Mississippi College Law Review

Volume 18
Issue 2 *Vol. 18 Iss. 2*

Article 5

1998

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Todd J. Zywicki

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18 Miss. C. L. Rev. 291 (1997-1998)

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MEND IT, DON'T END IT: THE CASE FOR RETAINING THE DISINTERESTEDNESS REQUIREMENT FOR DEBTOR IN POSSESSION'S PROFESSIONALS

*Todd J. Zywicki**

In the past few years, the "disinterestedness" requirement for counsel for debtors in possession has been the subject of several high-profile and controversial bankruptcy cases. Most famously, Weil, Gotshal & Manges was forced to disgorge approximately $1 million dollars in fees which had been paid for their representation of the debtor in *In re The Leslie Fay Cos.* bankruptcy case.[1] Since the *Leslie Fay* case, however, several other high-profile cases have resulted in extended disputes over the disqualification of counsel on disinterestedness grounds. At least one other major New York law firm has been the subject of a motion for disqualification and disgorgement of fees, in the amount of $1.8 million.[2] Although the problem is commonly linked in the public consciousness with large New York law firms, similar problems have arisen in large cases elsewhere, causing significant delay and disruption in those cases.[3] Moreover, several of these cases have spilled over into the mainstream national press, bringing

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* Assistant Professor of Law, George Mason University School of Law. J.D., University of Virginia; M.A. (Economics), Clemson University; A.B., Dartmouth College. The author was a member of the faculty at the Mississippi College School of Law when this Article was written, and he would like to thank the Mississippi College School of Law faculty, students, and administration for their intellectual support and colleagueship duiring his time there. This Article is dedicated to the fond memories of his time there. The author would like to express his deepest appreciation to the Honorable Judge Edith H. Jones for her insights and contributions to this Article. The author would particularly like to thank Susan Freeman, Scott Norberg, and David Skeel for comments on prior drafts of this Article and would also like to thank to the Honorable Judge Carolyn D. King, Chuck Wolfram, Elizabeth Holland, Susan Jensen-Conklin, Don Bernstein, and Gerald Smith for helpful discussions which made valuable contributions to the ideas contained herein. The author would also like to thank the participants and audience at a panel discussion at the Fall 1997 meeting of the American Bar Association, Section on Business Law. For financial support, the author would like to thank the Mississippi College School of Law and the Law and Economics Center at the George Mason University School of Law. Finally, the author would like to thank Glenda M. Raborn for her research assistance. Any errors, of course, are the author's responsibility.

1. *In re* The Leslie Fay Cos., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

2. *See Milbank Tweed Hit With $100 Million Lawsuit*, 31 BANKR. CT. DECISIONS, Issue 9, Oct. 14, 1997, at A9; *Should Milbank Tweed Be Required to Disgorge $1.8 Million Fee?*, 31 BANKR. CT. DECISIONS, Issue 7, Sept. 16, 1997, at A1; Paul M. Barrett, *Prosecutor Probes Milbank Tweed On Possible Conflict*, WALL ST. J., May 7, 1997, at B9 (discussing motion in *Bucyrus-Erie Co.* case to force Milbank, Tweed, Hadley & McCloy to disgorge $1.8 million in legal fees because of failure to disclose conflict of interest); Kurt Eichenwald, *Milbank, Tweed Is Accused of a Conflict*, N.Y. TIMES, Feb. 28, 1997, at D2 (same).

3. *See Conflict of Interest Questions Raised in Montgomery Ward Filing*, 30 BANKR. CT. DECISIONS, Issue 25, July 22, 1997, at A1 (discussing potential disqualification of Jones, Day, Reavis & Pogue from representing debtor, Montgomery Ward); *see also In re* Cajun Elec. Power Coop., Inc., No. 94-11474 (Bankr. M.D. La. Aug. 7, 1995) (unpublished opinion) (order disqualifying counsel for creditors' committee).

them to the public at large[4] and shaking the confidence of many observers in the fairness and efficiency of the bankruptcy system.[5]

For several years, many commentators have argued that the "disinterestedness" requirements of the Bankruptcy Code should be eliminated for professionals retained by a debtor in possession. Voices favoring change have become more prominent in response to these high-profile cases. Although *Leslie Fay* and *Bucyrus-Erie* are exaggerated examples, it is argued that similar problems regularly arise on a smaller scale throughout the country. Requiring counsel for a debtor in possession to be disinterested, it is argued, creates unnecessary confusion and prejudices administration of the case. As a result, debtors in possession are denied the opportunity to retain the most-qualified counsel, and the confusion wrought by the current standard results in unnecessary and expensive litigation that can disrupt the efficient administration of the case.[6]

As a result of these various problems, it is argued, professionals retained by a debtor in possession should not be subject to the disinterestedness requirement. Indeed, early in its work, the National Bankruptcy Review Commission recommended just such a revision to § 327, which would have eliminated the disinterestedness requirement for counsel for debtors in possession and replaced it with a standard which disqualified counsel from representing the debtor in possession only if he held an interest which was "materially adverse" to the estate.[7]

In the end, however, this proposal was rejected by vote of the Commission, and the disinterestedness requirement was retained for counsel for debtors in possession. The Commission instead proposed an amendment to § 1107(b) designed to remedy one consequence of the disinterestedness requirement. In this Article, I will argue that the Commission was correct in retaining the disinterestedness requirement for counsel for debtors in possession and in recommending an amendment to § 1107(b) to remedy the specific problem of debtor's counsel who holds a *de minimis* unsecured claim or equity interest in the debtor for pre-petition services.[8]

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4. *See* R. Craig Smith, Note, *Conflicts of Interest Under the Bankruptcy Code: A Proposal to Increase Confidence in the Bankruptcy System*, 8 GEO. J. LEGAL ETHICS 1045, 1046 n.9 (1995) (listing several articles in the New York Times and Wall Street Journal covering the disqualification debate in the *Leslie Fay* case).

5. *See* Smith, *supra* note 4, at 1046. Smith writes:

> As one of the most profitable law firms in the country, as well as boasting the nation's largest law firm bankruptcy practice, Weil, Gotshal has been involved in conflicts of interest battles five times during the past three years. Noting these problems, the New York Times intimated in its coverage that there may be something rotten at Weil, Gotshal, suggesting an unseemly connection between the law firm's success and their repeated conflicts violations.

6. In *Cajun*, the judge noted that the motion to disqualify counsel for the creditors' committee "of necessity cause[d] the Cajun proceeding to come to a screeching halt" and resulted in a several month delay in the confirmation of a reorganization plan.

7. The proposal presented to the Commission recommended elimination of the disinterestedness requirement only for counsel for debtors in possession, not for counsel for a Chapter 11 trustee. Thus, counsel for Chapter 11 trustees would have continued to be subject to the current disinterestedness requirement.

8. Indeed, some commentators have concluded that these scandals argue against, rather than in favor of, loosening the restraints of disinterestedness. *See Should Milbank Tweed Be Required to Disgorge $1.8 Million Fee?*, *supra* note 2, at A11 (statement of Phil Hendel); Letter from Jerry Patchan, Director, Executive Office for United States Trustee, to National Bankruptcy Review Commission (May 14, 1997) (copy on file with author) ("Instead of improving public and creditor sentiment about the bankruptcy system, this proposal will engender even more cynicism than exists today. We are not aware of any push by the public or the creditor body to change the system along the lines recommend . . . .").

In Part I of this Article, I discuss the current statutory framework surrounding the "disinterestedness" requirement and the relationship between the substantive standards of the so-called disinterestedness requirement and the disclosure obligations imposed by the Federal Bankruptcy Rules. Part II discusses the purposes furthered by the disinterestedness requirement as applied to professionals retained by a debtor in possession. Part III discusses and rebuts the arguments which have been advanced in support of eliminating the disinterestedness requirement as applied to debtors in possession. Part IV discusses the recommendations made by the Commission to cure specific problems caused by the strict disinterestedness requirement by carving out specific exceptions to its reach. Part V contains concluding remarks and thoughts for future action.

I. DEFINING "DISINTERESTEDNESS"

Under 11 U.S.C. § 327(a), a trustee "may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title."[9] Although § 327(a) refers only to a "trustee," by virtue of § 1107(a), the powers and limitations of a trustee in retaining professionals also apply to debtors in possession.[10]

Thus, as an initial matter, the interaction of § 327(a) and § 1107(a) gives the debtor in possession power to retain professionals. But under § 327(a), counsel for a debtor in possession must meet two requirements: (1) she must "not hold or represent an interest adverse to the estate," and (2) she must be a "disinterested person[]." The term "disinterested person" is defined in § 101(14). Section 101(14) regulates two types of relationships.[11] Subsections (A) through (D) reg-

9. 11 U.S.C. § 327 (1994).

10. 11 U.S.C. § 1107(a) provides, in pertinent part, that "a debtor in possession shall have all the rights . . . and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter." The legislative history of § 1107 clarifies this by observing that it

> places a debtor in possession in the shoes of a trustee in every way. The debtor is given the rights and powers of a chapter 11 trustee. He is required to perform the functions and duties of a chapter 11 trustee (except the investigative duties). He is also subject to any limitations on a chapter 11 trustee . . . .

H. REP. NO. 595 to accompany H.R. 8200, 95th Cong., 1st Sess. 404 (1977); S. REP. NO. 989 to accompany S. 2266, 95th Cong., 2d Sess. 116 (1978). *See also* 124 CONG. REC. 11, 102, which notes that

> throughout title 11 references to a 'trustee' are read to include other parties under various sections of the bill. For example, section 1107 applies to give the debtor in possession all the rights and powers of a trustee in a case under chapter 11; this includes the power of the trustee to operate the debtor's business under section 1108.

11. 11 U.S.C. § 101(14) provides:

> (14) "disinterested person" means person that--
> (A) is not a creditor, an equity security holder, or an insider;
> (B) is not and was not an investment banker for any outstanding security of the debtor;
> (C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;
> (D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and
> (E) does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason . . . .

ulate pre-existing relationships between debtor's counsel and the debtor. Subsection (E), on the other hand, regulates relationships between the debtor's counsel and third parties, such as creditors of the debtor. There has been some criticism of subsections (A) through (D), but to the extent that they are problematic, they are susceptible to discrete solutions.[12] Subsection (E), however, has been at the heart of the debate over disinterestedness.

In relevant part, subsection (E) defines a "disinterested person" as one who "does not have an interest *materially adverse* to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor . . . or for any other reason . . . ."[13] By its own terms, therefore, the statutory language of § 101(14)(E), incorporated by reference into § 327(a), requires that any interest referenced be *material.*

Despite the requirement in subsection (E) that the referenced connections be "material," courts have construed § 101(14)(E) "rigidly."[14] As a result, § 101(14)(E) has been applied as a "catch-all clause."[15] In particular, the final sentence of § 101(14)(E), finding a lack of disinterestedness "for any other reason," has been characterized as being "broad enough to include anyone who in the slightest degree might have some interest or relationship that would color the independent and impartial attitude required by the Code."[16]

In addition to requiring that professionals be "disinterested persons," § 327(a) also requires that those professionals "not hold or represent an interest adverse to the estate." Unlike the literal definition of "disinterested person," this provision of § 327(a) contains no materiality requirement. Case law, however, has poured this requirement that counsel have *no* interest adverse to the estate--regardless of materiality--into the definition of § 101(14)(E). Thus, rather than directly construing the "no adverse interest" requirement of § 327(a), case law has instead applied this requirement in a round-about manner through § 101(14)(E)'s disinterestedness requirement. As a result, the term "disinterestedness" has come to be refer to *any* interest adverse to the estate, creditors, or the debtor, *regardless* of materiality. In this Article, reference to the term "disinterestedness" is to the commonly-understood, strict definition created by case law. Regardless of whether strict disinterestedness is rooted in § 327(a)'s prohibition against

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12. For instance, subsection (a) states that a "disinterested person" is a person that "is not a creditor, an equity security holder, or an insider." The Commission has recommended an amendment to § 1107(b) which would mitigate the hardship caused by this provision when counsel is a *de minimis* creditor or equity holder. *See infra* at Part IV.

13. 11 U.S.C. § 101(14)(E) (emphasis added).

14. 3 COLLIER ON BANKRUPTCY ¶ 327.04[3][c] (Lawrence P. King ed., 15th ed. 1996) (citing cases). This was also the practice under the Bankruptcy Act. *See* Meredith v. Thralls, 144 F.2d 473, 475 (2d Cir. 1944), *cert. denied*, 323 U.S. 758 (1944).

