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NOTE SECTION 327(a): A STATUTE IN CONFLICT: A PROPOSED SOLUTION TO CONFLICTS OF INTEREST IN BANKRUPTCY

[*FN:* The authors received the 1997 New York State Bar Association Law Student Legal Ethics Award for this Note.]

Bankruptcy involves shifting relationships: today's enemy is tomorrow's friend [*FN:In re* Flanigan's Enters. Inc., 70 B.R. 248, 250 (Bankr. S.D. Fla. 1987).]

Introduction

Since at least the early seventeenth century, it has been recognized that an attorney should not represent conflicting interests. [*FN:* See Shore v. King, 45 Eng.Rep. 1135 (1603) (Hillary Term, 45 Eliz. in B.R.) (holding "words which impute double dealing to a lawyer, are actionable"). The word conflict derives from the Latin conflictus meaning "a collision or opposition between two substances." Although in the past conflict usually referred to an armed collision, the more common usage refers to an incompatible interest. See Brooke Wunnicke, Ethical Compliance for Business Lawyers § 4.1, at 48 (1986). This concept can also be traced as far back as biblical times. See Matthew 6:24 (stating that "[n]o servant can be the slave of two masters; for either he will hate the first and love the second, or he will be devoted to the first and think nothing of the second.").] This concept has been adopted from English courts into American jurisprudence. [*FN:* See*In re* Diamond Mortgage Corp. of Ill., 135 B.R. 78, 90 (Bankr. N.D. Ill. 1990) (stating it is fundamental that attorneys not represent conflicting interests absent full disclosure and consent of the parties); s ee also Model Code of Professional Responsibility DR 5−−105(A) (1980) (providing that lawyer should decline proffered employment if it would be likely to involve lawyer in representing differing interests); Model Rules of Professional Conduct Rule 1.7 (1983) (providing that lawyer shall not represent a client if representation will be directly adverse to another client, or will limit the lawyer's responsibilities to another client or third person).] Today in America's courts, [*FN:* "America's courts" refers to Federal as well as State courts.] conflicts of interest issues are influenced by professional codes of conduct and ethical rules promulgated by the American Bar Association. [*FN:* These rules are found in either the Model Code of Professional Responsibility or the Model Rules of Professional Conduct .] In bankruptcy proceedings, conflicts issues are predominantly governed by section 327 of the Bankruptcy Code. [*FN:* 11 U.S.C. § 327(a) (1994). Section 327 is substantially broader than the ethics rules. See Regina Stango Kelbon et al., Conflicts, the Appointment of "Professionals" and Fiduciary Duties of Major Parties in chapter 11, 8 Bankr. Dev. J . 349, 355 (1991) (stating Bankruptcy Code rules on ethical conduct are generally stricter than Model Code and Model Rules). For example, under the Model Rules, an attorney can represent a client whose interests are adverse to those of another client if each client consents, but the Bankruptcy Code makes no such exception. *Id.* Furthermore, where the Model Rules and Model code apply to only attorneys, the Bankruptcy Code applies to all professionals involved in a bankruptcy case. *Id.*] Bankruptcy courts have approached these issues by further incorporating the applicable ethical standards of their respective state bar organizations. [*FN:* S ee Diamond Mortgage , 135 B.R. at 89 (utilizing Illinois Code of Professional Responsibility); Pierson & Gaylen v. Creel & Atwood (*In re* Consolidated Bancshares Inc.), 785 F.2d 1249, 1256 n.6 (5th Cir. 1986) (quoting*In re* Philadelphia Athletic Club Inc., 20 B.R. 328, 334 (E.D. Pa. 1982)) (relying on Model Code of Professional Responsibility's "appearance of impropriety" standard, stating that "professionals engaged in the conduct of a bankruptcy case should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtors' estate or which might impair the high degree of impartiality and detached judgment expected of them"); *In re* Glenn Elec. Sales Corp., 99 B.R. 596, 598 (D. N.J. 1988) (recognizing that ABA Rules of Professional Conduct can be used to determine whether conflict of interest exists);*In re* Kendavis Indus. Int'l Inc., 91 B.R. 742, 752 (Bankr. N.D. Tex. 1988) (stating "Bankruptcy Code provisions dealing with conflicts of interest find their counterpart in ABA Code of Professional Responsibility"). See also Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors: Text, Cases, and Problems 753 (3d ed. 1996) (noting that attorney representing debtor in bankruptcy is subject to all canons and rules of ethics applicable to legal profession).]

Bankruptcy courts have a legitimate interest in preventing the existence of conflicts of interest, as they may lead to the subversion of the justice system. [*FN:* See*In re* Chou−Chen Chems. Inc., 31 B.R. 842, 852 (Bankr. W.D. Ky. 1983) (stating "[t]he lawyer working under the burden of a conflict of interest does a disservice to his court and runs the risk even of subverting the justice system."); Peugeot v. U.S. Trustee (*In re* Crayton), 192 B.R. 970, 975−76 (B.A.P. 9th 1996) (stating bankruptcy courts have "both the express

and inherent authority to regulate the attorneys who practice before it").] Such conflicts take on added significance when considering the bankruptcy estate, [*FN:* See Diamond Mortgage , 135 B.R. at 90 (opining that conflicts problems take on an "added dimension" when applied to representation of the bankruptcy estate). Fundamental conflict of interest concepts such as client consent and waiver "become difficult to apply when the client, the estate, is a fiduciary for another group, the creditor body; and where the clients decisions with respect to retention of professionals, including attorneys, are subject to judicial review after disclosure, notice and hearing." *Id.*] due to fiduciary obligations involving both the estate and the creditor body. [*FN:* See id; s ee also*In re* Leslie Fay Cos., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (citing 2 Collier on Bankruptcy ¶ 327.03 (Lawrence P. King ed., 15th ed. rev. 1996)) (noting concern over fiduciary obligation has lead § 327 standards to be strictly applied); Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994) (recognizing fiduciary responsibilities of professionals appointed pursuant to § 327(a)).] The two main concerns are the need to maintain the integrity of, and public confidence in, the bankruptcy process; [*FN:* See Diamond Mortgage, 135 B.R. at 90 (citing*In re* Michigan Gen. Corp., 78 B.R. 479, 484 (Bankr. N.D. Tex 1987).] and to "assure that counsel devotes undivided loyalty to [the client]." [*FN:* See id. (citing *In re* Lee, 94 B.R. 172, 178 (Bankr C.D. Cal. 1988)).] The second concern, loyalty to the client, has been recognized as a main policy reason for section 327. [*FN:* See First Interstate Bank of Nev., N.A. v. CIC Inv. Corp. (*In re* CIC Inv. Corp.), 192 B.R. 549, 553−54 (B.A.P. 9th Cir. 1996) (stating purpose of disinterestedness requirement under § 327(a) is to assure undivided loyalty to debtor); Rome , 19 F.3d. at 58 (explaining statutory requirements under § 327(a) serve important policy of ensuring undivided loyalty);*In re* Lee 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988) (noting purpose of requirements under § 327(a) is to assure undivided loyalty to debtor); see also Model Code of Professional Responsibility EC5−15 (1980) (stating "a lawyer must always weigh carefully the possibility that his judgment may be impaired or his loyalty divided if offered representation from multiple clients having even potentially differing interests."); Model Rules of Professional Conduct Rule 1.7 cmt. (1983) (stating "loyalty is an essential element in the lawyer's relationship to a client.").]

