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Ethical Considerations in Section 363 Bankruptcy Sales

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I. Restrictions on Acquisition of Estate Assets by Insiders and Court-Approved Professionals, and Advising Purchasers

A. Disqualifying Conflicts of Interest

A professional approved by the court to assist a trustee or debtor in possession cannot advise a purchaser of bankruptcy estate assets, because of the inherent conflict of interest in representing both a seller and buyer. *Rome v. Braunstein*, 19 F.3d 54, 61 (1st Cir. 1994) ("[S]imultaneous representation of the buyer and the seller in the same transaction is a prototypical disqualifying conflict of interest"); *In re Freedom Solar Ctr., Inc.,* 776 F.2d 14, 16-17 (1st Cir.1985).

The professional's status in the bankruptcy case affords "unique access to inside information concerning the nature and value of its assets, information that [the professional] could have used (or been tempted to use) to enable his other client…to submit a better calibrated bid than arm's-length bidders could venture…." *Rome*, 19 F.3d at 61. Such conflicts are not limited to attorneys. As one bankruptcy court held, a debtor's financial advisor who "performed a wide variety of tasks which largely shaped the companies' financial and operational structure," and also advised a major secured creditor who was to buy the estates' assets under the plan, became non-disinterested on account of the inherent conflict of interest. *In re Unitcast, Inc.*, 214 B.R. 979, 987-88 (Bankr. N.D. Ohio 1997).

A disqualifying adverse interest also exists when a bankruptcy court-approved professional itself possesses or asserts, as well as when it represents, a creditor's claim, an ownership interest, or status as a buyer. 11 U.S.C. § 327(a) (trustee may employ professionals "that do not hold or represent an interest adverse to the estate"); *see Rome*, 19 F.3d at 58 n.1 ("[A]n 'adverse interest' has been described in pragmatic terms as the 'possess[ion] or assert[ion] [of] mutually exclusive claims to the same economic interest, thus creating either an actual or potential dispute between rival claimants…or (2) [the possession of] a predisposition or interest under circumstances that render such a bias in favor of or against one of the entities.'") (quoting *In re Roberts*, 46 B.R. 815, 826-27 (Bankr. D. Utah 1985)); *In re Crivello*, 134 F.3d 831, 835-36 (7th Cir. 1998) (similar wording).

Involvement with investors acquiring or even attempting to acquire estate assets results in a disqualifying interest adverse to the estate. *In re New River Dry Dock, Inc.*, 497 Fed.Appx. 882, 887 (11th Cir. 2012) (broker agreed to manage estate marina and obtain ownership interest upon closing under plan); *In re W. Delta Oil Co.*, 432 F.3d 347, 356-57 (5th Cir. 2005) (lawyers' undisclosed potential acquisition was an interest adverse to the estate). As the Ninth Circuit held back in 1955:

> A fiduciary cannot purchase property which he is empowered to sell. Property in custody of a court of bankruptcy has a special status and is sacrosanct. No dealings therein will be tolerated which are tainted with the possibility of unfairness or of conflict between personal desires and trust obligations.
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> Even if there were full disclosure, adequacy of consideration, absence of secret profit, an open judicial sale will not avail separately or in combination as a defense for such a fiduciary.[6] The prohibition is absolute in the public interest. It is established to protect the courts themselves from suspicion of chicanery.

Donovan and Schuenke v. Sampsell, 226 F.2d 804, 811 (9th Cir. 1955).

B. Applicable Criminal Statute

When an officer of the court "knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11," that professional commits a crime. 18 U.S.C. § 154 (2000) (providing any "custodian, trustee, marshal, or other officer of the court" knowingly involved with an estate property purchase "shall be fined . . . and shall forfeit . . . office"). Using the mail in furtherance of a scheme to defraud a bankruptcy estate from receiving the actual value of estate assets being sold, and diverting part of the value to insiders and their bankruptcy counsel, has also been held to warrant a conviction for mail fraud. 18 U.S.C. § 1341; *U.S. v. Rosen*, 130 F.3d 5 (1st Cir. 1997) (counsel guilty of mail fraud in deceiving bankruptcy court with undisclosed side deal in connection with estate asset sale).

C. Fiduciary Duties

1. Prohibition or High Standards for Acquiring Assets

The fiduciary duty of loyalty includes prohibits a bankruptcy professional and officers of the DIP from self-dealing with estate assets. *In re Brook Valley VII, Joint Venture*, 496 F.3d 892 (8th Cir. 2007); *Donovan and Schuenke*, 226 F.2d at 811; *In re Performance Nutrition, Inc.*, 239 B.R. 93 (Bankr. N.D. Tex. 1999); *see also In re Frazin & Oppenheim*, 181 F.307, 309 (2d Cir. 1910) (explaining as a rule of equity, public policy and disinterestedness in the disposition of assets that trustees and their agents and attorneys cannot purchase a bankrupt's property). That principle is also cited, along with the proscription against such purchases in the bankruptcy crimes statute, for prohibiting bankruptcy estate professionals, trustees and DIPs from directly or indirectly acquiring estate assets. *See In re Exennium, Inc.*, 23 B.R. 782, 786-88 (B.A.P. 9th Cir. 1982) (former DIP counsel barred from purchasing lease from trustee after conversion), *rev'd as moot under § 363(m)*, 715 F.2d 1401 (9th Cir. 1983); *In re Chuck's Const. Co., Inc.*, 424 B.R. 202, 205-06 (Bankr. D. S.C. 2010) (extensive discussion); *In re Crestview Funeral Home, Inc.*, 287 B.R. 832, 837-39 (Bankr. D. N.M. 2002) (auctioneer's fees ordered disgorged since he and his contract employees bought property at the auction); *In re Allied Gaming Management, Inc.*, 209 B.R. 201, 203 (Bankr. W.D. La. 1997) (estate accountant cannot participate in ownership of company acquiring debtor under plan); *In re Sauer*, 191 B.R. 402, 409-11 (Bankr. D. Neb. 1995) (DIP counsel purchase of house after creditor foreclosed); *In re Rahe*, 178 B.R. 801, 802 (Bankr. D. Neb. 1995) (unethical and criminal for trustee's counsel to purchase estate property); *In re Q.P.S., Inc.*, 99 B.R. 843, 844-45 (Bankr. W.D. Tenn. 1989) (DIP's accountant prohibited from buying estate car).

Some courts have allowed such acquisitions by professionals, however, if the transaction is inherently fair, with the earmarks of an arm's-length bargain. *In re Brook Valley IV*, 347 B.R. 662, 675-76 (B.A.P. 8th Cir. 2006), *aff'd*, 496 F.3d 892 (8th Cir. 2007) (permissible with full disclosure and oversight); *In re Stanley*, No. 15-70378, 2016 WL 6915522 (Bankr. W.D. Va. July 29, 2016) (discussing extensive case law with one reference to the criminal statute); *In re A.W. Logging, Inc.*, 356 B.R. 506, 514 (Bankr. D. Idaho 2006) (court doubts wisdom of attorney purchasing product from DIP client for cash in ordinary course of business, but not disqualifying; court does not address statute); *In re Cornerstone Products, Inc.*, 416 B.R. 591, 611 (Bankr. E.D. Tex. 2008); *In re Schipper*, 109 B.R. 832, 835-37 (Bankr. N.D. Ill. 1989), *aff'd*, 933 F.2d 513 (7th Cir. 1991) and *In re Wilde Horse Enterprises, Inc.*, 136 B.R. 830 (Bankr. C.D. Cal.

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