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**Issues in Litigation**
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# THE NONAPPEALABILITY OF DISQUALIFICATION ORDERS IN BANKRUPTCY PROCEEDINGS

Section 327 of the Bankruptcy Code permits a trustee to employ "attorneys ... or other professional persons" so long as those persons are "disinterested persons" [1] who "do not hold or represent an interest adverse to the estate." [2] This test is rigidly applied, [3] and requires applicants affirmatively to disclose potential conflicts of interest. [4] The primary penalty assessed against a party found to have a conflict of interest is disqualification. [5]

Disqualification, especially of attorneys, can seriously impair a debtor's access to adequate representation. When a disqualification order is entered, the client immediately is separated from counsel of his choice. Attempts to correct an erroneous disqualification order at the end of the case are likely to prove futile, since courts will likely require the client to show that but for the improper disqualification, the client would have won the case.

Disqualification also makes life difficult for the disqualified attorney. Most obviously, a disqualified attorney can no longer represent the client, and therefore loses that source of revenue. In addition, a court may deny compensation for services rendered or expenses incurred prior to disqualification. [6] A disqualification order also damages an attorney's reputation by stating or implying that the attorney acted unethically. [7] Thus, clients and attorneys both have strong incentives to appeal disqualification orders.

Courts are currently divided over whether disqualification orders are appealable in bankruptcy cases. Outside the bankruptcy context, the Supreme Court has held that disqualification orders are not appealable. This article argues that because there is no meaningful ground ***544** for distinguishing bankruptcy cases from civil cases on the issue of the appealability of disqualification orders, courts deciding bankruptcy cases are compelled by Supreme Court precedent to follow the civil cases and hold that disqualification orders are not appealable as of right.

## Standing

Only clients can appeal a disqualification order; the client's attorney, as a nonparty to the underlying action, lacks standing to appeal. In *Richardson-Merrell, Inc. v. Koller*, [8] the Supreme Court held that the decision whether to pursue an appeal of an attorney's disqualification belongs to the client. The attorney has no independent right to appeal a disqualification order. [9] The same rule applies in the context of bankruptcy proceedings. [10]

## Appealability in Nonbankruptcy Proceedings

Title 28 USC § 1291 grants the courts of appeals jurisdiction over appeals from all "final decisions of the district courts," except where a direct appeal lies to the U.S. Supreme Court. The statutory requirement of a "final decision" means that "a party must ordinarily raise all claims of error in a single appeal following final judgment on the merits." [11] This final judgment rule is designed to promote efficient judicial administration while simultaneously emphasizing the deference appellate courts owe to the trial court's decisions on the many questions of law and fact that arise before judgment. [12] Immediate review of every trial court ruling, while permitting more prompt correction of erroneous decisions, would impose unreasonable disruption, delay, and expense. [13] It would also undermine the ability of trial courts to supervise litigation. [14] In Section 1291, Congress expressed a preference that some erroneous trial court rulings go uncorrected until the appeal of a final judgment, rather than having litigation punctuated by "piecemeal appellate review of trial court decisions which do not terminate the litigation." [15]

An order granting or denying a motion to disqualify counsel is not a final judgment within the meaning of Section 1291. [16] Pursuant to Section 1291, an appellate court has jurisdiction over such an order only if the order falls within the "collateral order" exception to the final judgment rule. [17] In *Cohen v. Beneficial Industrial Loan Corp.*, [18] the Supreme Court recognized a narrow exception to the final judgment rule for a "small class" of prejudgment orders that "finally determine claims of right separable from, and collateral to, rights asserted in the ***545** action, [rights which are] too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." [19] In *Richardson-Merrell*, the Court reiterated that to fall within the collateral order exception, "an order must at a minimum satisfy three conditions: it must [1] 'conclusively determine the disputed question,' [2] 'resolve an issue completely separate from the merits of the action,' and [3] 'be effectively unreviewable on appeal from a final judgment.'" [20]

The collateral order doctrine is a "narrow exception" to the finality rule, and its reach is limited to trial court orders affecting rights that irretrievably will be lost in the absence of an immediate appeal. Thus, cases concerning disqualification orders turn on the importance afforded to resolving the issue immediately.

