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THE SECTION 327(a) "DISINTERESTEDNESS" REQUIREMENT−−DOES A PREPETITION CLAIM DISQUALIFY AN ATTORNEY FOR EMPLOYMENT BY A DEBTOR IN POSSESSION?

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Introduction

A party generally should not be restricted in the choice of an attorney. [*FN:* See Schiessle v. Stephens, 717 F.2d 417, 420 (7th Cir. 1983) (acknowledging prerogative of party to have counsel of its choice) (citing Freeman v. Chicago Musical Instrument Co., 689 F.2d 715, 771 (7th Cir. 1982)); see also Analytica Inc. v. NPD Research Inc., 708 F.2d 1263, 1266 (7th Cir. 1983) (noting disqualifying counsel burdens client's case by added expense, time, and causing discontent of client).] Likewise, an attorney should be free to accept an engagement if the attorney does not hold or represent an interest adverse to the client and the engagement would not be in violation of applicable non−bankruptcy rules of professional responsibility. [*FN:* See M odel Rules of Professional Conduct Rule 1.16(a) (1995) (declining representation); id. Rule 6.2 (accepting appointments); M odel Code of Professional Responsibility EC 2−26 (1983) (regarding or accepting employment).] Once employed, the attorney owes a duty of loyalty to the client [*FN:* See Strickland v. Washington, 466 U.S. 668, 692 (1984) (describing duty of loyalty as most basic of duties owed to client); Cuyler v. Sullivan, 446 U.S. 335, 356 (1980) (stating client is constitutionally guaranteed loyalty of attorney by Sixth Amendment); see also M odel R ules of P rofessional C onduct Rule 1.7 cmt. 1−4 (1983) (regarding duty of loyalty to client); M odel Code of Professional R esponsibility DR 5−101 (1980) (refusing employment due to interests of lawyer).] and is required to carry out the client's instructions and directions subject to limitations imposed by law and applicable ethical standards. [*FN:* See M odel Rules of Professional Conduct Rule 1.2 (regarding scope of representation); M odel Code of Professional Responsibility EC 7−7, 7−8 (regarding duty of lawyer to client); id . DR 7−101 (representing a client zealously); id . DR 7−102 (representing client within bounds of law).] These are the fundamental principles that apply generally to the attorney−client relationship in non−bankruptcy cases.

However the Bankruptcy Code (the "Code") [*FN:* 11 U.S.C. §§ 101−1330 (1994 & Supp. I 1995).] under section 327(a), superimposes "disinterestedness" as an additional requirement for a professional person to qualify for employment by a "trustee." [*FN:* See id. § 327(a) (1994) (requiring professional employed by trustee be disinterested); id . § 101(14) (defining "disinterested person"); see also infra note 101.] Although a chapter 11 debtor in possession ("DIP") generally has all the rights, and is obligated to perform all of the duties, of a chapter 11 case trustee, [*FN:* See id. § 1107(a) (giving debtor in possession, subject to limited exceptions, all rights, powers and duties of trustee); see also U.S. Brass & Copper Co. v. Caplan (*In re* Century Brass Prods. Inc.), 22 F.3d 37, 39 (2d Cir. 1994) (noting debtor in possession exercises powers of trustee subject to same limitations imposed on trustee by Code).] section 327(a) does not explicitly apply to a DIP's professionals. [*FN:* See 11 U.S.C. § 327(a) (mentioning only trustee and not debtor in possession).] Section 327(a) sets forth two requirements for employment of a professional. First, the professional must not "hold or represent an interest adverse to the estate." [*FN:* See id.] Second, the professional must be a "disinterested person." [*FN:* See id .; see also id. § 101(14) (defining "disinterested person" with various attributes that would render person not disinterested). Under this definition, an attorney who has not been paid a fee due for prepetition services to a debtor is a creditor of the debtor and thus not a disinterested person. See id . § 101(14)(A).]

The issue considered by this article is whether the disinterestedness requirement of section 327(a) applies to professionals employed by a DIP, or is limited to those employed by a trustee. If applicable to a DIP, a further question is whether, as a matter of legislative policy, the disinterestedness requirement should not apply to the DIP's professionals and be restricted to those employed by a trustee. If not applicable to a DIP's professionals, it is established that the interested professional who does not hold or represent an interest adverse to the estate would be

eligible for employment by a DIP even though such person is a creditor.

In interpreting section 327(a)'s requirement of disinterestedness, the courts have developed a virtual uniform rule under which an attorney who holds a prepetition claim against a DIP for unpaid legal services or arising from any other transaction, is disqualified from representing the DIP in conducting the chapter 11 case. [*FN:* See United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3d Cir. 1994) (stating Code's provisions "unambiguously forbid a debtor in possession from retaining a prepetition creditor to assist in the execution of its Title 11 duties");*In re* Guard Force Management Inc., 185 B.R. 656, 662 (Bankr. D. Mass. 1995) (noting majority of courts follow strict rule whereby attorney with prepetition claim against "debtor is 'absolutely barred from representing the trustee or the debtor in possession.'") (quoting First Interstate Bank v. CIC Inv. Corp. (*In re* CIC Inv. Corp.), 175 B.R. 52, 55 (B.A.P. 9th Cir. 1994)).] Implicit in this rule of disqualification is that section 327(a) applies to professionals employed by a DIP as well as those employed by a trustee. The rule disqualifying a professional who is a creditor for lack of disinterestedness has been vigorously and rigidly applied to professionals employed by both trustees and DIPs in virtually every federal circuit. [*FN:* See Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356, 361 (11th Cir. 1994) (ruling attorney who was also creditor of debtor not disinterested); Price Waterhouse , 19 F.3d at 142 (ruling accounting firm with prepetition claim over $800,000 not disinterested and could not be employed by debtor in possession); Michel v. Eagle−Picher Indus. Inc. (*In re* Eagle−Picher Indus. Inc.), 999 F.2d 969, 972 (6th Cir. 1993) (disqualifying financial advisor with outstanding prepetition claim);*In re* BH & P Inc., 949 F.2d 1300, 1317 (3d Cir. 1991) (affirming removal of attorneys from service of trustee where attorneys also represented debtors of estate); Pierce v. Aetna Life Ins. Co. (*In re* Pierce), 809 F.2d 1356, 1363 (8th Cir. 1987) (finding attorney with prepetition mortgage on debtor's real estate not disinterested and not entitled to attorney's fees).]

The principal inroads relaxing the rule of disqualification have been in cases in which the prepetition claim of the attorney arose from services rendered in anticipation of the commencement of a chapter 11 case, [*FN:* See*In re* Martin, 817 F.2d 175, 181 (1st Cir. 1987) (holding security interest in estate of debtor in possession in contemplation of bankruptcy does not automatically disqualify attorney); see also *In re* Roberts, 46 B.R. 815, 849 (Bankr. D. Utah 1985), aff'd in part, rev'd in part, and modified in part , 75 B.R. 402 (D. Utah 1987) (stating debtor in possession's law firm, despite filing prepetition debt for legal fees and court costs owed for services rendered in contemplation of filing, and for filing bankruptcy case, does not either hold adverse interest or lack disinterestedness within meaning of § 327(a)).] or where the attorney−creditor waived his or her claim so as to cease to be a creditor. [*FN:* See *In re* Brennan, 187 B.R. 135, 152 (Bankr. D.N.J. 1995) (holding attorney's waiver of prepetition claim against debtor allows attorney to serve for debtor in possession, and noting such waivers are very common in bankruptcy cases in court's district); Roberts , 46 B.R. at 849 (noting law firm with prepetition claim not arising in connection with or in contemplation of bankruptcy case can eliminate status as creditor by waiving all such fees and costs).] A few courts have also strayed from the uniform approach to strictly enforce the disinterested requirement in reliance on a "Chinese wall." [*FN:* See Vergos v. Timber Creek Inc., 200 B.R. 624, 628−30 (W.D. Tenn 1996) (concluding § 327 does not require imputation of professional's disqualification to rest of firm, and finding that "Chinese wall" may sufficiently prevent effect of adverse interests);*In re* Chicago South Shore and South Bend R.R., 101 B.R. 10, 14 (Bankr. N.D. Ill. 1989) (permitting use of Chinese wall where prior representation by some members of law firm of adverse interest would normally disqualify firm).] In one recent case, the court declined to disqualify an entire law firm for lack of disinterestedness because of the lack of disinterestedness of one of its partners. [*FN:* See Vergos , 200 B.R. at 630 (holding that firm should be removed only upon finding of "proven conflicts of interest").] In reliance on a "Chinese wall" by which the disqualified partner would be screened away from the services to be performed by other partners in the law firm, the court held that the disinterestedness provision was not violated. [*FN:* See id. (holding screening devices may be utilized by law firm to prevent disqualification due to lack of disinterestedness but cautioned that adequacy of such devices must be measured on case−by−case basis).]

However, there are two subsections of section 327, subsections (d) and (e), that do not require disinterestedness. Under section 327(d), a trustee or his or her own firm is permitted "to act as attorney or accountant for the estate if such authorization is in the best interest of the estate." [*FN:* See 11 U.S.C. § 327(d) (1994).] However, even that provision, has been rigidly construed by courts as not permitting any interested professional other than an attorney or an accountant to serve. [*FN:* See United States Trustee v. Bloom (*In re* Palm Coast, Matanza Shores Ltd. Partnership), 101 F.3d 253, 258 (2d Cir. 1996) (holding trustee could not employ own real estate firm to handle sale of estate property). In Palm Coast , the court stated "[a] trustee who hires his own professional firm to assist him cannot be a 'disinterested person' who has no interest adverse to the estate." *Id.* It is unclear whether the court viewed the disabling factor to be a lack of disinterestedness or the existence of an interest adverse to the estate. See *In re* Blue, 146 B.R. 856, 858 (Bankr. W.D. Okla. 1992) (same);*In re* Alexander, 129 B.R. 183, 185 (Bankr. D. Minn. 1991) (same); Assistant United States Trustee v. John Galt, Ltd. (*In re* John Galt, Ltd.), 130 B.R. 464, 466 (S.D. W. Va. 1989) (holding trustee is limited to attorney or accountant status under § 327(d)).] The other provision of section 327 dispensing with the requirement of disinterestedness is subsection (e) which permits a trustee to employ an attorney for a specified purpose other than to conduct the chapter 11 case, even if such attorney does hold or represent an adverse interest. [*FN:* See 11 U.S.C. § 327(e) (allowing trustee to hire attorney who has represented debtor).] Under that provision, with court approval, a trustee may retain an attorney who, for example, engages in a special practice area of the law, but not to conduct the bankruptcy case.