The Bankruptcy Code therefore explicitly addresses conflicts of interest in the bankruptcy setting. [*FN:* See 11 U.S.C. § 327 (1994).] Section 327(a) of the Bankruptcy Code [*FN:* See id. § 327(a).] provides that:

the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title. [*FN: Id.*]

Courts have consistently held that section 327 and its accompanying sanctions [*FN:* The sanctions available under section 328 include both disqualification and disgorgement of fees. See id. § 328.] are to be rigidly applied. [*FN:* See 2 Colliers on Bankruptcy § 327, at 31 (Lawrence P. King ed., 15th ed. rev 1996);*In re* Rusty Jones Inc., 134 B.R. 321, 346 (Bankr. N.D. Ill. 1991) (stating conflicts of interests rules have been "more strictly applied in the bankruptcy context than in other areas of the law, at least insofar as professionals retained by the estate are concerned"); Pierson & Gaylen v. Creel & Atwood (*In re* Consolidated Bancshares Inc.), 785 F.2d 1249, 1256 n.6 (5th Cir. 1986) (stating "the standards for the employment of professional persons are strict, for Congress has determined that strict standards are necessary in light of the unique nature of the bankruptcy process");*In re* Cropper Co., 35 B.R. 625, 629−30 (Bankr. M.D. Ga. 1983) (noting strict standards applicable to bankruptcy); s ee also Mehdipour v. Marcus & Millichap (*In re* Mehdipour), 202 B.R. 474, 478 (B.A.P. 9th Cir. 1996) (stating bankruptcy court does not have power to allow employment of professional in violation of § 327); Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C., (*In re* Prince), 40 F.3d 356, 360 (11th Cir. 1994) (holding denial of compensation appropriate where conflicts of interest under which debtor's attorneys labored deprived debtor of conflict free, impartial, and independent evaluation of potential claims brought by and against debtor's estate); Gray v. English, 30 F.3d 1319, 1324 (10th Cir. 1994) (stating when deciding to deny fees under 328(c) or disgorgement of previously paid fees the court has some discretion and should lean toward denial of fees); see also Rome , 19 F.3d at 60 (1st Cir. 1994) (noting doubts as to whether a particular set of facts elevate to level of a disqualifying conflict of interest normally should be resolved in favor of disqualification).] Furthermore, the tests under sections 327 [*FN:* See 11 U.S.C. § 327 (1994).] and 328 [*FN:* See id. § 328.] are not subjective, nor are they influenced by a professional's good faith. [*FN:* See Rome , 19 F.3d at 58 (noting test under § 327(a) is neither subjective nor significantly influenced by "protestations of good faith") (citations omitted); s ee also*In re* Glenn Elec. Sales Corp., 99 B.R. 596, 600 (D.N.J. 1988) (explaining subjective good faith efforts of party to comply with Bankruptcy Rules are irrelevant).] Available sanctions for failure to comply with section 327 include disqualification and disgorgement of fees. [*FN:* See 11 U.S.C. § 328(c) (stating that "the court may deny allowance of compensation for services and reimbursement of expenses of a professional person. 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").] Any existing conflicts must be disclosed to the court under Rule 2014 of the Federal Rules of Bankruptcy Procedure. [*FN:* See Fed. R. Bankr. P . 2014 (1994). Rule 2014 describes the procedure for appointing an attorney pursuant to section 327. The rule provides that the trustee must make an application which discloses all connections of the person to be employed with any party in interest. See id; see also*In re* Diamond Mortgage. Corp. of Ill., 135 B.R. 78, 97 (Bankr. N.D. Ill 1990) (explaining purpose of section 2014 disclosure requirements allow the court , not the professional, to evaluate possible conflicts of interest and potential for sanctions under §§327(a) and 328(c)); s ee also Mehdipour, 202 B.R. at 480 (noting pursuant to § 327, professional has duty to "make full, candid and complete disclosure of all facts concerning his transactions with the debtor").] Under Rule 2014, "all connections" that are not *de minimus* must be disclosed to the court. [*FN:* See*In re* Leslie Fay Cos., 175 B.R. 525, 536 (Bankr. S.D.N.Y. 1994) (stating under Rule 2014, "all connections" not de minimus must be disclosed);

Diamond Lumber Inc. v. Unsecured Creditors' Comm. of Diamond Lumber Inc. (*In re* Diamond Lumber), 88 B.R. 773, 777 (N.D. Tex. 1988) (noting under Rule 2014, all relevant facts must be disclosed). Rule 2014 is more encompassing than section 327, and is broader than corresponding obligations provided in the Model Code of Professional Responsibility or the Model Rules of Professional Conduct. See*In re* McKinney Ranch, 62 B.R. 249, 254 (Bankr. C.D. Cal. 1986) (explaining bankruptcy disqualification rule is broader than ethics rule); Leslie Fay , 175 B.R. at 536 (same).] Failure to comply with Rule 2014 may result in sanctions, regardless of actual harm to the estate. [*FN:* See Medhipour , 202 B.R. at 480 (explaining court may sanction a professional for disclosure violations regardless of actual harm to estate).]

Section 327 appears to provide a two part test to qualify professionals: (1) that they do not hold an interest adverse to the estate; and (2) that they are "disinterested persons". [*FN:* See, e.g., Leslie Fay , 175 B.R. at 531 (stating §327(a) seemingly provides for two requirements to be satisfied); see also William H. Gindin, Professionals in Bankruptcy Proceedings: Appointment, Right to Compensation and Conflicts of Interest, 21 Seton Hall L. Rev . 895, 903 (1991) (noting §327(a) imposes a two−pronged test).] However, viewing this as a two−prong test is perhaps inaccurate. This dual requirement seems redundant and vague considering the Code's definition of "disinterested person" in section 101(14)(E). [*FN:* See 11 U.S.C. § 101(14)(E) (1994).] A "disinterested person" is in part defined as one who does not hold an interest materially adverse to the estate. [*FN:* See id. Section 101(14)(E) states that a disinterested person is one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in. or for any other any reason."] Courts have therefore differed as to whether section 327(a) creates a one−prong or two−prong test. The majority of courts have treated section 327(a) as a one−prong test with disinterestedness as the key point, [*FN:* Accord*In re* Star Broad., 81 B.R. 835, 838 (Bankr. D. N.J. 1988) (recognizing both prongs of § 327(a) test are satisfied if disinterestedness is shown);*In re* Stamford Color Photo Inc., 98 B.R. 135, 137 (Bankr. D. Conn 1989) (noting disinterestedness and adverse interest test overlap); H & K Developers v. Waterfall Village of Atlanta, Ltd. (*In re* Waterfall Village of Atlanta, Ltd.), 103 B.R. 340, 343 (Bankr. N.D. Ga. 1989) (noting disinterested person and adverse interest test overlap with "disinterested person" definition in Code); *In re* Martin, 817 F.2d 175, 179 (1st Cir. 1987) (recognizing concepts of disinterestedness and adverse interest are somewhat intertwined); Leslie Fay, 175 B.R. at 532 (recognizing concept of disinterestedness includes adverse interest test); see also Roger J. Au & Son Inc. v. Aetna Ins. Co. (*In re* Roger J. Au & Son Inc.), 64 B.R. 600, 604 (N.D. Ohio 1986) (noting "both prongs of the test are satisfied where counsel is not a disinterested person because of the manner in which the Code defines disinterested person."). But see*In re* The Red Lion Inc., 166 B.R. 296, 298 (Bankr. S.D. Tex. 1994) (recognizing requirements as separate for qualification of debtor's attorney).] thus identifying the twin requirements of section 327(a) as encompassing a "single hallmark." [*FN:* See Martin , 817 F.2d at 180 (stating "the twin requirements of disinterestedness and lack of adversity telescope into what amounts to a single hallmark").]

