common for portfolio companies to retain the same law firm as its private equity parent.\(^\text{57}\) In most cases, this practice is completely rational and beyond reproach. Indeed, in the ordinary course of business, the interests of the portfolio company and the private equity parent


\(^\text{54}\) See Dan Dunn, The Private Equity Sector Sees the Return of CEO Turnover, SLAYTON SEARCH PARTNERS (Aug. 2021), https://www.slaytonsearch.com/2021/08/ceo-turnover-private-equity-sector-2/ ("According to a 2018 survey by Alix Partners, 58% of private equity CEOs are replaced within two years of an investment. Over the lifetime of the private equity firm’s holding of a company, CEO turnover jumps up to 73%.").

\(^\text{55}\) Kamensky, supra note 1, at 36; cf. How Law Firms Can Capitalize on the Private Markets, PITCHBOOK: PITCHBOOK BLOG (Mar. 25, 2019), https://pitchbook.com/blog/how-law-firms-can-capitalize-on-the-private-markets ("In 2018 alone, more than 40,000 deals involving VC or PE financing, mergers or acquisitions took place in the United States.").

\(^\text{56}\) See Carrie Mandel, When Does a Private Equity Portfolio Company Need a General Counsel?, SPENCERSTUART (Mar. 2021), https://www.spencerstuart.com/research-and-insight/when-does-a-private-equity-portfolio-company-need-a-general-counsel ("It is important to understand that it is not unusual for lawyers to represent portfolio companies of their private equity clients.").

\(^\text{57}\) See Final Report of Examiner at 14, In re Caesars Ent. Operating Co., No. 15-1445 (Bankr. N.D. Ill. Mar. 15, 2016), ECF No. 3401 ("It is important to understand that it is not unusual for lawyers to represent portfolio companies of their private equity clients.").
are aligned. As such, attorneys can concurrently represent both entities without running afoul of the Code or Rules of Professional Conduct. But, in times of potential or realized financial distress, as scholars have noted, the fiduciary duties of the parent and its portfolio company diverge. In these instances, the attorney will face a conflict that, in Chapter 11, has the potential to systematically disadvantage creditors and distort foundational principles of bankruptcy.

And yet, attorneys are an oft-overlooked stakeholder in the operation of the Code. In the recent article “When Private Equity Firms Bankrupt Their Own Companies,” Brenden Ballou, special counsel at the Department of Justice Antitrust Division, describes how Sun Capital, private equity parent of the food chain Friendly’s, “demonstrated enormous skill in directing [Friendly’s] bankruptcy.” That is the wrong framing. Instead, a greater focus must be placed on the attorneys, those who have deep experience in restructuring and are often advising corporate strategy with Chapter 11 in mind.

Indeed, financial distress and corporate restructuring is a complex field and one in which the attorney plays an especially important role. The counsel for the estate oversees nearly every step of the restructuring and represents the DIP before the bankruptcy judge. Further, the bankruptcy bar is a small club and those who rise to prominence within it, especially debtor attorneys who occupy the upper echelon of the most elite firms, command great respect within the boardrooms and C-suites of distressed entities.

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58 See Danilo Scarlino, Zone of Insolvency, Directors’ Duties and Creditors’ Protection in U.S., 29 EUR. BUS. L. REV. 1, 2 (2018) (“Out of the zone of insolvency, the basic rule is that directors of a solvent corporation owe fiduciary duties exclusively to shareholders and that they do not owe such duties to creditors.”).


60 One of the most influential bankruptcy case books does not include a robust discussion of attorney conflicts under section 327. See generally DANIEL J. BUSSEL, DAVID A. SKEEL, JR. & MICHELLE M. HARNER, BANKRUPTCY (11th ed. 2021).


62 Stephen J. Lubben, The Chapter 11 Attorneys, 86 AM. BANKR. L.J. 447, 449 (2012) (“In the United States, however, corporate reorganization has long been an attorney-driven process . . . .”); Christopher M. Ashby, Comment, Bankruptcy Code Section 327(a) and Potential Conflicts of Interest—Always or Never Disqualifying, 29 HOUS. L. REV. 433, 435-36 (1992) (describing the complexity of bankruptcy and the need for experienced and competent counsel).

63 See id. (noting the central role attorneys play in Chapter 11 restructuring).
companies. Often, the management teams of those companies are more than willing to defer to expert attorneys who have handled dozens of restructurings both in and out of Chapter 11. As such, the incentives and conflicts faced by the bankruptcy attorneys are central to a modern understanding of sponsor-backed restructuring.

Notably, there is a growing acknowledgment that attorney conflicts are a problem within the context of private equity and Chapter 11. And yet, the ethical and legal duties of those attorneys have largely gone unstudied. Given private equity’s prominence in distressed finance markets, this is a surprising oversight that this Comment seeks to remedy.

II. CONSTRAINTS AND DUTIES OF RESTRUCTURING ATTORNEYS

Before examining specific conflicts that pervade modern Chapter 11 practices due to the rise of private equity, the relevant rules deserve a preliminary introduction. Bankruptcy practitioners are bound by both the rules of professional conduct and the Bankruptcy Code itself. Starting with the Code, section 327 provides that “the [DIP], with the court’s approval, may

64 See Strom, supra note 52 (highlighting the dominance of specific law firms in corporate restructuring and the law partners that are hired to build out competing practices).

65 See Lubben, supra note 62, at 449 (“The bankruptcy attorney—or at least some attorney—is the one professional a corporate debtor absolutely must retain, as there is no such thing as a ‘pro se’ corporate bankruptcy case. Because the American chapter 11 system is centered on the bankruptcy court, even nonlegal professionals must interact with the process through attorneys.”).

66 See, e.g., Kamensky, supra note 1, at 40-41 (“Bankruptcy courts routinely sidestep state law professional ethics requirements, finding that the Bankruptcy Code imposes different obligations on professionals even though they should both be presumably seeking to protect the client debtor-in-possession from the conflicting interests of its professionals.”).

67 There have been a few examinations of Section 327 but notably none address the unique challenges posed by private equity clients. See, e.g., Richard Lieb, The Section 327(a) “Disinterestedness” Requirement—Does a Prepetition Claim Disqualify an Attorney for Employment by a Debtor in Possession?, 5 AM. BANKR. INST. L. REV. 101, 102 (1997) (“The issue considered by this article is whether the disinterestedness requirement of section 327(a) applies to professionals employed by a DIP, or is limited to those employed by a trustee.”); Joseph D. Vaccaro & Marc R. Milano, Note, Section 327(a): A Statute in Conflict: A Proposed Solution to Conflicts of Interest in Bankruptcy, 5 AM. BANKR. INST. L. REV. 237, 240-41 (1997) (discussing the current state of law in conflicts in section 327(a) but not mentioning private equity); Alexander G. Benisatto & Alyson M. Fiedler, Note, The Disinterested Standard of Section 327(a): Applying an Equitable Solution for Potential Conflicts in Small Bankruptcies, 7 AM. BANKR. INST. L. REV. 363, 363 (1999) (providing an overview of the ethical statutory framework of the Bankruptcy Code and the impact of the rules of Professional Responsibility); Ashby, supra note 62, at 436 (“[T]he Code’s employment criteria fail to provide bankruptcy judges with the guidance necessary to effectively deal with the employment of counsel in reorganization cases.”); Williams, supra note 9, at 309 (discussing how the Code has the potential to create conflicts of interest to prevent recovery of attorney fees); Karen J. Brothers, Comment, Disagreement Among the Districts: Why Section 327(a) of the Bankruptcy Code Needs Help, 138 U. PA. L. REV. 1733, 1735 (1990) (discussing controversies in sections of the Code, including the employment of attorneys).
employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the [DIP] in carrying out the [DIP’s] duties.” Turning to section 101(14) of the Code, the term “disinterested person” is defined as:

[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 (C) 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.