As can be seen from the foregoing, both the Code and established ethical principles applicable to attorneys contain rigid safeguards necessary to insure that the DIP and the estate will be fully protected from adverse interests and conflicts of interests on the part of an attorney. A debtor's estate needs no additional protection beyond that afforded by the proscription against adverse interests and the provisions of canons of ethics regarding conflicts of interests. The superimposition of the additional requirement of "disinterestedness" does not enhance the estate's protection from any risk arising from the creditor status of the attorney. Moreover, any possible disadvantage to the estate by reason of representation of the DIP by an attorney who has no adverse interest but lacks disinterestedness would often be outweighed by the benefits of more efficient administration of the chapter 11 case resulting from the services of an attorney familiar with the DIP's historical development and problems that made it necessary for the DIP to file in bankruptcy.

Along with the good policy reasons for not disqualifying an attorney−creditor from representing the DIP, a careful analysis of the relevant provisions of the Code and their history lead to the conclusion that the requirement of "disinterestedness" is not applicable to an attorney for a DIP. [*FN:* See 11 U.S.C. § 327 (requiring that attorney does not represent or hold interest adverse to debtor or to the estate); see also Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, at 38 (1978), reprinted in 1978 U.S.C.C.A.N. 5781, 5824 (stating congressional purpose of § 327).] Without a "disinterestedness" requirement for the qualification of a DIP's attorney's, section 327(a) would nevertheless require that the attorney for the DIP "not hold or represent an interest adverse to the estate." [*FN:* 11 U.S.C. § 327(a).] The attorney would also be subject to the principles imposing fiduciary duties upon attorneys. [*FN:* See Model Rules of Professional Conduct Rule 1.2 (1995).] Compliance with fiduciary duties of loyalty is not only required by canons of ethics, but also by time−honored common law principles embodied in federal jurisprudence. [*FN:* See Hendry v. Pelland, 73 F.3d 397, 401 (D.C. Cir. 1996) (holding attorney had duty of "undivided loyalty" as basic fiduciary obligation); Cinema 5 Ltd. v. Cinerama Inc., 528 F.2d 1384, 1386 (2d Cir. 1976) (holding lawyers duty to client is that of fiduciary or trustee); see also supra note 3 and accompanying text .] The strength of the rule proscribing adverse interests is clear from the Supreme Court's decision in *Mosser v. Darrow* [*FN:* 341 U.S. 267, 271 (1951).] where the court noted that "[e]quity tolerates in bankruptcy trustees no interest adverse to the trust." [*FN:* Mosser , 341 U.S. at 271.] The Court was particularly concerned with the notion that although such interests are not always corrupt, they are always corrupting. [*FN:* See id.]

The rules prohibiting adverse interests are not the only protection for debtor estates. Professionals are also required to make complete disclosure of all material

effects in retention applications as part of the bankruptcy process for approval of their employment. [*FN:* Fed. R. Bankr. P. 2014 (requiring statement of specific facts showing, "to the best of the applicant's knowledge, all of persons connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee or any person employed in the office of the United States trustee").]

Debtor estates are further protected by provisions of section 328(c), under which the court is authorized to deny compensation to a professional person employed under section 327 if such professional, at any time during employment, fails to meet the standards set forth in sections 327 and 101(14) with respect to the matter on which the professional is employed. [*FN:* See 11 U.S.C. § 328(c) (1994) (permitting court to deny allowance of compensation upon finding of non−disinterestedness). This proscription reflects the principles pronounced by the Supreme Court in Woods v. City Nat'l Bank & Trust Co. , 312 U.S. 262, 268 (1941) (stating "[f]urthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service . . . . Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation.").] Under this provision requiring continuing compliance with section 327(a), any misstep by a professional could result in a forfeiture of compensation. [*FN:* See Neben & Starrett Inc. v. Chartwell Fin. Corp. (*In re* Park−Helena Corp.), 63 F.3d 877, 882 (9th Cir. 1995) (ruling that "[e]ven a negligent or inadvertent failure to disclose fully relevant information" may cause attorney to forfeit fees already earned); see also *In re* Hathaway Ranch Partnership, 116 B.R. 208, 220 (C.D. Cal. 1990) (noting discovery by court of inappropriate attorney disclosure may result in forfeiture of fees already earned).] Under certain circumstances, a professional person may even be required to disgorge compensation already paid, even where employment was approved by a bankruptcy court but the approval order was later reversed on appeal because of the professional's lack of disinterestedness. [*FN:* See United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994) (holding one ceasing to be disinterested at any time may be denied compensation); see also Michel v. Federated Dep't Stores Inc. (*In re* Federated Dep't Stores Inc.), 44 F.3d 1310, 1318 (6th Cir. 1995) (holding professional can have neither adverse interest nor be interested person); *In re* EWC Inc., 138 B.R. 276, 281 (Bankr. W.D. Okla. 1992) (finding allowance of compensation to interested persons illogical).]

Thus a requirement of disinterestedness is unnecessary. It is often counterproductive to debtors' efforts to reorganize,and oppressive to professional persons. The substantial body of requirements relating to the employment of professional persons in bankruptcy cases more than amply protects the interests that underlie the ethical principles embodied in the Code and the Bankruptcy Rules with respect to the employment of professional persons. [*FN:* See, *e.g.* , Fed. R. Bankr. P . 2014 (stating employment of professional persons requires professional to state detailed and specific facts in application of employment).] The disinterestedness requirement does not provide a significant additional layer of protection. This requirement may also operate unfairly to deprive a DIP of the attorney who is best qualified to undertake the representation. This may place the debtor at a disadvantage as compared with the official committee in the chapter 11 case. The only qualifying requirement for an attorney or accountant employed by a committee is that such professional person not represent any other entity having an adverse interest in connection with the case. [*FN:* See 11 U.S.C. § 1103(b) (1994) (requiring that no professional person employed by committee have interest adverse to estate).]Whereas, a committee professional is not subject to the section 327(a) requirement of disinterestedness.

Moreover, it is clear from the provisions of the Bankruptcy Code that there is nothing inherently improper in the representation of a party in interest by an attorney that is not disinterested. As noted above, a statutory committee for creditors or equity security holders in a chapter 11 case is authorized to employ an attorney who is not disinterested, provided that the attorney does not have an adverse interest. Similarly under section 327(d) a trustee may employ his own firm as attorney or accountant if such employment is in the best interest of the estate. [*FN:* See id . § 327(d) (allowing trustee to act as attorney or accountant for estate); United States Trustee v. Bloom (*In re* Palm Coast, Matanza Shores Ltd. Partnership), 188 B.R. 741, 743 (S.D.N.Y. 1995) (noting no statutory limitation on trustee's ability to hire own firm in any capacity); United States v. Freeland (*In re* Spungen), 168 B.R. 373, 376 (Bankr. N.D. Ind. 1993) (citing trustee's ability to hire own law firm).] However, by definition, the trustee ceases to be disinterested by employing his or her own firm. [*FN:* See 11 U.S.C. § 101(14) (defining "disinterested person").] By the Code provisions, Congress recognized there is nothing inherently improper in the employment of an attorney who is not disinterested.

I. Analysis of Code Provisions

A. Relevant Code Provisions

A careful reading of the Code does not reveal any provision requiring disinterestedness as a requirement for qualification of an attorney employed by a DIP. Nor is there any suggestion in the congressional history of the Code that disinterestedness is to be required for such qualification. [*FN:* See id. ; see also § 327(a) (citing disinterested requirement); see also Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, at 23 (1978), reprinted in 1978 U.S.C.C.A.N. 5781, 5809 (defining "disinterested person").] However, although no reasonable inference that there is such a requirement emerges from a literal reading of relevant provisions, the Code has been construed as requiring disinterestedness as a prerequisite of employment of professionals for a DIP. Moreover, it is quite clear that a drafting error was made during the legislative process leading to the enactment of section 327(a), which may give rise to an ostensibly unintended inference that disinterestedness is a requirement applicable to a DIP's professionals. The starting point for determining whether a DIP can hire only a disinterested person is the language of section 327(a). [*FN:* See 11 U.S.C. § 327(a) (imposing disinterestedness requirement).] It is clear from a close reading of section 327(a) that it does not apply to a DIP's professionals. Of course, in a chapter 11 case, in the absence of the appointment of a case trustee, references in the Code to a "trustee" also generally mean a DIP. [*FN:* See*In re* Tinley Plaza Assocs., 142 B.R. 272, 276 (Bankr. N.D. Ill. 1992) (noting "trustee" is synonymous with "debtor in possession" for the purpose of § 327(a)); *In re* Al Gelato Continental Desserts Inc., 99 B.R. 404, 406 (Bankr. N.D. Ill. 1989) (holding debtor in possession has all rights of trustee); Carlson v. Burns Nat'l Bank (*In re* Ewing), 54 B.R. 952, 954 (Bankr. D. Colo. 1985) (same).] Thus, because section 1107(a) of the Code provides that a DIP shall generally have all of the rights and is obligated to perform duties of a chapter 11 trustee, section 327(a) has been construed to apply to a DIP's attorney even though the statute refers only to a trustee's professional. [*FN:* See 11 U.S.C. § 327(a) (referring only to trustee); Meespierson Inc. v. Strategic Telecom Inc., 202 B.R. 845, 847 (D. Del. 1996) (disallowing appointment of attorney for debtors in possession for failing to meet disinterested standard);*In re* Leisure Dynamics, 32 B.R. 753, 755 (Bankr. D. Minn. 1983) (interpreting congressional intent to apply § 327 to debtors in possession).]

