PROFESSIONALS IN BANKRUPTCY PROCEEDINGS: APPOINTMENT, RIGHT TO COMPENSATION AND CONFLICTS OF INTEREST

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> No servant can be the slave of two masters; for either he will hate the first and love the second, or he will be devoted to the first and think nothing of the second.[1]

I. INTRODUCTION

There are few contexts in which application of the principle articulated in the passage above is more fundamental than in the area of participation by professionals in legal proceedings. In particular, the notion that one man cannot serve opposing interests succinctly describes the view espoused by the draftsmen of bankruptcy law.[2] Professionals involved in bankruptcy proceedings quickly discover the Bankruptcy Code's (the Code) extensive prohibitions when they seek to be retained in the case and are denied approval on the basis of carefully articulated statutes, which vigorously guard against conflicts of interest.[3] Unfortunately, professionals often learn about the Code's mandate later in the case when they seek to recover fees and are denied them because of the existence of a conflict.

This article endeavors to examine the law of appointments and compensation of professionals in the bankruptcy forum. The first portion will describe the role of the court in the appointment process. The second will focus upon recent developments in the

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1 *Matthew* 6:24.

2 Prior to the enactment of the modern Bankruptcy Code, compensation of professionals was governed by § 221(4) of the Bankruptcy Act of 1898, 30 Stat. 544 (1898), *repealed by* Pub. L. No. 95-598, 92 Stat. 2549 (1978), and by former Bankruptcy Rules 210 and 215. Several cases arising under the 1898 Act evidenced apprehension over conflicts of interest, and highlighted the courts' desire to remove its taint from the bankruptcy forum early on in the development of this area of the law. *See, e.g.*, Woods v. City Nat'l Bank and Trust Co., 312 U.S. 262, 268 (1941) (" 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service").

3 11 U.S.C. §§ 101(13), 327(a) (1988); FED. R. BANKR P. 2014.

area of conflicts of interests in bankruptcy proceedings with an emphasis on the issue of compensation.

II. COURT AUTHORIZATION OF PROFESSIONALS

Pursuant to Section 327(a)[4] of the Code, the trustee[5] must obtain court approval of his selection of a "professional."[6] In order to obtain the requisite approval, the trustee must follow the procedures set forth in Bankruptcy Rule 2014(a),[7] which requires, among other things, that the application for employment contain a detailed disclosure of the professional's connections with the debtor, creditors and all other parties in interest.[8]

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[4] 11 U.S.C. § 327(a) (1988). The statute reads as follows:

> (a) Except as otherwise provided in this section, the trustee, *with the court's approval*, 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.

Id. (emphasis added). *See infra* notes 36-82 and accompanying text.

[5] Although § 327(a) only refers to the trustee's employment of a professional, § 1107 of the Code makes § 327 applicable to debtors in possession. *See* 11 U.S.C. § 1107 (1988). Section 1107 states that "a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter." *Id.*

[6] *See, e.g.*, Dola Int'l Corp. v. Bordlemay (*In re* Dola Int'l Corp.), 88 Bankr. 950, 954 (Bankr. D. Minn. 1988) (management consultants considered professional persons under § 327(a)); Committee of Asbestos-Related Litigants and/or Creditors v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 60 Bankr. 612, 619-21 (Bankr. S.D.N.Y. 1986) (non-lawyer lobbyist not professional under § 327(a)); Frankfurth v. Cummins (*In re* Cummins), 8 Bankr. 701, 702 (Bankr. C.D. Cal. 1981), *rev'd*, 15 Bankr. 893 (Bankr. 9th Cir. 1981), *reh'g denied*, 20 Bankr. 652 (Bankr. 9th Cir. 1982) (real estate broker selling on commission is a "professional person").

[7] FED. R. BANKR. P. 2014(a) requires that:

> An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327 . . . of the Code shall be made only on application of the trustee or committee, stating the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditor, or any other party in interest, their respective attorneys and accountants. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants.

Id.

[8] Professionals cannot meet the requirements of Bankruptcy Rule 2014(a) by merely stating, in a conclusory fashion, that the professional holds or represents no interest adverse to the estate and is a disinterested person. In United States v.

Should a professional fail to receive the requisite court approval at the outset of the case, that professional may be left uncompensated.[9] Most courts will, however, grant professionals *nunc pro tunc*, or retroactive, appointments under extraordinary or special circumstances.[10]

Because *nunc pro tunc* appointments are analyzed on a case by

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Azevedo (*In re* Azevedo), 92 Bankr. 910 (Bankr. E.D. Cal. 1988), an application was submitted to the court that the court found to be insufficient because it repeated the requirements of § 327(a) in conclusory language. The *Azevedo* court stated that the verification

> must touch all the bases and set forth in affirmative terms the professional's relationship with the debtor *and* with creditors *and* with any other party in interest, *and* their respective attorneys and accountants. Normally, all the bases will have been touched if, after the required disclosures of any actual connections, the verification closes with the statement: "Except as set forth above, I have no connection with the debtor, creditors, or any other party in interest, their respective attorneys and accounts." If the statement appears to be complete, raises no concerns, and if the court has no reason to doubt its veracity, the application normally will be approved.

Azevedo, 92 Bankr. at 911 (emphasis in original) (quoting FED. R. BANKR. P. 2014(a)).

[9] The bankruptcy courts have broad discretion to deny compensation, or require disgorgement of funds, for failure to make full disclosure concerning disinterestedness. *See, e.g. In re* Willamette Timber Sys., Inc., 54 Bankr. 485, 489 (Bankr. D. Or. 1985) (attorney not entitled to fees for period prior to entry of court's order authorizing his appointment). *See also* Diamond Lumber, Inc. v. Unsecured Creditors' Comm. of Diamond Lumber, Inc. (*In re* Diamond Lumber, Inc.), 88 Bankr. 773, 776 (Bankr. N.D. Tex. 1988); *In re* Guy Apple Masonry Contractor, Inc., 45 Bankr. 160, 163 (Bankr. D. Ariz. 1984); *In re* Coastal Equities, Inc., 39 Bankr. 304, 308 (Bankr. S.D. Cal. 1984).

[10] *See infra* notes 11-35 and accompanying text. *See e.g., In re* Rheam of Ind., Inc., 111 Bankr. 87, 94 (Bankr. E.D. Pa. 1990) (court will only grant *nunc pro tunc* appointment when professional makes requisite showing of presence of extraordinary circumstances); Okamoto v. THC Fin. Corp. (*In re* THC Fin. Corp.), 837 F.2d 389, 392 (9th Cir. 1988) (*nunc pro tunc* appointment only granted in limited circumstances where applicant shows both satisfactory explanation for failure to receive timely court approval and that bankruptcy estate has been benefitted in significant manner); *In re* Aladdin Petroleum Co., 85 Bankr. 738, 741 (Bankr. W.D. Tex. 1988) (Bankruptcy Code militates against *nunc pro tunc* approval, absent showing of exceptional circumstances justifying failure to obtain pre-employment authorization); Carlson v. Burns Nat'l Bank of Durango (*In re* Ewing), 54 Bankr. 952, 954-55 (Bankr. D. Colo. 1985) (equity power to enter order for *nunc pro tunc* employment should be exercised only in "most extraordinary circumstances"); Fanelli v. Hensley (*In re* Triangle Chem., Inc.), 697 F.2d 1280, 1289 (5th Cir. 1983) (bankruptcy judge has discretion to enter order authorizing nunc pro tunc appointment of professional; however, the court noted that "[w]hile equitable powers may permit *nunc pro tunc* appointment in rare or exceptional circumstances, we do not intend by our holding to encourage any general nonobservance of the contemplated preemployment court approval"); *In re* BSJ Tower Assoc., 35 Bankr. 131, 133 (Bankr. D.P.R. 1983) (*nunc pro tunc* order of appointment may be issued in cases showing extraordinary circumstances).

case basis, an overview of case law will shed some light on the circumstances which must exist in order to justify such an appointment.[11] In *In re Freehold Music Center, Inc.*,[12] the president of the corporate debtor sought to employ a small accounting firm.[13] During a meeting in which the attorneys for the debtors and the accountants discussed the types of services to be rendered, the attorneys advised the accountants that, due to internal problems in the bankruptcy court, an order authorizing their retention might be delayed. Although the accountants were advised that the proper application would be prepared and submitted to the court, authorization for the retention of the accountants was never actually obtained. When informed that the court required an order of retention as a prerequisite to payment, the accountants stopped working.