15. 3 COLLIER, *supra* note 14, ¶ 327.04[5][a] (footnotes omitted). *See also Ethics: Is Disinterestedness a Viable Concept? A Discussion*, 5 AM. BANKR. INST. L. REV. 201, 216 (1997) (statement of Judge Charles Clevert) (characterizing subsection (E) as a "bucket provision").

16. 3 COLLIER, *supra* note 14, ¶ 327.04[3][c]. *See also In re* Consolidated Bancshares, Inc., 785 F.2d 1249, 1255 (5th Cir. 1986); *In re* Codesco, Inc., 18 B.R. 997, 999 (Bankr. S.D.N.Y. 1982) ("a 'disinterested' person should be divested of any scintilla of personal interest which might be reflected in his decision concerning estate matters").

"adverse interests" or § 101(14)(E)'s "disinterestedness" requirement, however, one thing is clear: the standard which has been applied has been strict and rigorous and all reform proposals have argued for a more lenient standard.

Section 1107(b) clarifies the scope of the disinterestedness requirement as applied to counsel for a debtor in possession: "Notwithstanding section 327(a) . . . a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case."[17]

Although the debtor in possession is not required to be disinterested, it does owe a fiduciary duty to the estate.[18] As the Supreme Court observed in *Commodity Futures Trading Commission v. Weintraub,* "if a debtor remains in possession . . . the debtor's directors have essentially the same fiduciary obligation to creditors and shareholders as would the trustee for a debtor out of possession."[19] The scope of the debtor in possession's fiduciary duties are ill-defined, but one thing is clear:

> This fiduciary duty means that Estate Counsel *may not* act as a hired gun for the DIP but instead must consider the instructions that he receives from his client to ensure "[t]hat he or she is receiving valid instructions from a competent fiduciary acting within the scope of the fiduciary's trust."[20]

The disinterestedness requirement also arises under § 328(c) in giving the court authority to deny compensation if "at any time during such professional person's employment . . . such professional person is not a disinterested person, or represents or holds an interest adverse to the estate with respect to the matter in which such professional person is employed."[21]

In addition to these substantive requirements, the Federal Rules of Bankruptcy Procedure also impose certain disclosure requirements on those who would serve as counsel to a trustee or debtor in possession. Under Bankruptcy Rule 2014, the application by the debtor in possession for retention of counsel shall "state . . . to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, and other party in interest . . . ."[22] In addition, the debtor's

17. 11 U.S.C. § 327(b) (1994).

18. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985); *In re* Marine Power & Equip. Co., 67 B.R. 643, 648 (Bankr. W.D. Wash. 1986); *In re* Colonial Ford, Inc., 24 B.R. 1014, 1021 (Bankr. D. Utah 1982); Tina L. Brozman, *Introduction,* 5 AM. BANKR. INST. L. REV. at p. i (1997); C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?*, 5 AM. BANKR. INST. L. REV. 47, 52 (1997) ("It is beyond all speculation that DIPs managing the affairs of a Bankruptcy Estate are fiduciaries."); *id.* at 53 (noting that majority rule is that DIPs "are 'officers of the court'" who have a fiduciary duty to act in the best interests of the Bankruptcy Estate *qua* Estate, including its creditors, equity interest holders, and possibly even other parties in interest"); Robert J. Landry, III & James R. Higdon, *Ethical Considerations in Appointment and Compensation of an Attorney for a Chapter 11 Debtor in Possession,* 66 MISS. L.J. 355, 358 (1996); Daniel B. Bogard, *Liability of Directors of Chapter 11 Debtors in Possession: "Don't Look Back -- Something May be Gaining on You,"* 68 AM. BANKR. L.J. 155, 212 (1994); Brenda Hacker Osborne, Note, *Attorneys' Fees in Chapter 11 Reorganizations: A Case for Modified Procedures,* 69 IND. L.J. 581, 588 (1994).

19. 471 U.S. 343, 355 (1985).

20. Bowles & Rapoport, *supra* note 18, at 60 (quoting *In re* Rivers, 167 B.R. 288, 300 (Bankr. N.D. Ga. 1994)).

21. 11 U.S.C. § 328 (C) (1994).

22. FED. R. BANKR. P. 2014(a).

application "shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest . . . ."[23] Thus, like the strict disinterestedness requirement, Rule 2014(a) requires full and frank disclosure of all "connections" that counsel may have with the identified parties. The disclosure requirement of Rule 2014 is independent of the substantive disinterestedness rules discussed above. Although commentators have advocated a loosening of the substantive disinterestedness requirement to disqualify counsel only for material and adverse conflicts of interest, they have all advocated retaining the strict disclosure language of Rule 2014.

The expansive disclosure requirements of Rule 2014 have led some commentators to argue that an adequate solution to the problem would be to loosen the substantive standards of § 327, but to continue to retain the strict disclosure requirements of Rule 2014. As noted above, the disclosure requirements of Rule 2014 are independent of the substantive requirements of § 327. Thus, it has often been stated that a failure to make a full and complete disclosure is sufficient standing alone to disqualify counsel or deny fees, regardless of whether there has been a violation of the substantive requirements of disinterestedness.[24]

This threat of punishment solely for a failure to disclose, however, is a paper tiger. In practice, courts are reluctant to punish a failure to disclose independent of some underlying substantive violation. Even in the *Leslie Fay* case, despite a blatant failure to disclose, the court still refused to disqualify debtor's counsel. Indeed, the court did not even force a full disgorgement of fees, instead forcing disgorgement only of fees and expenses directly attributable to the cost of the examiner's investigations and of the failure to disclose.[25] The limited nature of the sanctions imposed on debtor's counsel in that case has been characterized as "damaging" and "let[ting] those guys off with a slap on the wrist."[26] Indeed, debtor's counsel in the *Bucyrus-Erie* case has already argued that the mild penalty imposed in *Leslie Fay* provides precedent for a similarly mild sanction for the failure to disclose in its case.[27]

In practice, many courts have agreed with the *Leslie Fay* approach, forcing disgorgement of fees only where the failure to disclose conceals an underlying *substantive* violation of disinterestedness. In fact where a mere failure to disclose results in no identifiable harm to the estate, courts have been reluctant to punish such a non-disclosure.

Courts have pointed to two reasons for their reluctance to require disqualification and disgorgement of fees for mere failures to disclose, absent some underlying breach of the disinterestedness requirement. First, it has been argued that in some cases, disqualification would result in extreme hardship and expense to the

23. *Id.*

24. *See* Landry & Higdon, *supra* note 18, at 395. *See id.* n.157 (citing cases).

25. *In re* The Leslie Fay Cos., 175 B.R. 525, 538 (Bankr. S.D.N.Y. 1994).

26. *Should Milbank Tweed be Required to Disgorge $1.8 Million Fee?*, *supra* note 2, at A12 (statement of John Stark).

27. *Id.* at A11.

estate from replacing counsel at a late stage in the proceeding.[28] Second, it has been argued that it would be inequitable to disallow fees for valuable work performed where the nondisclosure does not relate to any substantive breach of the disinterestedness requirement.[29] There are few cases in which a court has disqualified counsel and/or forced a disgorgement of fees purely for a failure to disclose. In almost every case, the court also found the presence of a substantive conflict of interest which would have disqualified counsel had it, in fact, been disclosed.

It is understandable that courts will be reluctant to enforce strict disclosure requirements where they find no tangible harm to the estate as a result of the failure to disclose, and find that it would be inequitable and wasteful to disqualify debtor's counsel or require a punitive disgorgement of fees. While these reasons are persuasive on a case-by-case approach, the signals sent by this approach are distressing. It rewards counsel who fail to disclose all connections. After all, it is likely that these connections will never come to light. If they do, it is likely that the court will refuse to disqualify counsel because of the expense and delay to the estate which would result and permit the award of fees for actual benefits conferred. Because of the low likelihood of detection and the mild nature of the sanctions which might result from failure to disclose, it is likely that a loosening of the substantive standards for disinterestedness will also result in professionals shirking their duties to disclose fully.[30] In short, relying on courts to impose sanctions for failures to disclose, absent any underlying substantive violations, is a threat which is more apparent than real.

II. PURPOSES OF THE DISINTERESTEDNESS REQUIREMENT

Those who have advocated elimination of the disinterestedness requirement for debtor in possession cases have uniformly advocated its retention in cases involving Chapter 11 trusteeships. This suggests that disinterestedness serves some valid function in bankruptcy. Therefore, it is important to understand the purposes of the disinterestedness requirement to determine whether professionals retained by a debtor in possession should be exempted from it.

The requirement that professional persons employed by a trustee have no interest adverse to the estate was contained in former Bankruptcy Rule 215(a).[31] Under the Bankruptcy Act, only an attorney appointed to represent a Chapter X trustee was required to be "disinterested," as that term was defined in former

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28. *See Leslie Fay*, 175 B.R. at 538-39; *In re* Decor Corp., 171 B.R. 277, 284 (Bankr. S.D. Ohio 1994).

29. *See Leslie Fay*, 175 B.R. at 539; *In re* National Liquidators, Inc., 182 B.R. 186, 197 (S.D. Ohio 1995) (reversing bankruptcy court's order requiring complete disallowance of fees because full disallowance of fees is "inequitable and draconian" where there is no underlying adverse interest and "no actual harm to the bankruptcy estate"); *In re* Love, 163 B.R. 164, 170 (Bankr. D. Mont. 1993) (refusing to order complete allowance of fees for failure to disclose where there were some benefits to the estate from counsel's services); *In re* Amdura, 139 B.R. 963, 980 (Bankr. D. Colo. 1992) (refusing to disallow fees in toto for failure to disclose and permitting fees for services untainted by an underlying conflict and where the services benefited the estate); *In re* Kendavis Indus. Int'l, Inc., 91 B.R. 742, 762 (Bankr. N.D. Tex. 742); *In re* Roberts, 75 B.R. 402, 412 (Bankr. D. Utah 1987) (where equities outweigh the need for attorney discipline for failure to disclose conflicts, the law does not require the denial of fees).

30. *See* Patchan, *supra* note 8, at 4.

31. *See* 3 COLLIER, *supra* note 14, at ¶ 327.04[2][a].

Rule 1-202(c)(2).[32] Disinterestedness under the Act was defined similarly to the current rigorous definition of disinterestedness under the Code. Section 327(a) of the Code expanded the disinterestedness requirement to apply to all professional persons in all cases under the Code, regardless of whether a trustee is actually appointed.[33]

As now applied to professionals employed by a trustee or debtor in possession, the disinterestedness requirement is extremely strict. As a leading commentator writes:

> As a general principle, professional persons employed by the trustee should be free of any conflicting interest which might in the view of the trustee or the bankruptcy court affect the performance of their services or which might impair the high degree of impartiality and detached judgment expected of them during the administration of a case.[34]

There are three primary justifications for the disinterestedness requirement. First, "strict standards are necessary in light of the unique nature of the bankruptcy process," a process which raises problems absent from other areas of the law.[35] Second, strict disinterestedness requirements are necessary to preserve public and judicial confidence in the bankruptcy system.[36] Third, strict disinterestedness requirements ensure that the ethical standards for bankruptcy practice do not clash with state ethical rules. All three of these policy goals are applicable regardless of whether a case involves a trustee or a debtor in possession.

A. Disinterestedness and the Bankruptcy Process

Strict disinterestedness standards are necessary because of the unique pressures raised by the bankruptcy process.[37] The trustee and his professionals are required to act as fiduciary for the estate, its creditors, other parties in interest, and the court, and not solely as the debtor's advocate.[38] The disinterestedness standard, therefore, is designed to insure that all issues relevant to the administration of the estate are properly raised and vented before the court. As such, disinterestedness is designed to eliminate *any* conflicts that might cause the trustee and his professionals to favor one party over another, to "take it easy" on one

32. *Id.* at ¶ 324.04[3][a].

33. *Id.* (noting that this requirement "effects a change from prior law").

34. *Id.* at ¶ 327.04[4].

35. *In re* Consolidated Bancshares Inc., 785 F.2d 1249, 1256 n.6 (5th Cir. 1986) (citing *In re* Cropper Co., 35 B.R. 625, 629 (Bankr. M.D. Ga. 1983)).