However, it should not be assumed that Congress' use of the term "trustee" in section 327(a) was mere happenstance. Congress used the term "trustee" three times in section 327(a). [*FN:* See 11 U.S.C. § 327(a) (stating "the trustee , with the court's approval may employ . . . professional persons, that do not hold or represent an interest adverse to the estate, and are disinterested persons, to represent or assist the trustee on carrying out the trustee's duties under this title") (emphasis added).] By contrast, in Code section 1107,

Congress used the term "debtor in possession" as well as the term "trustee." [*FN:* 11 U.S.C. § 1107(a) (stating debtor in possession has all rights and shall perform all duties of "trustee" in chapter 11).] In section 1107(a), Congress identified a "debtor in possession" as the party having the rights of a chapter 11 trustee in a chapter 11 case in which a case "trustee" has not been appointed. [*FN:* See Palm Coast , 101 F.3d at 253. The contrast between the use of the terms "trustee" and "debtor in possession" in these statutory provisions is evident from the text of §1107(a): (a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter. 11 U.S.C. § 1107(a).] Under the maxim *expressio unis est exclusio alterius*, the mention of one thing implies the exclusion of another. [*FN:* See 11 U.S.C. § 1107(a); Ash v. Cort, 496 F.2d 416, 421 (3d Cir. 1974) (using maxim for proposition that courts should refrain from expansion of statute when legislation provides specific remedy);*In re* Aircrash Disaster Near Roselawn Indiana, 909 F. Supp. 1083, 1098 (N.D. Ill. 1995) (refusing to use maxim to vacate 28 U.S.C. § 1608).]

The literal language of section 327(a) does not bring a DIP's attorney within its disinterestedness requirement and could extend the requirement to a DIP's attorney only inferentially because of a DIP's status as equivalent to that of a trustee. Therefore, resort must be had to other provisions of the Code to support the conclusion reached by most courts that the disinterestedness requirement applies to a DIP's attorney. There are two such other provisions which are part of the calculus: section 328(c) [*FN:* See 11 U.S.C. § 328(c).] and section 1107(b). [*FN:* See id. § 1107(b); see also infra notes 50−67 and accompanying text (analyzing code sections 328(c) and 1107(b) to see whether disinterestedness requirement applies to debtor in possession).]

Section 328(c) authorizes, but does not require, a court to deny compensation to a professional person who is not disinterested at any time during such person's engagement under section 327 or section 1103. [*FN:* See 11 U.S.C. § 328(c).] The applicability of the section 328(c) authorization to deny professional compensation because of the lack of disinterestedness serves to confuse the scope of the requirement of disinterestedness. Thus, section 1103, which is within the express scope of section 328(c), authorizes an official committee to employ an attorney or accountant who does not have an adverse interest, but who may not be disinterested. Despite the absence of a requirement of disinterestedness under section 1103(a), section 328(c) explicitly authorizes a court to deny compensation to a person employed under section 1103 if at any time during employment such person lacks disinterestedness. This appears to be bad drafting, because Congress could not have intended to impose a requirement of disinterestedness through the back door of section 328(c).

However section 328(c), does have bearing on whether the disinterestedness requirement applies to a DIP's attorneys. [*FN:* See United States Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3d Cir. 1994) (holding § 328(c) does not authorize employment of interested professionals by debtor in possession);*In re* Patterson, 53 B.R. 366, 374 (Bankr. D. Neb. 1985) (denying compensation to attorneys for debtor in possession pursuant to § 328(c)); Merrimac Assocs. v. Daig Corp. (*In re* Daig Corp.), 799 F.2d 1251, 1253 (8th Cir. 1986) (stating § 328(c) allows denial of compensation to professionals for failure to meet disinterestedness standard).] Thus, by way of exception, section 328(c) refers to section 1107(b), a provision which deals with one aspect of the qualifications of a professional person employed by a DIP under section 327. [*FN:* See 11 U.S.C. § 1107(b) (noting sole employment by or representation of prepetition debtor is exception to disqualification under § 327); see also infra note 56 (quoting full text of 11 U.S.C. § 1107(b)).] Thus section 1107(b), together with section 328(c), thus creates an inference that section 327(a)'s requirement that a trustee's professionals be disinterested also requires disinterestedness on the part of a DIP's professionals. [*FN:* See 11 U.S.C. § 328(c) (noting exceptions in §§ 327(c) and 1107(b)). Section 328(c) provides: (c) Except as provided in §327(c), 327(e) or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under §327 or 1103 of this title if, at any time during such professional person's employment under §327 or 1103 of this title, 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.]

Literally read, section 328(c) would authorize a court to deny an allowance to a DIP's attorney, although such employment was approved by the court at the inception, if, at any time during such professional person's employment, such person is not disinterested. [*FN:* See 11 U.S.C. § 328(c);*In re* Diamond Mortgage Corp. of Ill., 135 B.R. 78, 89 (Bankr. N.D. Ill. 1990) (noting the retrospective nature of § 328(c)).] However properly construed, section 328(c) should not be read to entrap an attorney whose employment was approved by the court at the outset based upon full disclosure, because of a change of heart by the court or a reversal on appeal of the approval order below. [*FN:* See Price Waterhouse , 19 F.3d at 142 (reversing employment order).] Moreover the purpose of section 328(c), is to provide "a penalty for conflicts of interest." [*FN:* See S. Rep. No. 95−989, at 39 (1978); reprinted in 1978 U.S.C.C.A.N. 5787, 5825; Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994)

(stating § 328(c) authorizes penalty for conflict);*In re* EWC Inc., 138 B.R. 276, 281 (Bankr. W.D. Okla. 1992) (explaining § 328 as being placed in Code to provide penalty for conflicts).] Therefore, should not be construed to disqualify an attorney because of an unpaid claim for prepetition legal services. The fact that an attorney has not been paid does not give rise to a conflict that disables the attorney from the ongoing representation of the client, at least where there is no dispute regarding the unpaid fees.

With respect to postpetition fees, it is common for chapter 11 attorneys to have unpaid claims for postpetition legal services because of the statutory lag under section 331 of the Bankruptcy Code with respect to interim allowances. [*FN:* See 11 U.S.C. § 331;*In re* Augie/Restivo Baking Co., 64 B.R. 236, 238 (Bankr. E.D.N.Y. 1986) (stating compensation awarded to attorney must be interim under § 331 since there is no way court can ascertain compensation);*In re* Mansfield Tire & Rubber Co., 19 B.R. 125, 127 (Bankr. N.D. Ohio 1981) (reasoning interim compensation process will be used only to relieve economic burden on counsel and will leave to conclusion of proceeding for determination of final award).] However, a literal reading of section 328(c), if construed to rule out all conflicts of interest, would necessarily preclude a DIP from having any representation by an attorney who is not fully paid in advance for all services. [*FN:* See 11 U.S.C. § 328(c); see supra note 49 and accompanying text.] Thus, it seems that section 328(c) is not a basis for requiring a DIP's attorney to be disinterested. [*FN:* See 11 U.S.C. § 328(c); supra note 49 and accompanying text; see also*In re* McNor Inc., 116 B.R. 746, 753 (Bankr. S.D. Cal. 1990) (noting while § 328(c) gives court power to deny fees for professionals retained by debtor in possession, there is no requirement that such professionals be disinterested prior to filing);*In re* Huddleston, 120 B.R. 399, 402 (E.D. Tx. 1990) (allowing appointment of attorney for debtor in possession and its sole shareholder where attorney agreed to disgorgement if court found conflict under 328(c));*In re* Roberts, 75 B.R. 402, 413 (D. Utah 1987) (explaining § 328(c) does not mandate fee denial for disinterested professionals).]

Section 1107(b), which follows section 1107(a)'s provisions conferring a trustee's rights on a DIP, could be read to apply to a DIP's attorney the requirements of section 327(a) otherwise applicable only to a "trustee." [*FN:* See 11 U.S.C. §§ 1107(b) and 327(a). The following is the full text of §1107(b): (b) Notwithstanding §327(a) of this title, a person is not disqualified for employment under §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.] Section 1107(b) was enacted in 1978 as part of the original Code, and has not been amended substantially since its enactment. The congressional history of the Code contains no hint as to why section 1107(b) was included or as to the purpose for its cross−reference to section 327(a). [*FN:* See id. ; 11 U.S.C. § 327(a); supra note 56 and accompanying text (stating § 1107(b) in full text).] Indeed, while the House and Senate Reports preceding the 1978 Code's enactment stated that section 1107(a) "places a debtor in possession in the shoes of a trustee in every way," [*FN:* See S . Rep. No. 95−989, at 116 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5902; H.R. Rep. No . 95−595, at 404 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6360.] there was no reference in these Reports to the provisions of section 1107(b), which quietly found their way into the Code without any mention of its purpose in referring to section 327(a). [*FN:* See 11 U.S.C. §§ 1107(b) and 327(a); supra note 60 and accompanying text (stating § 1107(b) in full).] In light of the lack of illumination of the meaning of the ambiguous cross−reference to section 327(a) in section 1107(b), that provision could be read to mean nothing more than that the attorney's prepetition employment by the debtor does not give rise to a disqualifying conflict of interest. [*FN:* See id.]

During the legislative process leading to the enactment of the Bankruptcy Code in 1978, a Joint Legislative Statement was issued. [*FN:* See 124 Cong. Rec. S17000408, Daily Edition October 6, 1978.] That statement does not indicate that an attorney for a DIP must be disinterested. A mystery remains as to why section 1107(b) and particularly its cross reference to section 327(a), was included in the Code. [*FN:* See 11 U.S.C. §§ 1107(b) and 327(a).] In light of the absence of any hint in the legislative history that section 1107(b) was intended to require that a DIP's attorney be disinterested, these provisions of the Code are inadequate as a basis for disqualification based upon 327(a)'s requirement that a trustee's professionals be disinterested. [*FN:* See id.]