In short, attorneys cannot hold or represent an interest adverse to the estate and must be disinterested.

The combination of Section 327 and the definition provided in Section 101 focuses the conflict inquiry on the interests of the estate. Specifically, when professionals “hold or represent an interest adverse to the estate,” they cannot be retained. The two references to the disinterested standard, in Sections 327 and 101, are formally distinct but in reality collapse into a single test of attorney disinterestedness. Because the interest of the estate is to maximize its assets and reorganize in a manner that is acceptable to the creditors, no attorney can be retained who holds or represents interests contrary to that goal.

Additionally, like all attorneys, bankruptcy attorneys are constrained by the Rules of Professional Conduct in their jurisdiction. While each state may have slightly different rules or interpretations, they often closely track the Model Rules of Professional Conduct. Model Rule 1.7 provides that “a

69 Id. § 101(14).
70 In re Boy Scouts of Am., 35 F.4th 149, 158 (3d Cir. 2022) (noting that Section 327’s “purview is focused primarily on the interests of the estate”).
71 11 U.S.C. § 327(a) (emphasis added); see also id. § 101(14) (defining disinterested persons in part as lacking “interest materially adverse to the interest of the estate”).
72 See In re BH & P Inc., 949 F.2d 1300, 1314 (3d Cir. 1991) (“There is, indisputably, some overlap between the section 327(a) standard and section 101(14)(C) disinterest requirement.”); 1 COLLIER ON BANKRUPTCY ¶ 8.03(9) (16th ed. 2022) (“These two tests invoke the same consideration of whether the professional holds or represents an adverse interest to the interests of the debtor and its estate.”).
73 See Lieb, supra note 67, at 121 (“Bankruptcy courts have held that state codes setting forth ethical duties and rules of professional ethics apply in bankruptcy cases, and are relevant to attorney disqualification issues.”).
74 Vaccaro & Milano, supra note 67, at 244 (“Today, lawyers are subject to the applicable rules of professional ethics in their respective states. These are either based upon the Model Code or the Model Rules.”).
lawyer shall not represent a client if the representation involves a concurrent conflict of interest.” A concurrent conflict exists if the representation of one client is adverse to another client or, importantly, if there is a significant risk that the representation of the client will be materially limited by the lawyer’s responsibilities to another client, a former client, a third person, or by a personal interest of the lawyer. But even in the face of a concurrent conflict, the Rules of Professional Conduct provide a mechanism to permit the representation. First, the lawyer must reasonably believe that they can provide competent and diligent representation, and second, the attorney must receive informed and written consent from each client who may be adversely impacted.

III. THE THREE TYPES OF ATTORNEY CONFLICTS

Having defined the main rules governing attorney retention in Chapter 11, I will now turn to the three types of conflicts discussed within this Comment. First is a Type One conflict. A Type One conflict occurs when a firm represents its private equity client on a pre-petition transaction that could be attacked under the Code as a fraudulent transfer and then goes on to represent the estate. If a Type One conflict arises, the bankruptcy judge should disqualify the firm from representing the estate.

The second type of attorney conflict examined herein is a Type Two conflict. Type Two conflicts undermine the faithful execution of an attorney’s duties and occur when an attorney and/or the attorney’s firm has a longstanding and substantial relationship with a private equity client while simultaneously representing that private equity client’s portfolio company in a Chapter 11 bankruptcy. These conflicts are likely the most contentious because it is commonplace for the same firm to represent the debtor and its private equity parent. In these instances, the firm may not have advised a transaction that deserves scrutiny under Chapter 11, but it nonetheless operates with a conflict of interest that favors the private equity parent. Importantly, in these cases, the determination of whether the conflict is sufficient to bar an attorney is a question of fact for the bankruptcy judge.

Finally, the third type of conflict is a Type Three conflict that occurs within the zone of insolvency, completely outside of Chapter 11. These

75 MODEL RULES OF PROF’L CONDUCT r. 1.7(a) (AM. BAR ASS’N 2023).
76 Id.
77 MODEL RULES OF PROF’L CONDUCT r. 1.7(b) (AM. BAR. ASS’N 2023).
78 Id.
79 Final Report of Examiner, Richard J. Davis at 14, In re Caesars Ent. Operating Co., No. 15-1445, (Bankr. N.D. Ill. Mar. 15, 2016), ECF No. 3401 (“It is important to understand that it is not unusual for lawyers to represent portfolio companies of their private equity clients.”).
conflicts arise when a principal company is close to insolvency or, in some cases, insolvent but not bankrupt. These situations present serious conflicts of interest for attorneys who advise private equity firms and their portfolio companies.

Each of these three types of conflict rests on different normative and doctrinal grounds. The goal of this Comment is to provide practitioners, judges, and scholars with a common understanding of the types of conflicts, their impacts, and the arguments that can be brought forth to require more aggressive judicial control of attorney conflicts in bankruptcy litigation. Thereafter, this Comment will propose modest recommendations to address this novel issue.

A. Type One and Type Two Conflicts

Type One and Type Two conflicts are introduced and discussed together because the doctrinal and normative arguments underlying each type of conflict are substantially the same. As a brief reminder, Type One conflicts exist where the attorney for the debtor also represented the debtor’s private equity parent on a transaction under judicial scrutiny in Chapter 11. These conflicts are particularly pernicious to the proper functioning of Chapter 11 because one of the fundamental roles of the attorney for the estate is to maximize the assets of the estate by unwinding unscrupulous transactions.80 When the firm tasked with pursuing fraudulent transfer litigation also executed the challenged transaction, they face a clear conflict and are not disinterested.

One would think that proposition would not engender much debate. But in the case of Kirkland and Neiman Marcus, the judge rejected a creditor challenge to Kirkland’s retention “without even holding a hearing.”81 This result is surprising given the Code requires that counsel to the debtor be a disinterested party.82 Normatively, Kirkland had an interest in the MyTheresa transaction—they facilitated it for one of their most important clients.83 And yet, the judge allowed Kirkland to represent the estate.84 While the judge in that case did not issue a formal opinion and provided no reasoning for his decision,85 a misinterpretation of the disinterested standard,  

80 11 U.S.C. § 547(b).
81 Kamensky, supra note 1, at 45.
82 See 11 U.S.C. § 327(a) (“[T]he trustee, with the court’s approval, may employ one or more attorneys . . . that are disinterested persons.”).
83 Kamensky, supra note 1, at 39 (“Not only had the law firm structured the distribution of MyTheresa, but it had advised the Ares-led Board and operating company on the proprietary nature of the transaction.”).
84 Id. at 45.
85 Id.
discussed throughout this section, could be to blame for such a blatant oversight.