36. *Id.* (citing *In re* Philadelphia Athletic Club, Inc., 20 B.R. 328, 334 (Bankr. E.D. Pa. 1982); *In re* Envirodyne Indus., 150 B.R. 1008, 1018 (Bankr. N.D. Ill. 1993) ("It is clear that the standards of § 327(a) are to be strictly construed due to the unique nature of the bankruptcy system. Multiple representations which may be tolerable in a commercial setting after full disclosure are not permissible in the bankruptcy system." (citations omitted)).

37. Heightened standards of disinterestedness are required in other areas of law where particular public policy and fiduciary concerns make higher than usual standards necessary. *See* Louis S. Robin, *Responses to Ethics and Service Working Group Proposals Concerning Conflicts of Interests,* 102 COM. L.J. 224, 225 (1997) ("placing counsel under a higher standard is not one reserved only for bankruptcy attorneys"); *see also* Securities Investor Protection Act of 1970, 11 U.S.C. § 78eee(B)(6); *see also In re* Blinder, Robinson & Co., 131 B.R. 872, 878 (Bankr. D. Colo. 1991).

38. *See supra* notes 19-21 and accompanying text.

creditor or group of creditors, or to refuse to pursue possible claims or avenues of inquiry because of any direct or indirect pressures.[39] As one commentator has observed, "[i]ndirect or remote associations or affiliations, as well as direct, may engender conflicting loyalties. The purpose of the [disinterestedness] rule is to prevent even the emergence of a conflict irrespective of the integrity of the person under consideration."[40]

After all, it is the creditors' money that we are talking about.[41] The fundamental reality of a reorganization case is that the debtor is buying its continued existence with someone else's money.[4] Creditors are being forced to forego payment so that the debtor can spend it in hopes of reorganizing its operations--and paying its attorneys, accountants, and other professionals. It may be that creditors are better off overall as a result of foregoing payment in the short-run in exchange for a larger payoff at the end of the collective proceeding.[43] This does not change the fact, however, that the debtor is spending the creditors' money. As a result, creditors are entitled to have debtors' professionals who will be free of pressures to compromise the interests of some or all of them. As one court has written, "[t]he jaundiced eye and scowling mien of counsel for the debtor should fall upon all who have done business with the debtor recently enough to be potential targets for the recovery of assets of the estate."[44]

Consider the creditor's perspective. As a creditor in a Chapter 11 case, you are told that you cannot repossess whatever collateral you thought you could rely on to be paid off if the debtor defaults. If you are unsecured, you get paid pennies to the dollar on your claim, and if you were actually able to squeeze out some pittance of a payment on your claim, you may have to give it back as a preference. And, as the final indignity, not only do you have to pay your own attorney, you have to pay the *debtor's attorney* as well! In some circumstances, you may yourself go bankrupt while waiting to be paid. Moreover, while you sit there waiting to be paid the tiny bankruptcy dollars that may or may not be forthcoming someday from this debtor, the debtor's lawyers submit and receive periodic payments on a dollar for dollar basis for the work they have done, little of which you can really verify. Although we bankruptcy lawyers patiently explain to creditors why "it has to be done this way," they cannot be blamed for being somewhat skeptical. From their perspective, the bankruptcy system looks like a big party thrown for

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39. *See* 1 GEOFFREY C. HAZARD, JR. & WILLIAM HODES, THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT § 1.7:207, at 237 (1990) (noting that one purpose of *per se* rule in litigation context is that otherwise clients and the public at large "will be disturbed by the sight of one lawyer disloyally 'playing both sides of the street,' earning two fees, and *'possibly pulling his punches'*" (emphasis added)).

40. 3 COLLIER, *supra* note 14, at ¶ 327.03. The treatise goes on to argue caution in the application of § 101(14)(E) in a prophylactic manner so as not to disqualify professionals on the basis of "[r]elationships remote from the instant case which do not involve confidential information." This qualification, however, does not mitigate the danger of "conflicting loyalties" that might arise from direct and indirect pressures on even the most ethical lawyers.

41. *In re* Rusty Jones, Inc., 134 B.R. 321, 333 (Bankr. N.D. Ill. 1991).

42. *See* Scott F. Norberg, *Debtor Incentives, Agency Costs and Voting Theory in Chapter 11*, 46 U. KAN. L. REV. 507 (1998).

43. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY (1986).

44. *In re* McKinney Ranch Assocs., 62 B.R. 249, 255 (Bankr. C.D. Cal. 1986).

the debtor and bankruptcy professionals, where the creditors get little but the bill. Under such circumstances, it is difficult to explain to creditors why we need not be concerned about the disinterestedness of debtor's counsel.[45]

Moreover, it will be extremely difficult for creditors to exert any real oversight or control over the activities and fees of debtor's counsel. Many cases lack active creditor's committees and active committee counsel, partly as a result of a lack of confidence that the system is working.[46] In such cases, collective action problems result in inadequate oversight by creditors. Where secured creditors or creditors' committees actually do take an active role in the case, their counsel may lack an adequate incentive to scrutinize and object to professional fees because of a fear that debtor's counsel will later do the same to them. In practice, therefore, there is rarely active oversight of debtor's counsel.

It has long been recognized that the participants in a bankruptcy proceeding are entitled to demand disinterested counsel regardless of whether tangible harm to the estate can be demonstrated. As Justice Douglas observed in the seminal case of *Woods v. City National Bank & Trust,* "[w]here a[n attorney] was serving more than one master or was subject to conflicting interests, he should be denied compensation. It is no answer to say that fraud or unfairness were not shown to have resulted."[47] Justice Douglas explained the reason for this prophylactic rule:

> The incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interest exists, no more need be shown . . . .[48]

Thus, as Justice Douglas suggests, conflicts of interest in bankruptcy sound in the duty of loyalty an attorney owes to his client, and this duty is compromised wherever a conflict exists, regardless of its purported lack of materiality.

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45. *See Should Milbank Tweed Be Required to Disgorge $1.8 Million Fee?, supra* note 2, at A12, in which John Stark stated the following:

> You know, the whole bankruptcy system is so mysterious to non-lawyers. When companies are in financial distress, they literally hand over the entire management to these bankruptcy lawyers. In the Bucyrus Erie case, we used to refer to the fact that John Gallene was running the company . . . and he really was. Management didn't do anything without talking to John Gallene. That is not uncommon, and I don't know how you're going to change that phenomenon. So, if that is not going to change, then you've got to make sure that these bankruptcy lawyers clean up their act.

See also Eichenwald, *supra* note 2 ("Such potential conflicts are particularly important in bankruptcies, where the debtors' lawyers can play important roles in determining which creditors walk away with the most money, and what advisers or financiers get sued for deals that pushed the company toward insolvency.").

46. *See* Patchan, *supra* note 8, at 3.

47. Woods v. City Nat'l Bank & Trust, 312 U.S. 262, 268 (1941).

48. *Id.*

The pressures raised by the bankruptcy system will be present regardless of whether the estate is being administered by a trustee or a debtor in possession. In fact, because the debtor in possession has inherent conflicts of interest and is, by definition, not disinterested, this may caution in favor of requiring an even stricter adherence to disinterestedness for the debtor in possession's professionals than for a disinterested trustee.

B. Disinterestedness and Public Confidence in the Bankruptcy System

Disinterestedness is also critical to the preservation of public and judicial confidence in the integrity of the bankruptcy system. There is a strong public interest in the fair and efficient administration of the bankruptcy system. Large bankruptcy cases may directly impact thousands of creditors and shareholders and hundreds of commercial landlords. A large bankruptcy case may also impact thousands of employees and tens of thousands of patrons and customers. Moreover, the Bankruptcy Code provides the court with broad equitable powers[49] as well as arms debtors with massive powers to unilaterally affect the rights of creditors and other parties in the case.[50] As a result of these broad grants of power to actors in the bankruptcy system, the public has a large interest in the fair and impartial administration of the bankruptcy process. As a result, there must always be vigilance to ensure that the public has confidence in the bankruptcy system and that it is operated for the public benefit and not just to enrich debtors and their professionals.

There is already a widespread public perception that the bankruptcy system is nothing more than "a cash cow to be milked to death by [bankruptcy] professionals."[51] Whether accurate or not, this unquestionably is not an isolated opinion.[52] The disinterestedness of the estate's professionals is critical to the perception that the bankruptcy system is being administered fairly and efficiently.[53] Again, these concerns are present regardless of whether the estate is being administered by a trustee or a debtor in possession.

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49. *See* 11 U.S.C. § 105(a) (1994), which reads:

> The court may issue *any* order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party interest shall be construed to preclude the court from, sua sponte, taking *any* action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. (emphasis added).

50. *See, e.g.*, 11 U.S.C. § 362 (1994) (automatic stay); and 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1994) (providing for "cramdown" of secured creditor's interest).

51. *In re* Chas. A. Stevens & Co., 105 B.R. 866, 872 (Bankr. N.D. Ill. 1989).

52. *See* Patchan, *supra* note 8, at 3 ("Recent literature continues to indicate limited confidence at best that cases are administered for the benefit of the estate as opposed to the professionals in charge."). Judge Charles Clevert has observed that

> there is a segment of the public that doesn't like us. They don't trust courts, and they don't trust lawyers. And why? Because they think that we're constantly scratching each other's back. They think that people will say: "we have a rule and we're going to follow the rule," "wink-wink." And it is because of that sentiment, that the political types, and in this case, Congress, said "we're going to tell you that you must not have an adverse interest, and we're going to tell you again, in clearer language, that we definitely don't want you to have an adverse interest."

Ethics, *supra* note 15, at 203-04.

53. Robin, *supra* note 37, at 226 ("the enforcement of higher standards enhances the profession").

This perception that the bankruptcy system is especially prone to fraud and abuse is not new, nor is it ill-founded. Indeed, in enacting the Bankruptcy Code in 1978, Congress wrote against the backdrop of a long history of abuse and self-dealing in the bankruptcy system. The House Report accompanying the 1978 Bankruptcy Code summarizes Congress' concerns and indicates that the problems caused by "the lack of true creditor control, and the cronyism of the 'bankruptcy ring' are not new. They have plagued the bankruptcy system for many years. The Bankruptcy Commission documented them in detail in its study, and noted their persistence in the bankruptcy system for over forty years."[54]

As Justice Douglas observed in 1940, "[t]he history of fees in corporate reorganizations contains many sordid chapters."[55] In part, the "sordid history" to which Justice Douglas referred was the tale of the "Bankruptcy Ring," a story of corruption and in-breeding in bankruptcy practice which led to the reforms in the Chandler Act intended to bring the system under control.[56]

The notorious "bankruptcy ring" was first brought to light in the investigation of William J. Donovan on behalf of the United States District Court for the Southern District of New York. The scale of cronyism, corruption, and misfeasance which Donovan discovered in the bankruptcy system shocked the courts and the public and spurred Congress to action to clean-up the bankruptcy system.

On March 21, 1929, the Association of the Bar of the City of New York, the New York County Lawyers Association, and the Bronx County Bar Association petitioned the United States District Court for the Southern District of New York, requesting an investigation of the administration of bankruptcy practice in the Southern District. This request resulted from a report and presentment of the grand jury of the Southern District a month earlier and from disclosures in other proceedings indicating that the administration of the bankruptcy law "was characterized by serious abuses and malpractices on the part of attorneys, receivers, trustees, appraisers, custodians, auctioneers, and other persons and associations."[57] On March 6, 1929, Judge Thomas D. Thacher launched an investigation of the matter, and Donovan was selected as counsel for the three petitioning associations.[58] What he eventually discovered shook the bankruptcy system to its foundations.

The Donovan Report concluded that the bulk of bankruptcy practice in New York City was concentrated in the hands of approximately twenty-one law firms. Through a process of cronyism and inbreeding, this small group of lawyers and law firms led to rampant conflicts of interest and even cases of "outright theft."[59] In the end, the investigation resulted in the indictment of twelve attorneys. One

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54. *See* H. REP. NO. 595, *supra* note 10, at 96.

55. Dickinson Indus. Site v. Cowan, 309 U.S. 382, 388 (1940). *See also* Louis S. Robin, *Responses to Ethics and Service Working Group Proposals Concerning Conflicts of Interests,* 102 COM. L.J. 224, 225 (1997) (referring to the "unfortunate history" that led to the enactment of the disinterestedness standard).

56. *Dickinson,* 309 U.S. at 388. Other examples of professional misbehavior prior to the Chandler Act, including a discussion of Douglas's Protective Committee Report, are discussed in my companion Article in the Symposium. *See* Todd J. Zywicki, *Of Bubbling Pots and Bankruptcy Ethics: A Comment on Wolfram and Smith,* 18 Miss. C. L. Rev. 399 (1998).