In an attempt to rectify the situation, the debtor filed an application seeking to retain the accountants *nunc pro tunc* and to grant fees. In reviewing the application, the *Freehold Music* court set forth the following test to determine whether a professional is entitled to a *nunc pro tunc* appointment:

> The rule which must be applied therefore is one in which the [c]ourt balances the equities and exercises its discretion. It must weigh the good faith of the professional in proceeding without an order and take into account the response to information that the order has not been entered. It must further determine the emergent need for the services rendered and whether or not the debtors could have functioned without such services. Other factors for consideration include a determination of whose responsibility it was to obtain authorization, the applicant's relationship with the debtors and his own sophistication in the field.[14]

Because the court found that the accountants proceeded in good faith, that they performed services that were in the best interest of the debtors, and that the debtors' business could not be properly operated without the services of a qualified professional, the court authorized their employment *nunc pro tunc*.[15] Although *Freehold*

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[11] It is important, however, to recognize that because there is no consensus on what factors constitute a sufficient basis to grant *nunc pro tunc* appointments, the determination is made on a case-by-case basis. *See* Land v. First Nat'l Bank in Alamosa (*In re* Land), 116 Bankr. 798 (Bankr. D. Colo. 1990).

[12] 49 Bankr. 293 (Bankr. D.N.J. 1985).

[13] *Id.* at 294.

[14] *Id.* at 296.

[15] *Id.* In analyzing the issue, the *Freehold Music* court first rebutted Circuit Judge Tate's characterization of the Third Circuit as a jurisdiction that applies a "strict

Music was not appealed, uncertainty as to the grounds for *nunc pro tunc* appointments brought the issue before the Third Circuit in *In re Arkansas Co.*[16] In *Arkansas*, counsel for the Unsecured Creditors'

'inflexible *per se* rule' " against *nunc pro tunc* appointments. *Id.* at 295 (quoting *In re* Triangle Chemicals, Inc., 697 F.2d 1280, 1285 (5th Cir. 1983)). Circuit Judge Tate had identified the Third Circuit as employing a different standard than the other Circuits. *Id.* In order to demonstrate that the Third Circuit allowed *nunc pro tunc* appointments, the *Freehold Music* court distinguished the cases relied upon by Circuit Judge Tate, which were decided under the old Bankruptcy Act, and relied upon two Third Circuit cases, which were decided under the modern Bankruptcy Code.

The first modern case that the *Freehold Music* court referred to was *In re* Lewis, 30 Bankr. 404 (Bankr. E.D. Pa. 1983). In *Lewis* an attorney sought *nunc pro tunc* appointment to recover fees for services rendered during the reorganization. *Id.* at 405. The *Lewis* court denied the application for employment *nunc pro tunc*, basing its decision on *In re* Hydrocarbon Chem., Inc., 411 F.2d 203 (3d Cir. 1969), *cert. denied*, 396 U.S. 823 (1969), which stood for the proposition that an attorney could not be compensated by the Bankruptcy Court if he did not receive prior court approval for his employment. *Lewis*, 30 Bankr. at 405. With regard to *nunc pro tunc* appointment, the *Lewis* court articulated "that both [the applicant] and the members of his firm are experienced practitioners in this field of law" and that the attorney "did not file his application for approval of employment until after this [c]ourt had entered its show cause order." *Id.* at 405-06. The *Freehold Music* court, in interpreting the *Lewis* decision, noted that "[i]t is clear from [the *Lewis* court's] ruling that the application was too little, too late and that the equity test required by Judge Tate in *Triangle Chemicals*, [697 F.2d 1280 (5th Cir. 1983)], was not met." *In re* Freehold Music, 49 Bankr. at 295.

The second case that the *Freehold Music* court referred to in its attempt to illustrate that the Third Circuit permitted *nunc pro tunc* appointment was *In re* Bible Deliverance Evangelistic Church, 39 Bankr. 768 (Bankr. E.D. Pa. 1984). In this matter, the attorneys for the creditors' committee sought compensation. *Id.* at 770. The court, responding to the debtor's objection to compensating the attorneys because they had failed to obtain prior court approval, reasoned:

> Ordinarily, we adhere to the strict rule enunciated in *Lewis*, . . ., against nunc pro tunc fee awards. However, we believe counsel has demonstrated the existence of exceptional circumstances during the time period in question (March 29-April 12) requiring the immediate attention of counsel for the creditors committee. . . It was necessary to begin investigating the financial position of the debtor at once. Furthermore, counsel acted with reasonable promptness in filing its application for employment.

Id. at 772. Accordingly, this case, as relied upon by the *Freehold Music* court, evidences the fact that the Third Circuit permits *nunc pro tunc* appointment.

[16] 798 F.2d 645 (3d Cir. 1986). Although some of the bankruptcy courts in the Third Circuit had exercised the power to grant retroactive approval, *see In re* Freehold Music Center, Inc., 49 Bankr. 293 (Bankr. D.N.J. 1985); *In re* Bible Deliverance Evangelistic Church, 39 Bankr. 768 (Bankr. E.D. Pa. 1984), the Court of Appeals for the Third Circuit had yet to determine whether the bankruptcy courts actually possessed the power to grant retroactive approval to the employment of an attorney in chapter 11 proceedings. In determining that the bankruptcy court did have the power to grant retroactive approval, the court reasoned that nothing in the statute denied them the power to do so. *In re* Arkansas, 798 F.2d at 448. Therefore, the court expressed its agreement with those circuits which held that bankruptcy courts do have the power to authorize retroactive employment of

Committee inadvertently failed to file an application for court approval of its employment as counsel.[17] After thirteen months of rendering legal services to the Unsecured Creditors' Committee, counsel realized that it had failed to obtain the court approval required for payment. In an effort to receive compensation for the work it had performed, counsel moved the bankruptcy court to approve its employment retroactively. Although the bankruptcy court denied the motion in an order without an opinion, a subsequent hearing on the motion revealed that the bankruptcy judge believed he lacked the authority to approve counsel's appointment *nunc pro tunc*.[18]

On appeal, the district court determined that the bankruptcy court had incorrectly held that it was without power to grant approval *nunc pro tunc*.[19] The court, however, affirmed the denial of retroactive approval, observing that retroactive approval "should be limited to cases in which the party seeking approval shows that it would otherwise be subject to an *extraordinary hardship* not of its own

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professionals. *Id.* at 648-49 (citing Cohen v. United States (*In re* Laurent Watch Co.), 539 F.2d 1231 (9th Cir. 1976) (per curiam); Stolkin v. Nachman (*In re* Stolkin), 472 F.2d 222 (7th Cir. 1973)).