Type Two conflicts, on the other hand, occur when the counsel for the
debtor has a significant, pre-existing relationship with a private equity
sponsor. Type Two conflicts are distinguished from Type One conflicts
because the attorney, while arguably conflicted, has not represented the
parent company on any transaction under judicial scrutiny at the time of
filing. Nonetheless, law firms with preexisting relationships with major equity
holders that serve as the attorney to the estate can tilt the restructuring
process in favor of their equity clients.

To illustrate a Type Two conflict, consider the following hypothetical:
Attorney A is a prominent M&A partner at the Bloom law
firm. Attorney B
is an equally prominent restructuring partner at the same
firm. Both Attorney
A and B have built a strong and lucrative relationship with the private equity
firm Hourglass. Both Attorney A and B have seen their annual bonus increase
and firm stature rise due to the expanding business from Hourglass. Attorney
A receives significant deal flow from Hourglass, as well as standard corporate
work from its portfolio companies. Additionally, due to Hourglass’s
aggressive recapitalization and LBO strategies, many of its portfolio
companies operate in and around insolvency. So, they often turn to Attorney
B to advise both Hourglass and its portfolio company. Then, when it becomes
clear that a portfolio company is headed for Chapter 11, Attorney B signs an
engagement with the portfolio company, Hourglass retains separate counsel,
and the portfolio company files for Chapter 11. The portfolio company is now
operating as a DIP within Chapter 11 and requests that the court approve
Attorney B to serve as its counsel. Again, like Type One conflicts, Attorney
B normatively faces a conflict. Indeed, one of the major stakeholders in the
corporate restructuring is an important and lucrative firm client—one that
Attorney B (and Attorney A) would loathe to upset or disappoint by pursuing
a restructuring adverse to its interest (even if it were in the best interest of
the estate).

The Type Two hypothetical is no fantasy. With big law firms
simultaneously building out prominent M&A, corporate, and restructuring
groups to become one-stop shops, these particular conflicts are of real-world
import. For example, in 2019, the United States Trustee objected to
Skadden, Arps, Slate, Meagher & Flom LLP (“Skadden”) serving as counsel

Towards the Second Half of the Year, THOMSON REUTERS (July 17 2023),
[https://perma.cc/q9MP-8U4S] (discussing how law firms expand across different practices to
navigate changing economies).
to Stearns Lending while in Chapter 11 based on Skadden's relationship with Stearns' private equity parent Blackstone and concerns that the Skadden attorney would improperly favor Blackstone's interests.\(^87\) Skadden vehemently denied any conflicts and asserted it could proceed in the best interest of the estate.\(^88\) Ultimately, the judge agreed, certifying Skadden as attorney for the estate.\(^89\)

Skadden is not the only firm with deep ties to private equity that may color their representations in Chapter 11. Paul, Weiss, Rifkind, Wharton & Garrison LLP ("Paul Weiss") receives over $100 million of annual legal work from private equity client Apollo stemming from nearly 100 mergers and acquisitions,\(^90\) and presumably rakes in several millions more from representing portfolio companies on standard corporate matters and in Chapter 11 restructurings. Chairman Brad Karp described Apollo as a "longtime, valued client."\(^91\) Indeed, the relationship is so close between Apollo and Paul Weiss that one attorney noted that as a "parasite takes over its host, [Apollo] changed the whole culture of the corporate department."\(^92\)

So, the question becomes, if an Apollo-owned portfolio company goes into Chapter 11, can Paul Weiss truly be a disinterested representative for the estate? To bring the hypothetical into the real world, in 2022, when Paul Weiss represented Lumileds Holding BV in its prepackaged restructuring, did Paul Weiss favor the desires of Apollo, the majority owner of Lumileds?\(^93\)

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87 Andrew Scurria, *Stearns Lawyers Defeat Bankruptcy Watchdog’s Conflict Claims*, WALL ST. J. (July 31, 2019, 6:46 PM), https://www.wsj.com/articles/stearns-lawyers-defeat-bankruptcy-watchdogs-conflict-claims-1156461385 [https://perma.cc/69FK-8KXY] ("The U.S. Trustee's Office said Blackstone's business relationship with Skadden raised questions about whether the firm could be counted on to act in the best interest of its bankruptcy client, Stearns. The argument was that Skadden would engineer a sweetheart deal to deliver the business to Blackstone.").

88 Id. Skadden partner Jay M. Goftman said the suggestion that he or his firm was conflicted was "an insult to our independent directors, it's an insult to my firm, it's an insult to me." Id. Judge Shelley Chapman "rejected allegations that Skadden . . . wasn't fit to represent Stearns because of the law firm's work for Blackstone Group Inc. . . . Blackstone didn't provide Skadden with enough business—less than 1% of the firm's revenue—to raise questions about potential bias." Id.

89 Id.


91 Id. ("Apollo had directed over $100 million of annual legal work to Paul Weiss . . . . The relationship has pumped up the law firm's sizeable earnings . . . . leading to nearly 100 mergers and acquisitions in which Paul Weiss advised Apollo and its affiliates.").

92 Id.

Similarly, did Kirkland provide disinterested counsel to Avaya, a technology company that emerged from Chapter 11 under the control of Apollo, one of Kirkland’s most important private equity clients? In one sense, conflicts of interest are common in the legal arena and attorneys can presumably navigate them. But on the other, when legal fees from private equity clients are in the hundreds of millions per year and careers are on the line, the pressure can tilt the playing field. At a minimum, judicial scrutiny is prudent.

What’s more, the revolving door between private equity and corporate law is alive and well, raising further questions about conflicts. Apollo hired Sullivan & Cromwell partner Witney Chatterjee to be the firm’s chief legal officer, and Blackstone added Reginald Brown, a Washington-based Kirkland litigation partner, to its board in September of 2020. Most recently, Judge Robert Drain, who oversaw the controversial Purdue Pharma bankruptcy, joined Skadden’s restructuring practice.

Keith Wetmore, the former chair of Morrison & Foerster, summarized it bluntly: Law firms are willing to “crawl over burning glass” to land business with large private equity firms. If major U.S. law firms are willing to crawl over burning glass to appease private equity firms, it is certainly fair to question their willingness to unapologetically pursue the interests of the DIP in the face of a Type Two conflict.

To appropriately govern Type One and Type Two conflicts, judges should view the relationship between the firm and the private equity client holistically and apply both Section 327 and the Rules of Professional Conduct. Section 327, understood with reference to the definition of a disinterested person, bars anyone with an interest adverse to the estate from serving as attorney to the debtor.