57. *Id.*

58. *See* H. REP. NO. 595, supra note 10, at 97. Donovan conducted private and public hearings for over two months, examining over 1000 bankruptcy cases and 4000 witnesses.

59. *Id.*

attorney absconded and then committed suicide. Two pleaded guilty and received jail sentences.[60]

The Donovan investigation further discovered that the situation in New York City was not isolated. Based on studies in six different cities, the Donovan Report concluded that "fundamental defects in administration are not restricted to New York, but exist generally throughout the country."[61]

The Report identified several sources of these problems, including problems arising from the combination of administrative and judicial functions in bankruptcy judges and the underpayment of trustees and receivers.[62] But other problems identified in the Donovan Report remain so today, including the absence of effective creditor oversight in many cases and the difficulties of policing conflicts of interest.

Many of these concerns persisted in different forms up to the passage of the Bankruptcy Code. The legislative history of the Bankruptcy Code observed that at the time of the Bankruptcy Code, there was "a feeling among nonbankruptcy practitioners that there is a 'bankruptcy ring' that has an inside track on all bankruptcy matters, including the judges' favoritism."[63] The Bankruptcy Commission further reported that "a relatively small group of lawyers controlled the bankruptcy field. Those not within this group tended to regard them with suspicion and distrust."[64]

To the extent that the public comes to see the bankruptcy system as being operated purely for the benefit of bankruptcy professionals and debtors, confidence in the bankruptcy system is eroded. If this cynicism becomes sufficiently widespread, it could result in modifications to the system which will undermine its flexibility and ability to achieve its legitimate ends.

C. Disinterestedness and State Ethical Standards

The third factor underlying a strict adherence to disinterestedness for counsel is to ensure consistency between the ethical rules of the Bankruptcy Code and the various state ethical rules. The ethical rules of the Bankruptcy Code have never "fit" very tightly with state law ethical rules. This section briefly examines the ethical rules of the ALI's Restatement of the Law Governing Lawyers, the ABA's Model Rules of Professional Conduct, and the Model Code of Professional Responsibility, and contrasts these rules with those of the Bankruptcy Code.[65]

There are two primary difficulties in adapting state ethical standards to the bankruptcy law. First is the difficulty of determining which set of ethics rules to

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60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 95.

64. *Id.* at 96.

65. A majority of states base their state ethics rules on the Model Rules, while others rely on the Model Code or combinations of the two. *See* Joseph D. Vaccaro & Marc R. Milano, Note, *Section 327(a): A Statute in Conflict: A Proposed Solution to Conflicts of Interest in Bankruptcy*, 5 AM. BANKR. INST. L. REV. 237, 244 n.57 (1997).

apply to bankruptcy proceedings to determine when a conflict arises and if the conflict may be waived. Second, if the conflict can be waived in theory, there are significant problems which frustrate the application of the non-bankruptcy standards to a bankruptcy case.

A fundamental question that remains unanswered is whether the bulk of matters which arise in a bankruptcy case should be classified as litigation or transactional in nature. If bankruptcy is considered to consist largely of litigation-like matters, then strict *per se* rules that are similar to the requirements of the Bankruptcy Code will apply. If, on the other hand, most bankruptcy matters are considered to be more like transactional matters, then looser standards requiring conflicts to be material would apply. Unfortunately, it is not readily apparent whether bankruptcy proceedings should be governed by the general default ethical standards usually applied to transactional lawyers, or whether bankruptcy proceedings should be governed by the stricter ethical standards traditionally applied in litigation.

On closer inspection, however, analysis of applicable ethical codes and the realities of the bankruptcy process compel the conclusion that bankruptcy matters should be treated as more similar to litigation and that most ethical codes would consider them to be litigation matters. As a result, to ensure that bankruptcy lawyers meet the minimum requirements of state ethical codes, the Bankruptcy Code should continue to require adherence to disinterestedness.[66]

Under the American Law Institute's Restatement of the Law Governing Lawyers, the relevant sections are § 201, articulating the general standard governing conflicts of interest, and § 209, stating a special rule for litigation cases and "situations, not involving litigation, in which significant impairment of a client's expectations of the lawyer's loyalty would be similarly likely to litigation settings."[67] Section 201 defines a conflict of interest as existing when there is "a *substantial* risk that the lawyer's representation of the client would be *materially* and *adversely* affected by the lawyer's own interest or by the lawyer's duties to another current client, a former client, or a third person."[68]

By contrast, § 209 provides that absent consent of all affected parties, "a lawyer in civil litigation may not . . . (2) represent one client in asserting or defending a claim against another client currently represented by the lawyer, even if the matters are not related."[69] Thus, § 209 contains a special, *per se* rule regarding representation of clients that are adverse to each other in civil litigation.[70] This *per se* rule is grounded in the "underlying assumption that litigation

66. *See In re* Philadelphia Athletic Club, Inc., 20 B.R. 328, 337 (Bankr. E.D. Pa. 1982).

67. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 201 cmt. b (Rationale) (Proposed Final Draft No. 1, 1996). *See also* Gerald K. Smith, *Conflicts of Interest in Workouts and Bankruptcy Reorganization Cases*, 48 S.C. L. REV. 793, 838 (1997) ("there is sharp disagreement as to whether section 209(2) or section 21 should apply to the bankruptcy case as a whole").

68. RESTATEMENT § 201, *supra* note 67 (emphasis added).

69. *Id.* § 209.

70. *See* Smith, *supra* note 67, at 886 ("[T]he *Restatement* treats the duty of loyalty as absolute in so far as the litigation rule, but flexible in other contexts.").

involving the assertion or defense of a claim between two clients always creates a 'substantial risk' that the lawyer's representation of one client or the other will be 'materially and adversely' affected by the simultaneous representation of both clients, even in unrelated matters."[71]

The argument for applying § 209 in bankruptcy cases is similar to the reasons stated above which militate in favor of retaining a strict disinterestedness requirement, including concerns that a lawyer may pursue a case less effectively out of deference to another client[72] and for public confidence in the integrity of the legal system.[73] Indeed, in many ways, these features are present even more dramatically in a bankruptcy case than in the typical civil case. As the House Report on the Bankruptcy Code observed, "[b]ankruptcy is an area where there exists a significant potential for fraud, for self-dealing, and for diversion of funds. In contrast to general civil litigation, where cases affect only two or a few parties at most, bankruptcy cases may affect hundreds of scattered and ill-represented creditors."[74] What is relevant to the bankruptcy context is that if § 209 applies, then a lawyer may not represent one client in asserting or defending a claim against another current client, even if the simultaneous representation is in connection with unrelated matters, unless both consent.

Difficulty arises because most of the activity which takes place in a bankruptcy case does not fit neatly into the binary categorization of litigation versus non-litigation matters. In both volume and importance, most of the matters which arise in a bankruptcy case contain both litigation and non-litigation elements. In substance, however, the litigation model best describes the bulk of bankruptcy activity, and as a result, the ethical standards applicable to litigation cases should apply.

Very little of a typical bankruptcy case conforms to the classic definition of "litigation" matters. In fact, only adversary proceedings fit the classic mold, but contested matters are probably similar enough to also fall under the litigation provisions.[75] Even less, however, conform to the classic definition of transactional matters. Most matters in a typical bankruptcy case involve "administrative" matters, including the process of plan negotiation and plan confirmation. It is the administration of the estate, and particularly the development and confirmation of a plan, that usually involves the most significant controversies and that can have the greatest practical impact on the resolution of a claim.[76] These "administrative" matters, especially plan confirmation, are almost always more

71. Ethical Considerations for Bankruptcy Professionals' Questions Regarding Impact of Proposed American Law Institute Restatement of the Law Governing Lawyers, 2-3 (unpublished manuscript on file with author).

72. *See* RESTATEMENT, *supra* note 67, at § 209 cmt. e (suing present client in unrelated matter).

73. *See id.* at § 209 cmt. c (clients aligned in opposition to each other).

74. H.R. REP. No. 595, 95th Cong., 1st Sess. 88 (1977), *reprinted in* 1978 U.S.S.C.A.N. (92 Stat. 2549) 6050.

75. *See* Smith, *supra* note 67, at 886.

76. *See id.* at 893 (quoting statement of Judge Carolyn Dineen King at annual meeting of the American Law Institute) ("And you draw a distinction in your language here between the administration of the case, which sounds like sort of bookkeeping but is in fact where the heavy lifting is done in a bankruptcy case. So my suggestion is that it is naive, I think it looks naive, to buy into this distinction.").

important to the case than formal adversary proceedings and are interwoven throughout the so-called administrative proceedings of the case.[77] Moreover, if counsel is deemed to be disinterested for purposes of an "administrative" proceeding, but not for a contested matter, this will create an incentive for debtor's counsel to settle or otherwise avoid such issues before they rise to the level of a contested matter from which counsel might be disqualified. The results of these settlements or other conflict-avoidance strategies by debtor's counsel, of course, would be funded by other creditors who lack the leverage of a credible threat to disqualify debtor's counsel. As a result, many of bankruptcy's routine "administrative" proceedings create the same tensions as formal litigation and should continue to be governed by the same ethical rules.[78]

The Restatement's ethical rules are similar to those of the ABA's Model Rules and Model Code, which serve as the basis for state ethical rules.

Unless all parties give informed consent, the Model Code generally prohibits a lawyer from accepting representation that "will adversely affect his judgment on behalf of or dilute his loyalty to a client."[79] If the lawyer is requested to undertake or to continue representation of multiple clients "having *potentially* differing interests, he must weigh carefully the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment."[80] The Model Code defines "differing interests" broadly to "include every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest."[81] Moreover, the lawyer "should resolve all doubts against the propriety of the representation."[82]

As with the Restatement, the Model Code's rules governing litigation matters are even more strict. "A lawyer should *never* represent in litigation multiple clients with differing interests . . . ."[83] As for "potentially differing interests," the Model Code observes that "there are few [litigation] situations in which [the lawyer] would be justified in representing in litigation multiple clients with potentially differing interests."[84] Outside of litigation, the Model Code recognizes that it may be appropriate to serve multiple clients having potentially differing interests in matters, such as where "the interests vary only slightly" and "it is generally likely that the lawyer will not be subjected to an adverse influence and that he can retain his independent judgment on behalf of each client . . . ."[85]

The Model Rules retain rules which are more consistent with the maintenance of the disinterestedness standard than its abandonment.[86] Under Model Rule 1.7,

77. Even a confirmed plan results in a judgment which is then binding on all creditors and parties in interest.

78. *See* Smith, *supra* note 4, at 1053 ("In general, all attorneys are subject to the ethical conflicts rules of their respective state bars, which are in turn based upon either the Model Code or Model Rules.").

79. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-14 (1980); *see also In re* McKinney Ranch Assocs., 62 B.R. 249, 253 (Bankr. C.D. Cal. 1986).

80. MODEL CODE, *supra* note 79, at EC 5-15.

81. *Id.* at Definitions (1).

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. HAZARD, *supra* note 39, at 132.

a lawyer is strictly forbidden from representing a client if the representation "will be directly adverse to another client," unless she reasonably believes the representation "will not adversely affect the relationship with the other client" and each client knowingly consents after consultation.[87] Thus, for direct conflicts, the representation is forbidden, regardless of materiality.[88] For indirect conflicts, however, the rule is somewhat more lenient. The representation is forbidden if it "may be materially limited" by the lawyer's responsibilities to another client or to a third person, or the lawyer's own interests.[89]

What constitutes a "direct" conflict is defined relatively broadly and is certainly broad enough to include much of what comprises a typical bankruptcy case. Thus, the Comment indicates that "a lawyer ordinarily may not act as advocate against a person the lawyer represents in some other matter, even if it is wholly unrelated."[90] By contrast, the definition of indirect conflicts appears to be somewhat narrow. The Comment states, "[o]n the other hand, simultaneous representation in unrelated matters of clients whose interests are only generally adverse, such as competing economic enterprises, does not require consent of the respective clients."[91] While the example of "competing economic enterprises" is obviously illustrative only, it suggests that most conflicts, such as those which cause concern in bankruptcy, should be treated as direct conflicts and subject to the rule governing direct conflicts.