In *Firestone Tire & Rubber Co. v. Risjord*, [21] the Supreme Court held that a district court order denying a motion to disqualify counsel in a civil case cannot be appealed as a matter of right as soon as the order is entered. The Court stated:

> The decision whether to disqualify an attorney ordinarily turns on the particular factual situation of the case then at hand, and the order embodying such a decision will rarely, if ever, represent a final rejection of a claim of fundamental right that cannot effectively be reviewed following judgment on the merits. [22]

*Firestone* expressly left open the issue of whether orders *granting* disqualifications are subject to immediate appeal, as well as the issue of whether orders denying disqualifications in criminal cases are subject to immediate appeal. [23] The latter issue was effectively resolved in *Flanagan v. United States*, [24] in which the Court held that a district court's pretrial order disqualifying defense counsel in a criminal case is not immediately appealable under Section 1291. The unanimous opinion in *Flanagan* emphasized the strong interest of both the parties and society as a whole in the speedy resolution of criminal cases. [25]

In *Richardson-Merrell*, [26] the case most germane to the subject of this article, the Court extended *Firestone* and *Flanagan* to disqualification orders *granted* in the context of general *civil* litigation. In so doing, the Court rejected respondent's attempts to distinguish *Firestone* and *Flanagan*. First, respondent attempted to distinguish *Flanagan* by arguing that the societal interest in prompt adjudication is weaker in civil cases than in criminal cases. The Supreme Court rejected this argument, finding delay repugnant in both types of cases.

Second, respondent attempted to distinguish *Firestone* by arguing that frivolous disqualification motions often are filed for purposes of harassment. This would be discouraged, respondent argued, by granting immediate appeal whenever a disqualification motion is granted. The Court rejected this argument, finding that whatever benefit would be so obtained was outweighed by the harm caused by increased delay.

Third, respondent argued that immediate appeal should be granted to allow disqualified counsel to vindicate the imputation ***546** of misconduct. The Court, stating that the decision to appeal should turn entirely on the client's interests, held that counsel has no independent right to appeal a disqualification order.

Finally, respondent argued that immediate appeal should be granted to vindicate the client's choice of counsel. Prejudice to a litigant's right to counsel of her choice, respondent stated, is suffered the moment a disqualification order is entered, and is unlikely to be effectively reviewable after the entry of final judgment. This is so because a reviewing court probably would require the aggrieved party to show that but for the erroneous disqualification order, the outcome of the litigation would have been different.

The Court rejected this argument as well, holding that a disqualification order may be reviewed adequately on appeal of final judgment. [27] However, the Court, apparently wanting to provide an additional safety valve in the final judgment rule, also stated that a party whose lawyer is disqualified can seek immediate review of the order by asking for mandamus. [28] The standards for obtaining mandamus are more stringent than those of an ordinary appeal; the petitioner must show irreparable harm and a clear right to the relief sought. [29]

Thus, in the context of both civil and criminal litigation, an order granting a motion to disqualify counsel is final and is not immediately appealable under the collateral order doctrine. The Supreme Court's analysis has not, however, fully permeated cases arising in the context of bankruptcy proceedings.