98 Sullivan, supra note 90.

99 Id.
counsel to the estate or DIP. How one understands the term “interests” and how that term is applied in the bankruptcy context is the key to applying Section 327. Where “interests” are understood solely in economic terms and exclusively in relation to the estate itself (rather than any relevant stakeholder), law firms cannot be barred unless they themselves hold a financial interest in the estate as a creditor or equity holder or the firm represents such an entity in the bankruptcy proceeding itself (as opposed to in other matters current or past). In this way, the narrow view of Section 327 requires a finding of an “actual conflict of interest” described as “an active competition between two interests, in which one interest can only be served at the expense of the other.” Notably, an estate-specific financial-interest-only reading of Section 327 finds support in case law, and certainly, this interpretation can be rationalized. The estate is a legal entity created at the filing. It is nothing but a proverbial pile of quantifiable assets. So, to have an interest adverse to a quantifiable estate would be to have an interest in diminishing the size or value of that estate. In the context of bankruptcy, that only applies to a creditor or an equity holder—one that has a legal claim to a portion of the assets. Neither Type One nor Type Two conflicts are barred under this reading.

To illustrate this point, at the time of Neiman’s filing, Kirkland did not have any outstanding claims in the estate nor was it an equity holder in Neiman. Further, at the time of the bankruptcy, Kirkland was not representing Ares in the bankruptcy, nor was it representing any other party with a financial interest in the estate. Kirkland was only representing one

100 11 U.S.C. § 327(a).
102 In re Marvel Ent. Grp., Inc., 140 F.3d 463, 476 (3d Cir. 1998) (“A plain reading of [Section 327(a)] suggests that one is a ‘disinterested person’ only if he has no interest that is materially adverse to a party in interest in the bankruptcy.”) (emphasis added); In re O’Connor, 52 Bankr. 892, 897 (Bankr. W.D. Okla. 1985) (“Disqualification should be mandated when an actual, as opposed to hypothetical or theoretical, conflict is present. This in no way precludes disqualification for a potential conflict.”); Ashby, supra note 62, at 441 (“Other courts have taken a more permissive view, interpreting this language to prohibit only actual conflicts of interest.”).
104 Id. (establishing that an estate is a legal construct comprised of the assets available that the DIP has the right to manage and will be distributed as part of the plan).
105 See generally 11 U.S.C. § 101(10) (“(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor; (B) entity that has a claim against the estate of a kind specified in . . . this title; or (C) entity that has a community claim.”); 11 U.S.C. § 101(7) (“The term ‘equity security holder’ means holder of an equity security of the debtor.”).
106 See Debtors’ Opposition to Marble Ridge’s Expedited Examiner Motion at 21, In re Neiman Marcus Grp., No. 20–35219 (Bankr. S.D. Tex. May 7, 2020), ECF. No. 591 (dismissing Marble Ridge’s allegations of Kirkland & Ellis’ potential conflicts as “replete with factual inaccuracies and mischaracterizations”).
107 Id. at 22.
entity—the debtor estate. So, a traditional reading of Section 327 would not bar Kirkland’s retention.108 Similarly, looking to Type Two conflicts, a narrow reading would not bar Attorney B from representing the Hourglass portfolio company in Chapter 11 notwithstanding the Bloom firm’s deep relationship with Hourglass. Indeed, Attorney B is not a creditor, only represents the DIP, and does not represent any institution with a financial interest in the estate.

Because the Code was drafted at a time when bankruptcies were handled by specialist law firms that solely did restructuring,109 Section 327 neither contemplated the impact of major law firms cross-selling legal services nor the dominant position of private equity in corporate distress cases. Accordingly, a strict reading of Section 327 does not encompass Type One or Type Two Conflicts. This outcome, however, defies logic and the intent of the Code.110 In Type One conflicts, there is a clear conflict where the attorney for the estate must litigate a transaction consummated by its own firm. In Type Two conflicts, the private equity parent has its own priorities and preferences for the reorganization and also maintains a deep relationship with the attorney advising the portfolio company’s Chapter 11 strategy.

Further, limiting the breadth of the disinterested standard contravenes the intent of the Code insofar as attorneys operating under conflicts are unable to zealously represent the DIP.111 These conflicts, if unchecked, could improperly limit the size of the estate (by not pursuing fraudulent transfers) or facilitate an outcome that is not in the best interest of the estate or its creditors. Instead, judges and practitioners should read Section 327 with deference to the overall goals of Chapter 11: first to maximize the estate, and second to facilitate a creditor-approved restructuring that maintains the existence of the corporation. To effectively achieve that goal, lawyers must not be burdened by personal or firm conflicts that could prompt recommendations adverse to the interests of the estate.112

108 In re Marvel Ent. Grp., Inc., 140 F.3d 463, 476 (3d Cir. 1998) ("A plain reading of [Section 327(a)] suggests that one is a ‘disinterested person’ only if he has no interest that is materially adverse to a party in interest in the bankruptcy.").
109 Lubben, supra note 62, at 449.
110 See, e.g., In re Envirotech Indus., Inc., 150 B.R. 1008, 1016 (Bankr. N.D. Ill. 1993) ("[Section 327] is plainly concerned with . . . ensuring that professionals employed by the estate have no conflicts of interest with the estate.").
111 See, e.g., In re Michigan Gen. Corp., 78 B.R. 479, 483-84 (Bankr. N.D. Tex. 1987) ("The ‘actuality’ of the conflict is not per se that counsel might hold a preference [under Section 547], rather it is that counsel will be tempted to neglect its duties to the estate by being less than zealous in its investigation of the preference."); Cinema 5, Ltd. v. Cinerama, Inc., 528 F.2d 1384, 1387 (2d Cir. 1976) ("[T]he attorney must be prepared to show, at the very least, that there will be no actual or apparent conflict in loyalties or diminution in the vigor of his representation.").
112 Cinema 5, Ltd. v. Cinerama, Inc., 528 F.2d at 1387 (directly addressing the idea of loyalty and personal conflicts that animate legal representation especially in the context of firms not wanting to upset lucrative repeat clients).
What’s more, the paradigm shift in Chapter 11 brought about by private equity’s frequent use of the bankruptcy system undermines the continuing efficacy of an economic-interest-only reading of Section 327.113 Instead of a direct financial interest in the estate by way of a lien or equity rights, Type One and Type Two attorney conflicts are characterized by personal and firm interests in maintaining a relationship with private equity clients who are themselves adverse to the estate. On the personal level, the restructuring attorneys view the private equity firm and its portfolio companies as a lucrative source of business.114 As noted previously, private equity portfolio companies make up a significant portion of distressed companies and therefore represent a continuing stream of business for restructuring attorneys.115 At the firm level, Type One conflicts require attorneys to litigate fraudulent transfer claims against their own firm partners. In such a conflict, a firm’s restructuring partners would be litigating to unwind a transaction consummated by the firm’s corporate partners. No firm wants to admit it facilitated a fraudulent transfer. No restructuring partner wants to embarrass their corporate law colleagues by unwinding a transaction. And more to the point, no firm leadership wants to explain to a client that the firm is going to strip it of a prized asset or unwind a valuable transaction. These relationships create the potential for situations where the firm itself has interests adverse to those of the estate.

Importantly, there is no textual reason the phrase “interest adverse to the estate” must be limited to financial interests.116 Quite the opposite. Section 327 itself states that the purpose of employing an attorney is to “represent or assist the trustee in carrying out the trustee’s duties” under the estate.117 That purpose can be frustrated equally by financial interests in the estate and by financial interests in maintaining a relationship with a major equity holder. Put another way, if the function of Section 327 is to ensure vigorous representation of the estate, the precise nature of the adverse interest is immaterial.

