UNITED STATES BANKRUPTCY ADMINISTRATOR
MIDDLE DISTRICT OF NORTH CAROLINA

JOHN PAUL H. COURNOYER – BANKRUPTCY ADMINISTRATOR
101 S. EDGEWORTH ST.
GREENSBORO, NC 27401
(336) 378-4170
WWW.NCMBA.USCOURTS.GOV

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Re: Rule 2014 Disclosure of All Connections to Parties in Interest

To trustees, counsel, financial advisors, brokers, auctioneers, accountants, examiners, and other professionals to be employed in bankruptcy cases:

Professionals employed in bankruptcy cases must be disinterested and free from conflicts. To be employed, you must disclose of all connections to the debtor, creditors, and other parties. This enables the Court, the BA, and other parties to evaluate your disinterestedness. Disclosing all connections is required—even when a connection is not disqualifying. This memo provides guidance to assist you in complying with these disclosure requirements.

General Background

The Code defines "disinterested person" as a person that: (1) "is not a creditor, an equity security holder, or an insider," (2) "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 (3) "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*." 11 U.S.C. § 101(14) (emphasis added).

In addition to being disinterested, employed professionals must "not hold or represent an interest adverse to the estate."[1] 11 U.S.C. § 327(a). Courts have interpreted adverse interest to mean "(1) to possess or assert 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; or (2) to possess a predisposition under circumstances that render such a bias against the estate." *Bank Brussels Lambert v. Coan (In re AroChem Corp.),* 176 F.3d 610, 623 (2d Cir. 1999).

Rule 2014 requires that applications to employ professionals disclose "to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants,

[1] Of course, § 327(e) provides a limited exception, not addressed here.

the [bankruptcy administrator], or any person employed in the office of the [bankruptcy administrator]." Fed. R. Bank. P. 2014(a).

Failing to disclose connections is sanctionable in the court's discretion and may result in disqualification or the denial of compensation. *In re EBW Laser, Inc.,* 333 B.R. 351, 359 (Bankr. M.D.N.C. 2005).

The duty to disclose is continuing, and professionals are "under a duty to promptly notify the court if any potential for conflict arises." *In re Etheridge*, 2019 Bankr. LEXIS 3786, at *18-19 (Bankr. M.D.N.C. December 10, 2019) (quoting *In re W. Delta Oil Co., Inc.,* 432 F.3d 347, 355 (5th Cir. 2005)).

The disclosure must enable parties to evaluate the potential for conflict, and boilerplate statements will not suffice. *See, e.g., In re Granite Partners, L.P.,* 219 B.R. 22, 36 (Bankr. S.D.N.Y. 1998) ("A boilerplate statement that the professional may represent an unspecified creditor or party in interest in unrelated transactions in the future is insufficient disclosure of future connections.") Courts have reduced or denied fees when disclosures were perfunctory or contained insufficient detail to paint the true picture of the connection.

Connections that Must be Disclosed

The duty to disclose connections is intentionally broad, and the professional should disclose all connections regardless of whether they would be disqualifying. *See In re Persaud,* 496 B.R. 667, 675 (E.D.N.Y. 2013) ("The decision as to what information to disclose 'should not be left to counsel, whose judgment may be clouded by the benefits of the potential employment.'"); *Lumber, Inc. v. Unsecured Creditors' Comm. of Diamond Lumber, Inc.,* 88 B.R. 773, 776 (N.D. Tex. 1988) ("The duty to disclose is so broad because the court rather than the attorney must decide whether the facts constitute an impermissible conflict of interest.").

Additionally, disclosure of the connections elsewhere in the record, such as in the schedules or statements, will not insulate the professional from sanctions for non-disclosure in the employment application and supporting declaration or affidavit. *See, e.g., Quarles & Brady LLP v. Maxfield (In re Jennings)*, 199 F. App'x 845, 847 (11th Cir. 2006) ("[b]ankruptcy courts are not obliged to hunt around and ferret . . . in search of the basic disclosures required by Rule 2014").