## Appealability in Bankruptcy Proceedings

Pursuant to 28 USC § 158(a), a party may appeal as of right from "final judgments, orders, and decrees" entered by a bankruptcy judge. This is distinguished from a bankruptcy judge's interlocutory orders and decrees, from which a party may appeal only after first obtaining leave of the district court. [30] If a party appeals as of right an order that the district court later determines to be interlocutory, the court generally will construe the appeal as a motion for leave. [31]

The issue then becomes whether the district court should exercise its discretion to entertain the appeal. This request is evaluated by applying the test used to assess appeals to the circuit courts, as set forth in 28 USC § 1292(b). [32] As a result, leave to appeal will be granted only when the order from which the party appeals "involves a controlling question of law as to which there is substantial ground for difference of opinion and ... an immediate appeal from the order may materially advance the ultimate termination of the litigation." [33]

## *547 Is a Disqualification Order "Final" in the Context of Bankruptcy Proceedings?

If a disqualification order is final, a party may appeal the disqualification order as of right. A final order is an order that ends the litigation on the merits and leaves nothing for the court to do except execute the judgment. [34] As noted previously, a disqualification order would never be considered final outside the bankruptcy context. [35] However, courts generally view finality more flexibly in the bankruptcy context than in the context of general civil litigation. [36]

This more flexible definition is not infinite and does not swallow the general rule. For example, in bankruptcy cases paralleling the civil *Firestone* case, courts unanimously have held that a bankruptcy court's denial of a motion to disqualify counsel is not final and therefore is not appealable as a matter of right. [37]

There are several good reasons, however, for finding finality in an order *granting* disqualification but not in an order *denying* disqualification. The Second Circuit, in a pre-*Richardson-Merrell* general civil litigation decision, listed five. [38] First, when a disqualification order is granted, the losing party is immediately separated from counsel of her choice. If the order is erroneous,

  

correcting it by an appeal at the end of the case would require a party to show she lost the case because she was improperly forced to change counsel. This is an extremely onerous burden. Second, permitting an immediate appeal from the grant of a disqualification motion does not disrupt the litigation, since proceedings must be stayed in any case while new counsel is obtained. Third, the grant of a disqualification motion may effectively terminate the litigation if the party whose counsel is disqualified cannot afford to hire new counsel to continue the litigation. This problem will be particularly acute when the case is not a sure winner. Original counsel, already having invested significant "sunk costs" into litigating the case, may be willing to stick it out in the hope of a later payoff; new counsel, blessed with the knowledge obtained from old counsel's investment, may not be willing to make a similar initial investment. Fourth, the granting of a disqualification ***548** motion is a fair indication that a nonfrivolous issue has been raised; there is no similar assurance that appeals from denials of disqualification motions will raise a substantial question. Thus, it is far less likely that appeals from orders granting disqualification motions will be taken purely for tactical reasons. Fifth, disqualification often impairs the reputation of the disqualified attorney or law firm; this injury may never be corrected on appeal if the party is satisfied with the performance of new counsel and the outcome of the litigation.

As a result of these distinctions, courts are divided on the issue of whether a bankruptcy court's *granting* of a motion to disqualify counsel is final and therefore appealable. Three courts have held that it is not. *In re Blinder Robinson & Co., Inc.*;[39] *In re Turner*;[40] *In re Sharpe*.[41] The *Blinder* and *Sharpe* courts relied on the Supreme Court's *Richardson-Merrell* decision which, as discussed previously, held that in general civil cases, a disqualification order is not final and not subject to immediate appeal. The Court in *Richardson-Merrell* saw no significant substantive distinction between a court's granting of a disqualification order and a court's denial of such an order. Though *Richardson-Merrell* is not dispositive in the bankruptcy context, the *Blinder* and *Sharpe* courts held that the *Richardson-Merrell* rationale applied equally to bankruptcy cases. The Fifth Circuit employed this same analysis when, following the Supreme Court's civil case of *Firestone*, it held that a bankruptcy judge's order denying a disqualification order is not final.[42]

Thus, by this reasoning, the test is not whether there is a substantive distinction between the granting and the denying of a disqualification order. The Supreme Court in *Richardson-Merrell* recognized that there are several bases for distinction, but rejected them as not important enough to justify the imposition of different rules. Rather, the test is whether the bankruptcy context is sufficiently unique to justify a different rule than that imposed in the context of general civil litigation by *Richardson-Merrell*. Because, as the Fifth Circuit has indicated, there is no basis for granting greater appealability in bankruptcy cases than in civil litigation cases, courts should hold, pursuant to *Richardson-Merrell*, that a disqualification order is not final.