113 See Buccola, supra note 26, at 21 (describing the paradigm shift from creditor control to sponsor control due to private equity’s predominance over the ownership of large, distressed firms).

114 See Dezso, supra note 52 (showing private equity and venture capital are the core of many large law firms’ plans for long-term growth).

115 See Brendan Ballou, When Private-Equity Firms Bankrupt Their Own Companies, ATLANTIC (May 1, 2023), https://www.theatlantic.com/ideas/archive/2023/05/private-equity-firms-bankruptcies-plunder-book/673896/ [https://perma.cc/K7EA-C4NL] (“[C]ompanies bought by private-equity firms are 10 times as likely to go bankrupt as those that aren’t.”).

116 In re Granite Partners, 219 B.R. 22, 33 (Bankr. S.D.N.Y 1998) (“[A]dverse interest includes any interest or relationship, however slight, ‘that would even faintly color the independence and impartial attitude required by the Code . . . ’”).

By adhering to functional considerations of the Code, courts can reframe Section 327 to encompass a wider variety of attorney conflicts. Indeed, the textual reading of Section 327 is not the only understanding of attorney conflicts in bankruptcy. Courts have, in different contexts, been willing to scrutinize pre-petition activity that may put the partiality of the attorney in question. Section 327 can be understood to prohibit “any interest or relationship, however slight, that would even faintly color the independence and impartial attitude [of the attorney] required by the Code and Bankruptcy Rules.” Courts that take this view consider attorney loyalty to be the fundamental goal of Section 327. In sum, while the role of loyalty in a 327 determination is not settled, for Type One or Two conflicts, judges should ground their conflict analysis on loyal and zealous representation.

Importantly, bankruptcy judges have the leeway to make loyalty and zealfulness a central consideration. Indeed, Courts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists “in light of the particular facts of each case.”

The root of that discretion comes from the fact that the term “actual conflict of interest” is not defined in the Code and has been given meaning

118 See, e.g., In re Pillowtex, Inc., 304 F.3d 246, 251 (3d Cir. 2002) (defining an actual conflict as one that is likely to place a professional “in a position permitting it to favor one interest over an impermissibly conflicting interest”); In re Boy Scouts of Am., 35 F.4th 149, 158 (3d Cir. 2022) (noting that bias in favor of the debtor is a relevant factor); In re Granite Partners, 219 B.R. at 34 (considering appearances of conflicts); In re Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) (“The conduct of bankruptcy proceedings not only should be right but must seem right.”).

119 In re Granite Partners, 219 B.R. 473 (quotations omitted); see also id. at 38 (“No matter how thoroughly or fairly Willkie Farr conducted the investigation, the question will always linger whether it held back, or failed to bite the hand that feeds it quite as hard as the circumstances warranted.”).

120 See In re Prudent Holding Corp., 153 B.R. 639, 631 (Bankr. E.D.N.Y. 1993) (“Bankruptcy Code § 327(a) is a prophylactic provision designed to insure that the undivided loyalty and exclusive allegiance required of a fiduciary to an estate in bankruptcy is not compromised or eroded.”); see also In re Roger J. Au & Son., Inc., 101 B.R. 502, 505 (Bankr. N.D. Ohio 1989) (“Having to divide one’s allegiance between two clients is what Section 327 attempts to prevent.”); In re Envirodyne Indus., Inc., 150 B.R. 1008, 1016 (Bankr. N.D. Ill. 1993) (noting that Section 327(a) “is plainly concerned with a professional’s divided loyalties and ensuring that professionals employed by the estate have no conflicts of interest with the estate”).

121 See In re Relativity Media LLC, No. 18-1135, 2018 WL 3769967, at *2 (Bankr. S.D.N.Y. July 6, 2010) (“The case law that has attempted to define the standards set forth in Sections 327(a) and 327(c), frankly, is not necessarily all that consistent.”).

122 Cinema 5, Ltd. v. Cinerama, Inc., 528 F.3d 1384, 1386 (2d Cir. 1976) (directly addressing the idea of loyalty and personal conflicts that animate legal representation especially in the context of not wanting to upset lucrative repeat clients).

123 In re Star Broad., Inc., 81 B.R. 835, 844 (Bankr. D.N.J. 1988); see also In re Pillowtex, Inc., 304 F.3d at 254 (noting that bankruptcy courts have “considerable discretion in evaluating whether professionals suffer from conflicts”); In re Hoffman, 53 B.R. 564, 566 (Bankr. W.D. Ark. 1985) (deciding that the same counsel representing a Chapter 11 debtor and its equity holders is not a per se disqualifying conflict).
largely through a case-by-case evaluation of particular situations arising in the bankruptcy context.”

Further, bankruptcy judges faced with a conflicts issue should look beyond Section 327 to the Rules of Professional Conduct. The Rules of Professional Conduct provide the basic ethical ground rules for the practice of law. While attorneys are expected to hold firm against the pressures of operating in an adverse position to their current or former private equity clients, judges should fulfill their oversight role.

The In re Congoleum court did just that, finding that the Rules of Professional Conduct demonstrate that the attorney “cannot meet the Bankruptcy Code’s requirement of disinterestedness contained in section 327(a).” The exact overlap between the Rules of Professional Conduct and Section 327 is not perfectly definable, as they seem to impose different standards. That said, the distinction seems unsubstantial given most courts discuss the two together.

125 See In re Congoleum Corp., 426 F.3d 675, 692 (3d Cir. 2005) ("Our discussion of the Rules of Professional Conduct demonstrates that Gilbert also cannot meet the Bankruptcy Code’s requirement of disinterestedness contained in section 327(a).”); In re Corn Derivatives Antitrust Litig., 748 F.2d 157, 160 (3d Cir. 1984) (discussing how courts apply the power to disqualify under rules of professional conduct versus section 327); In re Relativity Media LLC, 2018 WL 3769967, at *2 (examining both the rules of professional conduct and section 327); In re Boy Scouts of Am., 35 F.4th 149, 158 (3d Cir. 2022) ("Section 327 and the Rules of Professional Conduct impose independent obligations."); TQ Delta, LLC v. zWire, Inc., No. 13-1835, 2016 WL 5402180, at 6–7 (D. Del. Sept. 26, 2016) (denying motion for disqualification despite violation of Rule 1.9 due to a failure to prove the “nature of the conflict” outweighed the importance of maintaining the privacy of the attorney-client relationship); Bos. Sci. Corp. v. Johnson & Johnson Inc., 647 F. Supp. 2d 369, 374 (D. Del. 2009) ("[Counsel’s] violation of Model Rule 1.7 notwithstanding, the court concludes that disqualification is not the appropriate remedy under the circumstances."); Wyeth v. Abbott Labs’ys, 692 F. Supp. 2d 453, 458–59 (D.N.J. 2010) (denying motion for disqualification even though there was "no dispute" that counsel violated Rule 1.7); Elonex I.P. Holdings, Ltd. v. Apple Comput., Inc., 142 F. Supp. 2d 579, 583 (D. Del. 2001) ("Even if the court were to find that there was no waiver and . . . [a violation of] Rule 1.7(a), disqualification is not warranted . . . .") But other courts have come out differently, See In re Amdura Corp., 121 B.R. 862, 870 (Bankr. D. Colo. 1990) ("As the Court observed in its opinion, general ethical standards concerning the employment of professionals are not necessarily the same as the more restrictive standards of Section 327 . . . .").