As a result of these varying interpretations, courts have had difficulty in deciding what conflicts will be disabling, "potential" conflicts of interest, or "actual" conflicts of interest. [*FN:* See Christopher M. Ashby, Comment, Bankruptcy Code Section 327(a) and Potential Conflicts of Interest−−Always or Never Disqualifying?, 29 Hous. L. Rev . 433, 440 (1992) (explaining courts have disagreed on what conflicts will disqualify an attorney due to Bankruptcy Code's lack of guidance).] An actual conflict is defined as occurring when an attorney serves two presently competing and adverse interests, [*FN:* See*In re* American Printers & Lithographers Inc., 148 B.R. 862, 866 (Bankr. N.D. Ill. 1992).] while a potential conflict is defined as occurring where the competition does not presently exist, but may become active if certain contingencies arise. [*FN:* See id.] While it is universally recognized that "actual" conflicts are always disabling, [*FN:* See*In re* Diamond Mortgage Corp. of Ill., 135 B.R. 78, 90 (Bankr. N.D. Ill 1990) (explaining universal recognition of rule that attorneys are prohibited from representing actual conflicts of interest in bankruptcy); s ee also Woods v. City Nat'l Bank and Trust Co. of Chicago 312 U.S. 262, 268 (1940) (stating "where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation.") The Woods decision gives wide latitude to a bankruptcy court's analysis of the conflict of interest question. See*In re* Chou−Chen Chems. Inc., 31 B.R. 842, 849 (Bankr. W.D. Ky. 1983) (reasoning that such freedom is needed due to varying circumstances).] courts have not been uniform on whether potential conflicts are disabling. [*FN:* See, e.g.,*In re* Leslie Fay Cos. Inc., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (discussing split among courts regarding potential conflicts of interest); *In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) (recognizing split of authority over question of whether potential conflicts are disabling), aff'd sub nom. Grabill Corp. v. Pelliccioni, 135 B.R. 835 (N.D. Ill. 1991). See also Ashby, supra note 31, at 439 (discussing split among courts). As noted in Ashby's Comment, it is not surprising that courts disagree whether potential conflicts are disqualifying, since they cannot agree on whether section 327(a) creates a one−prong or two−prong test. See id. at 440.] Courts have disagreed on the issue of the disqualification for potential conflicts of interest [*FN:* See Ashby, supra note 31, at 439 (noting courts radically disagree on whether potential conflicts of interest are disqualifying).] This Note will explore this difference of opinion, and attempt to shed some light on the difficult questions that arise when examining this issue.

While keeping an eye on the historical underpinnings, this Note will chronicle the current state of the law. Part I discusses the American Bar Association's rules on ethics as they relate to bankruptcy. Part II discusses case law dealing with the actual versus potential dichotomy. Finally, Part III proposes a new model to decide this issue.

I. The Rules of Ethics

It was not until 1908 that the American Bar Association (the "ABA") issued the Canons of Professional Ethics, the first official standards of professional ethics for attorneys. [See Charles W. Wolfram, Modern Legal Ethics 54 (1986) [hereinafter Wolfram] (stating canons reflected common values of lawyers). The Canons of Professional Ethics were largely taken from the 1887 Alabama State Bar Association. See id. at 54 n.21. See generally Henry S. Drinker, Legal Ethics 23−25 (1953) (explaining creation of canons as response to legal professions growing commercialism) ; James Willard Hurst, The Growth of American Law−−The Law Makers 329−330 (1950) (noting Canon's emphasizing honorable relations between lawyer, client, and fellow lawyers as opposed to lawyer's obligation to maintain "the law.") ; Edison R. Sunderland, History of the American Bar Association and its Work 110−12 (1953) (describing committee appointed to prepare Canon's and their work); Walter Burgwyn Jones, Canons of Professional Ethics, Their Genesis and History , 7 Notre Dame Law. 483 (1932) (analyzing Alabama's adoption of Code of legal ethics, committee's preparatory work, and Code's early effects on courts).] They consisted of thirty−two advisory statements, [*FN:* See Wolfram , supra note 37, at 56.] and attempted to give a uniform standard of conduct to foster the public perception of the legal profession. [*FN:* See id . , supra note 37 at 54. As bar associations became more active in enforcing professional standards through suspensions and disbarments, the Canons became widely regarded as "wholesome standards of professional action" or as "guidelines" for lawyers to follow. See id. at 55; s ee also *In re* Kuzman, 335 N.E.2d 210, 212 (Ind. 1975) (stating Canons of Professional Ethics "evidence proper standards of legal conduct for legal profession.") (citing Tokash v. State, 115 N.E.2d 745 (1953)).] Specifically, Canon 6 defined that which constituted representation of conflicting interests:

[i]t is unprofessional to represent conflicting interests except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this Canon, a lawyer represents conflicting interests when on behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose. [*FN:* See Canons of Professional Ethics Canon 6.]

This is a fundamental approach, and lays out a rudimentary foundation for determining conflicts of interest. [*FN:* See Wolfram, supra note 37, at 56 (explaining Canons, aside from historical importance, served as forerunner to present day Model Code and Model Rules).]

The Canons of Professional Ethics were superseded in 1969 by the Model Code of Professional Responsibility. [*FN:* See id . Adoption of the Model Code of Professional Responsibility was necessitated because the Canons were viewed as vague and outdated. The change was initiated by the president of the American Bar Association and future Supreme Court Justice Louis F. Powell Jr. *Id.* For an examination of the adoption of the 1969 Code, see Sutton, Introduction to Symposium−−The American Bar Association Code of Professional Responsibility, 48 Tex. L. Rev. 255 (1970).] In contrast to the Canons, the Model Code was adopted quickly in a great majority of states. [*FN:* See Wolfram, supra note 37, at 56.] However, the Model Code soon became controversial and less stable than the Canons. [*FN:* See id. at 57 (noting Code amendments every year from 1974 to 1980).] The Model Code is still followed today in several states even though it continues to be controversial. [*FN:* See infra note 48 and accompanying text .]

One very significant and controversial provision is contained in Canon 9 of the Model Code, [*FN:* See Model Code of Professional Responsibility Canon 9 (1980).] which states that an attorney should avoid the "appearance of impropriety." [*FN:* See id .] This vague standard has been especially problematic in courts' interpretation of section 327. [*FN:* See H & K Developers v. Waterfall Village of Atlanta, Ltd. (*In re* Waterfall Village of Atlanta, Ltd.), 103 B.R. 340, 344 (Bankr. N.D. Ga. 1989) (recognizing Canon 9 as source for strict standard used by some bankruptcy courts in deciding conflict of interest issues). Several bankruptcy decisions have used the Canon 9 standard in finding that a conflict existed. See, e.g.,*In re* Ira Haupt, 361 F.2d 164, 168 (stating the "conduct of bankruptcy proceedings not only should be right, but must seem right"). Courts and commentators alike have criticized the indiscriminate use of Canon 9. See International Elecs. Corp. v. Flanzer, 527 F.2d 1288, 1295 (2d Cir. 1985) (cautioning Canon 9 should not be used "promiscuously as a convenient tool for disqualification"); Board of Educ. v. Nyquist, 590 F.2d 1241, 1247 (2d Cir. 1979) (criticizing application of Canon 9 as "too slender a reed on which to rest a disqualification order except in the rarest of cases."); see also Wunnicke, supra note 2, § 4.5 at 54 (1987) (criticizing Canon 9 as not adequately guiding the practicing lawyer); Victor H. Kramer, The Appearance of Impropriety Under Canon 9: A Study of the Judicial Process Applied to Lawyers , 65 Minn. L. Rev . 243, 264 (1980) (criticizing Canon 9, stating it "has developed into a source of unpredictable post hoc rule−making regarding the standards of professional conduct").] Those adopting Canon 9 generally apply a very strict standard, holding that all conflicts of interest, actual or potential, lead to disqualification.