Two courts have held that a disqualification order is final and therefore immediately appealable. *In re BH&P Inc.*;[43] *In re Albright*.[44] Neither court mentioned *Richardson-Merrell*. The *BH&P* court's analysis focused on judicial economy, whereas the *Albright* court found that the disqualification order could cause irreparable harm by impairing petitioner's choice of counsel.

As noted above, however, both of these factors were explicitly rejected in ***549** the context of general civil litigation in *Richardson-Merrell*. I see no reason why they should be afforded more significance in bankruptcy cases than in civil litigation cases. Thus, under the analysis of *Richardson-Merrell*, I conclude that these cases were wrongly decided.

**Assuming a Disqualification Order is Not Final, Should a District Court Exercise Its Discretion to Review the Order?**

Even if a court finds that a disqualification order is not a final order appealable by right, a federal district court has the discretion to grant leave and thereby entertain an appeal from an interlocutory order of the bankruptcy court. The standard, as noted above, is whether a controlling question of law, with substantial ground for disagreement, exists, and whether its resolution would materially advance the end of litigation.[45] Issues of fact such as those concerning counsel's alleged conflicts of interest are within the bankruptcy court's discretion and will not support a petition for leave to appeal.[46]

In *In re Sharpe*,[47] the district court held that the bankruptcy court's order disqualifying creditor's counsel was not final. The district court nonetheless exercised its discretion to accept the appeal, doing so for three reasons. First, the disqualified firm had represented its client for several years. An erroneous disqualification thus could do long-term damage not easily remediable on appeal. Second, the conflict-of-interest law at issue (concerning the circumstances in which an attorney representing a party

adverse to a former client should be disqualified) was unresolved under Seventh Circuit precedent. Thus, a ruling by the district court would substantially contribute to the development of the law. Third, the party opposing appeal never objected to the petitioner's notice of appeal, "thereby implicitly indicat[ing] his acquiescence in this court's hearing the appeal." [48]

The court's first reason was explicitly rejected as an independent basis for allowing immediate appeal in *Richardson-Merrell*. The court's second reason will not be applicable in most cases, where the conflict-of-interest law is well settled. The court's third reason will be applicable only when opposing counsel fails timely to object to disqualified counsel's attempts to appeal. *Sharpe* therefore is a very narrow case, applicable only when the underlying issue of law is unresolved. Since this is unlikely to be true in the majority of cases, it is unlikely that courts will often exercise discretionary review over disqualification orders.

### The Collateral Order Doctrine

Even if a disqualification order is held nonfinal and the district court declines to exercise discretionary review, the order might arguably be reviewable under the collateral order doctrine. As noted previously, there are three conditions an order must meet before it can qualify under this doctrine. First, the order must conclusively determine the disputed question; second, it must resolve an issue completely separate ***550** from the merits of the action; and third, it must effectively be unreviewable on appeal from a final judgment. [49] These requirements are conjunctive: failure of any one results in failure of jurisdiction. [50]

The second and third conditions cannot, as a matter of law, be met in disqualification cases. In *Richardson-Merrell*, the Court held that a disqualification order "can be reviewed as effectively on appeal from a final judgment as on an interlocutory appeal," [51] thus negating the third condition of the collateral order exception. The Court also held that "orders disqualifying counsel in civil cases are not completely separate from the merits of the action," [52] thus negating the second condition. This latter rule is a per se rule, not subject to case-by-case determination. [53]

### Conclusion

There are strong arguments for allowing immediate appeal of disqualification orders. These were rejected, however, by the Supreme Court in several nonbankruptcy cases. Because there is no meaningful ground for distinguishing bankruptcy cases from civil cases on the issue of the appealability of disqualification orders, courts deciding bankruptcy cases are compelled to follow the Supreme Court cases and hold that disqualification orders centered in bankruptcy proceedings are not appealable as of right.