126 In re Congoleum Corp., 426 F.3d 675, 692 (3d Cir. 2005).
127 See In re Amdura Corp., 121 B.R. at 870 ("As the Court observed in its opinion, general ethical standards concerning the employment of professionals are not necessarily the same as the more restrictive standards of Section 327 . . . ."); see also In re Boy Scouts of Am., 35 F.4th at 158 ("Section 327 and the Rules of Professional Conduct impose independent obligations.").
128 See In re Boy Scouts of America, 35 F.4th at 160 ("[I]ndeed, courts in our Circuit often deny disqualification even when finding or assuming conflicts under the professional conduct rules."); Bos. Sci. Corp., 647 F. Supp. 2d at 374 ("[Counsel’s] violation of Model Rule 1.7 notwithstanding, the court concludes that disqualification is not the appropriate remedy under the circumstances."); Wyeth, 692 F. Supp. 2d at 458–59 (denying a motion for disqualification of counsel even though there was "no dispute" that counsel violated Rule 1.7).
Regardless, what seems clear enough is that loyalty should be central to Section 327 as it is in the Rules of Professional Conduct.129 The Rules require attorneys,130 and judges, to consider whether there is a “significant risk” that the firm representing the estate will be “materially limited” by responsibilities to its private equity client (or former client)131 or by a personal interest of the lawyer (including seeking future business from the private equity parent).132 The basic reasoning is straightforward, as taking an adversarial posture toward an existing or former client can impact the independent judgment of an attorney.133 Indeed, “[a] lawyer may be influenced by a client’s importance (such as a blue-chip publicly held company that generates lucrative revenues for the firm) and thereby advance its interests at the cost of the smaller client.”134 In an adversarial legal system there can be no room for divided loyalties without severely undermining the functionality of the courts.135

In re Relativity serves to exemplify this point.136 In that case, the creditors objected to Winston & Strawn LLP serving as attorneys to the debtor because the firm represented Netflix, which had a financial interest in the bankruptcy, in a separate patent litigation.137 The court considered allegations that Winston & Strawn “might go easy on Netflix to avoid irritating a current client.”138 The court found that argument unconvincing and in that instance, it may have been right.139 Indeed, it is unlikely that a single patent litigation case would be so important to the firm or a specific partner or group of partners to bias Winston & Strawn’s representation of the debtor. But, when

129 See supra notes 68–78 and accompanying text; see also In re Mercury, 280 B.R. 35, 52 (Bankr. S.D.N.Y. 2002) (citing to Canon 5 of the New York State Bar Association’s Code of Professional Responsibility which prohibits diluting loyalty to the client).
130 MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2023).
131 Id.; see also MARC I. STEINBERG, LAWYERING AND ETHICS FOR THE BUSINESS ATTORNEY, 120, 126-27 (5th ed. 2020) (“Conflicts may occur with respect to current as well as former clients.”).
132 MODEL RULES OF PROF’L CONDUCT r. 1.7(a)(2) (AM. BAR ASS’N 2023) (defining an attorney as conflicted where “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”); see also id. Rule 1.7 cmt. 10 (“The lawyer’s own interests should not be permitted to have an adverse effect on representation of a client.”).
133 STEINBERG, supra note 131, at 124.
134 Id.
135 Id. (quoting Marc I. Steinberg & Timothy U. Sharpe, Attorney Conflicts of Interest: The Need for a Coherent Framework, 66 NOTRE DAME L. REV. 1, 33 (1990)) (“Further, the breach of the lawyer’s duty of loyalty may have adverse effects on the United States’ legal system in which ‘opposing attorneys, within the bounds of legal and ethical norms, will engage in a zealous, uninhibited presentation of their client’s position.’”).
136 Supra note 112.
137 In Re Relativity Media LLC, No. 18-11358, 2018 WL 3769967, at *1, *3 (Bankr. S.D.N.Y. July 6, 2010).
138 Id. at *3.
139 Id.
private equity parents have financial interests in estates represented by their preferred law firms, the conflict is much more significant. As detailed at the outset of this Comment, the importance of private equity firms to the revenue streams of major law firms cannot be understated.140

To properly govern these conflicts, judges should examine two main factors to ensure loyal and zealous representation. First, the extent of the relationship between the attorney and their firm with the equity parent of the debtor company; and second, the complexity of the restructuring or rather the extent to which the various stakeholders are cooperating.

While the importance of each factor will vary depending on the circumstances, the first factor should hold more weight. If a law firm has a significant relationship with a major equity holder, that firm should not be permitted to represent the estate regardless of the complexity of the case. That is so because even in the most straightforward restructurings, decisions are made at the margins that could significantly impact the estate, creditors, and equity.141 Moreover, perception matters and judges should always seek to maintain an appearance of propriety.142 That is especially the case in bankruptcy which generally operates in the shadows but with immense power to alter economic rights.

Turning to the second factor, if the restructuring is simple and the stakeholders are cooperating, the judge may properly lower the level of scrutiny for attorney conflicts. In that context, the attorney is unlikely to make substantial decisions while in Chapter 11 under the guidance of the court. But, when a restructuring is contested, where creditors, equity holders, and/or management desire different outcomes, the loyalties of the attorney are paramount. While some argue that courts can and should assume attorneys act ethically, personal interest is a stubborn beast and the pressures to bring in business to sustain a law firm's bottom line can cloud the judgment of even the most pious attorney. Setting the bounds of these considerations (i.e., how significant of a relationship between a firm and an equity holder is too significant) is beyond the scope of this Comment. Rather, this section

140 See discussion supra Section I.A.
141 See Ashby, supra note 62, at 435-36 (“Formulating a viable reorganization plan is an arduous and complicated process that frequently requires the expertise of experienced bankruptcy counsel.”).
142 See Int’l Bus. Machs. Corp. v. Levin, 579 F.2d 271, 283 (3d Cir. 1978) (“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.”); In re Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) (“The conduct of bankruptcy proceedings not only should be right but must seem right.”); In re Granite Partners, 219 B.R. 22, 36 (Bankr. S.D.N.Y. 1998) (noting that bankruptcy courts should be concerned with the appearance of impropriety). But see In re Boy Scouts of Am., 35 F.4th 149, 158 (3d Cir. 2022) (holding that courts “may not disqualify an attorney on the appearance of conflict alone”).
provides judges with a doctrinal prism through which to view Type One and Type Two conflicts.

In conclusion, in the face of a Type One or Type Two conflict bankruptcy judges should resist the urge to rely upon the textual approach to applying Section 327. Instead, Courts should seek to understand the context of the relationship between the attorneys representing the estate and the interests adverse to that estate. Where the attorney faces a Type One or Type Two conflict described herein, Section 327 should disqualify their representation of the estate.