The Model Code was criticized for failing to provide relevant guidance for many problems actually faced by practitioners. [*FN:* See J. Auerbach, Unequal Justice 286, 288 (1976).] The perceived defects in the Model Code were

sufficiently severe [*FN:* The Model Code's discussion of conflicts of interest is arguably overbroad, stating that "[a] lawyer shall decline proffered employment if the exercise of his independent professional judgment on behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve him in representing differing interests." Model Code of Professional Responsibility DR 5−105a (1980).] to cause the ABA leadership to call for its thorough review. [*FN:* See William B. Spann, Jr., The Legal Profession Needs a New Code of Ethics, ABA Bar Leader Nov./Dec. 1977. (Spann, the author, was the ABA president). Wolfram supra note 37, at 60 n.70; s ee also The Legislative History of The Model Rules Of Professional Conduct: Their Development In The ABA House Of Delegates (1987) [hereinafter Legislative History] at V. (noting "piecemeal amendment of ABA Model Code . . . would not sufficiently clarify the profession's ethical responsibilities in light of changed conditions").] This led to the eventual adoption of the Model Rules of Professional Conduct in 1983. [*FN:* See Wunnicke, supra note 2 at 2. The stated purpose of the transformation from the Model Code to the Model Rules was a "comprehensive review of the ethical premises of the legal profession." *Id.* at 3 n.5; See also ***In re*** Roberts, 46 B.R. 815, 837 (Bankr. D. Utah 1985) (stating Model Rule attempted to "delineate areas of conflict left vague or unstated in the present Canons, ethical considerations,. and disciplinary rules."); aff'd in part, modified in part, rev'd in part, 75 B.R. 402 (D. Utah 1987). See generally Legislative History, supra note 51 (tracing development of Model Rules).]

The Model Rules' discussion of conflicts of interest is contained in Rule 1.7, and is significantly narrower than the Model Code, [*FN:* See*In re* McKinney Ranch Assocs., 62 B.R. 249, 253−54 (Bankr. C.D. Cal. 1986) (recognizing Rule 1.7 as a narrower view of conflicts than the Model Code's provisions).] essentially limiting it to representation that is "directly adverse" to another client or that is "materially limited" by representation of another client. [*FN:* Model Rules of Professional Conduct Rule 1.7 (1983) states: (a) a lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless: (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and (2) each client consents after consultation. (b) a lawyer shall not represent a client if the representation of that client may be materially limited by the lawyers responsibilities to another client or to a third person or by the lawyer's own interest, unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved . *Id.*] Furthermore, the Model Rules essentially eliminated the controversial Canon 9 "appearance of impropriety" standard, [*FN:* See McKinney Ranch , 62 B.R. at 257 (stating Model Rules have abandoned "appearance of impropriety" standard because it is unworkable).] a change that met approval by both the courts and commentators. [*FN:* See R. Craig Smith, Note, Conflicts of Interest Under the Bankruptcy Code: A Proposal to Increase Confidence in the Bankruptcy System, 8 Geo. J. Legal Ethics 1045, 1056 (1995) (discussing approval of Model Rules' rejection of Canon 9).]

Today, lawyers are subject to the applicable rules of professional ethics in their respective states. These are either based upon the Model Code or the Model Rules. [*FN:* A majority of states have based their ethical rules on the Model Rules. See William I. Kohn & Michael P. Schuster, Deciphering Conflicts of Interest in Bankruptcy Representation, 98 Com. L. J. 127, 127 (1993) (explaining that a majority of states have adopted the model rules, although the actual versions may differ). See also Michael Sacksteder, Formal Opinion 95−390 of the ABA's Ethics Committee: Corporate Clients, Conflicts of Interest, and Keeping the Lid on Pandora's Box, Nw. U. L. Rev . 741, 743 n. 12 (1997) (stating that presently, the majority of states have adopted in some form the American Bar Association's Model Rules of Professional Conduct). The following 36 states have adopted amended versions of the Model Rules: Alabama Alaska Arizona Arkansas Colorado Connecticut Delaware Florida Hawaii Idaho Indiana Kentucky Kansas Louisiana Maryland Michigan Minnesota Mississippi Missouri Montana Nevada New Hampshire New Jersey New Mexico North Dakota Oklahoma Pennsylvania Rhode Island South Carolina South Dakota Texas Utah Washington West Virginia Wisconsin Wyoming ***Id.*** The District of Columbia also has adopted an amended version of the Model Rules. ***Id.*** Furthermore, New York, Oregon and Virginia have amended versions of the Model Code that incorporate portions of the Model Rules. ***Id.*** at n. 13. Illinois uses the structure of the Model Rules, and incorporates portions of both the Model Rules and Model Code. ***Id.*** North Carolina's ethics code incorporates structure and substance from both the Model Code and the Model Rules, and California relies on neither the Model Code nor the Model Rules. *Id.*] These rules have often been used as guidelines when courts interpret

section 327. [*FN:* See *In re* Marine Power & Equip. Co., 67 B.R. 643, 654 (Bankr. W.D. Wash. 1986) (stating anti−conflict provisions in Bankruptcy Code "find their counterparts in the codes of professional responsibility that govern the practice of law generally"); Marsha L. Goldstein et. al., Ethical Considerations for Bankruptcy Professionals: Disinterestedness, Conflicts of Interest, and Retainers, C995 Ali−Aba 397, 426 (1995) (stating "many bankruptcy courts have analyzed conflict of interest issues with respect to the relevant provisions of both the Bankruptcy Code and the Model Code"). Consider, however, that "a violation of professional ethics does not in any event automatically result in disqualification of counsel." W.T. Grant & Co. v. Haines 531 F.2d 671, 677 (2d Cir. 1976).] Those courts using the Model Code usually find that potential conflicts are disabling, due to the "appearance of impropriety" that is inherently created, while courts using the Model Rules generally find that only actual conflicts are disabling. This variance in ethical rules is a primary reason why courts have differed in their interpretations of section 327(a). [*FN:* See Smith, supra note 56, at 1059 (noting tension between approaches of Model Code and Model Rules is illustrated in bankruptcy courts' varied interpretations of section 327).]

III. Potential v. Actual Conflicts of Interest

A. Case Law−−The Unclear Interpretation in the Nation's Bankruptcy Courts

When discussing whether an attorney representation will cause a conflict of interest in violation of section 327, an obvious question is whether it must be an actual, or merely a potential conflict of interest. Because the Bankruptcy Code provides very little guidance, courts have had problems determining which conflicts will disqualify an attorney. [*FN:* See Ashby, supra note 31, at 440 (explaining courts have had difficulty determining what conflicts disqualify because Code provides very little guidance); 3 Daniel R. Cowans, Bankruptcy Law and Practice 6th ed. 360, 365 (1994) (explaining conflicts of interest issues are problematic for both attorneys and courts and line between actual and potential conflicts is not always clear).] Courts have therefore resolved this issue in different ways. [*FN:* See*In re* Leslie Fay Cos., 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (discussing differences in courts' interpretations of § 327);*In re* Grabill Corp., 113 B.R. 966, 970 (Bankr. N.D. Ill. 1990) (noting split of authority among courts over whether distinctions should be drawn between actual and potential conflicts of interest); s ee also Asbhy, supra note 31, at 438−39 (discussing ambiguous statutory framework of § 327(a) and differing interpretations employed by courts); Smith, supra note 56, at 1049 (noting existence of confusion in applying standards to bankruptcy conflicts of interest).] There are two main classifications of cases in this area: (1) those that disqualify an attorney only for actual conflicts of interest, and, (2) those that disqualify for either actual or potential conflicts of interest. [*FN:* Note that under either of these formulations, an actual conflict is always disabling. See supra note 34 and accompanying text.] This note will also discuss a recent Southern District of New York case which attempts to rectify this situation, *In re Leslie Fay.* [*FN:* Leslie Fay , 175 B.R. at 533 (proposing test that asks whether interest would cause attorney to "act any differently").]