Moreover, Model Rule 1.7(a) flatly prohibits representation of opposing parties in litigation.[92] The Comment states, "[o]rdinarily, a lawyer may not act as advocate against a client the lawyer represents in some other matter, *even if the other matter is wholly* unrelated."[93] The exceptions to this general injunction are narrow and turn on whether the interests are actually adverse in *type*, not on the materiality of the adverse interest.[94]

As this brief discussion suggests, a threshold question for trying to mesh the ethical rules of the Bankruptcy Code with various state ethical rules is whether bankruptcy proceedings should be governed by the strict *per se* rules applied to conflicts in litigation, or whether they should be treated to the more generous non-litigation rules. Regrettably, the drafters of the various ethical rules have by and large ignored the difficulties raised by bankruptcy proceedings. Only the Restatement has recognized that the problem even exists.[95] Prior to the Third Restatement, the Restatement has traditionally been silent on the issue of whether

87. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (1997).
88. HAZARD & HODES, *supra* note 39, at 132.
89. MODEL RULES, *supra* note 87, at Rule 1.7(b).
90. *Id.* at Rule 1.7 cmt. (Loyalty to a Client).
91. *Id.*
92. *Id.* at Rule 1.7 cmt. (Conflicts in Litigation).
93. *Id.*
94. *Id.*
95. RESTATEMENT, *supra* note 67, at § 201 (Proposed Final Draft No. 1) (amended Oct. 31, 1996).

bankruptcy ethics issues were governed by the general rule of § 201 or the stricter litigation rule of § 209. Most evidence of intent, however, seems to point in the direction that bankruptcy matters should be governed by the stricter standard of § 209.[96]

This traditional silence, however, was shattered--albeit irresolutely--during the drafting of the Third Restatement. Early in the drafting process, it was proposed that the Restatement be amended to make bankruptcy proceedings explicitly subject to § 201. After much debate and consideration, this proposal was rejected. Instead, the drafters of the Restatement have decided to take "no position on the applicability of Subsection (2) in the many situations that may arise in bankruptcy."[97] In light of this decision not to decide, it remains unsettled whether § 201 or § 209 controls in bankruptcy.[98]

Even if the stricter litigation standards apply, most state ethical rules are merely default rules which may be waived if all affected parties consent.[99] But no waiver of the disinterestedness requirements of the Bankruptcy Code is permitted.[100] Moreover, this is appropriate in that conflicts of interest rules are often made non-waiveable[101] or difficult to waive[102] where "the public interest in maintaining public confidence in the legal system outweighs the interest of individual lawyers and individual clients in freely contracting with each other."[103] Because of the history of ethical problems in bankruptcy, the structural features of bankruptcy cases which make them prone to ethical abuse, and the central role played by the bankruptcy system to the public, bankruptcy may present a situation where conflict of interest rules should be non-waiveable. Finally, it is questionable whether a fiduciary is even permitted to waive a conflict of interest.[104]

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96. *See* Smith, *supra* note 67, at 886 ("[T]he limited discussion of bankruptcy matters in Chapter 8 of the *Restatement* suggested that a bankruptcy case is a variety of civil litigation."); *id.* (describing correspondence with Professor Charles W. Wolfram, Reporter for the *Restatement,* which "made it clear that Professor Wolfram viewed the filing of a bankruptcy case as the commencement of civil litigation"). Although bankruptcy issues are mentioned only in passing in the comments to the Restatement, such references uniformly occur in the discussion related to § 209, implicitly suggesting that the matters would be governed by § 209. *See* RESTATEMENT, *supra* note 67, at § 209 cmt. d(iii) (Complex and multi-party litigation) (discussing conflicts of interest in bankruptcy); *id.* Reporter's Note to Comment d(iii) (Complex and multi-party litigation) (citing cases discussing conflicts of interest in bankruptcy); *see also* RESTATEMENT § 201 cmt. b (Rationale) (stating that § 209 applies, rather than § 201, in "situations, not involving litigation, in which significant impairment of a client's expectations of the lawyer's loyalty would be similarly likely to litigation settings").

97. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 209 (Proposed Official Draft 1996), *reprinted in* Smith, *supra* note 67, at 897. *See also* Charles W. Wolfram, *The Boiling Pot of Lawyer Conflicts in Bankruptcy,* 18 Miss. C. L. Rev. 383 (1998) (discussing ALI's decision to take no position on conficts of interest in bankruptcy).

98. *Id.* ("There is substantial disagreement whether various bankruptcy proceedings should be considered under Subsection (2)."). The drafters of the *Restatement* should be applauded for at least recognizing that the issue exists. There is no evidence that the drafters of the Model Code or Model Rules have even considered the special problems raised by bankruptcy.

99. Under the *Restatement,* for instance, if the representation would give rise to a conflict of interest under § 201, then counsel is forbidden from undertaking the representation absent consent by "all affected clients and other necessary persons."

100. *See In re* Envirodyne Indus., 150 B.R. 1008, 1016 (Bankr. N.D. Ill. 1993); *In re* Amdura, 121 B.R. 862, 866 (Bankr. D. Colo. 1990); 3 COLLIER, *supra* note 14, at ¶ 327.04[7][a][i].

101. *See, e.g.,* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.8 (1997).

102. In criminal cases, for instance, it is more difficult for co-defendants to waive conflicts of interest to have one attorney represent both of them. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 cmt. (1997) (Conflicts in Litigation).

103. HAZARD, *supra* note 39, at 123.

104. *See* CHARLES WOLFRAM, MODERN LEGAL ETHICS § 7.2.4, at 348 (1986). Even if such a rule does not apply in bankruptcy, the fiduciary nature of the debtor in possession's role may require that the waiver of the conflict is permissible only if in the best interest of the estate, rather than merely the desire of the debtor.

Even if waiver were permitted, it would often be difficult or impossible to waive such conflicts in bankruptcy and remain true to the duty of loyalty owed by an attorney to his clients. The difficulty of securing waivers in bankruptcy cases manifests itself in two ways. First, it is not clear who the "client" is in bankruptcy who needs to consent to the waiver. Second, even if it would be theoretically possible to identify who needed to consent to such a waiver, it may be impossible as a practical matter to do so because consent would have to be forthcoming from hundreds or even thousands of affected parties.

Under state ethical standards, a prerequisite for waiving a conflict is that the client knowingly waive the conflict after consultation. As discussed above, the client in a bankruptcy case is the estate as a whole. But for purposes of trying to determine who must consent to the waiver, it is difficult to specifically identify who is the "estate." Are all creditors and parties in interest collectively the "client"? Until it is established who is actually the "client," it is impossible to determine who must consent to the representation.

If the estate is the client, then under established ethical principles, all parties who comprise the estate must give knowing consent to waive the conflict. In a large Chapter 11 case, of course, this may require the consent of several hundred or even thousand equity holders, creditors, and parties in interest. Securing informed consent under such circumstances is simply unrealistic.[105]

It is commonly argued that as a result of the inability to secure effective waivers of conflicts of interest, such waivers should be excused in bankruptcy cases. But this conclusion does not follow from the premise. In all other areas of law, a failure to secure the waiver of a conflict bars the attorney from the representation. The *reason* why the attorney is unable to secure the waiver is simply irrelevant--the client could have genuine concerns, unfounded paranoia, or even sheer spite. The bottom line is that the failure to secure the waiver prohibits the attorney from undertaking the representation. It is not clear why a different rule should apply in bankruptcy proceedings. In all other areas of the law, the failure to secure a waiver disqualifies the attorney from the representation--it does not entitle her to ignore the waiver requirement and undertake the representation anyway. As a result, under established ethical rules, the inability to secure waivers of conflicts should have the effect of barring the attorney from the representation.

Alternatively, it is argued that as a result of these administrative difficulties, conflicts in bankruptcy could be waived by providing the affected parties with notice of the proposed representation and permitting it unless an affected party objects. While this approach may provide a workable solution to the problem, it is questionable whether it does so in a manner which is consistent with the purposes of the conflict of interest rules.

Allowing conflicts to be waived in this manner reverses the usual burden for waiving conflicts and ignores the duty of loyalty which supports the conflict of

105. *See* Smith, *supra* note 67, at 896 (reprinting statement of Mr. Brian Redding to the American Law Institute).

interest rules. Because of the duty of loyalty owed from an attorney to his clients, conflicts can be waived only upon knowing and express consent by the client after consultation. The proposed procedure, on the other hand, would reverse this process by permitting the representation unless the client affirmatively objects to it. Thus, rather than putting the burden on the attorney to secure an informed and consensual waiver, the proposed process would put the burden on the client to object. It is difficult to see how reversing this burden is compatible with the duty of loyalty owed by an attorney to his client.

Allowing conflicts to be waived as a result of the inaction of a client also ignores the practical realities of the situation. The client in such a situation is confronted with a situation where it lacks an adequate incentive to object to the representation. It is just one creditor of many in the case, and it will have to incur the costs of hiring another attorney and pursuing the objection unilaterally. It is unrealistic and unfair to force any single creditor to bear this burden merely to protect its right to conflict-free counsel. These collective action and free-rider problems are insuperable.

It has been argued that as the representatives of the estate, the creditors' committee should be empowered to review and object to the proposed representation on behalf of the body of creditors and parties in interest which comprise the estate. Again, however, this ignores the fact that the attorney's duty to avoid conflicts of interest sounds in the duty of loyalty.[106] As a result, ethics rules generally require the knowing consent of *every* client to waive the conflict.[107] While the creditors' committee represents the body of unsecured creditors for many purposes, its interests are not synonymous, and the creditors as a whole are entitled to speak for themselves on many issues.[108] Because of the importance of conflict-free counsel to the operation of the bankruptcy system, waivers of conflicts should require the express consent of every creditor and party in interest.

Creating a system in which the ethical rules imposed in bankruptcy could be less strict than those imposed under state ethics laws ignores the compelling reasons discussed in Part II for requiring a stricter ethical standard in bankruptcy cases than otherwise. It also would likely place attorneys in the awkward position of complying with federal law, but being derelict in their duties under state ethical rules. Mere compliance with the federal ethical rules would expose the attorney to prosecution under state ethical standards. On the other hand, voluntary compliance with the stricter state ethical standards would frustrate the purpose of creating the more lenient federal rules.

To avoid this incongruous result, state ethical rules arguably could be preempted by the Bankruptcy Code so as to protect bankruptcy lawyers who comply with

106. *See* HAZARD, *supra* note 39, at 121 ("Although all . . . basic duties a lawyer owes to a client are implicated in conflict of interest situations, the duties of loyalty and confidentiality hold center stage."); ("The duty of loyalty is obviously heavily implicated in conflict of interest situations."). *Id.*

107. *See id.* at 123 ("Waiver of an important right is usually valid only if it is knowing and intelligent, however, and permitting a client to waive is generally conditioned upon the requirement of prior disclosure of the conflict or 'consultation' with the client.").

108. For instance, simply because the creditor's committee gives its approval to a debtor's reorganization plan, every creditor is given an opportunity to vote on the plan before it is confirmed, and if enough unsecured creditors oppose it, then the opinion of the unsecured creditors committee is simply irrelevant.

the more lenient federal standards. The drastic step of federal preemption in the traditionally state-controlled area of professional ethics rules, however, should only be undertaken for the most compelling reasons.[109] I am unaware of any principled justification for singling out bankruptcy lawyers for preferential treatment, as opposed to say, criminal lawyers, employment lawyers, or antitrust lawyers who usually practice in federal court. Absent such a compelling reason, holding bankruptcy lawyers to a lower ethical standard than other practicing lawyers smacks of special-interest favoritism and should be eschewed.

III. ARGUMENT FOR ELIMINATION OF THE DISINTERESTEDNESS REQUIREMENT AS APPLIED TO DEBTOR IN POSSESSION'S PROFESSIONALS

Despite these strong reasons favoring the continued application of the disinterestedness requirement to professionals representing debtors in possession, many commentators have called for its elimination. Several arguments have been advanced in support of the proposition. Upon closer scrutiny, however, none of them adequately identifies the problem which is purported to exist with the current system nor do they explain why the elimination of the disinterestedness requirement as applied to debtors in possession is warranted. In support of the call for eliminating the disinterestedness requirement, the following arguments have been advanced: (i) the current application of disinterestedness to counsel for debtors in possession was a drafting error in the Code; (ii) the debtor should be entitled to its choice of counsel; (iii) there is an inability of debtors to find adequate counsel with sufficient resources to execute fully all aspects of the bankruptcy case; and (iv) the need exists to correct the current non-uniformity in the application of disinterestedness standards throughout the country. None of these alone or in combination, however, support the abandonment of disinterestedness. This Part of the Article discusses and critiques each of these separate arguments in turn.

