“Yet Another View of In re Pillowtex”

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I was writing an article on conflicts of interest in bankruptcy cases when the December/January issue of the ABI Journal hit my desk. The issue contained not one, but two articles discussing the implications of the Third Circuit’s decision in In re Pillowtex, 304 F.3d 246 (2002). White and Medford’s Disinterestedness and Preferential Transfers and Salerno and Kroop’s Revisiting Retentions both offer sound guidance for the issues posed by Pillowtex for practitioners. I think, however, that Pillowtex reflects a far more significant caution than is reflected in these articles: the court in Pillowtex signals that practical fixes for conflicts of interest cannot ultimately cure practices specifically prohibited by the Bankruptcy Code. So, I think yet another article on Pillowtex is in order.

In Pillowtex, the Jones Day firm applied to be counsel for the debtor in possession. In its application it disclosed certain payments it had received pre-petition. The U.S. Trustee alleged that these payments were preferential and therefore disqualified the firm under the “adverse interest” and “disinterestedness” requirement of 11 U.S.C. § 327. Jones Day claimed that the payments were not preferential. It further argued that, even if the payments were subsequently determined to be preferential, Jones Day could cure the problem by agreeing to return the payments in question.

The District Court for the District of Delaware, sitting as the bankruptcy court in Delaware, agreed with Jones Day and approved Jones Day’s retention with conditions in its order that would require the firm to return any payments determined to be preferential. The U.S. Court of Appeals for the Third Circuit reversed, finding that “the court’s order incorporating the two conditions does not resolve the question of whether Jones Day received an avoidable preference and was therefore not disinterested and whether it should have been disqualified.”

The articles of Messrs. White and Medford and Messrs. Salerno and Kroop reflect the general reaction to the Pillowtex decision. There is concern about the practical burdens that Pillowtex will impose on firms that represent debtors in possession; speculation that the U.S. Trustee is getting into the preference recovery business, at least with regard to pre-petition payments to professionals; the suggestion that everybody does
it and creditors generally accept the practice; and a discussion of the steps to take to avoid a Pillowtex issue.

These concerns notwithstanding, Pillowtex sends a clear message that some conflicts will disqualify counsel, and disqualifying conflicts cannot be ignored.

Pillowtex builds upon a long line of Third Circuit cases that have disqualified counsel because of conflicts of interests. Pillowtex cites to In re BH&P

Id. at 56.

White and Medford, at 54. (“Thus, professionals would be wise to resolve potential conflicts early in a bankruptcy case”).

949 F.2d 1300 (3d Cir. 1991).

140 F.3d 463 (3d Cir 1998).

180 F.3d 504 (3d Cir. 1999).

Pillowtex at 254.

White and Medford at 38.

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