1. Only Actual Conflicts are Disqualifying

The position of these cases is that potential conflicts of interest are not disabling, only actual conflicts are. These decisions either reject Canon 9's "appearance of impropriety standard" [*FN:* See, e.g., Board of Educ. v. Nyquist, 590 F.2d 1241, 1247 (2d Cir. 1979) (criticizing application of Canon 9 as "too slender a reed on which to rest a disqualification order except in the rarest of cases.").] or restrict its reading. [*FN:* See H & K Developers v. Waterfall Village of Atlanta, Ltd. (*In re* Waterfall Village of Atlanta, Ltd ,), 103 B.R. 340, 344 (Bankr, N.D. Ga, 1989) (discussing cases that have interpreted Canon 9 flexibly).] *In re Stamford Color Photo Inc.* [*FN:* 98 B.R. 135 (Bankr. D. Conn. 1989).] relied on the Model Rules, and overruled an objection to an attorney due to the lack of an actual conflict of interest. The court stated that "merely hypothesizing that conflicts may arise is not a sufficient basis to warrant [disqualification]." [*FN:* See id. at 138.] The court set forth a test for determining which conflicts are disabling, stating that "a court must balance the right to freely choose counsel, the need to maintain ethical standards, the interests of justice, evidence of actual impropriety, and its own ability to continuously control its officers and use the remedy of disqualification if called for." [*FN:* See id. at 137 (citing Central Milk Producers v. Sentry Food Stores Inc., 573 F.2d 988, 993 (8th Cir. 1978); Emle Indus. Inc. v. Patentex Inc., 478 F.2d 562, 564−65 (2d Cir. 1973); Fisher Studio Inc. v. Lowe's Inc., 232 F.2d 199, 204 (2d Cir. 1956)).]

Another often−cited case that evokes the "actual only" view is *H & K Developers v. Waterfall Village of Atlanta, Ltd*. (*In re Waterfall Village of Atlanta, Ltd.)*, [*FN:* 103 B.R. 340 (Bankr. N.D. Ga. 1989).] which rejected a strict reading of Canon 9, and held that while a retained attorney had potential conflicts of interest, there was no actual conflict of interest, and thus no reason for disqualification. [*FN:* See id. at 345 (stating "[t]here has been no showing of an actual conflict of interest or display of undivided loyalties on the part of [the law firm]"). The court recognized the "two prong" test of the 11th Circuit, which looks to (1) whether there is a reasonable possibility that some specifically identifiable impropriety (actual conflict) occurred ; and (2) if likelihood of public suspicion outweighs the social interest in the attorneys continued representation in the case. *Id.* at 344 (citing Woods v. Covington County Bank, 537 F.2d 804 (5th Cir. 1976)).] In *In re Martin*, [*FN:* See 817 F.2d 175 (1st Cir. 1987).] the 1st Circuit also employed a test whereby actual conflicts of interest were disqualifying, but potential conflicts alone were not, [*FN:* See id. at 182.] stating that "horrible imaginations alone cannot be allowed to carry the day . . . [n]ot every conceivable conflict must result in sending counsel away to lick his wounds." [*FN:* See id. at 183.]

2. Either Actual or Potential Conflicts are Disqualifying

This line of cases serves to disqualify counsel for an actual or a potential conflict of interest. The rationale for this approach is largely grounded in Canon 9's appearance of impropriety" standard. [*FN:* Model Code of Professional Responsibility Canon 9 (1980) (providing that "[a] lawyer should avoid even the appearance of impropriety"); Waterfall Village , 103 B.R. at 344 (explaining rationale for the "strict constructionist rule" is grounded in Canon 9).] A similar rationale is embodied in the policy

behind Canon 9 which is to improve public confidence in the system. [*FN:* See*In re* CF Holding Corp, 164 B.R. 799, 808 (Bankr. D. Conn. 1994) (stating that the "general concerns of the Code and the courts to promote public confidence in the integrity of the bankruptcy system are compelling reasons to apply a prophylactic rule in considering the extent of the fiduciary duties of an attorney for a debtor in possession").]

In *In re BH & P, Inc.* [*FN:* 949 F.2d 1300 (3d Cir. 1991).] the court employed a rebuttable presumption that a potential conflict of interest is in fact disqualifying. [*FN:* See id. at 1312−13.] In *In re Roger J. Au & Son,* [*FN:* 64 B.R. 600 (N.D. Ohio 1986).] the court utilized a per se rule, finding both actual and potential conflicts to be disqualifying. [*FN:* See id. at 605.] In *Shaw & Levine v. Gulf & Western Indus. Inc., (In re Bohack)* [*FN:* 607 F.2d 258 (2d Cir. 1979).] the court held that an actual conflict of interest was not a prerequisite to disqualification, but rather concerned itself with the potential manifestation of the conflict. [*FN:* See id. at 263.] In *In re Codesco* [*FN:* 18 B.R. 997 (Bankr. S.D.N.Y. 1982). While the Codesco court did present a strict view regarding potential conflicts of interest, it nevertheless found that there were no grounds to disqualify counsel. *Id.* at 1001.] the court recognized that both potential and actual conflicts are disabling. [*FN:* See id. at 999 (stating "there should be no opportunity for the existence of conflicting interests . . .").] This was based on the Canon 9 standard. [*FN:* See id. at 999 (stating "[t]here is no question that the purpose of the incorporation of the disinterested requirement in 11 U.S.C. [section] 327 was to prevent even the appearance of a conflict irrespective of the integrity of the person or firm under question.").] The court reasoned that disinterestedness requires that a professional be "divested of any scintilla of personal interest which might be reflected in his decision concerning estate matters." [*FN:* See id. at 999.] The 10th Circuit has recognized that attorney representation of potential targets for the recovery of assets of the bankruptcy estate warrants disqualification. [*FN:In re* Interwest Bus. Equip. Inc. 23 F.3d 311 (10th Cir. 1994). The court quoted*In re* McKinney Ranch Assocs., 62 B.R. 249 (Bankr. C.D. Cal. 1986): "It is the duty of counsel for the debtor in possession to survey the landscape in search of property of the estate, defenses to claims, preferential transfer's, fraudulent conveyances and other cause of action that may yield a recovery to the estate. The jaundiced eye and scowling mien that counsel for the debtor is required to cast upon every one in sight will likely not fall upon the party with whom he has a potential conflict. . . ." *Id.* at 254.] *In re Kendavis Indus. International Inc.* [*FN:* 91 B.R. 742 (Bankr. N.D. Tex. 1988).] went a step further, finding that "[t]he concept of potential conflicts is a contradiction in terms. Once there is a conflict, it is actual − not potential." [*FN:* See id at 754.]

The appearance of impropriety standard as set out in Canon 9 is the primary justification driving this line of case law. While focusing on the possibility of conflict, the courts tailor their reasoning in prophylactic terms, concerned with potential harm to the estate. Although forward looking in its logic, the courts, reliance on the appearance of impropriety standard is too obscure a standard to deal realistically with ethical problems faced by bankruptcy practitioners.