The term connection is undefined in the Rules. *Collier* finds the use of this term is "unfortunate." 9 *Collier on Bankruptcy* ¶ 2014.05 (16th ed. 2023). Indeed, it could be construed to the point of absurdity. Is a lawyer required to disclose prior, unrelated cases where they served as opposing counsel to another party's counsel? What if a real estate broker is a member of the same charitable organization as the

debtor's president? What if they live in the same neighborhood? Thus, courts have found some things too small to constitute connections under Rule 2014. *See, e.g., In re Fundamental Long Term Care, Inc.,* 613 B.R. 484 (Bankr. M.D. Fla. 2020) (serving as opposing counsel to counsel for another party was not a "connection" that required disclosure).

That said, the sanctions for non-disclosure can be severe, and professionals should err on the side of over-disclosure. The following non-exhaustive list of examples, together with the gratuitous collection of caselaw attached, reflect connections that courts have found required disclosure:

- **Any direct or indirect claim or interest.** For example, in an unpublished case in this district, the Court denied a fee application for over $90,000 in fees sought by debtor's counsel, when it failed to disclose an outstanding pre-petition balance owed by the debtor. Counsel's willingness to waive the pre-petition fees, once the non-disclosure was discovered, was unavailing.

- **Pre-petition representation.** For example, when a broker failed to disclose its pre-petition representation of the debtor, it warranted denial of all compensation, even if the broker had separately told the trustee. *In re Kings River Resorts, Inc.*, 342 B.R. 76 (Bankr. E.D. Cal. 2006).

- **Concurrent representation of affiliated debtors and disclosure of intercompany transactions.** For example, when experienced chapter 11 counsel failed to disclose its intent to represent both a corporate debtor and its 100% shareholder in concurrent chapter 11 cases, it violated Rule 2014. The court rejected the "small community" defense that the cases were both proceeding before the same judge, with overlapping attorney involvement, in a smaller judicial district. *In re Hutch Holdings, Inc.*, 532 B.R. 866 (Bankr. S.D. Ga. 2015). Also, in cases where counsel seeks simultaneous representation of affiliated debtors, evaluating intercompany dealings is critical, and they should be disclosed. *See, e.g., Quarles & Brady LLP v. Maxfield (In re Jennings)*, 199 F. App'x 845, 847 (11th Cir. 2006).

- **Pre-petition payments (including retainer payments).** For example, numerous published cases have denied compensation when professionals failed to disclose pre-petition payments received by the debtor.

- **Business dealings.** For example, when an individual associated with a financial advisor was in discussions with an individual associated with the

debtor about a possible new business venture, non-disclosure violated Rule 2014. *In re Condor Systems,* 302 B.R. 55 (Bankr. N.D. Cal. 2003).

- **Connections to potential litigation targets**. For example, when a trustee's counsel failed to disclose the firm's client and business relationships to potential litigation targets, or that the firm represented a professional association for accountants and had a policy against suing accountants, it resulted in substantial fee disallowance and disgorgement. *In re Granite Partners, L.P.,* 219 B.R. 22 (Bankr. S.D.N.Y. 1998).

- **Connections to affiliates.** For example, when debtor's counsel failed to disclose that it also represented the 50% owner of an entity that received property transfers shortly prepetition, or that the 50% owner served as the debtor's broker, it warranted complete denial of all fees. *In re Mitchell,* 497 B.R. 788 (Bankr. E.D.N.C. 2013).

- **Connections to the Court.** Rule 2014 doesn't explicitly require disclosure of connections to the court, but many firms follow this practice, and it is encouraged. The fallout for Jackson Walker LLP, when one of its partners had an undisclosed, intimate, live-in relationship with former Judge Jones in the Southern District of Texas, should provide sufficient caution against non-disclosure.

- **Connections to the BA's office.** Any connections to me or the BA office's staff must be disclosed.

- **Close personal connections.** For example, in a pre-Code case, the Second Circuit agreed with the disqualification of debtor's counsel who was a close friend of the former chairman of the debtor's board, when the former chairman was a potential litigation target. *In re Bohack Corp.*, 607 F.2d 258, 263 (2d Cir. 1979); *see also, e.g., In re Diamond Mortg. Corp. of Illinois,* 135 B.R. 78, 93 (Bankr. N.D. Ill. 1990) (finding disclosures deficient in many respects, including the failure to disclose close friendship and "office mate" relationships).