## Footnotes

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1 Section 101 of the Code prescribes five tests which, if satisfied, render a person "disinterested." These tests are summarized in the Code's legislative history as follows:

> A person is a disinterested person if the person [1] is not a creditor, equity security holder or insider; [2] is not and was not an investment banker of the debtor for any outstanding security of the debtor ...; [3] has not been an investment banker for a security of the debtor within three years before the date of the filing of the petition, or an attorney for such an investment banker ...; [4] is not an insider of the debtor or of such an investment banker; and [5] does not have an interest materially adverse to the estate.
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> HR Rep. No. 595, 95th Cong., 1st Sess. 310-11 (1977); S. Rep. No. 989, 95th Cong. 2d Sess. 23 (1978).

  

2 11 USC § 327.

3 In re Consolidated Bancshares, Inc., 785 F2d 1249, 1256 n.6 (5th Cir. 1986); Meredith v. Thralls, 144 F2d 473 (2d Cir. 1944), cert. denied, 323 US 758 (1944).

4 See, e.g., In re Western Office Partners, Ltd., 105 BR 631 (Bankr. D. Colo. 1989).

5 Lawrence P. King, Collier on Bankruptcy ¶ 37.03[3][f] at 327-55 (1993).

6 See, e.g., In re Philadelphia Athletic Club, Inc., 38 BR 882, 884 (Bankr. ED Pa. 1984); In re Paine, 14 BR 272, 275 (WD Mich. 1981).

7 Law Offices of Seymour M. Chase, PC v. Federal Communications Comm'n, 843 F2d 517, 527 (DC Cir. 1988) (Wald, CJ, dissenting).

8 472 US 424, 435 (1985).

9 Id.; see also Wilson v. Southwest Airlines, Inc., 880 F2d 807, 817 (5th Cir. 1989) (holding that only parties to an action may appeal judgments rendered in that action); Law Offices of Seymour M. Chase, PC v. Federal Communications Comm'n, 843 F2d 517, 518 (DC Cir. 1988) (holding that a disqualification order is unreviewable when the appeal is filed by the attorney rather than the client).

10 In re Blinder Robinson & Co., Inc., 132 BR 759, 762-763 (D. Colo. 1991).

11 Firestone Tire & Rubber Co. v. Risjord, 449 US 368, 374 (1981).

12 Id.

13 Richardson-Merrell, Inc. v. Koller, 472 US 424, 430 (1985).

14 Id.

15 United States v. Hollywood Motor Car Co., 458 US 263, 265 (1982).

16 See Richardson-Merrell, 472 US at 430 (1985).

17 Id.

18 337 US 541 (1949).

19 Id.

  

20 Richardson-Merrell, 472 US at 430 (1985) (quoting Coopers & Lybrand v. Livesay, 437 US 463, 468 (1978)).

21 449 US 368, 377 (1981).

22 Id.

23 Id., 449 US at 372 n.8.

24 465 US 259 (1984).

25 Id.

26 472 US 424 (1985).

27 Id., 472 US at 435.

28 Id.; see also In re American Airlines, Inc., 972 F2d 605 (5th Cir. 1992).

29 Mallard v. United States District Court, 490 US 196, 314 (1989); Matter of Sandahl, 980 F2d 1118, 1119-1121 (7th Cir. 1992) (discussing mandamus requirements in the context of disqualification orders).

30 Id.

31 See, e.g., In re Nucor, Inc., 118 BR 786, 788 (D. Colo. 1990); In re Global Marine, Inc., 108 BR 1007, 1009 (SD Tex. 1988); In re Sharpe, 98 BR 337, 339 (ND Ill. 1989); B. Rule 8003(c).