17 *In re Arkansas*, 798 F.2d at 646.

18 Judge Commisa believed that the Third Circuit's decision in *In re* Hydrocarbon Chem., Inc., 411 F.2d 203 (3d Cir. 1969) (in banc), *cert. denied*, 396 U.S. 823 (1969), precluded him from granting *nunc pro tunc* appointments. *Arkansas*, 798 F.2d at 646. Although the Third Circuit in *Hydrocarbon* affirmed a denial of a counsel fee where counsel had failed to obtain prior court approval, the *Arkansas* court viewed *Hydrocarbon* as easily distinguishable. *Arkansas*, 798 F.2d at 647.

In *Hydrocarbon*, the attorney seeking compensation was employed by counsel for the debtor. *In re* Hydrocarbon, 411 F.2d at 204. The court, in denying counsel fees, stated that "[w]e would deny compensation on the ground alone that there is no provision in the Bankruptcy Act for paying more than one fee to counsel for the debtor, nor is there any provision in the Act for employment of other counsel for the counsel for the debtor unless he compensates them himself." *Id.* at 205. The *Hydrocarbon* court also emphasized that a receiver was in place managing the property and had already appointed two law firms and an accountant to perform any services that the estate needed. *Id.* Therefore, the court found that "there was no necessity whatsoever for counsel of the debtor employing counsel without the approval of the court . . . ." *Id.* Accordingly, even a timely application would have been denied in *Hydrocarbon* and, thus, there was no need for the court to discuss the possibility of a *nunc pro tunc* approval. *Id.* In short, the *Hydrocarbon* case has been described as "one of those cases where some reason other than the failure to obtain prior approval controlled the disallowance of payment of attorney's fees." *Arkansas*, 798 F.2d at 647 (citation omitted).

19 *In re* Arkansas, 55 Bankr. 384, 385 (D.N.J. 1985). The district court indicated that, although the Third Circuit had never recognized the power to grant *nunc pro tunc* appointment, it found the decision in *In re* Triangle Chemicals, Inc., 697 F.2d 1280 (5th Cir. 1983), to be persuasive. Therefore, it believed that there was discretion to grant *nunc pro tunc* appointment in rare or exceptional circumstances.

making."[20] Counsel for the committee appealed again, and the Court of Appeals for the Third Circuit affirmed the ruling below.[21] The circuit court, however, softened the standard slightly when it held that "*nunc pro tunc* approval should be limited to cases where *extraordinary circumstances* are present."[22]

The Third Circuit adopted a two-part test to determine whether extraordinary circumstances exist. First, the bankruptcy court must find, after a hearing, that the professional is disinterested and, therefore, could have been appointed initially.[23] Second, the bankruptcy court must determine whether the circumstances in the case excuse the professional's failure to have obtained prior approval.[24] The *Arkansas* court established several factors to guide a consideration of whether the circumstances adequately excuse the failure to obtain prior approval including, *inter alia*:

> [W]hether the applicant or some other person bore responsibility for applying for approval; whether the applicant was under time pressure to begin service without approval;[25] the amount of delay after the applicant learned that initial approval had not been granted;[26] the extent to which compensation to the applicant will prejudice innocent third parties; and other relevant factors.[27]

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20 *Arkansas*, 55 Bankr. at 386 (emphasis added).

21 *Arkansas*, 798 F.2d at 651.

22 *Id.* at 649 (emphasis added).

23 *Id.* at 650.

24 *Id.*

25 *See also* F/S Airlease, Inc. v. Simon, 844 F.2d 99, 107 (3d Cir. 1988), *cert. denied*, 488 U.S. 852 (1988) ("time pressure factor" relates to "whether there is sufficient time to request court approval before the professional's services must begin;" for time pressure factor to be significant there must be an "emergency situation in which services [must be] initiated within a very short period before approval [can] be sought;" and approval must be sought promptly).

26 *See also In re* TM Carlton House Partners, Ltd., 93 Bankr. 875, 877 (Bankr. E.D. Pa. 1988) (accounting firm's five month delay in seeking to amend bankruptcy court order approving its appointment so that the appointment was retroactive to date when firm first performed appraisal services prevented court from granting *nunc pro tunc* appointment).

27 *Arkansas*, 798 F.2d at 650 (footnotes added); the courts have employed a variety of criteria in determining whether or not extraordinary circumstances exist. For example, in *In re* Sinor, 87 Bankr. 620 (Bankr. E.D. Cal. 1988), the court listed the following criteria to determine whether to retroactively ratify a professional's employ:

> 1. Did the employing entity expressly contract with the professional person to perform the services which were thereafter rendered?
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> 2. Did the applicant provide sufficient notice of the application to creditors and parties in interest and thus provide an opportunity for filing objections?
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> 3. But for the requirement of pre-employment approval, does

Based upon this analytical framework, the circuit court affirmed the holdings of both the bankruptcy and district courts by denying counsel's application, and determined that oversight by an attorney is not a sufficient ground for retroactive appointment.[28]

The Third Circuit revisited the issue of *nunc pro tunc* appointments in *F/S Airlease, Inc. v. Simon*.[29] *F/S Airlease* involved a broker for the debtor corporation who argued that he was entitled to *nunc pro tunc* appointment or, in the alternative, that he was entitled to a brokerage fee pursuant to 11 U.S.C. § 503(b)(1)(A).[30] In evaluating the brokers's argument for *nunc pro tunc* appointment under the two part test set forth in *Arkansas*, the *F/S Airlease* court held that no extraordinary circumstances existed.[31] Thus, the Third Circuit determined that the broker was not entitled to *nunc pro tunc* appointment.[32]

In rejecting the broker's alternative argument, that his services

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the applicant otherwise meet the requirements of § 327(a) and Bankruptcy Rule 2014(a)?

4. If the "gap period" was unreasonably long, did the applicant satisfactorily explain to the court the failure to obtain prior court approval?

5. Did the applicant's services benefit the estate in some significant manner?

Id. at 623.

28 *Arkansas*, 798 F.2d at 651.

29 844 F.2d 99 (3d Cir. 1988), *cert. denied*, 488 U.S. 852 (1988).

30 *Id.* at 108. Section 503(b)(1)(A) provides in pertinent part:

(b) After notice and a hearing, there shall be allowed administrative expenses, . . ., including —

(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case[.]

11 U.S.C. § 503(b) (1988).

31 *F/S Airlease*, 844 F.2d at 108.

32 *Id.* at 109. In denying *nunc pro tunc* appointment, the court focused upon two factors "of particular relevance" set forth in *Arkansas*. *Id.* at 106. The first factor concerned the issue of who bore responsibility for obtaining prior court approval for employment of the professional. *Id.* The broker argued that he was not responsible because Bankruptcy Rule 2014(a) provided that orders approving the employment of professionals "shall be made only on application of the trustee or committee." *Id.* (quoting FED. R. BANKR. P. 2014(a)). The court, however, disagreed by observing that the broker still had the responsibility to ensure that the approval had been sought. *Id.* at 106-07.