Historically, under the former Bankruptcy Act the disinterestedness requirement applied only to bankruptcy trustees. [*FN:* See 1938 Bankruptcy Act Rule 10−202(c)(2); reprinted in Collier on Bankruptcy ¶ 10−2−2.06 (Asa S. Lawrence P. King & Herzog, 14th ed. 1977).] It is clear that the attorneys for a DIP in an arrangement proceeding under chapter XI of the former Act were not subject to a requirement of disinterestedness. [*FN:* See infra note 89.] In the absence of anything more than ambiguous language enacted as part of the 1978 Code, it should not be assumed that Congress intended a major departure from the prior law. [*FN:* See Midlantic Nat'l. Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 501 (1986) (stating normal rule of statutory construction if Congress intends to change interpretation of judicially created concept through legislation, it makes that intent clear and explicit); Edmonds v. Compagnie Generale Transatlantique, 443 U.S. 256, 266−67 (1979) (holding Court of Appeals cannot modify pre−existing rights merely because Congress was silent as to rights in a 1972 amendment).] It appears that the courts, without a solid basis, have imported into the Code the statutory structure applicable to chapter X trustees under

the former Bankruptcy Act which required that their attorneys be disinterested. The result is the needless disqualification of attorneys who hold claims for prepetition services. [*FN:* See Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356, 361 (11th Cir. 1994) (holding attorney who was creditor not disinterested); Pierce v. Aetna Life Ins. Co. (*In re* Pierce), 809 F.2d 1356, 1363 (8th Cir. 1987) (holding attorney with prepetition mortgage on debtor's estate was not disinterested and not entitled to fees); *In re* Guard Force Management Inc., 185 B.R. 656, 662 (Bankr. D. Mass. 1995) (noting majority of courts follow strict rule whereby attorney is barred from representing trustee/debtor in possession if attorney has prepetition claim). But see *In re* Martin, 817 F.2d 175, 181 (1st Cir. 1987) (holding attorney with security interest in estate of debtor in possession does not automatically disqualify attorney); *In re* Roberts, 46 B.R. 815, 849 (Bankr. D. Utah 1985) (noting law firm with prepetition claim can eliminate status as creditor by waiving all fees and costs), aff'd in part, modified in part, rev'd in part on other grounds , 75 B.R. 402 (D. Utah 1987).]

B. Early Bankruptcy Act Statutes Relating to Trustees and Committees

In enacting the Code, Congress revamped the statutes concerning whether a debtor estate would come under the tutelage of an independent trustee, ousting the debtor of possession and the right to operate its business. [*FN:* See infra note 89 and accompanying text (noting prior to enactment of Code, disinterested requirement applied only to trustee).] The need for an independent trustee as the representative of all parties in interest, including the debtor, creditors, and equity security holders, and requiring disinterestedness of the trustee's professionals, was appropriate under chapter X of the 1938 Bankruptcy Act because of the role of the trustee as the representative of all parties. [*FN:* See supra note 64 and accompanying text (discussing Former Bankruptcy Rule 10−202(c)(2)); see also Meredith v. Thralls, 144 F.2d 473, 474 (2d Cir 1944) (holding any trustee under former chapter X must be disinterested), *cert. denied* , 323 U.S. 758 (1944); *In re* Realty Assocs. Secs. Corp., 56 F. Supp. 1007, 1007 (E.D.N.Y. 1944) (stating trustee must not have any personal interest in decision concerning reorganization).] The trustee was not to be an advocate for any particular constituency or party in interest.

By significant contrast, the creditors in a chapter 11 case under the Code have the right under section 1103 to be represented by an official committee formed pursuant to section 1102. [*FN:* See 11 U.S.C. § 1102 (providing for formation of creditors' and equity security holders' committees).] In some cases, where there are divergent interests, diverse creditor groups are represented by multiple official committees. [*FN:* See id. §§ 1103 and 1102; *In re* Salant Corp., 53 B.R. 158, 161 (Bankr. S.D.N.Y. 1985) (holding Code does not mandate or preclude multiple creditors' committees); *In re* White Motor Credit Corp., 18 B.R. 720, 722 (Bankr. N.D. Ohio 1980) (stating substantial number of different creditors of five affiliates should have separate creditors committees instead of single committee).] In a proper case, under section 1102, official committees are also formed to represent equity security holders. [*FN:* See 11 U.S.C. § 1102.] Professional fees for official committee professionals are borne by the estate under Code sections 330(a)(1) and 503(b)(2). [*FN:* See id . §§ 330(a)(1) and 503(b)(2).]

However, there was no statutory authorization for the formation of official committees in chapter X proceedings under the former Bankruptcy Act. Ad hoc groups were formed to provide representation for creditor constituencies or shareholder groups. [*FN:* See Vermilion Bay Land Co. v. Fitzgerald (*In re* Mount Forest Fur Farms of Am.), 157 F.2d 640, 647 (6th Cir. 1946) (emphasizing that committees act in quasi−public capacity); *In re* Realty Assocs. Secs. Corp., 156 F.2d 480, 482−483 (2d Cir. 1946) (upholding award given to "Bondholder's Protective Committee"); Empire Bldg. Bondholders Protective Comm. v. Buildings Dev. Co., 98 F.2d 844, 845 (7th Cir. 1938) (tracing history and activities of committee).] The compensation for professionals who served on such unofficial committees was dependent upon a finding of substantial benefit to the estate at the conclusion of the reorganization case. [*FN:* See Mount Forest , 157 F.2d at 647 (stating that allowing or disallowing compensation for committee is within courts discretion); Realty Assoc. , 156 F.2d at 482−83 (upholding lower court's determination of compensation for committee); Empire Bldg. , 98 F.2d at 845 (holding that committee must intend to aid debtor directly); see generally 6A Collier on Bankruptcy ¶ 13.06, at 582−83 (Lawerence P. King & James Wm. Moore eds. 14th ed. 1977) (stating substantial benefit rule and citing cases implementing rule). A "substantial contribution" test is used for compensating professionals serving unofficial committees in chapter 11 cases under the code. See 11 U.S.C. § 503(b)(3)(D) and (4); 4 Norton Bankruptcy Law and Practice 2d § 78:7 (1991).]

In light of the statutory provisions for representation of creditors and equity security holders by official committees in chapter 11 and for payment of their professional fees, such committees are able to protect their own interests. [*FN:* See 11 U.S.C. § 1103 (providing creditors have right to be represented by official committee); id § 1102 (stating official committees may be formed to represent equity security holders); see also id. § 503(b)(2) (providing professional fees for official committee professionals).] Consequently, 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. Neither a DIP nor a creditors' committee should have a strategic hold over the other. [*FN:* See Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 129−31 (1939) (stating creditor is prevented from using strategic hold over debtor to gain advantage over other creditors); *In re* Hoskins, 102 F.3d 311, 316 (7th Cir. 1996) (holding midpoint of bargaining range is reasonable approximation of likely

average valuation of debtor's automobile and secured creditor and defaulting debtor would agree upon so long as chapter 13 was not filed); see also Douglas G. Baird et al., Game Theory and the Law 39 (1994) (finding midpoint is natural point to which bargaining partners will gravitate if they want to avoid wasting time with bluffing and haggling).] Both the DIP and creditors' committee should have representation by an attorney of its choice. A committee should not be able to use as leverage a proceeding to disqualify the long−time attorney for the debtor, in order to gain an advantage, solely because the attorney did not get paid for prepetition services. In light of the role of the DIP under chapter 11, a prohibition against material adverse interests is more than sufficient to protect the estate, without the additional requirement of disinterestedness.

C. Trustees Generally are not Appointed in chapter 11 Cases

Congress intended that in most chapter 11 cases, a trustee would not be appointed, [*FN:* See H.R. Rep. No. 95−595, at 232 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6191−92.] and creditors would be represented by official committees rather than by an independent trustee. [*FN:* See H.R. Rep . No. 95−595, at 235, reprinted in 1978 U.S.C.C.A.N at 6194−95 (stating negotiations between creditors and debtors occur in reorganization cases mostly through committees of creditors).] Since the independence of a case trustee was a significant reason for the 1938 Act's requirement that a trustee's attorney be

disinterested, elimination of case trustees from most chapter 11 cases calls for the elimination of disinterestedness as a requirement for a DIP's professionals.

A DIP is not itself required to be disinterested. While an insolvent DIP owes duties to the creditor body and ultimately to the equity security holders, the fact is that a DIP is itself an entity that exercises substantial powers and generally operates a going business. It does so for the benefit of all parties in interest, but at times may appropriately have positions that compete with, or are diametrically opposed to, the interests of the creditors or shareholders. [*FN:* See Wachovia Bank & Trust Co. v. Dameron, 406 F.2d 803, 806 (4th Cir. 1969) (allowing trustee opportunity to work out plan, even when opposed by creditors); Corr v. Flora Sun Corp., 317 F.2d 708, 718 (5th Cir. 1963) (same).] Thus, without breaching any duty, a debtor may propose and seek confirmation of a plan of reorganization that creditors have stated they will oppose. [*FN:* See*In re* Bermec Corp., 445 F.2d 367, 369 (2d Cir. 1971) (stating creditors may change their minds when plan is actually proposed); Wachovia Bank , 406 F.2d at 806 (holding trustee should have opportunity to work out plan, even though opposing interests claim the plan will be futile); Corr , 317 F.2d at 710 (holding trustee has ability to work out plan over opposition of secured creditors).] As a further example, a debtor may seek to dispose of a major asset in a particular way that is opposed in strenuous litigation by an official committee. [*FN:* See Lionel Corp. v. Committee of Equity Sec. Holders (*In re* Lionel Corp.), 722 F.2d 1063, 1063 (2d Cir. 1983) (holding equity committee provided sufficient proof to support its objections to sale).]