3. The "Leslie Fay" test

A recent bankruptcy case decided in the Southern District of New York attempted to shed some light on this convoluted issue. [*FN:In re* Leslie Fay Cos., 175 B.R. 525 (Bankr. S.D.N.Y. 1994). This case was not only observed closely by members of the bankruptcy profession, but also attracted the attention of the media. See, e.g., Laurence Zuckerman, Judge Assails Lawyers for Leslie Fay, N.Y. Times, Dec. 16, 1994, at D1; Frances A. McMorris, Weil Denies Conflict in Leslie Fay Case, Wall St. J., Nov. 4, 1994, at B3.] *In re Leslie Fay Cos., Inc.* [*FN:* 175 B.R. 525.] involved Leslie Fay, a major American clothing manufacturer, that filed for bankruptcy under chapter 11. Weil Gotshal & Manges, a large New York law firm, [*FN:* Weil, Gotshal & Manges ranks among the top ten New York Law firms in stature, size, and profits per partner, and is best known for its bankruptcy department, which is considered "one of the best in the country." See Shelia V. Malkani & Michael F. Walsh, The Insider's Guide To Law Firms 436 (2d. ed. 1994); See also Laurence Zuckerman, Leslie Fay's Lawyers Deny Wrongdoing, N.Y. Times , Nov 4, 1994, at D3 (describing Weil Gotshal as the fourth richest law firm in the country in 1993).] represented the debtor in prepetition and subsequent proceedings. [*FN:* Leslie Fay Cos ., 175 B.R. at 527.] Weil Gotshal had originally been retained to assist the audit committee of Leslie Fay, which was investigating possible fraud in the company. [*FN:* See id. at 529.] An independent examiner appointed at the behest of Leslie Fay, and approved by the creditors committee, found that Weil Gotshal had failed to disclose its relationships with parties who had an interest in the audit committee findings, and that Weil Gotshal also failed to disclose that it had represented one of Leslie Fay's largest creditors. [*FN:* See id.] Due to these conflicts, the U.S. Trustee moved to have Weil Gotshal disqualified on the grounds that they failed to meet the disinterested requirements of section 327. [*FN:* The U.S. Trustee believed that Weil Gotshal's "lack of disinterestedness called the integrity of the Audit Committee's investigation into question, regardless of how thoroughly the investigation was actually performed." See *Id.* at 531.] The court held that Weil Gotshal had failed to disclose potential conflicts of interest [*FN:* See id. at 533−38.] under Rule 2014 [*FN:* Fed. R. Bankr. P. 2014 .] warranting monetary sanctions, but not disqualification. [*FN:In re* Leslie Fay Cos. Inc. 175 B.R. 525 at 538−39 (Bankr. S.D.N.Y. 1994). The Leslie Fay court, having found, "non−disclosure aside, Weil Gotshal had performed the

investigation properly," imposed sanctions, not disqualification. See id. at 539. See also *In re* Stamford Color Photo Inc., 98 B.R. 135 (Bankr. D. Conn. 1989) (stating "counsel should be disqualified when a conflict casts some doubt as to the vigor with which he or she will represent the client's interest or when the attorney is in a position to use privileged information gained through prior representation of a party opponent." See id. at 137 (emphasis added); General Elec. Co. v. Indus. Prod. Inc., 683 F. Supp 1254, 1258 (N.D. Ind. 1988) (explaining "the 7th Circuit first stresses that disqualification is a drastic measure which should not be imposed unless absolutely necessary . . . [m]oreover, motions for attorney disqualification must be reviewed with extreme caution to avoid their misuse as techniques for harassment").]

In discussing Weil Gotshal's potential conflict, the court detailed a comprehensive analysis of section 327(a) of the Bankruptcy Code. [*FN:* See 11 U.S.C. § 327(a) (1994).] In examining the two prong analysis of section 327, [*FN:* The two prong test is the same as that which is discussed supra , (1) that the attorney does not hold or represent an interest adverse to the estate and (2) that the attorney is disinterested. Leslie Fay., 175 B.R. at 530.] the court recognized the "single hallmark" theory of *In re Martin.* [*FN:* See id. (recognizing "the twin requirements of disinterestedness and lack of adversity telescope into what amounts to a single hallmark") (quoting *In re* Martin, 817 F.2d 175, 181 (1st Cir. 1987)).] The court approached the issue by acknowledging the current split of authority in the bankruptcy courts. [*FN:* See id. at 532 (noting that courts have been "far from uniform in their analysis of section 327).] In explaining the debate over potential versus actual conflicts of interest, the court formulated its own test. The court explained that if the representation of another interest could plausibly cause the debtor's attorney to act any differently, then there would be a conflict of interest adverse to the estate. [*FN:* The court explained that it is more productive to ask whether a professional has "either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors− an incentive sufficient to place those parties at more than acceptable risk or reasonable or the reasonable perception of one" [or] "[i]n other words, if it is plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that other representation, then they have a conflict and an interest adverse to the estate." *Id.* at 533.]

While acknowledging that "courts have generally declined to formulate a bright−line test" [*FN: Id.* (citing*In re* Garza, 1994 WL 282570 *2 (Bankr. E.D. Va. Jan. 19, 1994)).] the *Leslie Fay* test runs into the same problems as the majority of other courts, as the test it proposes is somewhat vague. While seemingly clear and concise on the issue, this result may fail to accomplish section 327(a)'s ultimate goal, which is to ensure loyalty and untainted advice to the debtor. [*FN:* See supra note 13 and accompanying text (explaining assuring loyalty to client is one of main policy reasons behind section 327(a)).]

There may be instances when the representation of another interest does cause the attorney to act differently, yet still remain in the best interests of the estate. [*FN:* This is evidenced in the Leslie Fay case, where the creditor's committee wanted Weil Gotshal to remain as counsel for the debtor. See id., 175 B.R. at 531.] The goals of loyalty and untainted advice may still be accomplished although not meeting the *Leslie Fay* standard. In its reasoning the court does not take into account the specific facts that drive every case. [*FN:* See Harold & Williams Dev. Co. v. U.S. Trustee (*In re* Harold & Williams Dev. Co.), 977 F.2d 906, 909−10 (4th Cir. 1992) (stating courts should not "abdicate the equitable discretion granted to them by establishing rules of broad application which fail to take into account the facts of a particular case and the overall objectives of the bankruptcy system.") (Citations omitted).] Attention to specific facts should temper this rigid rule into a more flexible application. The *Leslie Fay* test may create more uncertainty in an area of the law that is already hard to predict. With attorneys fees and numerous hours of work at risk, the need for predictability and stability are paramount. The proposed model will attempt to bridge the gap between what has become a morass of uncertainty and statutory vagueness. A standard that ensures predictability is the only standard that can help protect and serve the interests of the debtor.