- **Connections related to committee solicitation efforts.** For example, when counsel coordinated with another individual to cold-call prospective committee members in Asian countries about serving as their proxy in the committee formation meeting, as part of a *quid pro quo* where the individual was promptly hired as the committee's translator once he obtained the proxy

and led the committee to hire counsel, it required disclosure under Rule 2014 in addition to being ethical misconduct. *In re Universal Bldg. Prod.*, 486 B.R. 650, 664 (Bankr. D. Del. 2010).

/s/ John Paul H. Cournoyer

John Paul H. Cournoyer
U.S. Bankruptcy Administrator
Middle District of North Carolina

EXHIBIT A

Selected Caselaw
Last Updated May 23, 2024

- *In re Bon-Air Partnership,* 521 Fed. Appx. 131 (4th Cir. 2013) (unpublished) (representing a bank in an unrelated action to recover on a personal loan against one of the debtor's partners was "too attenuated" to render law firm conflicted from serving as trustee's counsel)
- *In re Etheridge*, 2019 Bankr. LEXIS 3786, Case No. 18-11303, Doc. No. 68 (Bankr. M.D.N.C. December 10, 2019) (special counsel failed to disclose that he was the largest creditor of the debtors, or that he intended to file a § 523 action against the debtors, warranting denial of all fees)
- *In re EBW Laser, Inc.*, 333 B.R. 351 (Bankr. M.D.N.C. 2005) (counsel failed to disclose a pre-petition agreement providing for contingent fee upon sale of laser machines, warranting a reduction in fees even though the connection was not disqualifying)
- *In re Textile Indus., Inc.*, 198 B.R. 902 (Bankr. M.D.N.C. 1996) (accounting firm failed to disclose that debtor still owed it money for pre-petition services, and was therefore disinterested)
- *In re Mitchell,* 497 B.R. 788 (Bankr. E.D.N.C. 2013) (when debtor's counsel failed to disclose that it also represented the 50% owner of an entity that received property transfers shortly prepetition, or that the owner served as the debtor's broker, it was an actual conflict of interest and warranted complete denial of fees)
- *Kun v. Mansdorf,* 558 Fed. Appx. 755 (9th Cir. 2014) (unpublished) (failure to disclose $4,000 in unpaid prepetition attorney's fees violated Rule 2014, and warranted fee denial and disgorgement)
- *Quarles & Brady LLP v. Maxfield (In re Jennings)*, 199 F. App'x 845, 847 (11th Cir. 2006) (affirming Rule 2014 violation for failing to disclose all connections to eleven affiliated debtors, including non-disclosure of intercompany dealings between the debtors, and rejecting the argument that the information was elsewhere in the record since "[b]ankruptcy courts are not obliged to hunt around and ferret . . . in search of the basic disclosures required by Rule 2014")

- *In re W. Delta Oil Co., Inc.,* 432 F.3d 347, 355 (5th Cir. 2005) (reversing a bankruptcy court order allowing fees when debtor's counsel failed to disclose that they were potential investors in an entity that would acquire the debtor's assets under a proposed plan)

- *In re Park-Helena Corp.*, 63 F.3d 877 (9th Cir. 1995) (affirming finding that failure to disclose that the debtor's president paid counsel's pre-petition retainer violated Rule 2014 and warranted denial of all fees)

- *U.S. v. Gellene*, 182 F.3d 578 (7th Cir. 1999) (affirming criminal conviction arising from law firm partner's willful non-disclosure of creditor representations in Rule 2014 affidavit)

- *In re Hot Tin Roof, Inc.*, 205 B.R. 1000 (1st Cir. B.A.P. 1997) (affirming denial and disgorgement of all fees for counsel who failed to disclose prior representation of debtor's sole shareholder, or connections among affiliated debtors, since counsel "had an obligation to disclose any and all connections . . . no matter how insignificant or irrelevant he may have believed those connections to be")

- *In re Granite Partners, L.P.,* 219 B.R. 22 (Bankr. S.D.N.Y. 1998) (trustee's counsel failed to disclose the firm's client and business relationships to potential litigation targets, or that the firm represented a professional association for accountants and had a policy against suing accountants, resulting in substantial fee disallowance and disgorgement)

- *In re Hutch Holdings, Inc.*, 532 B.R. 866 (Bankr. S.D. Ga. 2015) (lamenting the problems of a "perfunctory approach" to disclosure, and finding a Rule 2014 violation when corporate debtor's counsel's failed disclose its prior representation of the debtor's 100% shareholder in non-bankruptcy matters, nor its representation of the shareholder in his individual chapter 11 case)