Both legally and ethically, a DIP itself may properly take positions that could be viewed as rendering it not disinterested. [*FN:* Cf. 11 U.S.C. § 327(d) (1994) (allowing court to authorize trustee to act as attorney or accountant if in best interest of estate); id. § 327(e) (allowing trustee to employ attorney that has represented debtor when in best interest of estate).] That being so, there should be no such requirement with respect to the professionals who advise or advocate for the DIP. The estate would be amply protected by a requirement that the professional neither itself have nor represent any interest that is materially adverse to the estate. If the professional neither has nor represents such interest, it is unlikely that the estate will be harmed because the professional is not disinterested. In most instances, the lack of qualification of a professional person because of an adverse interest would cure any substantial problem otherwise posed by an interest that would render such person not disinterested. For example, if a professional person held a prepetition disputed claim against the debtor for fees, such professional would hold an adverse interest, and, if such interest were material, there would be no need for an additional requirement of disinterestedness.

II. Historically, the bankruptcy act only required that a trustee's attorney be disinterested

Under the former Bankruptcy Act as amended in 1938, chapter X was applicable to larger debtors, which were generally companies whose securities were not publicly held. [*FN:* See former Bankruptcy Act, chapter X, reprinted in A Collier on Bankruptcy App. Pt. 3−112 − 3−148 (Lawerence P. King ed., 15th ed rev. 1996) (concerning corporate reorganization).] chapter X mandated the appointment of an independent trustee in cases where the debts amounted to at least $250,000. [*FN:* See former Bankruptcy Rule, 10−202(a), reprinted in 13A Collier on Bankruptcy 10−202−1 (Lawerence P. King & James Wm. Moore eds., 14th ed 1977) (requiring corporation to have $250,000 minimum in debt to file for liquidation).] Hence, in virtually all chapter X cases, a trustee was appointed and became the owner and manager of

the debtor' business and the estate for the benefit of all parties in interest. [*FN:* See former Bankruptcy Rule, 10−207, reprinted in Collier supra note 85, at 10−207−1 (authorizing trustee to continue business if in best interest of estate).] Unlike chapter X, old chapter XI, which provided for the arrangement of unsecured debts, did not mandate the appointment of a trustee. [*FN:* See former Bankruptcy Rule 215(a), reprinted in Collier supra note 85, at 10−215−1.] Thus a trustee was rarely appointed in chapter XI cases.

Under chapter X, the trustee was required to employ a disinterested attorney. [*FN:* See former Bankruptcy Act §157, reprinted in Collier supra note 84, at App. Pt. 3 3−121; Bankruptcy Rules 10−206(a), reprinted in Collier supra note 85, at 10−206−1 (permitting employment of professional that is not disinterested for special purposes); Bankruptcy Rules 10−202(c)(2), reprinted in Collier supra note 85, at 10−202−1 (providing "trustee shall be disinterested").] Under old chapter XI, however, in those rare cases where a trustee was appointed, there was no requirement in the statute or chapter XI rules that the attorney for the chapter XI DIP be disinterested. [*FN:* See former Bankruptcy Rule 215(a), applicable under chapter XI Rule 11−22, reprinted in Collier supra note 85, at 10−215−1.] All that was required under old chapter XI was that the attorney not represent an adverse interest. [*FN:* See former Bankruptcy Rule 215(a), applicable under chapter XI Rule 11−22, reprinted in Collier supra note 85, at 10−215−1; *In re* Best W. Heritage Inn Partnership, 79 B.R. 736, 739 (E.D. Tenn. 1987) (discussing chapter X and accompanying rules of prior law and comparing to chapter XI); Smith , "Disinterestedness": 1995−96 Annual Survey of Bankruptcy Law , 639−644.]

When the proposed revision of the 1938 Act was under consideration by the Commission on Bankruptcy Laws of the United States, it did not recommend a requirement that an attorney for a DIP be disinterested. [*FN:* See Commission Report §7−201(b) at 234, H.R. Doc. No . 93−137, at § 1−102(22) (1973); S. Rep. No. 95−2266 at §§ 1−101(14), 1107 (1978).] In 1978, upon the Commission' recommendations, Congress enacted chapter 11 to provide for the debtor to remain in possession, contemplating that the appointment of a chapter 11 trustee would usually not be ordered. [*FN:* See id.] The notion was that creditors could protect their own interests through official committees without an independent trustee, and by means of the Code section 1121 provisions for ending the debtor' exclusive time to file a plan. [*FN:* See id.]

In view of this history, it is not surprising that section 327(a) was written to apply to a professional person for a "trustee," without naming a DIP. However, the introductory phrase of section 1107(b) referring to section 327(a) was written into the statute without any legislative explanation, which created an implication that disinterestedness was required for the DIP's professionals. [*FN:* See 11 U.S.C. § 1107(b) (1994).] It appears that this phrase may have been necessary in order to avoid disqualifying the debtor's own prepetition attorney merely because of such prepetition representation, and even if the attorney did not hold a claim against the debtor and did not otherwise lack disinterestedness. [*FN:* See Best Western , 79 B.R. at 739 (stating that exception created by § 1107(b) may have been necessary because debtor's prebankruptcy attorney was disqualified from representing trustee, even though "attorney" was not used in defining "disinterested" or "disinterested person"); see also H.R. Rep. No. 95−595, at 310−11 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5902; S. Rep. No . 95−989, at 404 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6360; Joint Legislative Statement, 124 Cong. Rec . S17,408 (daily ed. October 6, 1978), at S17,419; Report of the Commission on Bankruptcy Laws of the United States, H.R. Doc. No . 93−137, at § 1−102(22) (1973).]

While an argument based upon the literal language of section 1107(b) could make the requirement of disinterestedness generally applicable to the professionals for the DIP, it is not in accord with the history of the Bankruptcy Act and the Code. The Code disregards the fact that there is no explicit language in the Bankruptcy Code mandating that an attorney for a DIP be disinterested.

IV. What is disinterestedness?

A. The Notions of Disinterestedness and Adverse Interest Merge

In most material respects, because of the definition of "disinterested person" in section 101(14) of the Code, [*FN:* See 11 U.S.C. § 101(14): (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 of 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 the subparagraph (B) or (C) of this paragraph, or for any other reason;] the section 327(a) requirement of disinterestedness is redundant of the section 327(a) proscription against having or representing an adverse interest. [*FN:* See *In re* Roberts, 46 B.R. 815, 828 (D. Utah 1985) (stating perceived

redundancy of these two requirements), aff'd in part, modified in part, rev'd in part on other grounds 75 B.R. 402 (D. Utah 1987).]

Some courts have viewed the section 327(a) requirement of "disinterestedness" as merging with section 327(a)s requirement that there be no adverse interest. [*FN:* See*In re* Martin, 817 F.2d 175, 178 (1st Cir. 1987) (noting intertwining of these two concepts); see also Roberts , 46 B.R. at 828 (noting element of redundancy in terms).] While these dual requirements of section 327(a) are designed to prevent connivance or overreaching by a professional person, some cases also extend section 327(a) to require that the professional person's retention not involve even an appearance of impropriety. [*FN:* See*In re* Lotus Properties, LP, 200 B.R. 388, 394 (Bankr. C.D. Cal. 1996) (noting belief that any future appearance of impropriety demonstrates conflict); see also*In re* Paolino, 80 B.R. 341, 345 (E.D. Pa. 1987) (concluding disinterestedness covers mere appearance of impropriety).] This was not new to the Code, as courts have long been concerned with preventing the appearance of impropriety. [*FN:* See Mosser v. Darrow, 341 U.S. 267, 274 (1951) (stating "a trusteeship is serious business and is not to be undertaken lightly or be discharged").] That goal, however, can be accomplished by means of precluding employment of a professional person who has or represents a material adverse interest, or where the court finds that an actual conflict exists. In addition, codes of ethics fix appropriate standards of conduct. [*FN:* See Model Code of Professional Responsibility DR 5−105(B) (1980) (stating lawyer must cease representation if his judgment is clouded by adverse interests); Model Rules of Professional Conduct Rule 1.7(a) (1983) (mandating attorney cannot represent client with interest adverse to another represented client).]

B. The Case Law Treatment of Disinterestedness

The disinterestedness and adverse interest requirements were addressed in an instructive appellate decision in *In re BH & P Inc.* [*FN:* See*In re* BH & P Inc., 949 F.2d 1300, 1315 (3d Cir. 1991) (stating that term "actual conflict" is not defined in Code and has been given meaning largely through case−by−case evaluation of particular circumstances arising in bankruptcy context).] That case involved multiple representation by attorneys of both a corporate debtor and its principal shareholders in separate chapter 7 cases. [*FN:* See id. at 1302−04 (reviewing history of case).] The 3rd Circuit affirmed a decision below which held that the attorneys had disqualifying conflicts resulting from the representation in those cases of both the corporation and its principals. [*FN:* See id. at 1318 (holding that trustee and counsel were properly disqualified).] However, the court accepted a finding made below that there was an "actual conflict" and that there was an "actuality" that one of the debtor's estates would favor the other while the attorneys served both. [*FN:* See id. at 1315.]

The court in *BH & P*, however, declined to formulate a bright−line test for disqualification, holding that a case−by−case approach should be taken. [*FN:* See id. at 1316 (noting that "flexible" approach may be used).] Nevertheless, the 3rd Circuit endorsed the bankruptcy court's adoption of a standard that could disapprove employment of a professional because of a potential conflict, unless there was little possibility that it would become actual and the reasons for employing the particular professional were compelling. [*FN:* See BH & P , 949 F.2d at 1316 (stating factors to be used in "flexible standard").] As stated by the 3rd Circuit in *In re BH & P*:

This flexible approach will require the bankruptcy courts to analyze the factors present in any given case in order to determine whether the efficiency and economy which may favor multiple representation must yield to competing concerns affecting fairness to all parties involved and protection of the integrity of the bankruptcy process. [*FN:* See id.]