The second factor that the court analyzed was whether the applicant was under any type of time pressure to begin services so that prior approval could not reasonably have been sought. *Id.* at 107. The Third Circuit Court disagreed with the two lower courts which had found that the broker "operated under severe time pressures to locate another lessee for the aircraft." *Id.* The circuit court, in contrast, held that the broker was not faced "with any time pressure at all with respect to seeking court approval for his . . . services." *F/S Airlease*, 844 F.2d at 107.

could be treated as a regular administrative expense, the court stated that section 503(b)(1)(A) encompasses expenses for the protection and conservation of the estate, including repairs, upkeep, rent and taxes.[33] The court further observed that the authority to pay administrative expenses for professionals is found not in section 503(b)(1)(A), but rather in section 503(b)(2).[34] The court determined that because the broker was a professional and had failed to seek prior court approval, he was not entitled to use any other sections of the Code to circumvent the requirements of section 327(a).[35]

III. THE TWO-PRONGED TEST OF SECTION 327(a)

In addition to requiring court approval of the trustee's selection of a professional, section 327(a) imposes a two-pronged test for determining whether a professional will qualify for employment. First, the professional is not permitted to "hold or represent an interest adverse to the estate" and, second, he must be a "disinterested person[]."[36] If the professional fails to meet either portion of the test, the court may deny compensation.[37]

Because the Code does not define "interest adverse to the estate," the courts have interpreted that holding or representing an interest adverse to the estate includes:

(1) . . . [P]ossess[ing] or assert[ing] any economic interest that

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[33] *F/S Airlease*, 844 F.2d at 108.

[34] *Id.* 11 U.S.C. § 503(b)(2) (1988) provides in pertinent part:

> (b) After notice and a hearing, there shall be allowed administrative expenses, . . ., including —
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> (2) compensation and reimbursement awarded under section 330(a) of this title[.]

Id.

[35] *F/S Airlease*, 844 F.2d at 108-09. *See also In re* Channel 2 Assoc., 88 Bankr. 351 (Bankr. D.N.M. 1988) (professional person whose employment was not approved by bankruptcy court was not entitled to payment of compensation as an administrative expense); *In re* Mansfield Tire & Rubber Co., 65 Bankr. 446, 465-66 (Bankr. N.D. Ohio 1986) (professional services compensable from estate only if authorized prior to performance).

[36] 11 U.S.C. § 327(a) (1988).

[37] 11 U.S.C. 328(c) (1988), which provides, in relevant part:

> [T]he court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 . . . 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 interest of the estate with respect to the matter on which such professional person is employed.

Id.

> would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant;[38] or (2) . . . possess[ing] a predisposition under circumstances that render such a bias against the estate.[39]

With respect to the second prong of the test, section 327(a) requires that the professional be disinterested. The Code defines a disinterested person as one who "is not a creditor,[40] an equity se-

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[38] *See also* Parker v. Frazier (*In re* Freedom Solar Center, Inc.), 776 F.2d 14 (1st Cir. 1985). The *Parker* debtor was a closely held corporation whose stock was held entirely by its sole officer, Freeman. *Id.* at 15. Counsel for the debtor filed a voluntary chapter 7 liquidation petition, and Freeman simultaneously employed the same counsel to represent him and a new corporation established to purchase the debtor corporation's assets. The trustee requested that debtor's counsel withdraw from representing Freeman and the new corporation because he would be representing clients with opposing interests. Counsel refused to obey this request. The bankruptcy court found that there were two adverse interests between the debtor and Freeman. *Id.* at 16. First, Freeman was interested in stalling the turnover of the assets to the trustee, whereas the debtor corporation was willing to cooperate with the trustee. *Id.* Second, Freeman would attempt to purchase the assets at the lowest price while the debtor would seek the highest price possible. *Id.* Based upon these findings, the bankruptcy court observed that "when the sole shareholder desires to purchase the estate's assets . . . adverse interests do result." *Id.* at 17 (citing *In re* Watson Seafood & Poultry Co., 40 Bankr. 436, 442 (Bankr. E.D.N.C. 1984)) (debtor's counsel fees denied where debtor's counsel represented the debtor's controlling shareholder and a prospective purchaser of the estate). Accordingly, the bankruptcy court held that counsel could not represent both parties. *Id.* at 15. When this matter reached the court of appeals, the First Circuit reinstated the bankruptcy court's finding that debtor's counsel could not also represent the debtor's sole shareholder who was seeking to purchase the debtor's assets. *Id.*

[39] *In re* Roberts, 46 Bankr. 815, 827 (Bankr. D. Utah 1985). *See also* Roger J. Au & Son, Inc. v. Aetna Ins. Co. (*In re* Roger J. Au & Son, Inc.), 64 Bankr. 600, 604 (N.D. Ohio 1986) (quoting *In re* Roberts); *In re* O'Connor, 52 Bankr. 892, 96 (Bankr. W.D. Okla 1985) (quoting *In re* Roberts).

[40] Although section 101(13)(A) states that a creditor may not be considered to be a disinterested person, not all courts are willing to apply a per se rule that would disqualify attorneys for holding a security interest in an estate. In Michel v. Carter (*In re* Carter), 116 Bankr. 123, 125 (E.D. Wis. 1990), the debtor assigned its interest in a land contract to a law firm as collateral for payment of legal fees for services to be rendered in the future. *Id.* The Untied States Trustee objected to the firm representing the debtor on the ground that the firm was not a disinterested person since the prepetition assignment caused the firm to become a creditor of the estate. *Id.* at 125.

In analyzing the United States Trustee's position, the district court focused upon the language of the Bankruptcy Code. First, Senior District Judge Reynolds noted that the Code "defines creditor as 'an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.' " *Id.* (quoting 11 U.S.C. § 101(9)(A)). Further, the court contended that "claim" is defined by the Code as the "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *Id.* (quoting 11 U.S.C. § 101(4)(A)). Although the court found that the firm was a creditor

curity holder or an insider"[41] and one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to . . . the debtor . . . or for any other reason."[42] A comparison of section 327(a) and section 101(13) indicates that to "hold . . . an interest adverse to the estate" in section 327(a) and to "have an interest materially adverse to the estate" in section 101(13) are identical considerations. Consequently, according to the Code's definition of the term, by being a "disinterested person" one automatically satisfies both prongs of the test.[43]

Although the definitions mentioned above may shed some light

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because it had a right to payment contingent upon its performing legal services for the debtors during the bankruptcy proceedings, it refused to apply the per se rule offered by the United States Trustee which would automatically disqualify an attorney from representing a debtor once the attorney is determined to be a creditor. *Id.* at 126-27.

The district court first noted that the circuits were split as to the validity of the rule offered by the United States Trustee. *Id.* at 126. Judge Reynolds explained that the Eighth Circuit in the case of Pierce v. Aetna Life Ins. Co. (*In re* Pierce), 809 F.2d 1356, 1362-63 (8th Cir. 1987), adopted the type of per se rule advocated by the United States Trustee. *Michel*, 116 Bankr. at 126. The *Pierce* court held that the statute's intent was clear and that a professional who is a creditor does not qualify as a disinterested person under 11 U.S.C. § 101(13). *Pierce*, 809 F.2d at 1362-63. Next, the district judge observed that the First Circuit, in *In re* Martin, 817 F.2d 175, 183 (1st Cir. 1987), adopted the contrary position. *Michel*, 116 Bankr. at 126. The *Martin* court eschewed "the affixation of pejorative labels to the kind of mortgage arrangement entered into between the debtors and [the law firm]," and declared that it was "not prepared to say across the board that a retainer of this type is good—or bad—in every instance." *Martin* 817 F.2d at 181.

After reviewing both positions, the *Michel* court found the view set forth by the First Circuit persuasive. *Michel*, 116 Bankr. at 126. Therefore, the court concluded that a professional who fits the Code's definition of "creditor" is not automatically disqualified on that basis. *Id.* at 126-27. Finally, the court held that counsel had satisfied the requirement of disinterestedness. *Id.* at 127.