IV. Proposed Model

The use of the standard set forth under section 327 has caused problems for attorneys in that it has led to unfair sanctions and disqualifications. [*FN:* See Gerald K. Smith , House of Delegates Recommendation , 1991 A.B.A. Sec. Bus. L. Rep . 8 [hereinafter " ABA Recommendation "] (noting that use of disinterestedness standard has led to disqualification of attorneys after they have spent considerable time and money on the case); Jay Lawrence Westbrook, Fees and Inherent Conflicts of Interest, 1 Am. Bankr. Inst. L. Rev . 287, 303 (1993) (recognizing that overbroad rules applied to ethical issues are unfair to attorneys).] Other proposed standards might give too much discretion to the courts, which could lead to inconsistent results. [*FN:* See Leslie Fay 175 B.R. at 539; see also*In re* Flanigan's Enters. Inc., 70 B.R. 248, 254 (Bankr. S.D. Fla. 1987) (citing Hon. John D. Ayer, How to Think About Bankruptcy Ethics, 60 Am. Bankr. L. J. 355 (proposing a "smell test")).] Furthermore, disqualification motions under sections 327 and 328 are subject to abuse by creditors. [*FN:* See *In re* Roberts, 46 B.R. 815, 846 (Bankr. D. Utah 1985) (stating that attorneys use disqualification motions for strategy reasons), aff'd in part, modified in part, rev'd in part, 75 B.R. 402 (D. Utah 1987); Hassett v. McColley (*In re* O.P.M. Leasing Servs. Inc.), 16 B.R. 932, 934 (Bankr. S.D.N.Y. 1982) (noting attorneys sometimes divert focus of litigation from merits of case for tactical and psychological advantage);*In re* Iorizzo, 35 B.R. 465, 469 (Bankr. E.D.N.Y. 1983) (recognizing use of disqualification motions for tactical reasons); Westbrook, supra note 108, at 289 (recognizing

adversary parties bring conflict of interest challenges to gain a tactical advantage); see also Model Rules of Professional Conduct Rule 1.7 cmt. 15 (1983) (explaining courts should cautiously assess an objection based on conflict issues due to potential for misuse).]

Today, with huge law firms such as Weil, Gotshal [*FN:* See supra note 91 (discussing prominence of Weil, Gotshal & Manges).] handling megabankruptcy matters, [*FN:* See Westbrook, supra note 108, at 288 (explaining bankruptcy has recently become part of large firm practice and these firms are inherently more suspect to conflicts in conducting debtor work); William H. Gindin, Professionals in Bankruptcy Proceedings; Appointment, Right to Compensation and Conflicts of Interest, 21 Seton Hall L. Rev. 895, 913 (1991) (noting larger firms have larger client bases, leading to more potential conflicts). Another consideration is the recent trend where units of law firms move to other law firms. See id. at 915. Thus, if the bankruptcy department of one firm moves to another, a whole new area of conflicts could develop. See id.] it is very unlikely, if not impossible, for conflicts of interest not to exist. [*FN:* See *In re* Flanigan's Enters Inc., 70 B.R. 248, 250 (Bankr. S.D. Fla. 1987) (stating "[u]nlike other forums and battlefields, where the lines of conflict are clearly drawn, in bankruptcy court, interested parties face proceedings with multiple litigants where parties' interests, positions and relationships may change several times from prefiling to postfiling and even thereafter."); H & K Developers v. Waterfall Village of Atlanta, Ltd., (*In re* Waterfall Village of Atlanta, Ltd.) 103 B.R. 340, 346 (Bankr. N.D. Ga. 1989) (recognizing multi−layering of interests would create potential conflicts of interest for any attorney employed to represent debtor); see also David A. Rosenweig, Sections 327−331−−Attorney Compensation, Annual Survey of Bankruptcy Law (Norton ed., 1994−1995) (recognizing it is fairly common in large law cases for a single law firm to represent multiple related debtors); 3 Collier on Bankruptcy ¶ 327.04[5] (Lawrence P. King ed., 15th ed. rev. 1996) (explaining in large multi−debtor reorganizations, it is commonplace for one large law firm, or a group of law firms, to represent all debtor entities); Warren & Westbrook , supra note 7, at 753 (noting that multiparty environment of chapter 11 negotiations often causes similarly situated parties to become intensely competitive adversaries).] Rules providing that both potential and actual interests are disqualifying can be overbroad. [*FN:* See Westbrook, supra note 108, at 303 (explaining overbroad rules are unfair when applied to inherent ethical problems).] In the same vein, those courts that hold only actual conflicts as disabling could allow a firm to continue, simply because a disastrous situation has not yet occurred. Therefore, the proposal asserts that the dichotomy between actual and potential conflicts should be lessened significantly. While it is admittedly true that actual conflicts are of course more dangerous, potential conflicts can, and often do, rise to the same problematic level and thus should not be easily dismissed.

A. Court Focus

Courts should essentially focus on 2 variables when approaching a conflict of interest problem: [*FN:* While courts should continue to consider the disinterestedness requirement, this Note proposes that the focus should essentially be on the following variables. Compare subsection E, infra, for this Note's proposal to eliminate the disinterestedness standard for counsel for the debtor in possession.] (1) the materiality of the conflict; [*FN:* See Marsha L. Goldstein, et. al., Ethical Considerations for Bankruptcy Professionals: Disinterestedness, Conflicts of Interest, and Retainers , C995 ALI−ABA 397, 444 (1995) (stating some courts have required a showing of materiality of adverse interests before ordering disqualification); *In re* Mahoney, Trocki, & Assoc. Inc., 54 B.R. 823, 827 (Bankr. S.D. Cal. 1985) (stating "the question is not whether a conflict exists, but whether that conflict is materially adverse to the estate, creditors, or equity security holders."); Pierson & Gaylen v. Creel & Atwood (*In re* Consolidated BancShares) 785 F.2d 1249, 1256 (5th Cir. 1986) (remanding for determination of whether simultaneous representation constituted a "legally disabling conflict of interest."); N.S. Garrott & Sons, 63 B.R. 189, 192 (Bankr. E.D. Ark. 1986) (stating "[c]ase law interpreting 11 U.S.C. § 327(c) recognizes that attorneys may have conflicts which are technical and nondisqualifying.").] and (2) the effect of harm that it has had or could have on the estate. [*FN:* See *In re* Watson Seafood & Poultry Co. Inc., 40 B.R. 436, 440 (Bankr. E.D.N.C. 1984) (noting a bankruptcy court is court of equity, and the judge should not be bound by inflexible rule mandating denial of fees in all cases where conflict exists) (citation omitted); Model Rules of Professional Conduct Rule 1.7 cmt. [4] (1983) (stating "the critical questions are the likelihood that a conflict will eventuate and , if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client").] If the conflict is material and has had an adverse effect on the estate, then the attorney should have section 328 sanctions imposed. If however, the conflict is either not material, or does not affect the estate, the attorney should be allowed to proceed without sanctions.

The question naturally arises as to what constitutes "materiality." Materiality should be defined to meet the circumstances surrounding a bankruptcy proceeding. For example, many courts have recognized that attorneys will always have a self−interest in the bankruptcy proceeding. Once the ball gets rolling, the lawyer or law firm can become, in essence, a creditor. [*FN:* See *In re* Martin, 817 F.2d 175, 180 (1st Cir. 1987) (explaining attorney becomes a creditor to estate as soon as compensable time is spent on the account); s ee also Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356, 359 (holding law firm that received payment within ninety−day period immediately preceding debtor's filing of chapter 11 petition was a creditor of the debtor).] Thus it is simple to see that any complaint of self−interest would necessarily have to rise above the lawyer's interest in receiving compensation in order to qualify as "material." Likewise, the Bankruptcy Code recognizes in section 327(c) [*FN:* See 11 U.S.C. § 327(c) (1994).] that a professional is not disqualified solely because of representation of a creditor in another matter. [*FN:* See id .] Materiality should therefore be defined as interest that is

reasonably likely to cause significant harm to the estate.

It is for this reason that this proposal contains a two part test to determine whether an interest is matereial: (1) Does the interest serve to divide the attorney's loyalty to the debtor? Courts have recognized that preserving loyalty of the attorney was the main purpose of section 327(a). [*FN:* See supra note 13 and accompanying text; see also Wolfram, supra note 37, at 324 (stating (1) "conflicts of interest problems should become ethical violations only at the point at which a reasonable probability of material impairment of loyalty or confidentiality exists" and (2) conflict of interest questions should be applied with "keen attention to the discrete policy and other concerns that inform the rules on the particular subject").] (2) Does the interest harm the creditors' claims to their interests? In analyzing this, courts must look to exactly what the creditors' claims are, and focus on the totality of circumstances and determine what interests are being infringed upon.