A. The Application of Disinterestedness to Professionals Retained by the Debtor in Possession was a Drafting Error

The first argument in favor of repeal of the disinterestedness requirement as it applies to professionals retained by the debtor in possession is that its initial application was the result of a "drafting error" in the 1978 Code and was not intended by Congress.[110] In particular, it is argued that the reach of § 1107 is over-inclusive in that it accidentally results in the application of the disinterestedness requirement of § 327 to debtors in possession when it was intended to apply only to professionals retained by a trustee. All available evidence, however, points to the contrary conclusion.

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109. Butner v. United States, 440 U.S. 48 (1979).

110. *See* Gerald K. Smith, *Disinterestedness*, ANN. SURV. OF BANKR. L. 1995-1996, at 639, 640 (William L. Norton, Jr., ed. 1995).

"The task of resolving the dispute over the meaning of [a statutory provision] begins where all such inquiries must begin: with the language of the statute itself." Section 1107 of the Bankruptcy Code clothes the debtor in possession with all of the rights and powers as a trustee, subject to the same restrictions.[112] Thus, under the plain language of the statute, the debtor in possession has the power to employ professionals, but those professionals must be disinterested and hold no interest adverse to the estate. Thus, by the plain language of the statute, the disinterestedness requirement applies with full force to professionals retained by a debtor in possession. "In this case it is also where the inquiry should end, for where, as here, the statute's language is plain 'the sole function of the courts is to enforce it according to its terms.'"[113]

Application of the plain language rule is even more *apropos* in a situation, such as this, where the alleged drafting error is supposedly what Congress has *not* written by a failure to explicitly except counsel for a debtor in possession from the disinterestedness requirement. This is a far bolder argument than the typical scenario where a scrivener's error results in a misstatement, and the misstatement results in irrational results which plainly contradict congressional intent. Here, there is no statement at all and no basis to believe that Congress ever intended to make such a statement. Indeed, it is only as a result of the cross-reference between § 327 and § 1107 that a debtor in possession has authority to employ counsel in the first place.[114] The idea that Congress meant to give the debtor in possession power to employ counsel under § 327(a), but then just "forgot" to exclude them from the reach of the disinterestedness requirement of § 327, is a remarkable proposition which requires significantly greater support than has been forthcoming.

Contextual evidence reinforces the textual reading of the statute.[115] Section 1107(b) specifically refers to the applicability of § 327(a) to a debtor in possession[116] and explicitly carves out an exception to the application of § 327(a) to a

111. United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989).

112. Gerald Smith has argued that the report of the Commission of the Bankruptcy Laws of the United States supports the concept that the disinterestedness requirement was not supposed to be applied to the debtor in possession. Smith, *supra* note 110, at 640. The evidence he cites for this proposition, however, is inapplicable to the question of whether professionals retained by the debtor in possession must be disinterested, in that he cites the report as it relates to the retention of professionals for a "special purpose." *See id.* at 641 n.16. The ability to retain non-disinterested professionals for a "specified special purpose" is governed by § 327(e), not § 327(a), and applies equally to trustees and debtors in possession. Thus, the evidence cited is irrelevant to the intent of § 327(a). Even if it were, it would provide evidence of an intent to apply the disinterestedness standards differently to trustees and debtors in possession, in that § 327(e) applies equally to both.

113. *Ron Pair,* 489 U.S. at 241; *see also* Todd J. Zywicki, *Cramdown and the Code: Calculating Cramdown Interest Rates Under the Bankruptcy Code,* 19 T. MARSHALL L. REV. 241, 247 (1994).

114. Thus, it is simply incorrect to claim, as has one commentator, that "no reasonable inference that there is [a disinterestedness requirement] emerges from a literal reading of relevant provisions," as the textual argument for the applicability of the disinterestedness requirement arises from the same source as the authority of the debtor in possession to employ counsel in the first place. Lieb, *infra* note 162, at 106. Similarly, it is illogical to argue that "section 327(a) of the Bankruptcy Code was carefully written so as to apply to professionals serving a 'trustee,'" unless one also intends to suggest that debtors in possession have no authority at all to employ professionals at all. *Id.* at 119.

115. *See* United States Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 371 (1988) ("Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . ."); *see also* Zywicki, *supra* note 113, at 248.

116. *See* § 1107(b) ("Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession . . . .").

debtor in possession.[117] It should go without saying that it would be unnecessary to carve out an exception to § 327(a) specifically with respect to a debtor in possession if that requirement did not apply to a debtor in possession in the first place.[118] Thus, the plain language of the statute is reinforced by contextual evidence which indicates that the disinterestedness requirement was intended to apply to a debtor in possession's professionals.[119]

The "drafting error" argument, therefore, actually requires the existence of a *triple* drafting error: the "inadvertent" failure to exclude debtors in possession from the reach of the disinterestedness requirement in § 327(a), *plus* the "inadvertent" reference to § 327(a) in the introductory clause of § 1107(b), *plus* the specific reference to the debtor in possession in § 1107(b). By contrast, there is *no* text, context, or legislative history which suggests that Congress intended to exempt professionals employed by a debtor in possession from the reach of the disinterestedness requirement. At some point, piling one purported drafting error upon another causes the "drafting error" argument to collapse in a heap of implausibility.

The only evidence of congressional intent to which advocates of the "drafting error" argument have pointed is that applying the disinterestedness requirement to the debtor in possession's professionals enacted a change from Chapter XI of the Bankruptcy Act. Under Chapter XI of the Bankruptcy Act, the disinterestedness requirement applied only to a trustee and his professionals, and not to professionals for a debtor in possession.[120] It is further argued that this practice was changed "accidentally" through the unintended interaction of § 327 and § 1107. Citing the canon of construction stated in *Midlantic National Bank*,[121] it has been argued that Congress could not have intended to make such a "major departure from the prior law" without some specific legislative history or other indicia to indicate that Congress intended to make such a change.[122]

This argument misunderstands the Supreme Court's holding in *Midlantic* and the degree to which pre-Code practice is relevant in construing the plain language of the Bankruptcy Code. As the Supreme Court wrote in *Ron Pair Enterprises*, "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'"[123] Such evidence of

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117. *See id.* (excluding from § 327(a) disqualification because of "such person's employment by or representation of the debtor before the commencement of the case").

118. Indeed, Gerald Smith has admitted that "it can be inferred . . . from § 1107(b) that Congress intended to bring the employment of counsel for the debtor in possession under § 327." Smith, *supra* note 110, at 643.

119. It has been suggested that this reference in § 1107(b) is simply superfluous, and that there was no purpose behind this provision in § 1107(b) which calls off the applicability of § 327 in the stated circumstances. *See* Smith, *supra* note 110, at 643. But this argument that Congress inserted a provision that had no purpose and was pure surplussage is simply implausible when compared to a reading of the statute which gives those provisions a logical reading.

120. *Id.*

121. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 501 (1986).

122. Richard Lieb, *The Section 327(a) "Disinterestedness" Requirement–Does a Prepetition Claim Disqualify an Attorney for Employment by a Debtor in Possession?*, 5 AM. BANKR. INST. L. REV. 101, 110 (1997); Smith, *supra* note 110, at 643-44.

123. United States v. Ron Pair Enters. Inc., 489 U.S. 235, 242 (1989) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

contrary intent may be inferred if the textual meaning conflicts with other sections of the Code, with important state or federal interests, or with legislative history.[124] Here, as in *Ron Pair Enterprises*, the textual requirement that professionals retained by a debtor in possession be disinterested does not conflict with any other sections of the Code, with important state or federal interests, or legislative history. "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute."[125]

As *Ron Pair* makes clear, pre-Code practice is useful only in limited circumstances. Pre-Code practice is illuminating only where the court makes the initial determination that the plain meaning of the text is ambiguous and inconsistent with "other provisions of the Code itself," or other indicia of congressional intent.[126] Thus, pre-Code practice provides "interpretive assistance" *only* where "a literal application of the statute would be 'demonstrably at odds with the intentions of its drafters."[127] Thus, there is no "pale presumption" that pre-Code practice is always relevant.[128] Where the "natural interpretation of the statutory language does not conflict with any significant state or federal interest, nor with any other aspect of the Code," nor with any other evidence of legislative intent, "[t]here is no reason to suspect that Congress did not mean what the language of the statute says."[129] As there is no evidence that applying the disinterestedness requirement to a debtor in possession's professionals produces unreasonable or irrational results clearly at odds with congressional intent, *Midlantic* is simply irrelevant, and the plain language of the statute should be applied.

Moreover, even if pre-Code practice were relevant here, the limited role afforded to it by the *Midlantic* exception does not justify ignoring the plain language of the statute. The change made in this case hardly constitutes a "significant" change from prior practice. Moreover, this doctrine properly applies only where the preexisting doctrine is judicially-created; it is not an appropriate canon to apply where the Code provision simply overrules a prior legislative provision.[130] Even if this were considered to enact a "significant" change in the law, the absence of legislative history is largely irrelevant in light of the presence of multiple other indicia of congressional intent.[131]

Chapters X and XI of the Bankruptcy Act were combined into a single Chapter 11 under the Bankruptcy Code. In creating this synthesis, the Code drew from some aspects of Chapter X practice and some aspects of Chapter XI practice.

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124. *Id.* at 243.

125. *Id.* at 240-41.

126. *Id.* at 244. There is no claimed ambiguity in the statutory language here.

127. *Id.* at 244.

128. *Id.* at 245.

129. *Id.* at 245-46.

130. *See id.* at 245 ("*Kelly* and *Midlantic* made clear that, in an appropriate case, a court must determine whether Congress has expressed an intent to change the interpretation of a *judicially created* concept in enacting the Code." (emphasis added)).

131. *See id.* at 240, stating that

> it is worth recalling that Congress worked on the formulation of the Code for nearly a decade. It was intended to modernize the bankruptcy laws, and as a result made significant changes in both the substantive and procedural laws of bankruptcy . . . . In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took.

The plain language of the Code evidences an intent by Congress to carry over to all cases the disinterestedness requirement for trustees appointed pursuant to Chapter X. After all, Chapter X was created by the Chandler Act to cleanup the reorganization process for large publicly-held corporations which had been marked by widespread graft, corruption, and criminality.

Given the success of the Chandler Act reforms in weeding out corruption, and given further that most cases under the Code would be administered by a debtor in possession rather than a trustee (including, especially, large cases which had been administered by a disinterested trustee under Chater X), there is every reason to believe that Congress intended to carry over the disinterestedness requirement and apply it to debtors in possession under the Code. Thus, it is questionable whether the change could even be said to constitute a "significant" change at all, as it just illustrates an expansion of Chapter X practice into a new, but similar, situation. By contrast, there is simply no evidence to suggest that Congress intended in the Code to return in most cases to a system similar to that which had spawned the corruption and fraud which preceded the enactment of the Chandler Act.

As noted above, Congress did not write on a clean slate in this area. Instead, Congress evidenced an awareness of the traditional ethical problems which had plagued the bankruptcy system and the structural difficulties which made the bankruptcy system especially prone to abuse and self-dealing.[132] The well-publicized findings of the Donovan investigation and Douglas's protective committee investigation, and the recognition that similar problems of conflicts of interest and a "bankruptcy ring" persisted even at the time of the Bankruptcy Code, belies the argument that there is no history or legislative history to support the view that Congress intended to apply the disinterestedness requirement to counsel for a debtor in possession.

By contrast, there is every indication that Congress believed that many of the Chandler Act reforms succeeded in cleaning up troublesome aspects of the bankruptcy system. Among these reforms had been the application of the disinterestedness requirement, especially in large cases. The "sordid history" of bankruptcy practice in America presents ample evidence that Congress intended to apply the disinterestedness requirement to professionals employed by debtors in possession under the Code. Rather than evidencing a lack of consideration by Congress of the issue, therefore, the lack of legislative history specifically referring to the change probably indicates consensus support for the extension of disinterestedness to the debtor in possession and an absence of controversy on the topic.