41 11 U.S.C. § 101(13)(A) (1988) (footnote added).

42 11 U.S.C. § 101(13)(E) (1988). The bankruptcy courts often cite to COLLIER'S discussion of this Code section:

> It appears 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 . . . . Indirect or remote associations or affiliations, as well as direct, may engender conflicting loyalties. The purpose of the rule is to prevent even the emergence of a conflict irrespective of the integrity of the person under consideration.

2 COLLIER ON BANKRUPTCY, ¶ 327.03, at 327-30 to 327-32 (15th ed. 1990) (citations omitted) (hereinafter COLLIER ON BANKRUPTCY).

43 *E.g.*, Roger J. Au & Son, Inc. v. Aetna Ins. Co., (*In re* Roger J. Au & Sons, Inc.), 64 Bankr. 600, 604 (Bankr. N.D. Ohio 1986) ("both prongs of the test are satisfied where counsel is . . . a 'disinterested person' because of the manner in which the Code defines 'disinterested person' ").

on the requirements for employment as a professional, an examination of case law that has applied section 327 will help to emphasize the role it plays with respect to employment and compensation of professionals. In reviewing the cases that follow, it is important to keep in mind that the courts sought to determine whether the professional was "free of any conflicting interest which might . . . affect the performance of [his or her] services or which might impair the high degree of impartiality and detached judgment expected . . . during the administration of the case."[44] If a court finds that the professional has a conflict of interest, the professional will not be employed or compensated. Therefore, it is useful to examine the most common circumstances in which courts have determined that the professional chosen is not sufficiently free from conflicts.

A. Representation of Two Debtors in Possession

One situation in which the bankruptcy courts have determined that a professional cannot qualify as a disinterested person arises in the context of representation of related debtors in possession, where one of the debtors has a claim against the estate of the other debtor.[45] This situation arose in *In re Star Broadcasting,*

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[44] *Id.* (citing COLLIER ON BANKRUPTCY, *supra* note 42, ¶ 327.03[3][a], at 327-13.

[45] When disqualifying a professional from representing two debtors in possession, an emphasis is placed on the fact that one of the debtors is indebted to the other. For example, in *In re* Vanderbilt Assoc., 117 Bankr. 678 (D. Utah 1990), the court did not disqualify a law firm that represented two related debtors in possession, where neither of the debtors in possession owed any obligations or had any adverse relationships with the other. *Id.* at 680. The facts of the case reveal, however, that they did have a relationship with one another in that they shared a common general partner.

Although the bankruptcy court found that two conflicts existed with such an arrangement, the district court did not agree. *Id.* at 681. First, it disputed the bankruptcy court's finding that a conflict existed because either one of the debtors could assert a claim against the general partner. *Id.* The bankruptcy court reasoned that under chapter 7, the trustee may assert claims "against the general partner if the general partner is personally liable." *Id.* (citing 11 U.S.C. § 723(a)). If one of the debtors asserted a claim, the bankruptcy court posited, a conflict would exist because it would reduce the general partner's assets available to service the remaining debtor. The district court found fault in this legal conclusion, however, because § 723, the section relied on by the bankruptcy court for the apparent conflict, applies solely to chapter 7 cases. *Id.* (quoting 11 U.S.C. § 103(b) (1988)). The district court found that no conflict existed because the present case was under chapter 11. *Id.*

Second, the district court overturned the bankruptcy court's finding that a conflict existed with respect to each debtor's plan of reorganization. *Id.* at 681-82. The bankruptcy court noted that the plans called for equity contributions by the limited partners, and if more money was needed, the general partner would make up the difference. *Id.* at 682. With this type of arrangement, the bankruptcy court held that if the general partner gave money to one of the estates, the other estate

Inc.,[46] where a law firm moved for an order declaring that its representation of both the debtor corporation and its sole owner did not represent a conflict of interest.

In 1986, both Sandra M. Shenfeld (Shenfeld) and Star Broadcasting, Inc. (SBI), a corporation wholly-owned by Shenfeld, filed chapter 11 petitions for reorganization. In 1987, Shenfeld and SBI discharged their original counsel and obtained court orders authorizing the substitution of Cole, Schotz, Bernstein, Meisel & Forman (Cole, Schotz) as counsel for both debtors in possession. A few months after the court approved the representation by Cole, Schotz, several creditors opposed the continued dual representation of both debtors in possession, based upon alleged conflicts of interests between the two debtor estates.[47]

The court, focusing primarily upon the fact that Shenfeld was an unsecured creditor of SBI, determined that an actual conflict existed.[48] Judge Gambardella reasoned that, although Shenfeld proposed to waive her claims against SBI for monies loaned to the corporation, the representation of both parties would be in direct conflict.[49] The bankruptcy judge concluded:

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would be prejudiced because the amount of money available to the second debtor would be depleted. *Id.* This fact, combined with the fact that the same law firm represented both debtors, caused the bankruptcy court to find a conflict in the dual representation. *Id.* Although conceding that the plans did call for such a contingency, the district court reasoned that it was merely a potential conflict, rather than an *actual* conflict. *Id.* (emphasis added). Accordingly, the court did not disqualify counsel because it determined that a potential conflict was an insufficient ground for disqualification. *Id. Contra In re* Oliver's Stores, 79 Bankr. 585, 594 (Bankr. D.N.J. 1987) (potential conflict of interest may be enough to disqualify an attorney from representation); *In re* BH&P, Inc., 103 Bankr. 556, 563-64 (Bankr. D.N.J. 1989) (courts should treat actual and potential conflicts similarly), *rev'd on other grounds*, 119 Bankr. 35 (D.N.J. 1990).

46 81 Bankr. 835, 836 (Bankr. D.N.J. 1988).

47 *Id.* at 837.

48 *Id.* at 841.

49 *Id.* The court distinguished the case of *In re* Guy Apple Masonry Contractor, Inc., 45 Bankr. 160 (Bankr. D. Ariz. 1984), which was offered by Shenfeld and SBI in support of their position. *Star Broadcasting*, 81 Bankr. at 842. In *Guy Apple*, a law firm represented both Guy Apple in a chapter 11 proceeding and one of its debtors, University Block, in another chapter 11 proceeding. 45 Bankr. at 164. University Block owed Guy Apple both a large prepetition debt and an undetermined amount for rent incurred as an administrative expense during the proceedings. *Id.* at 165. Although the bankruptcy court found that an actual conflict of interest existed due to the inter-company unsecured and administrative claims, it focused primarily on whether the conflict was materially adverse to the estate, creditors, or equity security holders. *Id.* at 166. In finding that the firm's representation of both debtors was not materially adverse to the estate, the *Guy Apple* court opined:

The [c]ourt simply finds that at this late stage continued representa-

> if Shenfeld waives her claims against SBI, her estate is lessened in value from which her creditors may collect and SBI's estate is increased in value since they would not have to pay Shenfeld her purported claim. Conversely, if Shenfeld does not waive her claim against SBI and succeeds in collection thereof, her estate is enhanced and SBI's estate is lessened.[50]

Applying this reasoning, the court held that, by representing both SBI as a debtor in possession and Shenfeld as a debtor in possession and a creditor of SBI, Cole, Schotz disqualified itself due to the conflict of interest.[51] Therefore, counsel could not be employed by both debtors.[52]

> tion of the debtor by present counsel would be in the best interests of the estate. The major issues remaining to be resolved relate to the amount and priority of various claims from debtor's attempted rejection of a collective bargaining agreement. Present counsel is intimately familiar with these issues and the background necessary to debtor's effective assertion of its position. It would be both counterproductive and unduly expensive at this point to require new counsel to become familiar with these files.