- *In re Leslie Fay Companies, Inc.,* 175 B.R. 525 (Bankr. S.D.N.Y. 1994) (law firm's failure to disclose representation of non-debtor companies was a Rule 2014 violation, when the principals of those companies were potential targets of a fraud investigation that the firm would undertake)

- *In re C&C Demo, Inc.,* 273 B.R. 502 (Bankr. E.D. Tex. 2001) (corporate debtor's counsel's failure to disclose representation of the debtor's equity holders in chapter 13 cases violated Rule 2014)

- *In re Blue Ridge Limousine and Tour Service, Inc.,* 2014 WL 4101595 (Bankr. E.D. Va. 2014) (Rule 2014 did not require disclosure that the primary secured creditor had recommended the debtor's financial consultant, when it wasn't a mandate from the creditor and the creditor had only worked with the consultant in one prior case)

- *In re Byington,* 454 B.R. 648 (Bankr. W.D. Va. 2011) (the debtor's son's payment to counsel to cover the debtor's chapter 11 filing fee was a connection that required disclosure under Rule 2014, especially when the debtor had made a pre-petition transfer to the son)

- *In re Cody*, 122 B.R. 520 (Bankr. N.D. Ohio 1990) (failure to disclose that the debtor provided architectural services to counsel's shared office space was a Rule 2014 violation)

- *In re Condor Systems,* 302 B.R. 55 (Bankr. N.D. Cal. 2003) (financial advisor violated Rule 2014 by failing to disclose the fact that its principals were in negotiations with a representative of the debtor's largest shareholder about a possible new business venture)

- *In re American Intern. Refinery, Inc.,* 676 F.3d 455 (5th Cir. 2012) (affirming Rule 2014 violation for failure to disclose payment of retainer by a creditor and prepetition representation of debtor)

- *In re Greater Blessed Assurance Apostolic Temple, Inc.,* 628 B.R. 554 (Bankr. M.D. Fla. 2021) (failure to disclose unpaid pre-petition fees of $1,015, which violated Rule 2014 and rendered him disinterested, warranting complete denial of over $90,000 in requested fees since there is "no *de minimus* threshold excusing an attorney" from their disclosure requirements)

- *In re Manstone Countertops LLC,* 2013 WL 1289124 (Bankr. D. Ariz. 2013) (disclosing a $25,000 prepetition retainer to counsel, but omitting that the payment was an "earned-upon-receipt" flat fee under the fee agreement, was an inadequate disclosure)

- *In re Wright,* 578 B.R. 570 (Bankr. S.D. Tex. 2017) (failure to disclose fee sharing arrangement with other lawyers violated Rule 2014 and multiple Code sections, and further hearing on damages for violations would be held)

- *In re Song,* 2008 WL 6058782 (9th Cir. B.A.P. 2008) (holding that bankruptcy court has discretion to craft the remedy for a Rule 2014 violation; when counsel failed to disclose prepetition representation of the debtors, all fees could have been denied, but the bankruptcy court had discretion to award nearly all fees despite the nondisclosure)

- *In re Private Asset Group Inc.,* 579 B.R. 534 (Bankr. C.D. Cal. 2017) (failure to disclose special counsel's prior personal loans to chapter 7 trustee warranted partial fee disgorgement, when court concluded that counsel did not know disclosure was required, but should have known)

- *In re Fundamental Long Term Care, Inc.,* 613 B.R. 484 (Bankr. M.D. Fla. 2020) (serving as opposing counsel to counsel for another party was not a "connection" that required disclosure, nor was a "multi-link chain of relationships" that indirectly connected counsel and a former partner of a litigation target, nor was representation of a litigation target in an unrelated matter 13 years earlier, nor was previously serving as co-counsel with litigation target law firm)[2]

- *In re Whitten Pumps, Inc.*, 2011 WL 10676930 (Bankr. E.D. Cal. 2011) (failure to disclose pre-petition retainer payments from the debtor and the debtor's officer, totaling $10,000, warranted complete denial of fee application since the system relies on trusting professionals to disclose their connections and "[n]o bankruptcy judge can or should condone any erosion of this trust")

