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## DETERMINING AND MANAGING CONFLICTS OF INTEREST IN BANKRUPTCY CASES

*This article offers a summary of the conflict of interest and disclosure requirements for estate professionals under the Bankruptcy Code, provides an overview of recent court actions to punish counsel for actual conflicts of interest and failures to disclose, and offers guidance on best practices to avoid conflicts of interest in your next bankruptcy estate representation.*

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It is exciting to bring in a new bankruptcy representation. Attorneys must, however, bear in mind the requirements of the Bankruptcy Code, including ethical rules regarding retention, disclosures, and conflicts of interest. By getting in front of these issues, attorneys can avoid costly sanctions, reputational damage, and fee disgorgement. The first section of this article summarizes applicable statutes and the Federal Rules of Bankruptcy Procedure — highlighting disclosure requirements for any estate professional. The second section provides a sampling of recent case law regarding conflicts of interest in bankruptcy cases, while the third section offers tips for avoiding conflicts of interest and disclosing potential conflicts as they arise.

### CONFLICTS OF INTEREST AND DISCLOSURE REQUIREMENTS

Section 327(a) of the Bankruptcy Code, among others, governs the retention of estate professionals, including legal counsel and most financial consultants. Under section 327(a), an estate may retain and compensate an attorney, accountant, or other

professional so long as such professional does “not hold or represent an interest *adverse* to the estate” and such professional is a “disinterested person[.]”<sup>1</sup>

The Bankruptcy Code does not define an “adverse” interest, so case law shapes the definition. Courts differ, however, as to the exact test or standard to be applied. Many courts, including the Second Circuit, apply the test initially set forth in *In re Roberts*, which provides that an adverse interest is one where (1) the possession or assertion of any economic interest that would tend to decrease the value of the bankruptcy estate or create an actual or potential dispute with the estate as a rival claimant or (2) a predisposition of bias against the estate.<sup>2</sup> Courts within the Third Circuit tend to focus on

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<sup>1</sup> 11 U.S.C. § 327(a).

<sup>2</sup> *In re Roberts*, 46 B.R. 815, 826-27 (Bankr. Utah 1985); see also *In re Level 8 Apparel LLC*, 2023 Bankr. LEXIS 1006, \*17-18 (Bankr. S.D.N.Y. April 13, 2023) (an “interest adverse to the estate” means “either (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

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