Id. at 167. The *Star Broadcasting* court distinguished *Guy Apple* based upon this passage because it found that "the court in *Guy Apple* was more concerned with the effects of disqualification on the estate given the facts of [the] case." *Star Broadcasting*, 81 Bankr. at 843.

50 *Star Broadcasting*, 81 Bankr. at 841.

51 *Id.*

52 *Id.* at 844. *See also In re* Hoffman, 53 Bankr. 564 (Bankr. W.D. Ark. 1985). In *Hoffman*, the corporate debtor in possession was in the farming business, holding assets of approximately $800,000 and liabilities of approximately $3,000,000. *Id.* at 564. The debtor was a closely-held corporation which was owned equally by both Charles L. Hoffman (Hoffman) and L. Craig Shackelford (Shackelford). *Id.* Hoffman was an unsecured creditor for approximately $240,000 and also had a contingent claim, with Shackelford, for $1,150,000. *Id.* Shackelford held the contingent claim and a noncontingent unsecured claim of approximately $330,000. *Id.* Shackelford was a chapter 11 debtor in possession in his own reorganization case, while Hoffman was a debtor in a chapter 7 liquidation proceeding. *Id.* The same law firm represented all three parties in both prepetition and postpetition proceedings. *Id.* at 564. A bank creditor objected to the law firm's representation of all three parties. *Id.* at 564.

The court held that counsel may represent the corporate debtor in possession and at the same time represent the chapter 7 debtor. *Id.* at 565. The court reasoned that the attorneys could represent an adverse interest in the chapter 7 case because they did not represent the estate, were not required to be disinterested, and did not require court approval to represent the chapter 7 debtor. *Id.* (citations omitted).

The court, however, determined that the same counsel could not represent both the corporate debtor in possession and the chapter 11 debtor. *Id.* at 566. The court reasoned that "[t]he creditors in each case have an interest in being paid. Where one estate is indebted to the other, there exist two groups of creditors which have conflicting claims and payment for one group is necessarily at the expense of the other." *Id.* The court then posited that a conflict of interest inherently exists in a chapter 11 proceeding "if counsel simultaneously represent[s] a chapter 11 cor-

B. Representation of Debtor and its Creditors

Another situation in which a court would disqualify a professional and refuse compensation arises where the professional presently[53] represents both a debtor and its creditors. This situation arose in *In re BH & P, Inc.*[54] In this proceeding the debtor corporation, BH&P, initially filed a chapter 11 petition.[55] Later, the case was converted to chapter 7 and a trustee, Carmen J. Maggio (Maggio), was appointed. Pursuant to a court order, the trustee retained Ravin, Greenberg & Zackin (Ravin, Greenberg) as counsel and Bederson & Co. (Bederson) as accountants.

Subsequently, two principals of BH&P also filed chapter 7 petitions. The same trustee was appointed in these proceedings, without the knowledge of the bankruptcy court,[56] and Ravin, Greenberg and Bederson again served as attorney and accountant, respectively. Not until after Maggio filed a motion for joint administration did the bankruptcy court learn that the trustee and the professionals represented all three estates.[57] The bankruptcy court further discovered that the trustee knew from the

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porate debtor in possession, and an individual equity security holder who is also a debtor in possession and who is also a creditor of the debtor corporation in a pending chapter 11 case . . . ." *Id.* (citing *In re* Roberts, 46 Bankr. 815 (Bankr. D. Utah 1985); *In re* Watson Seafood & Poultry Co., 40 Bankr. 436 (Bankr. E.D.N.C. 1984); *In re* WPMK, Inc., 42 Bankr. 157 (Bankr. D. Hawaii 1984); *In re* Chou-Chen Chem., Inc., 31 Bankr. 842 (Bankr. W.D. Ky. 1983); *In re* Sambo's Restaurants, Inc., 20 Bankr. 295 (Bankr. C.D. Cal. 1982); *In re* King Resources Co., 20 Bankr. 191 (D. Colo. 1982); *In re* 765 Assoc., 14 Bankr. 449 (Bankr. D. Hawaii 1981); Barton v. Chrysler (*In re* Paine), 14 Bankr. 272 (W.D. Mich. 1981)).

53 Courts have also denied fees where an attorney *previously* represented the opposing interest in connection with the bankruptcy proceeding. *See In re* South Pacific Island Airways, 68 Bankr. 574, 578 (Bankr. D. Haw. 1986) (attorney denied all fees and costs relating to representation of creditors' committee where attorney formerly represented debtor). *But see In re* Highway Truck Drivers & Helpers Local Union 107, 86 Bankr. 404 (Bankr. E.D. Pa. 1988) (attorney and firm as counsel to creditors not disqualified where debtor consulted with attorney before he joined the firm about possibility of filing bankruptcy due to limited nature of consultation between attorney and debtor); *In re* Flanigan's Enters., Inc., 70 Bankr. 248, 253 (Bankr. S.D. Fla. 1987) (debtor's law firm not disqualified on ground of conflict of interest although members of firm had previously been associated with firm which represented creditor on prior matters with debtor, where there was no showing that debtor's legal representation in any way prejudiced creditor).

54 103 Bankr. 556 (Bankr. D.N.J. 1989), *rev'd on other grounds*, 119 Bankr. 35 (D.N.J. 1990).

55 *Id.* at 558.

56 The Bankruptcy court did not have knowledge that Maggio was appointed as trustee for all estates because, at the time the situation arose, the various cases were assigned to different judges. The Bankruptcy Rules require notice to the court of the acceptance of appointment as a chapter 7 trustee. *See* FED. R. BANKR. P. 2008.

57 *In re BH&P*, 103 Bankr. at 559.

outset of the two subsequent cases that BH&P had claims against the individual debtors.[58]

In determining whether the payment of fees was proper, the court focused upon whether the trustee and the professionals were properly disinterested as required by the Code.[59] First, the bankruptcy court analyzed the appointment of the same trustee in all three proceedings.[60] Bankruptcy Judge Stripp maintained that in order to be appointed, the chapter 7 trustee had to be a "disinterested person" in each of the cases.[61] In determining that the trustee was not disinterested as to the estates of the principals of BH&P, Judge Stripp reasoned as follows:

> "Creditor" is defined by Code § 101(9)(A) as an entity that has a claim against the debtor that arose at or before the order for relief . . . . "Claim" is defined by Code § 101(4) as a right to payment of any nature. A bankruptcy trustee is the representative of the debtor's estate by virtue of Code § 323(a), with the capacity to sue and be sued. If an estate holds a claim against another person, such claim is an asset of the estate under Code § 541(a)(1), and the trustee is the person who holds it as the estate's representative and is authorized to prosecute it. A trustee of an estate which holds a claim against another estate is therefore a "creditor" of the latter estate as defined by Code § 101(9). If a trustee is a creditor of an estate, he or she is not a disinterested person as to that estate by virtue of Code § 101(13)(A). It follows that because Maggio is trustee of BH&P, he is not a disinterested person within the meaning of Code § 101(13)(A) as to the estates of [the principals] because he holds claims against those estates.[62]

Relying on the fact the trustee was representing a creditor of the individual debtors' estates, the court concluded that the trustee, Maggio, could not serve as trustee for the estates of the principals.[63]

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58 *Id.* One of the claims was "for transfers from BH&P within a year of its bankruptcy petition of approximately $1.7 million into seven real estate tax shelters of which [the two principals] were the sole limited partners." *Id.*

59 *Id.* at 560-61.