- *In re Cascadia Project LLC,* 2011 WL 2134379 (Bankr. W.D. Wash. 2011) (the debtor's financial adviser agreed to acquire an ownership interest in the debtor and the debtor's servicing agency under the proposed plan, rendering it disinterested; this should have been disclosed immediately, and the court denied any fees that accrued after the agreement occurred)

- *In re Sabre Intern., Inc.*, 289 B.R. 420 (Bankr. N.D. Okla. 2003) (state-court receiver, who became the debtor's CEO by vote of board members appointed

[2] The BA believes the Court reached a reasonable result in this case but disagrees with part of the analysis. Prior representation of a litigation target should have been disclosed. Similarly, although serving as co-counsel with another law firm typically should not arise to the level of a "connection," the BA thinks the analysis is different when the other law firm is a litigation target in avoidance litigation to be pursued by counsel seeking employment. Finding that the connections should have been disclosed would not have stripped the court of its discretion not to apply sanctions. *See, e.g. In re Song,* 2008 WL 6058782 (9th Cir. B.A.P. 2008) (discussing the bankruptcy court's discretion to determine the appropriate remedy, if any, for nondisclosure).

under a secured creditor's pledge agreement, was also a shareholder at the accounting firm employed by the debtor; the accounting firm failed to disclose unpaid prepetition fees or amounts held in its trust account, which warranted denial of fee application since Rule 2014 "is not a 'no harm, no foul' area of the law")

- *In re Kings River Resorts, Inc.*, 342 B.R. 76 (Bankr. E.D. Cal. 2006) (failure to disclose that broker had represented debtor prepetition warranted denial of admin claim for commission, even if broker had told the trustee about prior representation, since there is a duty of disclosure to the court)

- *In re Miners Oil Co., Inc.,* 502 B.R. 285 (Bankr. W.D. Va. 2013) (a connection requiring disclosure under Rule 2014 arose when a corporate debtor's bankruptcy case was filed due to issues arising from its principal's divorce case, and counsel had met with principal and contacted separate counsel about representing him in his individual chapter 11 case)

- *In re Diamond Mortg. Corp. of Illinois,* 135 B.R. 78, 93 (Bankr. N.D. Ill. 1990) (attorney's disclosures were deficient in many respects, including failure to disclose pre-petition claim, close friendship and "office mate" relationships with parties in interest, or that he had done general corporate work for the debtor's former management)

- *In re Universal Bldg. Prod.*, 486 B.R. 650, 664 (Bankr. D. Del. 2010) (when committee co-counsel coordinated with another individual "to cold-call creditors that [the individual] did not represent for the purpose of being retained by them to attend the Committee formation meeting and to cast a proxy in favor of [co-counsel]" it required disclosure under Rule 2014, in addition to being ethical misconduct)

- *In re LPN Healthcare Facility Inc.*, 498 B.R. 196, 200 (Bankr. S.D. Ohio 2013) (accounting firm failed to disclose that it also was providing accounting services to the debtor's manager, sole shareholder, and other individuals and entities with family ties, warranting vacation of prior employment order)

- *In re Jore Corp.*, 298 B.R. 703 (Bankr. D. Mont. 2003) (disallowing substantially all fees, totaling over $1.8 million, when counsel disclosed that it had obtained a conflicts waiver from the primary secured creditor, who it represented on unrelated matters, but failed to disclose that the conflict waiver contained a litigation exception)

- *Beirne, Maynard & Parson, L.L.P. v. Cypresswood Land Partners*, 2010 U.S. Dist. LEXIS 146549 (S.D. Tex. 2010) (affirming the disallowance of all fees owed to debtor's counsel due to the inadequate disclosure of counsel's representation of debtor's principal, but reversing the disgorgement of payments made by the principal since the bankruptcy court lacked jurisdiction to order disgorgement of non-estate property paid by the principal towards his independent fees owed to the firm)

- *In re Southmark Corp.*, 181 B.R. 291 (Bankr. N.D. Tex. 1995) (accounting firm hired by examiner failed to disclose that its prior auditing work for a litigation target, and "when it came time to investigate [the debtor's] securities claims against [the litigation target], [the accounting firm] pulled its staff, did not pursue the investigation and did not disclose this activity to the court," which warranted fee disgorgement and an award of attorneys' fees and costs incurred in connection with the disgorgement motion)