B. Protection of the Debtor's Right to Choose Counsel of its Choice

It is also argued that requiring counsel for the debtor to be disinterested unduly interferes with the right of the debtor to choose counsel of its choice. This argument is usually raised in the context of allowing the debtor to continue using the counsel that it had pre-petition because (1) the debtor has the same right as any

132. *See supra* notes 45-64 and accompanying text.

other party to retain counsel of its choice; and (2) the ability to retain pre-petition counsel will reduce administrative costs to the estate since counsel will be familiar with the debtor and its business. To the extent that strict application of the disinterestedness requirement interferes with the ability of the debtor to hire counsel of its choice, it is argued that this works an unnecessary hardship on the debtor and works to the detriment of the estate. This argument does not justify repeal of the disinterestedness requirement as applied to counsel for the debtor in possession.

It is argued that the right to employ counsel of one's choice is a bedrock principle of the American legal system, predicated on the adversary system. "A DIP in a bankruptcy case should have substantial freedom to choose its own attorney. Under our system of jurisprudence, a party should be able to select an attorney of its choice. This is true in both civil and criminal cases."[133] "Consequently," it is concluded, "a DIP should be able to pursue avenues of its own with professionals of its own choice, even if those professionals are not disinterested. It should be able to retain a professional of its first choice, not its second or third choice."[134]

But the right of the debtor to retain counsel of his choice is not unfettered once the debtor files for bankruptcy relief. The debtor and its professionals have a fiduciary duty to all parties, not just the debtor. If the debtor were paying for its counsel out of its own pocket, then it would be reasonable to allow it full discretion to choose counsel. But the debtor is *not* spending its own money--it is spending the creditors' money. As a result, the debtor's private right to retain counsel of its choice must be consistent with the systemic and public policy goals of the bankruptcy system. Given the choice of several disinterested counsel, the debtor's choice should be honored. This observation, however, does not support allowing the debtor to retain non-disinterested professionals.[135]

Moreover, this begs the central question of why a debtor in possession should have an unfettered right to choose counsel of its choice, but a trustee should not. Should not a trustee also be entitled to "retain a professional of its first choice, not its second or third choice"? It is recognized that when a trustee is appointed, his discretion in choosing counsel is limited. This suggests a broader principle--the right to employ counsel of one's choice is often limited, especially in bankruptcy, by other goals of the legal system. Thus, there is nothing illogical about limiting the discretion of a debtor in possession to choose counsel of its choice, as trustees suffer under the same limitation.

It is also argued that permitting the debtor to retain pre-petition counsel--even if not disinterested--will reduce the administrative expenses of the estate because that counsel will already have a working knowledge of the debtor and its business.[136] As an initial matter, this observation rests on a questionable empirical foundation. In many cases, the counsel which the debtor in possession seeks to

133. Lieb, *supra* note 122, at 123 (footnotes omitted).

134. *Id.* at 112.

135. *See In re* Envirodyne Indus., 150 B.R. 1008, 1018 (Bankr. N.D. Ill. 1993).

136. *See* Lieb, *supra* note 122, at 123.

hire will have no pre-existing relationship with the debtor; thus, no administrative expenses will be saved by permitting the debtor to hire that counsel.[137]

Leaving aside the accuracy of the assumption that disinterestedness generally disqualifies the debtor in possession's pre-petition counsel, this argument suffers from logical flaws as well. Under this logic, a Chapter 11 trustee should also be able to retain the debtor's pre-petition counsel, even if not disinterested. After all, the trustee will have significantly less of a working knowledge of the business than would the debtor in possession. As a result, the trustee would have an even *greater* need to be able to retain pre-petition counsel so as to learn about the debtor's business. Nonetheless, no one has proposed eliminating disinterestedness to allow a Chapter 11 trustee to retain non-disinterested counsel. Thus, if this rationale is not sufficient to justify abandonment of the disinterestedness requirement for a Chapter 11 trustee, it is difficult to understand how it justifies its repeal in the weaker case of a debtor in possession. Indeed, precisely *because* the debtor in possession is interested, this suggests an even more compelling case that its counsel should be disinterested.[138]

C. The Inability to Find Competent Counsel and the Inability to Obtain Waivers

In most large bankruptcy cases, the debtor remains in possession of its estate throughout the case. The larger and more complicated the case, the greater the need for sophisticated and competent counsel with sufficient ability and resources to administer these cases in an efficient manner. As a result, it is argued that especially in these large, complex cases, the resources of a large law firm are necessary to properly represent the debtor.[139] Often, however, the debtor's preferred counsel will have as a client one or more of the debtor's creditors or some other party in interest. As a result, under the strict disinterestedness standard of the Code, it is argued that all large firms (and, hence, all qualified counsel) will be disqualified from representing the debtor. Moreover, these large firms either cannot or will not be able to get waivers from clients with which a conflict of interest may exist. It is concluded that as a result of the strict disinterestedness requirements of the Code, the debtor will be unable to secure adequate representation, thereby harming the estate and its administration.[140]

This argument is based on an empirical question. The proponents of this argument have advanced no empirical evidence to demonstrate that any debtors in possession have been forced to "make do" without qualified counsel in a large,

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137. *See Ethics, supra* note 15, at 214 (statement of Joel Pelofsky) (noting that Weil, Gotshal had no pre-existing relationship with the debtor in the *Leslie Fay* case).

138. *See id.* at 208 (statement of Joel Pelofsky) ("because the old management is not disinterested, there has to be some curb on that management's ability to go in and do whatever it wants to do for the benefit of the prepetition entity").

139. *See* Smith, *supra* note 67, at 898 (quoting statement of Sheldon H. Elsen to the annual meeting of the American Law Institute).

140. *See* 3 COLLIER, *supra* note 14, ¶ 327.03, (Lawrence P. King ed., 15th ed. 1996), which states as follows:

> Past experience has shown that in large chapter 11 reorganization cases with widespread creditor interests, it has become increasingly difficult to obtain the services of competent counsel with offices sufficiently staffed to handle all of the varied legal services required in the case, who could meet the strict requirements of "disinterestedness."

complicated case.[141] Nor has there been any evidence of harm to debtors or the bankruptcy system caused by the purported disqualification of "all" counsel with sufficient resources and ability to carry out a given case. Even if there have been such incidents, there is no empirical evidence to suggest that it is a sufficiently large problem to justify the abandonment of the disinterestedness requirement and its benefits. Finally, while such a scenario may have been plausible several years ago, the multiplication of large bankruptcy cases and widespread development and dissemination of bankruptcy expertise across the legal profession makes it virtually inconceivable that the application of disinterestedness would disqualify all counsel with sufficient ability.[142]

One suspects that the proponents of this argument are not so much concerned that a debtor in possession will be forced to go without competent counsel to the detriment of the estate. Instead, it appears that this concern is animated by a sense that the disinterestedness requirement falls disproportionately hard on large law firms who will often have as clients large lenders and other creditors who the firm will be representing in other, unrelated matters.

As more and more large companies have sought the relief of Chapter 11, more and more large firms that traditionally eschewed bankruptcy practice have gotten into the game.[143] The increased size and frequency of these cases, combined with other changes in the 1978 Code which raised the fees which could be earned for bankruptcy work, has "mad[e] Chapter 11 more lucrative, and large firms were lured into the practice."[144] Because the disinterestedness requirement has a greater impact on large firms than others, even though it does not work to disqualify all firms, it does tend to disqualify large firms at a disproportionate rate.[145]

It has also been argued that to the extent that a conflict is caused by one or a few specific conflicts, this problem can be cured by hiring special counsel pursuant to § 327(e). But this is not an adequate solution for two reasons.

First, if it is known at the outset of the case that counsel has conflicts that will require appointment of special counsel, then it is simply a knowing duplication of administrative expenses to appoint such counsel with the understanding that special counsel will also be appointed, as opposed to simply appointing disinterested counsel from the outset of the case.

Second, it will often be during the case that facts will come to light that give rise to a conflict, and debtor's counsel at that time will have to make a judgment

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141. *See* Patchan, *supra* note 8, at 3 ("We are not aware of any case in which a debtor was unable to obtain competent representation because of the disinterestedness rules.").

142. *See Ethics, supra* note 15, at 214 (statement of Joel Pelofsky) (arguing that "to some degree talent is fungible" and that "there are a lot of people out there who are talented").

143. Luther Brickman & Jonathan Klein, *The Use of Advance Fee Attorney Retainer Agreements in Bankruptcy: Another Special Law for Lawyers?*, 43 S.C. L. REV. 1037, 1060 n.103 (1992); *Ethics, supra* note 15, at 209 (statement of Judge Charles Clevert).

144. Nina Martin, *Boom Times for Bankruptcy*, A.B.A.J., Dec. 1991, at 82, 83.

145. Similarly, one suspects that the lack of concern over the application of disinterestedness to Chapter 11 trustees is primarily a function of the fact that such cases usually are relatively small and generate little in the way of fees, rather than on a principled distinction between debtors in possession and trustees.

as to whether further investigation is warranted. The same forces that make it undesirable to rely on interested counsel to bring such an action will also make it undesirable to rely on interested counsel to undertake further investigation of the matter or to refer the matter to outside counsel.

That conflicts of interest can infect the initial decision to undertake further investigation into a matter is highlighted by the *Leslie Fay* case.[146] In that case, counsel for the debtor in possession failed to disclose to the court that it represented not only the debtor in possession, but also certain targets (Michael L. Tarnopol and Steven Friedman) of an audit committee investigation into alleged accounting irregularities.[147] Although the court's holding turned, in part, on the failure to disclose those relationships, the foundation of the court's decision was the belief that the relationships would interfere with counsel's ability to impartially and thoroughly investigate the allegations against those parties so as to determine whether further action against them was warranted. As the court observed, "[debtor's counsel] had a perceptible economic incentive not to pursue the *possibility* of claims against Tarnopol and Friedman with the same vigor and intensity it might have otherwise applied."[148]

In response to this conclusion by the court, debtor's counsel contended that it investigated the allegations and concluded that no viable claims against Tarnopol and Friedman existed, and as a result, there was no adverse interest and conflict requiring disclosure.[149] The court rejected this argument, reasoning that the conflicts interfered with the impartiality of the preliminary investigation into whether further action was warranted.[150]

Similar concerns were expressed by the Eleventh Circuit in denying fees to the law firm of Sirote & Permutt and requiring complete disgorgement of fees in *In re Prince*.[151] In *Prince*, the law firm performed estate planning services for Prince, who later filed bankruptcy, and his wife. At the same time that the law firm was representing Prince, it was also representing Prince's company, PBR Electronic, Inc. Five months prior to Prince filing an individual Chapter 11 case, Sirote & Permutt provided estate planning services to Prince which enabled him to convey approximately $600,000 in property to Mrs. Prince for no valuable consideration. Sirote & Permutt was later retained by Prince for his bankruptcy case. At the outset of the case, Sirote & Permutt filed a statement pursuant to Bankruptcy Rule 2014 which stated that the law firm had no connection to the debtor. The law firm's assistance in effectuating the $600,000 transfer later came to light, and Sirote & Permutt withdrew as Prince's counsel. On appeal to the Eleventh Circuit, the court held that it was justified to force Sirote & Permutt to disgorge all fees already paid in the case and to pay no further fees.

146. *In re* The Leslie Fay Cos., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

147. *Id.* at 529.

148. *Id.* at 534.

149. *Id.*

150. *Id.* The court noted, for instance, that debtor's counsel placed undue reliance on the testimony of an unreliable witness and reached its conclusion that no further action was warranted before the final results of an audit committee report were in. *Id.*

151. Electro-Wire Prods, Inc. v. Sirote & Permutt, P.C., 40 F.3d 356, 359 (11th Cir. 1994).

The Eleventh Circuit's primary concern was that the lack of disinterestedness on the part of Sirote & Permutt "demonstrate that the conflicts of interest which Sirote labored under clearly prejudiced the Debtor's estate. By representing Prince in his bankruptcy proceedings, Sirote deprived Prince of a conflict-free, impartial, independent evaluation of the potential claims of and against his estate."[152] The court stated that it was beside the point whether the $600,000 transaction was actually a fraudulent conveyance. Instead, what was critical for the court was that conflict-free, disinterested counsel was necessary to determine whether the claim was worth pursuing.[153] As the court observed, "because we find Sirote's inability to independently evaluate claims for its client, not its failure to pursue claims, is the actual prejudice to the Debtor, we find [the] discussion [of whether the claim had merit] of interest but not controlling."[154] Quoting Justice Douglas's opinion in *Woods*,[155] the court concluded that "[t]he accurate measure of prejudice here is not what Sirote actually did or did not do in handling Prince's case, but rather whether Sirote could have unbiasedly made decisions in the best interest of its client."[156] It should also be observed that the court's concern about the failure to disclose the conflict was mentioned only in passing, and that the court's primary concern was with the *substantive* failure to comply with disinterestedness and the negative impact that had on the ability of counsel to engage in an unbiased investigation.[157]

As *Leslie Fay* and *Prince* demonstrate, it will not be sufficient to permit the appointment of non-disinterested counsel with the expectation that special counsel can be appointed later if investigation reveals conflicts with respect to a specific issue. This is because, as an initial matter, the court will have to rely on that counsel to conduct the initial investigation to determine whether the appointment of a special counsel is warranted to pursue the question further. Just as any litigation brought on behalf of one client against another (even in an unrelated matter) will be fatally tainted with conflicts, any investigation as to further action by one client against another will be similarly tainted. Thus, where such a relationship exists, it is proper to presume that the relationship gives rise to an adverse interest and to disqualify counsel accordingly.