60 *Id.* at 561.

61 *Id.* at 560.

62 *Id.* at 561 (citation omitted).

63 *Id. Cf.* Hassett v. McColley (*In re* O.P.M. Leasing Serv., Inc.), 16 Bankr. 932 (Bankr. S.D.N.Y. 1982). O.P.M. Leasing Services, Inc. (O.P.M.) was a wholly-owned subsidiary of Cali Trading International, Ltd. (Cali). James Hassett (Hassett) was appointed trustee when O.P.M. filed a petition for relief under chapter 11. *Id.* at 935. As trustee for O.P.M., Hassett filed an involuntary petition under chapter 11 against Cali, and an order for relief was entered. *Id.* at 936. Hassett then moved for appointment of a trustee for Cali, and an order for relief was granted.

Next the court focused upon each of the professionals and utilized section 327(c),[64] which mandates disapproval of a professional's employment where there is an "actual conflict of interest."[65]

Id. Hassett was selected by the United States Trustee to represent the estate of Cali, and the court was alerted that there was a potential for conflict. *Id.* The United States Trustee, however, noted that Hassett was a proper choice and if any actual conflict arose in the future it could be dealt with at that time. *Id.* On these facts the court approved Hassett as Cali's trustee. *Id.* at 938.

Albert Reisman, the chapter 7 trustee of one of Cali's two shareholders, asserted two reasons why Hassett and his attorneys should have been removed from the representation of Cali. *Id.* at 936. First, O.P.M. had claims against Cali for $134,153.98. *Id.* Second, and most significantly, Hassett, on behalf of both estates, filed suit to recover certain shares of bank stock. *Id.* Hassett believed that this bank stock was owned by either O.P.M. or Cali, and Reisman alleged that a conflict would arise if Hassett was successful in recovering this stock. *Id.*

The bankruptcy court, citing several Second Circuit decisions, held that a conflict does not arise where Hassett, as O.P.M.'s trustee, was a creditor of Cali. *Id.* at 938-39 (citations omitted). Further, the court held that no conflict existed with respect to the bank stock unless Hassett actually succeeded in recovering it. *Id.* at 939. Additionally, even if Hassett did recover the stock, Bankruptcy Judge Lifland posited that proper case management could avoid any conflict. *Id.* at 940. For these reasons, the bankruptcy court chose not to remove Hassett and his attorneys from representing the Cali estate. *Id.*

Although the outcome in *O.P.M. Leasing* is contrary to the outcome in *In re BH&P*, one might postulate that the cases are consistent with one another. In *O.P.M. Leasing*, Judge Lifland specifically found that full disclosure had been made to the court and that no actual conflicts existed. In *In re BH&P*, however, the corporation had actual claims against the individuals. Further, in *O.P.M. Leasing*, the situation arose early in the case. In comparison, it occurred at the end of the case in *In re BH&P*. Accordingly, one might argue that, in actuality, the outcome of these cases parallel one another.

64 11 U.S.C. § 327(a) (1988) provides in full:

> In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

Id.

65 *In re BH&P*, 103 Bankr. at 562. Judge Stripp set forth the following analysis as to why actual and potential conflicts of interest should be treated similarly even though § 327(c) expressly prohibits only actual conflicts of interest:

> The terms "actual" and "potential" conflict merely describe different stages in the same relationship. As previously noted, an actual conflict can be defined as an active competition between two interests, in which one interest can only be served at the expense of the other. A potential conflict can then be defined as one in which the competition is presently dormant, but may become active if certain contingencies occur.

Id. at 563.

With this definition in mind, Judge Stripp advanced two special reasons why such actual and potential conflicts should be treated similarly. First, the judge posited that even where a conflict is potential, the fact that there is a possibility of

Applying section 327(c) to Bederson, Judge Stripp ruled that counsel must be disqualified.[66] The bankruptcy judge found that Bederson's duties in all three cases included the investigation of irregular transfers and potential causes of action. Accordingly, the judge charged that it would be difficult for an accountant employed for such reasons to remain objective as to all three estates because a possibility existed that Bederson would be called to testify for both sides in support of their respective positions.[67]

Subsequently, the court addressed the representation of the Ravin, Greenberg firm. In reviewing the duties of Ravin, Greenberg, Judge Stripp again determined that disqualification was proper because counsel would have to "assert claims *on behalf of* Maggio as trustee of BH&P, [and] *against* Maggio as trustee of [the principals]."[68] Moreover, a possibility existed that the estates of the principals would assert claims against each other, or against BH&P, and Ravin, Greenberg would be left to defend opposing sides.[69]

In short, the court concluded that "where an attorney or accountant for a trustee also represents or is employed by a creditor," the professional involved has a conflict of interest.[70] Consequently, the professionals were removed as attorney and accountant for the trustee in the principals' cases.[71]

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future active competition is enough to affect the manner in which events develop. *Id.* at 564. Judge Stripp stated that "the existence of a 'potential' conflict can change circumstances so that the deck is stacked by the time the conflict becomes 'actual.' " *Id.* at 564. Second, the bankruptcy judge expressed the concern that a court would be faced with delay when a potential conflict becomes actual because the trustee or professionals would have to be disqualified in midstream. *Id.* The court opined that serious problems could have been avoided if a professional without a potential conflict would have been employed in the first instance. Based upon this rationale, the court chose to disapprove employment of a professional where a potential conflict exists, notwithstanding an awareness that section 327(c) only refers to actual conflicts. *Id.*

66 *Id.* at 566.

67 *Id.* at 565.

68 *Id.* (emphasis added).

69 *Id.*

70 *Id.* at 566.

71 *Id.* *See also In re* Lee Way Holding Co., 100 Bankr. 950 (Bankr. S.D. Ohio 1989) (counsel for chapter 11 debtor was disqualified and had to disgorge fees where counsel was involved in representation of major creditor both pre-petition and after appointment as debtor's counsel); *In re* Status Game Corp., 102 Bankr. 19 (Bankr. D. Conn. 1989) (prior and current representation of debtor's principal secured creditor appeared as conflict of interest and resulted in disqualification of counsel who served as debtor's attorney); *In re* Sixth Ave. Car Care Center, 81 Bankr. 628, 631 (Bankr. D. Colo. 1988) (counsel for debtor in possession precluded because law firm also represented parties that "stand in the shoes of the secured creditor and it is difficult for the court to understand how an attorney could represent both the principal secured creditor and the debtor in possession"); *In re*

C. Representation of Creditors' Committee and its Individual Members

The final situation to be analyzed arises when counsel to the creditors' committee simultaneously represents some of the individual members of the committee. In 1987, Judge Tuohey grappled with this type of representation in *In re Oliver's Stores, Inc.*[72] In *Oliver's*, individual members of the Unsecured Creditors' Committee (Committee) requested that the counsel retained by the Committee file a law suit against the debtor's former accountants.[73] Essentially, Judge Tuohey determined whether section 1103(b)[74] precluded the attorney from representing members of the Committee in their individual capacity.[75] While Judge Tuohey conceded that section 1103(b) does not have a per se rule proscribing the representation of both the Committee and an individual creditor, he perceived a need to take a cautious approach by disqualifying a professional where a potential conflict existed.[76]

To emphasize his point, Judge Tuohey indicated that the standard governing conflicts of interest for counsel representing creditors' committees is a rigid one.[77] The judge stressed that "the integrity of the bankruptcy system demands that the professionals serving the committee not place themselves in a situation where their independence, loyalty and integrity can be questioned by the unsecured creditor body whom they represent."[78] Based upon this rationale, the court refused to authorize the dual

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Michigan Gen'l Corp., 78 Bankr. 479 (Bankr. N.D. Tex. 1987) (counsel disqualified because counsel represented various affiliated debtors which put law firm in position of representing both creditors and debtors in the same case).

