



U.S. Department of Justice

Executive Office for United States Trustees

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Office of the Director

Washington, DC 20530

December 4, 2019

**MEMORANDUM**

TO: United States Trustees

FROM: Clifford J. White III   
Director

SUBJECT: Principles to Guide USTP Enforcement of the Duty of Professionals to Disclose Connections to a Bankruptcy Case Under 11 U.S.C. §§ 327 and 1103 and Fed. R. Bankr. P. 2014

Pursuant to 28 U.S.C. § 586(a)(3)(I), the United States Trustee Program (USTP) has an important responsibility to review applications in chapter 11 cases to employ law and other professional firms (“professional firms”)<sup>1</sup> that will seek payment from the bankruptcy estate. Due to the multiplicity of interests in a case—from large to small creditors, from employees to other stakeholders—the Bankruptcy Code and Rules mandate that professional firms disclose their connections to other parties in the case and satisfy conflict of interest standards.

Although all parties in a case may object to the adequacy of a professional firm’s disclosures and to a professional firm’s retention because of potential or actual conflicts, it is usually only the USTP that makes inquiries or files objections. Our role as the “watchdog” of the bankruptcy system is to faithfully read and apply the Code and Rules and to raise issues that we have identified so that the court may make the ultimate determination on a professional firm’s employment.

The organizational structure of many professional firms seeking to be retained in bankruptcy cases has grown more complex in recent years. Some professional firms are affiliates of larger businesses that provide a variety of services to clients, both inside and outside of the bankruptcy system. In addition, some professional firms (including parents and affiliates) sponsor funds that invest in their business clients, in distressed debt that may be at issue in a bankruptcy case, or in industries (including competitors of their business clients) to which they provide services.

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<sup>1</sup> As used herein, this term includes the individual professionals of a professional firm.

The increasingly complex profile of professional firms subject to the disclosure and conflict provisions of 11 U.S.C §§ 327 and 1103 and Fed. R. Bankr. P. 2014 makes both our review of employment applications and the court's decision on such applications more challenging. Accordingly, set forth below are the general principles that should guide you, as USTP personnel, in reviewing applications to employ professional firms in bankruptcy cases.

1. **Enforce the Law.** The USTP's responsibilities start and stop with a textual reading and expert application of the Bankruptcy Code and Rules. Although professional firms may adopt internal protocols that guide their processes for compliance, these internal protocols cannot change substantive law. Nor can these protocols provide a safe harbor for a firm that does not meet the strict legal requirements governing disclosures and conflicts.

2. **Disclose Connections on the Public Record.** It is the USTP's position that relevant bankruptcy law requires professional firms to disclose on the public record their connections to a case, even if they have a contractual arrangement to keep client information, including client names, confidential. The USTP will argue that a professional firm required to disclose information must either publicly disclose it on the record or file a properly supported motion to seal it under section 107 of the Bankruptcy Code for the court to adjudicate. Should the professional firm choose to file a motion to seal rather than publicly disclose the required information on the record, the USTP has a responsibility to object to any motion that does not satisfy the high bar for sealing.

3. **Disclose Affiliate Connections.** It is the USTP's position that a professional firm being employed must disclose the connections of all its affiliates. Every case is fact specific and, in some circumstances, a professional firm may be able to show that it is sufficiently separate from its affiliates to excuse affiliate disclosure.<sup>2</sup> The applicant seeking to employ the professional firm bears the burden of proof and only the court has authority to excuse affiliate disclosure.

4. **Disclose Connections Based on Investments.** Investments by the professional firm's investment affiliates or by their individual professionals may create conflicts and, depending on the circumstances, those conflicts can be just as serious as conflicts created by working for clients with adverse interests. It is the USTP's position that relevant bankruptcy law requires the professional firm to disclose connections that extend to investments in clients and other entities that may be a party in interest in the case, such as a stalking horse bidder, DIP lender, or other creditor. Investments include direct investments in such entity, as well as investments made through third parties.

In deciding whether investments must be disclosed, the USTP will analyze two key factors: (1) knowledge and (2) control. If the professional firm knew or could have known about the investment in a particular entity that may be involved in the case or an investment in the debtor's industry, then it is the USTP's position that the investment should be disclosed. Or, if the professional firm controlled or could have controlled the selection of the investment in a

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<sup>2</sup> Separate incorporation may not be dispositive of whether affiliate disclosure may be excused. Professional firms routinely disclose connections of their separately incorporated affiliates when, for example, the separate legal entities belong to an international cooperative.

relevant entity or industry, then it is the USTP's position that the investment must be disclosed. Thus, for example, a typical investment in a diversified mutual fund that is managed by an independent outside advisor need not be disclosed. But a professional firm that sponsors pooled investments in clients who may be parties in interest in the case may be required to disclose those investments.

It is vital that the USTP acts consistently from district to district in this and other legal matters. Please ensure that all staff who review chapter 11 retention applications are familiar with these general disclosure principles. Each case will have unique facts that should be considered in a manner consistent with these principles.

The Office of the General Counsel should be consulted if there are any questions regarding these principles or their application in specific cases. This memorandum may be expanded and will be incorporated into the USTP Policy and Practices Manual, which will be made available to the public.<sup>3</sup> This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the ultimate determination on the obligations of professionals under section 327 and Fed. R. Bankr. P. 2014 resides solely with the court. Nothing in this memorandum has any force or effect of law, and nothing stated herein imposes on parties outside the USTP any obligations that go beyond those set forth in the Bankruptcy Code and Rules.

Thank you for your continued cooperation and diligence in this important area of responsibility.

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<sup>3</sup> The USTP will continue to review and update this internal guidance, as appropriate. Moreover, nothing in this internal guidance: (1) limits the USTP's discretion to request additional information necessary for the review of a particular application; (2) limits the USTP's discretion to file comments or objections to applications, including as to whether a professional firm is disinterested or otherwise satisfies the statutory standards for retention in the case; or (3) creates any private right of action on the part of any person enforceable against the USTP or the United States.