Another multiple representation situation was presented to the 10th Circuit in *In re Interwest Business Equipment Inc.* [*FN:* See Interwest v. Business Equip. Inc. (*In re* Interwest Bus. Equip. Inc.), 23 F.3d 311 (10th Cir. 1994) (denying application for joint representation of three estates by one law firm on basis of conflict of interest).] In that case, the court also adopted a subjective standard under which the retention of a professional would be approved "only when that professional's judgment and advocacy would be unclouded by divided loyalty." [*FN:* See id. at 316.] In *Interwest*, the 10th Circuit stated:

The policy behind disqualification for representing potentially conflicting interests provides the key to its extent. The 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. The representation of any such party disqualifies counsel from representing a debtor. Any more remote potential conflict should not result in disqualification. [*FN:* See id . (quoting*In re* McKinney Ranch Assoc., 62 B.R. 249, 255 (Bankr. C.D. Cal 1986).]

Applying the analysis of *Interwest*, if a professional received a fee payment during the preference period, or there was the possibility of a claim for malpractice for prepetition advice, the prepetition professional could be a target, and thus may be disqualified for having an adverse interest.

C. Some Observations

It can be seen from these cases that despite the seemingly objective definition of "disinterested person" in section 101(14), [*FN:* See 11 U.S.C. § 101(14) (1994).] many issues over section 327(a) disqualification cannot be decided on a simple or objective basis. The section 327(a) requirement of disinterestedness poses serious problems for a DIP and its professionals because of the ambiguity of the statute [*FN:* See Brenda Hacker Osborne, Attorney's Fees in chapter 11 Reorganization: A Case for Modified Procedures , 69 Ind. L.J. 581, 582 (1994) (noting courts have not been consistent in deciding whether being owed prepetition fees will be enough to disqualify attorney under § 327); see also*In re* Diamond Mortgage Corp. of Ill., 135 B.R. 78, 93 (Bankr. N.D. Ill. 1990) (comparing how some courts use literal approach, and others are more flexible in reading § 327).] and its potential to deprive the DIP of the best available professional assistance. [*FN:* See Osborne, supra note 113 at 587 (stating "[t]he DIP is harmed when its counsel is disqualified after working on the case"); see also*In re* Guy Apple Masonry Contractor Inc., 45 B.R. 160, 167 (Bankr. D. Ariz. 1984) (stating removing counsel would not be in best interest of estate).] It also subjects a DIP to needless harassing litigation from other constituencies who may seek leverage by asserting disinterestedness claims. [*FN:* See*In re* Iorizzo, 35 B.R. 465, 468 (Bankr. E.D.N.Y. 1983) (stating that court is required to carefully exercise its discretion and weigh all competing factors involved when motion is made objecting to debtor's choice of counsel). But see Shaw & Levine v. Gulf & W. Indus. Inc. (*In re* Bohack Corp.), 607 F.2d 258, 263−64 (2d Cir. 1979) (noting that "possible delay and additional expense caused by replacement are clearly outweighed by "considerations of the integrity of the judicial process").] The potential benefits of a disinterestedness requirement are far outweighed by the harm of a statutory provision imposing such requirement, which generates tactical litigation and is unnecessary in light of both the prohibition against adverse interests and requirements under applicable canons of ethics. [*FN:* See Model Code of Professional Responsibility DR 5−105(B) (1980) (stating "lawyer shall not continue multiple employment if the exercise of his independent professional judgment . . . will be . . . adversely affected by his representation of another client"); see also Model Rules of Professional Conduct Rule 1.7(a) (1983) (stating "lawyer shall not represent a client if the representation of that client will be directly adverse to another client").]

One of the problems with section 327(a)'s requirement of disinterestedness is its obvious overlap with the prescription against holding or representing an adverse interest. [*FN:* See 11 U.S.C. § 327(a) (1994) (mandating attorney to be disinterested and without adverse interest); see also id . § 328(c) (contemplating that professionals must be disinterested and not hold any adverse interests);*In re* Lotus Properties, LP, 200 B.R. 388, 391 (Bankr. C.D. Cal. 1996) (discussing interplay between determination of adverse interest and attorney disinterestedness).] At a minimum, section 327(a) should be narrowed so as to limit the question of disqualification to the better−established legal principles governing material adverse interests. Under this approach, retention could be denied if the bankruptcy court were to find that an estate would in fact be prejudiced by approving the retention of a particular professional person because of such person's interest in relation to the estate.

V. Reasons for eliminating a requirement

of disinterestedness

The following are among the principal reasons why the requirement of disinterestedness should not apply to a professional person retained by a DIP:

First, section 327(a) of the Bankruptcy Code was carefully written so as to apply to professionals serving a "trustee." [*FN:* See 11 U.S.C. § 327(a) (stating trustee may employ professionals "to represent or assist the trustee in carrying out the trustee's duties"). A DIP, that has the rights and powers of a chapter 11 case trustee, has the right, subject to court approval, to everyday professionals pursuant to § 1107(a). See id. § 1107(a).] Neither the explicit language of section 327(a) nor its history calls for the application of the disinterestedness requirement to a DIP's professionals. Congress selectively used the word "trustee"

and the word "debtor in possession" in various places in the Code, but did not write section 327(a) so as to apply to a professional person employed by a DIP. [*FN:* See*In re* Eagle−Picher Indus. Inc., 139 B.R. 869, 871 (Bankr. S.D. Ohio 1992) (stating § 327 does not apply "to the employment of professional persons by entities other than the trustee"), rev'd on other grounds, 999 F.2d 969 (6th Cir. 1993). But see Roberts , 46 B.R. at 826 (noting that disinterested and adverse interest standards apply when evaluating professionals employed by debtor in possession pursuant to § 327(a));*In re* Leisure Dynamics, 32 B.R. 753, 754 (Bankr. D. Minn. 1983) (stating "attempt at distinguishing the requirements § 327(a) by the Code's use of the word "trustee" is meaningless: the qualification requirements apply to both the trustee and the debtor in possession"), aff'd, 33 B.R. 121 (D. Minn. 1983).]

Second, the Code should be applied in a manner that recognizes the distinct roles of the several major parties in interest in a chapter 11 case. The official creditors' committee, as the representative of creditors, is authorized to retain

attorneys, accountants and other agents, without restriction, [*FN:* See 11 U.S.C. § 1102(a)(1) (stating United States trustee shall appoint creditor's committee); see also*In re* Barney's Inc., 197 B.R. 431, 440 (Bankr. S.D.N.Y. 1996) (stating all creditor's with unsecured claims are authorized to be on creditors' committee).] except for the section 1103(b) proscription that the professional person shall not represent "any other entity having an adverse interest in connection with the case." [*FN:* See 11 U.S.C. § 1103(b); see also United Steel Workers of Amer. v. Lampl (*In re* Mesta Mach. Co.), 67 B.R. 151, 157 (Bankr. W.D. Pa. 1986) (holding creditors' committee counsel may not represent any other entity having adverse interest to creditors).] Section 1103(b) even provides that the representation by an attorney or accountant of several creditors of the same class as represented by the committee while representing the committee, is not the per se representation of an "adverse interest." [*FN:* See 11 U.S.C. § 1103(b) (1994).] Creditors' committees are thus substantially unrestricted in their selection of professionals, and can choose the persons most qualified. [*FN:* See Peter C. Blain & Diane Harrison O'Gawa, Creditor's Committee's Under chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers, and Duties , 73 Marq. L. Rev. 581, 596 (1990) (noting "committee enjoys broad freedom in selecting professionals and agents").] The DIP should not be at a relative disadvantage.

Attorneys and other professional persons representing a DIP should be available to the DIP because of their ability to represent the DIP effectively and economically. There should not to be a disqualification for anything other than a material adverse interest. The heightened degree of disqualification because of other types of disinterestedness places the DIP at a disadvantage, as compared with the relative freedom of an official committee to select its own professionals. [*FN:* Compare 11 U.S.C. § 327(a) (requiring court approval and that professional must meet disinterested standard), with id . § 1103(b) (stating simply no adverse interest may be represented).] The DIP should not be deprived of the services of its prepetition professionals if they do not have a material adverse interest. Nor should a DIP be subjected to tactical litigation brought against it by a creditors' committee or other party in interest challenging the DIP's selection of a professional who does not have or represent an adverse interest. [*FN:* See supra note 77 and accompanying text.]

Third, the history of the pre−Code bankruptcy statutes suggests that Congress never intended that disinterestedness apply to a DIP's professionals. [*FN:* See S. Rep . 95−598, at 38 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5824 (stating expressly that § 327 was to apply to trustees).] The genesis of disinterestedness under section 327(a) can be traced to provisions of the 1938 Act and certain provisions of the former Bankruptcy Rules relating to the provisions of chapter X of that former Act. In light of that history, the requirement should not be read into chapter 11 of the Code except as to a chapter 11 trustee, and such requirement should not apply to a DIP's professionals.

Fourth, a requirement of disinterestedness can operate unfairly both to a DIP and to a professional person employed by the DIP, even long after the employment has been approved by the bankruptcy court. It has been held that sections 327(a) and 328(a) are so strong that even if the professional person's employment was approved by an order of the bankruptcy court, the professional person may be required to disgorge fees received in reliance on that order in the event of its reversal based on a finding of lack of disinterestedness. This required disgorgement could occur even after years of outstanding service by the professional. [*FN:* See Michel v. Federated Dep't Stores Inc. (*In re* Federated Dep't Stores Inc.), 44 F.3d 1310, 1319 (6th Cir. 1995) (interpreting §328 to mean court may deny compensation to professional person appointed under §327(a) if person "ceases to be disinterested at any time during such employment").]

The term "disinterested person" is defined in section 101(14) of the Code both objectively and also in a catch−all provision encompassing a person that has "an interest materially adverse to the interest of any class of creditors, equity or security holders, by reason" of certain specific relationships. [*FN:* See 11 U.S.C. § 101(14)(e) (1994); see also United States Trustee v. Bloom (*In re* Palm Coast: Matanza Shares L.P.), 101 F.3d 253, 258 (2d Cir. 1996) (stating professional firm hired by trustee, which is trustee's own firm and not a firm of attorneys or accountants, cannot be disinterested and have no interest adverse to estate).] Under section 101(14)'s literal language, an attorney who served prior to bankruptcy and was not paid in full is disqualified. [*FN:* See 11 U.S.C. § 101(14)(E); see also*In re* 419 Co., 133 B.R. 867, 870 (Bankr. N.D. Ohio 1991) (stating attorney who represented debtor prepetition was disqualified);*In re* Carrousel Motels Inc., 97 B.R. 898, 900−01 (Bankr. S.D. Ohio 1989) (holding that even appearance of conflict created by prepetition representation is enough to merit disqualification).] Moreover, such disqualification might apply even if the attorney were to waive his or her claim for unpaid prepetition fees.