72 79 Bankr. 588 (Bankr. D.N.J. 1987).

73 *Id.* at 590.

74 11 U.S.C. § 1103(b) (1988) provides:

> (b) An attorney or accountant employed to represent a committee . . . may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

Id.

75 79 Bankr. at 592.

76 *Id.* at 595. *See also In re* Levy, 54 Bankr. 805, 808 (Bankr. S.D.N.Y. 1985) (attorney retained by creditors' committee can represent others with parallel interest but prohibited if there is actual conflict of interest); *In re* Grant Broadcasting of Philadelphia, 71 Bankr. 655 (Bankr. E.D. Pa. 1987) (prohibition if counsel represents an individual creditor and creditors' committee where hired by individual to litigate potentially adverse issues to other committee members).

77 *In re Oliver's Stores*, 79 B.R. at 597.

78 *Id.*

representation.[79] Judge Tuohey reasoned that it was the professional's duty to maximize the recovery for the Committee, and an action brought against the debtor's accounting firm could result in the accounting firm's seeking indemnification or contribution from the debtor or its blameworthy officers.[80] Once the debtor corporation became a party to the lawsuit, the *Oliver's Stores* court recognized that the professionals would be in the position of representing an adverse interest because the debtor's chance of being exposed to a large claim would, in effect, result in a significant diminution of the balance available to the Committee.[81] Accordingly, Judge Tuohey concluded that counsel for the committee could not represent individual creditors.[82]

IV. CONCLUSION

A careful examination of the cases discussed in this article, with reference made to the dates of the various opinions, suggests a trend toward a much more rigid imposition of the rules of conflict. Years ago, people dealt with one another on the assumption that a lawyer could bring objectivity to a matter, and need not consult with one client about representation of another client. Today, the court is continually concerned with conflicts both actual and potential. The question, of course, is where this trend leads us in the field of bankruptcy.

In the first place, it has become exceedingly difficult for an attorney to represent creditors as well as debtors, for whether that attorney represents a creditor in a particular case or not, the debtor may be indebted to a former client of that attorney. For example, in this era of large banks, if an attorney once represents a bank, the possibility of subsequently being asked to represent a debtor indebted to that bank looms large. Banks, of course, are in a position to take advantage of this circumstance, and by spreading their work around, limit the ability of any firm to represent creditors as well as debtors.

Even where a firm limits its practice to creditors, the same problem exists. If the attorney has ever represented Bank A and is asked to represent Bank B in a given case, it could turn out that it is in the interest of Bank B that a lien held by Bank A (repre-

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79 *Id.*

80 *Id.* (citing H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 350 (1983)).

81 *Id.* at 596.

82 *Id.* at 597.

sented by another attorney) may, in fact, be the subject of an attack. The attorney is caught in an impossible situation.

With respect to law firms themselves, the larger the firm the broader the client base. The broader the client base, the greater the likelihood that a simple conflict search will turn something up. Superimposed upon this is the recent trend, particularly in the larger cities, where units of firms move from one firm to another. Thus, the bankruptcy department of firm A may move to firm B and in so doing develop a whole new area of conflicts of interest.

The implications of this trend merit concern. The first and most obvious problem is that as specific clients and the public in general become more sophisticated, less cowed by the majesty of the legal profession and more demanding of total loyalty, clients will require the full and absolute loyalty of attorneys. If a debtor names a particular bank as one of its creditors, that bank will be likely to refuse to waive the conflict if they are willing to have another attorney handle the matter.

This has severe economic implications for the practice of law, for the answer lies only in the development of sub-specialties. The future may well hold a prospect that firms will represent only debtors, or only trustees, or only creditors committees. When it comes to representing secured creditors, they may only be able to represent one bank. If that bank does not supply sufficient business, the firm is put in a difficult position. There may be advantages to this in terms of client loyalty or the vigor of counsel's representation, but it may also place great limitations upon the ability of the lawyer to gain a broad view of any given field. A creditors committee lawyer who has represented a debtor in another case may understand the problems involved in that type of representation far better than one who has done nothing but represent creditors committees. By the same token, a lawyer representing a secured creditor is better off if he has had experience representing trustees.

Former Judge Arlin Adams addressed the issue in a recent article.[83] Judge Adams decried the loss of the lawyer as a public servant and urged that the lawyer serve the public interest by exercising independence both from their business community and from their clients. Clearly, the narrow approach to conflicts inhibits the lawyer in his or her exercise of such independence. If a

[83] Adams, *The Legal Profession: A Critical Evaluation*, 74 J. AM. JUDICATURE SOC'Y 77 (1990).

secured creditor can, for practical purposes, direct that an attorney represent only other secured creditors who never have a conflict with the first secured creditor, the lawyers will not have the breadth necessary to serve the public interest as suggested by Judge Adams. Further, the lawyer will lose the perspective necessary to make a complete analysis of the problem being faced. A lawyer who represents a debtor today, a creditor tomorrow and a trustee next week, will be inhibited by this sub-sub-specialization and required to operate in such a narrow field that the proverbial "big picture" may be missed.

Thus, not only will the public lose broad perspective but the practice in any given field will reach a level of specialization that will require experts in narrow areas of their own expertise. Needless to say, this specialization may well place the practice outside the realm of affordability. This may be the ultimate irony. Firms that need the protection of the Code because they are losing money or because they have cash flow problems or because they need intelligent restructuring may not be able to afford to go bankrupt. For with sub-sub-specialization will come, as surely as night follows day, a significant increase in hourly rates. The most important lesson to be learned from this discussion is that lawyers must be candid with one another, candid with their clients and candid with the courts. They must recognize when limitations inhibit, rather than encourage, the appropriate representation of their clients but they must always keep in mind that they cannot serve the proverbial "two masters" of which Matthew warned.[84]

As Judge Adams put it: "The necessity to develop 'instant expertise' is particularly troublesome . . . as it is inconsistent with the traditional vision of legal practice as a diverse and liberal endeavor. Excessive specialization inevitably detracts from the rich and full legacy of the profession."[85]

The basic tension between the imposition of a narrow perspective required by the rules concerning conflicts and the truisms stated by Judge Adams suggest no easy solution. For the practitioner caught between the two, it is necessary to bring both the facts of representation and the need for such representation to the attention of the court. Because the courts are becoming more sensitive to the issues discussed above, professionals must ensure that the requirements set forth for employment and com-

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[84] *See supra* note 1 and accompanying text.

[85] Adams, *supra* note 83, at 80.

pensation of professionals are followed correctly. The most effective way to be certain that the requirements have been met sufficiently is to analyze the circumstances closely and disclose all information to the court. If any questions arise concerning the professional's employment, the best solution is to bring a motion requesting a hearing before the judge.

Occasionally, counsel is unable to determine at the outset that there are existing conflicts of interest. One way to deal with this problem may be to advise the court that all possible checks have not been made and request a limited period of time to complete the investigation. If such a procedure is allowed, an order may be entered and the attorney or other professional can be paid for the limited period, even if later investigation reveals that the professional cannot serve.

Candor protects against disaster.