B. Type Three Conflict

The final conflict that the rise of private equity has introduced or, at the very least, elevated, occurs in the zone of insolvency and is what I call a Type Three conflict. A Type Three conflict occurs where a single firm represents a private equity parent company and its portfolio company while the portfolio company is on the edge of or operating within insolvency. These are conflicts that predate filing and therefore are not governed by bankruptcy judges. 143

While it is hornbook corporate law that fiduciary duties shift once a company is insolvent, 144 the scholarship is brimming with debates on the definition of the zone of insolvency, where it starts, and how to characterize it. 145 All of those questions have been scrutinized at length. Left out of the


144 Jared A. Ellias & Robert J. Stark, Bankruptcy Hardball, 108 CALIF. L. REV. 745, 761 (2020) (explaining the shift in fiduciary duties for insolvent companies); John A. Pearce II & Ilya A. Lipin, The Duties of Directors and Officers Within the Fuzzy Zone of Insolvency, 19 AM. BANKR. INST. L. REV. 361, 366 (2011) (“When the corporation becomes insolvent, the fiduciary duties of directors and officers switch to cover the company’s creditors.”).

145 See Danilo Scarlino, Zone of Insolvency, Directors’ Duties and Creditor Protection in U.S., 29 EUR. BUS. L. REV. 1, 17 (2018) (“The problem of when [a] company is in the zone of insolvency is strictly linked to the different problem of when the company is insolvent at all because determining insolvency in ‘real time’ can be extremely difficult, as complex corporate assets and liabilities often escape concrete evaluation.”); see generally Frederick Tung, Gap Filling in the Zone of Insolvency, 1 J. OF BUS. & TECH. L. 607 (2007) (arguing that court enforcement of fiduciary duties in the zone of insolvency for commercial creditors is generally unnecessary); Pearce & Lipin, supra note 144, at 379-385 (arguing for the adoption of techniques from the financial services industry to identify the zone of insolvency); see also H. H. Rajak, Director and Officer Liability in the Zone of Insolvency: A Comparative Analysis, 11 POTCHEFSTROOM ELEC. L.J. 1, 58 (2008) (expressing skepticism of
conversation, however, has been the attorney and her duties in the zone of insolvency. In fact, attorneys face a conflict minefield in the zone when representing private equity clients.\textsuperscript{146} As noted throughout, single firms often represent both private equity firms and their portfolio companies.\textsuperscript{147} And often this is of little consequence. While solvent, the interests of the private equity parent and its portfolio company are aligned.\textsuperscript{148} In this environment, a concurrent representation is well within the bounds of the relevant law and the rules of professional conduct.

But the relationship between major law firms, private equity, and their portfolio companies can lead to some significant conflicts in the zone of insolvency. As the portfolio company’s debt situation becomes dire, attorneys should remain on alert for a change in the fiduciary duties of their two clients. If the portfolio company reaches insolvency, the attorney must withdraw from one client.\textsuperscript{149} Unfortunately, in reality, these precautions are not always taken.

The run-up to the 2015 bankruptcy of Caesars Entertainment Operating Company (CEOC) provides an illuminating use case. CEOC was controlled by its parent Caesars Entertainment Company (CEC) which was wholly owned by private equity firms Apollo and TPG.\textsuperscript{150} In response to legal claims against CEC for improper transactions in the zone of insolvency, the court appointed a special examiner to review over fifteen transactions between 2008 and 2014.\textsuperscript{151} In addition to legal claims against the parent and its private equity owners, the examiner addressed potential claims against Paul Weiss, which

\textsuperscript{146} See Richard Levin & Angela M. Allen, \textit{A Review of Potential Conflicts in Private-Equity Representation}, 28 AM. BANKR. INST. J. 54, 55 (“Lawyers should think ahead early in a workout and consider the likelihood of potential intercompany claims before the portfolio company becomes insolvent and well before it needs to file a Chapter 11 case.”).


\textsuperscript{148} Jared A. Ellias & Robert J. Stark, \textit{Bankruptcy Hardball}, 108 CALIF. L. REV. 745, 761 (2020) (explaining the shift in fiduciary duties for insolvent companies); see also Danilo Scarlino, \textit{Zone of Insolvency, Directors’ Duties and Creditor Protection in U.S.}, 29 EUR. BUS. L. REV. 1, 2 (2018) (“Out of the zone of insolvency, the basic rule is that directors of a solvent corporation owe fiduciary duties exclusively to shareholders and that they do not owe such duties to creditors.”).

\textsuperscript{149} \textit{MODEL RULES OF PROF'L CONDUCT} r. 1.16 (AM. BAR ASS’N 2023) (noting that an attorney should withdraw if he or she is unable to represent the client in accord with the rules of professional conduct).

\textsuperscript{150} Davis, \textit{supra} note 57, at 1.

\textsuperscript{151} Id.
served as counsel to both the parent and its subsidiary in the run-up to bankruptcy (in the zone of insolvency).

In mid-March of 2016, the court-appointed examiner released the much-anticipated 1,787-page report on the events leading up to the 2015 bankruptcy of Caesars Entertainment. The principal question being investigated was whether in structuring and implementing these transactions assets were removed from CEOC to the detriment of CEOC and its creditors. Ultimately, the Special Master answered in the affirmative, finding that assets were improperly removed and there were plausible claims of constructive and actual fraudulent transfer and breach of fiduciary duty that amounted to somewhere between $3.6 and $5.1 billion in potential damages.

The law firm behind these transactions was Paul Weiss. Paul Weiss, in the run-up to CEOC’s formal bankruptcy filing, was representing the operating company (CEOC) and the parent company (CEC), which was owned by Apollo. As noted, Apollo was “a very significant client of Paul Weiss on matters unrelated to Caesars.” As CEOC began to falter under an unsustainable debt load, Paul Weiss faced a Type Three conflict by representing CEOC and its parent company CEC. By not withdrawing, Paul Weiss was exposed to claims for malpractice and aiding and abetting breach of fiduciary duty. Indeed, the “court-appointed bankruptcy examiner found . . . that Paul, Weiss, Rifkind, Wharton & Garrison was in a compromised position when it simultaneously represented parent company Caesars Entertainment Corp. and its casino-operating subsidiary in intercompany transactions during a period when the operating unit became insolvent.”

Further, Paul Weiss, unsurprisingly, was more responsive to the desires of Apollo, their largest and most lucrative client, systematically disadvantaging CEOC, its other client, in a breach of the firm’s professional duties under

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152 See id. at 14-19 (noting that CEOC moved its representation to Paul Weiss “in late spring 2011,” which represented CEOC in “virtually every transaction investigated by the Examiner,” and that the firm “also represented CEC, CEOC’s then 100% shareholder”).