A DIP and the estate could be severely prejudiced if its prepetition professional were disqualified because a prepetition professional may be the person most knowledgeable and up to speed for the DIP. A great deal of needless expense could be entailed for a new professional to come on board at the inception of a chapter 11 case.

VI. Interplay of the Bankruptcy Code with Codes of Ethic

There is a developed body of ethical responsibilities imposed upon all attorneys under state codes of ethics and disciplinary regulations. [*FN:* See generally Model Rules of Professional Conduct (1983) (as of 1995 adopted in whole or part by 38 states and the District of Columbia); Model Code of Professional Responsibility (1980) (currently used as basis for codes of minority of states, including New York, California, and Massachusetts).] Bankruptcy courts have held that state codes setting forth ethical duties and rules of professional ethics apply in bankruptcy cases, and are relevant to attorney disqualification issues. [*FN:* See*In re* Kendavis Indus. Int'l Inc., 91 B.R. 742, 748 (Bankr. N.D. Tex. 1988) (stating court should consider ethical implications when ruling on "propriety of awarding professional fees"); see also*In re* Coastal Equities Inc., 39 B.R. 304, 311 (Bankr. S.D. Cal. 1984) (holding ethical violations are relevant when determining fees because they will "lessen the value of services");*In re* Devers, 12 B.R. 140, 142 (D.D.C. 1981) (same).] These ethical duties, which are superimposed on the Code's section 327(a) requirement that an attorney not have or represent an adverse interest, are sufficient to ensure that the DIP will be properly served and that interests adverse to the estate will be avoided. [*FN:* See*In re* Roberts, 46 B.R. 815, 849 (Bankr. D. Utah 1985) (holding law firm's violations of canons of ethics were violations of § 327(a)), aff'd in part, rev'd in part and modified in part , 75 B.R. 402 (D. Utah 1987). See generally John D. Ayer, How to Think About Bankruptcy Ethics , 60 Amer. Bankr . L.J. 355, 378−84 (1986) (concerning ethics and behavior of lawyers).]

Canon 5 under the American Bar Association's Model Code of Professional Responsibility provides that a "lawyer should exercise independent professional judgment on behalf of a client." [*FN:* See Model Code of Professional Responsibility Canon 5.] Ethical Consideration 5−1 emphasizes how far this loyalty extends: "The professional judgment of a lawyer should be exercised within the bounds of the law solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interest, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client." [*FN:* See id EC 5−1.] The ABA's Model Rules of Professional Conduct requires in Rule 1.7 that a lawyer decline simultaneous representation of two clients if the dual representation of both clients would directly conflict or materially affect the lawyer's ability to represent each of the clients, unless: (1) the lawyer reasonably believes that the two representations will not adversely affect each other; and (2) the clients consent to the simultaneous representation. [*FN:* Model Rules of Professional Conduct Rule 1.7(a).]

Since an attorney for a DIP is required to comply with ethical standards of conduct, the attorney is obliged primarily to serve the interests of the DIP, not those of the creditor body or other constituencies. [*FN:* See id. (stating that purpose of rule is to assure that counsel devotes undivided loyalty to debtor).] While it is commonly thought that a DIP owes duties to the creditor body, the fact remains that the attorney−client relationship calls for the DIP's attorney primarily to serve the interests of the DIP. [*FN:* See id. ;*In re* Lee, 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988) (recognizing conflict of interest rules applied more strictly in bankruptcy to "assure that counsel devote undivided loyalty to the debtor").] A lack of disinterestedness on the part of the DIP's attorney should thus be a matter of primary concern to the DIP, not to others. [*FN:* But see*In re* Iorizzo, 35 B.R. 465, 468 (Bankr. E.D.N.Y. 1983) (stating that in determining whether to grant approval of attorney employed by DIP pursuant to § 327(a) court must consider best interests of estate); Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355 (1985) (noting that in chapter 11 case DIP or trustee is obligated to act only in best interest of entire estate including creditors and owners).]

Nevertheless, a number of bankruptcy courts have declined to permit a DIP to waive a conflict of its attorney, and have disqualified the attorney from further representing the DIP. [*FN:* See*In re* American Printers & Lithographers Inc., 148 B.R. 862, 867 (Bankr. N.D. Ill. 1992) (finding "consent by the clients does not always create disinterestedness in bankruptcy");*In re* Diamond Mortgage Corp. of Illinois., 135 B.R. 78, 90 (Bankr. N.D. Ill. 1990) (recognizing certain conflicts waivable outside bankruptcy context are prohibited from waiver by Bankruptcy Code);*In re* Amdura Corp., 121 B.R. 862, 866 (Bankr. D. Colo. 1990) (noting difference between consent to conflict in commercial setting and in bankruptcy setting); see also*In re* Patterson, 53 B.R. 366, 373 (Bankr. D. Neb. 1985) (noting that non−disinterested firm may not represent debtor even though debtor may have consented to such representation).] Other bankruptcy courts, however, have treated such waivers as evidence that no disqualifying conflict exists. [*FN:* See Hunter v. Head (*In re* Head), 110 B.R. 621, 625 (Bankr. M.D. Ga. 1990) (holding consent of all creditors not required when waiver not controlling as to issues before court); Dechert Price & Rhoads v. Direct Satellite Communications Inc. (*In re* Direct Satellite Communications Inc.), 96 B.R. 507, 521 (Bankr. E.D. Pa. 1989) (discounting potential conflict when fully disclosed and totally consented to by debtor).] There is no sound reason why conflict waivers should be governed by different rules in bankruptcy cases than those generally applicable in civil litigation. Nor should disqualification issues in general be treated any differently in bankruptcy cases than in all other civil cases.

In sum, nothing more should be required to achieve the objectives of the Bankruptcy Code with respect to professionals serving a DIP than the requirement that the professional neither have nor represent a material adverse interest, and the assurance that the professional must comply with the applicable canons of ethics. [*FN:* See Gerald K. Smith, House of Delegates Recommendation , 1991 ABA Section of Business Law Rep. , 7−9 (stating that relevant test should be whether any historical connections with debtor create materially adverse interest).] By restricting the disqualification provision so as not to

include disinterestedness, a DIP will be encouraged to utilize the services of a professional who served the DIP prepetition, making it more efficient and less costly for the DIP to have quality representation in the chapter 11 case.

A DIP in a bankruptcy case should have substantial freedom to choose its own attorney. [*FN:* See id. (ABA recommendation notes that disinterested standard causes substantial problems in that it "does not fill the vacuum left by the abandonment of an independent trustee").] Under our system of jurisprudence, a party should be able to select an attorney of its choice. [*FN:* See*In re* Hecks Inc., 83 B.R. 410, 423 (Bankr. S.D. W.Va. 1988) (holding that bankruptcy court improperly denied motion to retain lead counsel);*In re* Allard, 23 B.R. 517, 518 (Bankr. E.D. Mich. 1982) (proclaiming that it is not for court to select counsel for trustee); see also *In re* Market Response Group, 20 B.R. 151, 152 (Bankr. E.D. Mich. 1982) (stating "only in the rarest cases should the trustee be deprived of the privilege of selecting his own counsel") (quoting*In re* Mandell, 69 F.2d 830, 831 (2d Cir. 1934)); supra note 1.] That is true in both civil and criminal cases. [*FN:* See U.S. Const. amend. VI; see also Powell v. Alabama, 287 U.S. 45, 53 (1932) (stating Sixth Amendment jurisprudence provides that accused "should be afforded a fair opportunity to secure counsel of his own choice"); Wilson v. Mintzes, 761 F.2d 275, 279 (6th Cir. 1985) (holding "accused has right to conflict−free counsel [and] counsel of choice").] Indeed, if a DIP is prohibited from retaining an attorney that has long served the debtor prepetition, it is likely that the client is the one that will suffer the most, rather than the attorney who loses a potentially lucrative engagement. [*FN:* See Nancy B. Rapoport, Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy Cases , 26 Conn. L. Rev. 913, 985−986 (1994) (placing upon client "the onus of determining whether he is willing to risk the possibility of some mid−game substitutions of counsel").] It is at the time of the debtor's financial crisis, when it is forced to take the drastic step of filing in chapter 11, that the client needs the attorneys in whom the client has confidence and who have served the client over the years. [*FN:* See id. (positing that for this reason client should make final decision).] There is no reason why a creditor should be allowed to interfere with the DIP's selection of counsel in the absence of a compelling reason. [*FN:* See Frankfurth v. Cummins (*In re* Cummins), 15 B.R. 893, 896 (B.A.P. 9th Cir. 1981) (noting that "reason for the rules relating to retention of professional personnel and the setting of their fees is to protect the estate and its creditors from unwarranted and gratuitous claims"); Michel v. Federated Dep't Stores, Inc. (*In re* Federated Dep't Stores Inc.), 114 B.R. 501, 504 (Bankr. S.D. Ohio 1990) (noting that as general rule, DIP may select its own professionals); rev'd sub nom. on other grounds, 44 F.3d 1310 (6th Cir. 1995).] All too often such interference by a creditor or committee is to gain a tactical advantage by depriving the DIP of the professional of its choice. [*FN:* This type of behavior is in contrast with the purpose of the Code in authorizing professionals to assist the trustee in order to more effectively conserve the assets of the estate and fulfill the trustee's obligations. See Bennett v. Williams, 87 B.R. 122 (Bankr. S.D. Cal. 1988)) (stating that this purpose is why trustees seek out professionals with expertise), aff'd , 892 F.2d 822 (9th Cir. 1989).] There are thus good policy reasons why the disinterestedness requirement should not apply to a DIP's professionals.