32 Global Marine, 108 BR at 1009; In re Blinder Robinson & Co., Inc., 132 BR 759, 764 (D. Colo. 1991); In re Klein, 70 BR 378, 380 (ND Ill. 1987).

33 28 USC § 1292(b). The Sixth Circuit has interpreted Section 1292(b) as requiring four elements: (1) the question involved must be one of "law"; (2) it must be controlling; (3) there must be a substantial ground for "difference of opinion" about it; and (4) an immediate appeal must materially advance the ultimate termination of the litigation. In re Southern Indus. Banking Corp., 70 BR 196, 201 (ED Tenn. 1986), citing Cardwell v. Chesapeake & Ohio Ry. Co., 504 F2d 444, 446 (6th Cir. 1974).

34 Catlin v. United States, 324 US 229, 233 (1945); In re TCL Investors, 775 F2d 1516, 1519 (11th Cir. 1985); In re Johns-Manville Corp., 32 BR 728, 731 (SDNY 1983).

35 See supra note 16 and accompanying text.

36 See, e.g., In re Delta Serv. Indus., 782 F2d 1267, 1269 (5th Cir. 1986); In re Teleport Oil Co., 759 F2d 1376, 1377 (9th Cir. 1985); In re Comer, 716 F2d 168, 171 (3rd Cir. 1983); In re Saco Local Dev. Corp., 711 F2d 441, 444-446 (1st

  

Cir. 1983); 16 Wright & Miller, Federal Practice & Procedure § 3926, at 60 (Supp. 1985) (noting that "[i]n many ways, bankruptcy proceedings justify a distinctive and more flexible definition of finality.").

37 Delta, 782 F2d at 1272; In re Westwood Shake & Shingle, Inc., 971 F2d 387, 389 (9th Cir. 1992); In re Nucor, Inc., 118 BR 786, 788 (D. Colo. 1990) In re Global Marine, 108 BR 1007, 1008 (SD Tex. 1988); see also In re PHM Credit Corp., 99 BR 762, 765 (ED Mich. 1989) (applying the same rule to appeals from appointment); Johns-Manville, 32 BR at 731 (holding nonfinal a Section 327 order authorizing debtor-manufacturer of asbestos products to retain law firms to lobby for legislation proposed for resolving damage claims of asbestos litigants).

38 Armstrong v. McAlpin, 625 F2d 433, 440-441 (2d Cir. 1980), vacated, 449 US 1106 (1981).

39 132 BR 759, 763 (D. Colo. 1991) (holding such a claim nonfinal and declining to exercise discretionary review).

40 85 BR 910, 912-913 (ND Ga. 1988) (holding nonfinal a bankruptcy court's Section 327 order denying petitioner's application for approval of employment of an attorney to represent petitioner in a state court medical malpractice action in which petitioner was the defendant).

41 98 BR 337, 339 (ND Ill. 1989) (holding such a claim nonfinal, but nonetheless exercising discretionary review).

42 In re Delta Serv. Indus., 782 F2d 1267, 1272 (5th Cir. 1986) ("We can discern no basis for granting greater appealability to orders denying motions to disqualify counsel in bankruptcy cases than to those in ordinary civil cases.").

43 949 F2d 1300, 1307 (3d Cir. 1991).

44 95 BR 560, 561 (ND Ill. 1989).

45 See supra notes 32-33 and accompanying text.

46 In re Nucor, Inc., 118 BR 786, 788 (D. Colo. 1990); In re Global Marine, Inc., 108 BR 1007, 1009 (SD Tex. 1988).

47 98 BR 337 (ND Ill. 1989).

48 Id. at 340.

49 Richardson-Merrell, 472 US at 430.

50 In re Delta Serv. Indus., Inc., 782 F2d 1267, 1272 (5th Cir. 1986); Gibbs v. Paluk, 742 F2d 181, 183 (5th Cir. 1984).

51 Richardson-Merrell, 472 US at 438.

52 472 US at 439.

  

53 Id.

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