154 Davis, supra note 57, at 1.

155 Id.

156 Id. at 14-19.

157 Id. at 14.

158 Id.


160 Davis, supra note 57, at 14 (“The Caesars General Counsel . . . believed that Paul, Weiss was more responsive to the Apollo (and TPG) directors than they were to him.”).
Rule 1.7. In short, Paul Weiss should have ceased representing both CEOC and CEC in the fall of 2012 once they were reasonably aware that CEOC was insolvent. Nonetheless, the examiner concluded that CEOC did not have strong claims against Paul Weiss, raising questions of creditor recourse. Indeed, while the Special Master’s report laid out a litany of remedies for the fraudulent transfers and other misdeeds undertaken by Apollo, he did not provide any remedies to address the actions taken by Paul Weiss.

The threshold problem for policing attorney conflicts in the zone of insolvency is a lack of judicial control. Because the attorneys are operating outside of the judicial system, their behavior is largely unchecked outside of potential malpractice or aiding and abetting fiduciary duty claims, which, as the Special Examiner noted, are unlikely to succeed. More practically, the zone of insolvency must be policed by the attorneys themselves.

There is no doubt that the zone of insolvency is a complex topic and attorneys operating within the zone face perplexing ethical questions. Still, these conflicts should be thoroughly examined especially because financial distress is commonly resolved not in Chapter 11, but in the zone of insolvency. Attorneys have a duty not only to avoid conflicts, but arguably also the appearance of conflicts. As such, attorneys representing portfolio and parent companies, faced with Type Three conflicts, should diligently track the financial status of their clients and retain separate counsel as soon as an argument for the company’s insolvency could be made.

IV. SOLUTIONS

Finally, this Comment presents three solutions and suggestions to police attorneys’ conflicts in and around insolvency. Each of these will be addressed

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161 See id. at 15 (asserting that, according to Rule 1.7, when interests diverge, a lawyer can represent multiple clients only if the “lawyer can competently represent both clients and if both clients provide informed consent”).

162 Id. at 18 (“The existence of a conflict, however, does not automatically create liability.”).

163 See id. at 19-20 (“Calculating new valuations would require extensive additional work and would need to be based on the most recently available results and projections.”).

164 See id. at 18 (“First, based on the evidence any claim against Paul Weiss for aiding and abetting a breach of fiduciary duty by either CEOC’s directors or CEC would be weak.” (footnote omitted)).

165 See Idzelis, supra note 33 (“[P]rivate equity firms, being skillful financial engineers, will try to avoid bankruptcy through distressed debt exchanges.”).

166 See Int’l Bus. Machs. Corp. v. Levin, 579 F.2d 271, 283 (3d Cir. 1978) (“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.”); In re Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) (“The conduct of bankruptcy proceedings not only should be right but must seem right.”). But see In re Boy Scouts of Am., 35 F.4th 149, 158 (3d Cir. 2022) (holding that courts “may not disqualify an attorney on the appearance of conflict alone” (citation omitted)).
briefly. I hope that further scholarship on the issue will either flesh out these ideas or provide novel approaches to addressing attorney conflicts in bankrupt and pre-bankrupt companies.

**A. Disclosure and Consent to Conflict**

First, it is standard practice for law firms to request conflict waivers from current and former clients.\(^{167}\) Indeed, Model Rule 1.7 provides that attorneys can represent two clients with adverse interests if they reasonably believe themselves able to do so and obtain informed and written consent.\(^{168}\) That standard should not change in bankruptcy. Instead, if a bankruptcy judge makes a preliminary finding that the relationship between the firm and a private equity sponsor is such that there is a risk of a conflict or diluted loyalty, the firm should seek a conflict waiver from the creditors provided via creditor vote.\(^{169}\) Obviously, companies in Chapter 11 often have several creditors, and creditor cooperation is a central part of corporate restructuring. Taking that into account, along with the general presumption that a debtor should be able to select his own attorney,\(^{170}\) any requirement of creditor consent to a conflict must thread the needle between being sufficiently difficult to respect debtor’s choice of counsel and being achievable for creditors in the most extreme cases of attorney conflict of interest.

Given the fundamental role of creditor voting in bankruptcy, allowing creditors to jointly consent to an attorney conflict will not fundamentally alter the structure of Chapter 11 in many respects.\(^{171}\) Borrowing from existing voting practices, at least two-thirds of the number of creditors should be required to vote against it in order to deny the debtor its choice of an attorney.\(^{172}\)

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167 See Model Rules of Prof’l. Conduct r. 1.7 cmt. 31 (AM. BAR ASS’N 2023) (“The lawyer should, at the outset of the common representation and as part of the process of obtaining each client’s informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other. In limited circumstances, it may be appropriate for the lawyer to proceed with the representation when the clients have agreed, after being properly informed, that the lawyer will keep certain information confidential.”).

168 Id. r. 1.7(b).

169 See 11 U.S.C. § 1126(c) (defining the creditor voting).

170 See Williams, supra note 9, at 320 (noting the Court’s “balance between prohibiting the unethical conduct of attorneys and other social interests including a litigant’s right to freely chosen counsel”).

171 See 11 U.S.C. § 1126(c)-(d) (defining the creditor and equity class voting).

172 That threshold is borrowed, in part from the requirements in Section 1126(c) for plan acceptance. 11 U.S.C. § 1126(c) (“A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount [of total claim value] and more than one-half in number of the allowed claims of such class held by creditors . . . .”).
B. Public Shaming, Judicial Notice

Another option is for bankruptcy judges to take on a role akin to the special master in the Caesars case. While the examiner ultimately found that the legal claims against Paul Weiss were weak, he did not shy away from calling out their obvious and material conflict of interest causing significant embarrassment to the firm.\(^\text{173}\) By expressly identifying the improper behavior, the special examiner caused reputational damage to Paul Weiss which may have changed future behavior.

Notably, one of the benefits of taking judicial notice of conflicts of interests is that even judges that take the narrowest view of Section 327—only barring adverse financial interests—could look to the Rules of Professional Conduct and opine on the appropriateness of the attorney’s actions even if they do not believe the behavior rises to the level of disqualification under the Code.

C. Bankruptcy Code of Ethics

Finally, more specific prohibitions on the types of conflicts discussed herein could be worked into a Code of Ethics specifically for bankruptcy attorneys. While the idea of a Bankruptcy Code of Ethics is not novel,\(^\text{174}\) including protections for creditors against attorney conflicts would be a novel addition.

CONCLUSION

Private equity and major law firms involved in restructuring have become interdependent corporate actors. This relationship threatens the ability of restructuring attorneys to provide competent, zealous, and loyal representation to debtor estates. To properly address the impacts of the paradigm shift towards sponsor-control, bankruptcy judges should look closer at attorney conflicts. This Comment provides a first step in defining the relevant conflicts and setting the doctrinal table for a more substantive review of conflicts that have the potential to undermine the ethical underpinnings of Chapter 11 corporate restructurings.

\(^{173}\) See Davis, supra note 57, at 14-15 (noting Paul Weiss’s conflict of interest in its representation).

\(^{174}\) See Nancy B. Rapoport, Our House, Our Rules: The Need for a Uniform Code of Bankruptcy Ethics, 6 AM. BANKR. INST. L. REV. 45, 47 (1998) (advocating for increased guidance “to bankruptcy lawyers on such subjects as conflicts of interest and duties of lawyers toward their ‘official entity’ clients in bankruptcy cases” (footnotes omitted)).