Furthermore, the requirement makes no sense when measured by logical ethical standards. The most common basis for disqualification of a DIP's attorney is that the attorney has a claim against the estate for prepetition services, thereby disqualifying the attorney as a "creditor" under the definition of disinterestedness. [*FN:* See, e.g., United States Trustee v. Price Waterhouse, 19 F.3d 138, 140−42 (3d Cir. 1994) (holding that accounting firm owed money from prepetition services was disqualified from rendering postpetition service).] But a prepetition debt is generally not distinguishable from a postpetition debt of an attorney for services rendered before and during the chapter 11 case, which are generally calculated on the same basis. Since unpaid postpetition fees are not disqualifying, a claim for unpaid prepetition fees also should not be disqualifying. [*FN:* See*In re* Martin, 817 F.2d 175, 180 (1st Cir. 1987) (reasoning that section 327(a) should not be read to foreclose employment by DIP of attorney who is in any respect creditor given that any attorney who may be retained to represent debtor in possession becomes creditor of estate as soon as any compensable time is spent on chapter 11 case).]

Furthermore, an attorney is not a "creditor" as defined by section 101(10) with respect to a postpetition fee claim. [*FN:* See 11 U.S.C. § 101(10)(A) (1994) (defining creditor as "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor").] A "creditor" is defined as the holder of a prepetition "claim." [*FN:* See*In re* Federated Dept. Stores Inc., 135 B.R. 973, 979 (Bankr. S.D. Ohio 1992) (stating claimants with claims arising after date of filing of chapter 11 bankruptcy petition were not creditors within meaning of Code), aff'd in part, rev'd in part, 175 B.R. 924 (Bankr. S.D. Ohio 1992); see also 11 U.S.C. § 101(5) (defining "claim").] Consequently such attorney, although the holder of a "claim," is not ineligible as a "creditor" by reason of having a postpetition claim to continue to serve the DIP. [*FN:* See*In re* Diamond Mortgage Corp. of Ill., 135 B.R. 78, 88 n.5 (Bankr. N.D. Ill. 1990) (noting that attorney who represented debtor prepetition is not precluded from being appointed as special counsel postpetition).] Under this analysis, the mere holding of a "claim" does not render the professional interested. There is no logical or ethical reason to disqualify a professional for holding a claim that arose prepetition.

An attorney holding a postpetition claim may nevertheless be disqualified under section 101(14)(E)'s definition of disinterested person, which includes any person that has "an interest materially adverse to the interest of the estate." [*FN:* See 11 U.S.C. § 101(14)(E) (defining disinterested person as 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").] Thus, if a postpetition claim is large, and there is any dispute as to the amount due, there could be a lack of disinterestedness. As the foregoing discussion illustrates, there is no good reason for applying a different rule for automatic disqualification of an attorney depending on whether the attorney's claim is a prepetition or postpetition claim.

It therefore follows that ethical principles do not require the retention of a professional to be predicated on the qualification of the professional as a disinterested person as defined by section 101(14) of the Code. The elimination of the disinterested person requirement does not require that ethics be cast aside. Nor does sound policy require a professional to be such a disinterested person.

VII. Prior Reform Efforts

It is not surprising, given the prevailing climate over recent years in which the public has viewed attorneys in a bad light, that the requirement of disinterestedness has remained in the Code since 1978, when it was carried into section 327(a) from the 1938 Act. Nevertheless, there are good policy reasons consistent with ethical goals for the elimination of disinterestedness.

First, the object of a chapter 11 case is to preserve and enhance the going−concern value. [*FN:* See*In re* Russell, 60 B.R. 42, 44 (Bankr. W.D. Ark. 1985) ("Principal purpose of chapter 11 is to restructure business debts so that business may continue to operate and the creditors receive the 'going concern' value of the assets of the estate as opposed to liquidation value");*In re* Cooper Prop. Liquidating Trust Inc., 61 B.R. 531, 537 (Bankr. W.D. Tenn. 1986) (noting primary purpose of chapter 11 is to allow debtor to implement plans for payment to creditors).] That goal can be furthered by enabling a DIP to have the services of attorneys, accountants and financial advisors who served the DIP before the chapter 11 filing and who are thoroughly familiar with its problems, affairs and possible solutions. Such professionals may also bring to the case historical knowledge of the debtor' problems and a greater likelihood of contributing to their solution. Second, avoiding the disqualification of such professionals can substantially reduce what may otherwise be enormous professional fees incurred by the DIP.

In 1991 the American Bar Association' House of Delegates passed a resolution that was recommended by the ABA Business Law Section calling for an amendment to section 327(a) that would have both modified the "adverse interest" requirement and rescinded the disinterestedness requirement of section 327(a). [*FN:* See Smith, supra note 141, at 7−9.] Under the ABA's 1991 Resolution, disqualification by reason of an adverse interest would have been modified so as to disqualify a professional only if such interest was "materially" adverse to the estate. [*FN:* See id.] With respect to attorneys, the ABA's 1991 Resolution called for a requirement that would have disqualified the attorney if the attorney's employment would "violate nonbankruptcy standards of professional responsibility generally applicable in the district where the case is pending." [*FN:* See id.] The 1991 Resolution went on to propose that section 1107(b) be eliminated.

The ABA's 1991 Resolution was based upon a report by its Bankruptcy Ethics Subcommittee which reviewed the history of the requirement of disinterestedness as applied to an independent trustee under former chapter X, and concluded that the requirement of disinterestedness was inappropriate with respect to a DIP's attorney because it operated, at times, to disqualify an attorney for retention by a DIP even though the applicable ethical rules would not have been violated. [*FN:* See id.] As stated in a report of the Bankruptcy Ethics Subcommittee upon which the 1991 Resolution was based: [*FN:* See id.]

[T]he Bankruptcy Bench assumes that counsel for a debtor in possession must be disinterested. The result has been a substantial restriction on the right to choose counsel. The effect has been to cause attorneys with historic ties to a debtor to be automatically disqualified (in some jurisdictions) as bankruptcy counsel for that debtor. The Committee believes that traditional legal ethics, as well as the Constitution, emphasize the right of a person to select counsel and the correlative lawyer's obligation to respond to the lawful desires of the client. A number of bankruptcy courts have utilized the Bankruptcy Code "disinterestedness" standard to impose a different set of duties upon the lawyer−−ironically, not upon the debtor itself−−and often to punish the debtor's counsel who were perceived as acting too vigorously for the debtor, rather than for the estate.

* * *

The difficulty with the disinterestedness standard being applied to counsel for the debtor in possession is not that it is silly but that it causes substantial problems. It does not fill the vacuum left by the abandonment of an independent trustee and the idea that it might is misleading. The disinterestedness standard often disqualifies counsel most knowledgeable and best equipped to handle the reorganization. It does this by focusing on historical identity with the debtor, which should not be disqualifying in and of itself. The relevant test should be whether any of the historical connections with the debtor creates a materially adverse interest. The fact that the lawyer or a partner of the lawyer may be a creditor, stockholder, director or officer should not be the end of the inquiry; the issue is whether it creates a problem. Whether the debtor is represented by the historical lawyer or a new lawyer, the lawyer must still take direction from those in control, and is therefore not disinterested.

The obligation of counsel for the non−disinterested debtor in possession to follow the direction of his own client, ahead of the interests of others, is underscored by the ABA Model Rules of Professional Conduct. Model Rules 1.2(a) and 1.4(b), for example, require a lawyer to abide by the client's decision concerning the objectives of representation, and explain a matter to the extent reasonably necessary to permit the client to make informed decisions about the representation. There was no counterpart to these rules in the 1969 Code of Professional Responsibility.

ABA Model Rule 1.13, again with no counterpart in the Model Code, provides that a lawyer represents an entity through its duly authorized constituents. The lawyer is to follow their instructions, unless they seek to violate a legal obligation to the organization or violate a law imputed to the organization which results in substantial injury to the organization−−not to others. Even then, the lawyer may not simply follow the dictates of others or his own beliefs as to the best interests of all. If he cannot persuade the highest authority in the organization to comply with the organization's clear legal duties, and he believes the violation will substantially injure the organization, his only option is to resign. Model Rule 1.13(c). The notion that the debtor in possession's attorney must be disinterested, so that he can act in the best interest of the estate and all its constituents and report on a disinterested basis to the judge, is contrary to fundamental precepts of the Model Rules. [*FN:* The above portions of the Report underlying the 1991 Resolution were set forth in an excellent monograph prepared by Susan M. Freeman, Esq. of Lewis and Roca, LLP, Phoenix, Arizona, entitled "Conflicts and Disinterestedness−−What Ethics Standards Should the Code Direct for Non−trustee Counsel?"]

It does not appear that any bill has been introduced in Congress to carry out the amendments proposed by the 1991 Resolution, or to effect any other changes to section 327(a) in regard to disinterestedness.

Conclusion

The notion of disinterestedness as a requirement for a trustee's retention of professional persons was carried into chapter 11 from the former Bankruptcy Act as amended in 1938. As written in the Code, it was to apply to the retention of professionals by case trustees. The provisions of the Code, however, have been interpreted to apply to retentions by DIPs. This was an unintended result, which probably occurred because of drafting errors in section 1107(b) of the Code.

The standard for qualification of a professional person to serve a DIP should be one requiring that the professional person neither have nor represent an interest that is materially adverse to the estate. That requirement, coupled with those of applicable codes of ethics, will ensure that a proper standard of conduct is met by professionals who serve a DIP, and will tend to achieve reduced costs for professional representation, without working unfairness to the creditor or equity security holder constituencies.

The case law requirement of disinterestedness for DIPs' attorneys should be eliminated. Indeed, in 1996, the National Bankruptcy Review Commission proposed that the requirement of disinterestedness for attorneys and other professionals retained by a DIP in a chapter 11 case should be eliminated. Under the Commission's proposal, there would be no change in section 327(a)'s requirement that such professionals not have an interest materially adverse to the estate, and that there be disclosure to the court of all potential conflicts. This position is worthy of consideration by Congress.