D. Uniformity, Predictability, and Consistency

The final argument made on behalf of eliminating the disinterestedness requirement is that the current rule is fraught with fuzziness and unpredictability. As a result, it is argued that this has confused bankruptcy lawyers, who are unable to determine with certainty whether they are, in fact, in compliance with the disinterestedness requirement. It is further argued that this has given rise to a contradictory and confused body of case law which is inconsistent throughout

152. *Id.* at 360.
153. *Id. See also* Landry & Higdon, *supra* note 18, at 399-401.
154. *Electro-Wire Prods, Inc.*, 40 F.3d at 360 n.1.
155. Woods v. City Nat'l Bank & Trust, 312 U.S. 262 (1941).
156. *Electro-Wire Prods, Inc.*, 40 F.3d at 360.
157. *Id.* at 361.

the country. It is believed that replacing the current rule with an inquiry into the "material" nature of the conflict will eliminate the "relativities" of this analysis by requiring the court to examine the significance of the connection or relationship.

While these concerns are unquestionably valid, eliminating the disinterestedness requirement and its accompanying benefits is an overbroad and unwise solution to these problems. The problems with taking this step would be exacerbated by replacing the disinterestedness rule with a rule which focused on the "materiality" of the conflict, as such a rule likely would *increase* unpredictability and the role of "relativities" in the inquiry, as well as lead to greater problems of non-uniformity.

There is a widespread perception that there is a lack of uniformity in the application of the disinterestedness requirement throughout the country. The empirical basis for this claim is suspect, at best.[158] On closer examination, this non-uniformity is concentrated in only a handful of districts relative to the country as a whole--New York, Los Angeles, and Chicago--where the courts apparently have been more lenient in enforcing the disinterestedness requirement. To the extent that these districts are the source of non-uniformity, it certainly is not obvious that the solution to the problem of non-uniformity is to bring all the other districts in the country *down* to the level of these districts, as compared to requiring those districts to raise their standards *up* to those of the rest of the country.[159]

Even if it is accepted for the sake of argument that the current approach is characterized by ambiguity and non-uniformity, abandoning disinterestedness in favor of a "materially adverse" standard would exacerbate these problems. As drafted, the current rule has the virtue of being a bright-line rule which directs the court to examine whether there is *any* interest adverse to the estate. Thus, the court need only identify whether a conflict *exists* and need not inquire as to the degree of that conflict.[160]

Focusing on whether a conflict is *materially* adverse will complicate the analysis significantly. Under this approach, the court will have to make fact-intensive inquiries into *two* variables: (1) whether there is an adverse interest; and (2) whether that adverse interest is material. Thus, rather than making a straightforward yes-no inquiry, under the proffered standard, the court would have to weigh the degree of the interest in every case. Trying to quantify the materiality of the interest in every case will *increase* the importance of relativities in the analysis over the current rule. Thus, rather than eliminating or even mitigating the purported uncertainty of the current rule, searching for whether an interest is materially adverse will actually exacerbate uncertainty and non-uniformity.[161]

158. *See* Patchan, *supra* note 8, at 3 ("Notwithstanding a few aberrant cases, the vast majority of Courts have concluded that the statute means what it says and apply it accordingly.").

159. *See id.* ("our experience today is that the overwhelming majority of Courts apply the bright line rule in a prompt and straightforward manner").

160. *See id.* ("The premise that a few Courts ignore the bright line rule does not justify, in our view, its wholesale elimination."); *Ethics, supra* note 15, at 208 (statement of Joel Pelofsky).

161. *See* Robin, *supra* note 37, at 227.

Finally, if the purported concern is that the current disinterestedness rule is too vague and unworkable to apply consistently, one is left to speculate why these arguments do not apply with equal force to a Chapter 11 trustee. If the legal rule itself is the problem, should this argument not apply with equal force to a Chapter 11 trustee? Nonetheless, no one has argued that the vagueness of the current rule justifies its repeal for a Chapter 11 trustee, implying that the rule can be applied predictably and uniformly in that context. Thus, one is left to speculate whether the purported concerns about lack of uniformity and predictability in the debtor in possession situation are merely a stalking horse for a different agenda.

IV. Fixing Discrete Problems with Discrete Solutions

As a result of the foregoing arguments, the National Bankruptcy Review Commission decided to retain the application of the disinterestedness requirement to counsel and professionals for a debtor in possession. At the same time, the Commission recognized that one problem which had been caused by the application of the disinterestedness requirement was that it often would unnecessarily disqualify counsel who held a claim against the estate for pre-petition services.

"The most common basis for disqualification of a DIP's attorney is that the attorney has a claim against the estate for pre-petition services, thereby disqualifying the attorney as a 'creditor' under the definition of disinterestedness."[162] This creates an anomaly in the Code in that it permits the debtor in possession to retain pre-petition counsel under § 1107(b), but, under § 101(14)(A), defines that counsel is not to be disinterested if he remains unpaid for pre-petition services to the debtor. It is illogical to allow pre-petition counsel to continue representing the debtor in bankruptcy, but not if counsel is still owed money for the pre-petition work it did. From this, some commentators have taken the illogical step of concluding that it justifies abandonment of disinterestedness generally, so as to avoid its application in this specific context.[163]

The Commission properly rejected this extreme conclusion. Instead, the Commission recognized that the application of disinterestedness often had the effect of disqualifying pre-petition counsel in situations where doing so failed to further the overall purposes of disinterestedness. Thus, the Commission has recommended carving out this scenario from the reach of the disinterestedness requirement to the extent that pre-petition counsel is the holder of an "insubstantial unsecured claim against or equity interest in the debtor." Rather than throwing out the entire disinterestedness scheme to rectify one narrow problem, the Commission's approach retains disinterestedness and carves out a narrow exception which corrects the specific problem without abandoning disinterestedness completely.[164]

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162. Lieb, *supra* note 122, at 124.

163. *See id.*

164. *See* Robin, *supra* note 37, at 224 (noting that "minor" creditors and shareholders, "no matter how few shares owned," are often disqualified under the disinterestedness requirement).

The superiority of the Commission's approach to proposals to scrap disinterestedness completely is evident in its decision to limit this protection to "insubstantial" claims or equity interests. This language recognizes that an exception should be carved out to allow counsel with a pre-petition claim to continue representing the debtor, but only in circumstances where such representation would be consistent with disinterestedness. Where counsel holds a claim which is insubstantial in amount in relation to the overall size of the case, the interests of the professional are unlikely to diverge substantially from the interests of other creditors and parties in the case, and the professional is unlikely to be influenced by his interests, in a manner which would sacrifice the interests of the estate to his private interests. As a result, the purposes of the disinterestedness requirement would not be compromised by permitting a debtor in possession to employ professionals who hold small claims or equity interests in the debtor. This solution also gives effect to § 1107(b)'s language permitting a debtor in possession to retain pre-petition counsel, so long as consistent with the disinterestedness requirement.

Courts had dealt with this problem in an *ad hoc* fashion, occasionally permitting the representation only upon waiver by counsel of its pre-petition claim or similar remedy. In practice, courts have held that a pre-petition claim disqualifies pre-petition counsel from serving as counsel to the debtor in possession unless the pre-petition claim is solely the result of work done in preparation for the bankruptcy filing.[165] But this result is far from uniform. Moreover, the purposes of the disinterestedness requirement are not served by distinguishing between a general claim for services and services incurred in preparation for filing bankruptcy. The central question is whether having the claim itself will tend to compromise the disinterestedness of counsel. Focusing on the services which the claim represents is irrelevant to this question.

As a result of these considerations, in the end, the Commission decided to retain the application of the disinterestedness standard to debtors in possession, but to amend § 1107(b) to permit employment of counsel with an insignificant claim against the estate for pre-petition services or an insignificant equity interest. This approach represents a coherent and reasonable balance between the goals of disinterestedness, while allowing debtors in possession to retain pre-petition counsel who have knowledge and expertise about the debtor and the case.

V. CONCLUSION

It is doubtful that the debate over disinterestedness is over. Indeed, even though the Commission forcefully stated its support for the disinterestedness requirement, it also admitted that there are some particular situations where off-

165. *See* John D. Penn & Stacey Jernigan, *Survey of the Law: Disqualification of Professionals Having Prepetition Claims*, 1996-97 ANN. SURV. BANKR. L. 167, 168 (William L. Norton, Jr., ed. 1996).

setting concerns justified carving out exceptions to disinterestedness, such as for insignificant creditors or equity holders.

The Commission also considered adding a further exception to § 1107(b) for "ceremonial" or "insignificant" officers.[166] In the end, the Commission determined that such an exception was too difficult to draft in a sufficiently clear and narrow manner which could be applied predictability and consistently with the goals of the disinterestedness requirement. Thus, there was no principled opposition to drafting such an exception, so long as it could be drafted in a workable and limited manner.

Other proposals met with strong substantive objections. For instance, the Commission considered the problems of duplication of counsel in cases where the debtor owns multiple subsidiaries, resulting in potentially unnecessary administrative expenses. As to this proposal, however, it was concluded that duty of loyalty concerns justified a retention of the current approach to these questions despite the possibility that, in some cases, it might result in unnecessary administrative expenses.

Finally, several ideas were raised, but failed because the Commission lacked sufficient time and resources to study them further. For instance, it may be time to revisit some of the *per se* exclusions enumerated in §§ 101(14)(A)-(D), most of which were drafted in response to specific abuses under the Bankruptcy Act. Similarly, it merits further study as to whether there are some types of secured claims which may nonetheless be "insignificant" in light of the goals of disinterestedness and the proposed amendment to § 1107(b).

Upon further study, such amendments may be concluded to be appropriate or may be rejected. Valid arguments are present on both sides of these issues. Unfortunately, careful consideration of many of these pragmatic reforms was headed-off by the Commission's initial decision to abandon disinterestedness completely. This action effectively precluded a more careful review of disinterestedness and its requirements until the more general question was resolved. By the time the Commission finally revisited the issue and decided to recommend the retention of disinterestedness, it lacked the time and resources to undertake a more detailed review of these particular issues.

As a result of these forces, the Commission was able to take action only on the most pressing problems and least controversial amendments which had been proposed, as reflected in the proposed changes in § 1107. The Commission's rash decision to call for the elimination of the disinterestedness requirement for professionals for a debtor in possession unfortunately foreclosed an opportunity for meaningful review of further reforms.

Thus, the decision to retain the disinterestedness requirement for professionals retained by a debtor in possession should not be read as a conclusion that the current system is perfect. It is not. But it is better to identify the specific problems caused by the current system and draft reforms tailored to correcting those problems. One need not throw out the baby with the bath water.

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166. *See* Robin, *supra* note 37, at 224.

The disinterestedness requirement furthers important policy goals, as evidenced by the general agreement that it is appropriate when applied to professionals retained by a trustee. It was created to deal with recurring problems of criminality, corruption, and self-dealing which have marked the history of the bankruptcy system and which arise from the structure of the bankruptcy system itself. So long as these temptations remain and effective creditor oversight and control is absent, the need for disinterestedness remains.

The disinterestedness requirement has been in place for professionals retained by debtors in possession for almost twenty years, and for trustees for several decades longer. The sky has not fallen. Advocates of repealing disinterestedness for professionals representing debtors in possession simply have failed to demonstrate that the bankruptcy system would work better without disinterestedness than with it. Isolated problems have been identified--and then solved with discrete solutions. So far, however, no one has identified any problem or problems for which abandonment of the disinterestedness requirement for professionals retained by the debtor in possession is the solution.