B. Equitable Solution

The proposed solution is consistent with basic principles of equity. [*FN:* See*In re* Briggs Transp. Co., 780 F.2d 1339, 1343 (8th Cir. 1985) (recognizing that "[e]ssential to any analysis of the meaning of and policy behind any section of the bankruptcy code is the recognition that a bankruptcy code is a court of equity. Bankruptcy courts do not read statutory words with a computer's ease, but operate under the overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction.").] Under section 105(a) of the Bankruptcy Code [*FN:* 11 U.S.C. § 105(a) (1994).] a bankruptcy court is allowed to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." [*FN:* See id.; Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206−07 (1988) (discussing equity role of Bankruptcy Court); Wasserman v. Immormano (*In re* Granger Garage), 921 F.2d 74, 77 (6th Cir. 1990) (discussing section 105(a)); Thomas M. Devaney, Comment, The Klein Sleep Decision: Section 502(b)(6) Lease Damages Cap as the Rule, Not the Exception, 4 Am. Bankr. Inst. L. Rev . 557, 578−79 (1996) (suggesting section 105(a) be used to control administrative expense claims for future damages).] Since it has been recognized that the goal of section 327(a) is "undivided loyalty and untainted advice", [*FN:* See supra note 13 and accompanying text (explaining that assuring loyalty is a main policy reason behind section 327(a); Carlos J. Cuevas, Bankruptcy Code Section 105(a) Injunctions and State and Local Administrative and Civil Enforcement Proceedings , 4 Am. Bankr. Inst. L. Rev . 365, 372 (1996) (stating that section 105(a) should only be used in a manner consistent with other Code provisions).] use of the proposed method is consistent with the powers granted under section 105(a). [*FN:* See Cuevas, supra note 125, at 372 (stating that section 105(a) should only be used in manner consistent with other Code provisions). This reading of section 105(a) runs into a potential problem when viewed in light of Childress v. Middleton Arms, L.P., (*In re* Middleton Arms, L.P.) , 934 F.2d 723 (6th Cir. 1991). In this case, the court held that "section 105(a) cannot be used to circumvent the clear directive of section 327(a)." *Id.* at 725. Section 327(a), however, appears to be extremely ambiguous. The crux of this section is that a professional cannot hold a "materially adverse interest" to the estate, yet the Bankruptcy Code fails to define "materially adverse interest." See Electro−Wire Prods. Inc. v. Sirote & Permutt, P.C. (*In re* Prince), 40 F.3d 356, 361 (11th Cir. 1994) (discussing lack of Code definition for "interest materially adverse to the estate").]

C. Rejection of the Canon 9 "Appearance of Impropriety" Standard

Another goal of this approach is to escape the standards that have focused on the "appearance of impropriety" that is set forth in Canon 9 of the Model Code. [*FN:* Model Code of Professional Responsibility Canon 9 (1980); See Wunnicke , supra note 2, at 54 (discussing vagueness of Canon 9). Note that all attorneys are subject to the rules of their respective state bars concerning ethical conflicts, which are based upon either the Model Code or the Model Rules. Stephen Gillers & Roy D. Simon, Regulation of Lawyers, Statutes and Standards 3 (1996). The Model Rules take a narrower approach towards conflicts of interest problems than the Model Code. *In re* McKinney Ranch Assocs., 62 B.R. 249, 253 (Bankr. C.D. Cal. 1986).] Canon 9 is problematic, as its focus is centered on something as innocuous as "appearance," [*FN:* See Emle Indus. Inc. v. Patentex Inc., 478 F.2d 562, 564−65 (2d Cir. 1973) (stating that "ethical problems cannot be resolved in a vacuum").] and is quite ambiguous. [*FN:* See Edna Celan Epstein, et al., Conflicts of Interest: A Trial Lawyer's Guide (1984) (recognizing that Canon 9 takes as a point of reference the ethical preconceptions of the disinterested observer); s ee also*In re* Royal Bedding Co., 42 B.R. 257, 261 (Bankr. W.D. Pa. 1984) (interpreting Canon 9 as utilizing an "eye of the beholder" test).] As such, Canon 9 has been heavily criticized, [*FN:* See supra notes 46−52 and accompanying text (discussing criticism of the Canon 9 "appearance of impropriety" standard).] and has been superseded by the Model Rules in a majority of states. [*FN:* See supra note 57.] Although some states still employ the Model Code and Canon 9, [*FN:* See, e.g.,*In re* Caldor Inc. 193 B.R. 165, 181 (Bankr. S.D.N.Y. 1996) (noting that Canon 9 appearance of impropriety standard is applicable in New York);*In re* Sauer, 191 B.R. 402, 409 (Bankr. D. Neb. 1995) (noting that Canon 9 appearance of impropriety standard is applicable under Nebraska law); s ee also supra note 57 (listing jurisdictions that apply the Model Rules).] bankruptcy is a creature of the federal courts, [*FN:* See U.S. Const . art. I, § 8, cl. 4 (preempting Field of Bankruptcy).] and the regulation of ethics should be uniform throughout. [*FN:* See MSR Exploration, Ltd. v. Meridian Oil Inc. 74 F.3d 910, 914 (9th Cir. 1996) (stating need for uniform laws in bankruptcy and power of Congress to provide); see also 2 Joseph Story, Commentaries on the Consitution of the United States § 1107 (2d ed. 1851) (stating reasons for conferring bankruptcy power upon the United States "result from the importance of preserving harmony, promoting justice, and securing

equality of rights and remedies among the citizens of all the states").] Bankruptcy practitioners in the 9th Circuit should adhere to the same ethical requirements as the 2nd Circuit and vice versa. A consistent standard encompassing all Bankruptcy Courts is the best way to ensure a predictable and successful approach to conflicts of interest in bankruptcy representation.

The Note thus proposes that the outdated Canon 9 should no longer dictate bankruptcy policy, and the "appearance of impropriety" standard should, at last, be laid to rest. [*FN:* See WT Grant & Co. v. Haines 531 F.2d 671, 677 (2d Cir. 1976)) (stating that "a violation of ethics does not in any event automatically result in disqualification of counsel"); s ee also Central Milk Producers Cooperative v. Sentry Food Stores Inc. 573 F.2d 988, 991 (8th Cir. 1978) (noting violation of ethical guidelines does not necessarily warrant disqualification of counsel); General Elec. Co. v. Industra Prods. Inc. 683 F. Supp. 1254, 1258 (N.D. Ind. 1988) (recognizing disqualification is a drastic measure not to be imposed unless absolutely necessary).] In its place, the Model Rules on ethics should be followed. [*FN:* See Smith, supra note 56 (proposing Congress amend section 327 to incorporate Model Rules).]

D. Elimination of the Actual−Potential Dichotomy

Furthermore, this standard will end the frustration of the actual−potential dichotomy. While this proposed solution follows the *Leslie Fay* [*FN:In re* Leslie Fay Cos., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).] approach of essentially eliminating the actual−potential issue, it is stronger in that it is more predictable than the standard set forth in *Leslie Fay* which asks whether the representation will cause the attorney to "act any differently." [*FN:* See id. at 533.]

E. Elimination of the Disinterestedness Standard for Counsel for the Debtor

in Possession

The final suggestion of this proposed standard is that the disinterestedness requirement be eliminated for the debtor in possession. This is consistent with the National Bankruptcy Review Commission's view on the matter. [*FN:* See Memorandum from Lawrence P. King & Elizabeth I. Holland to the National Bankruptcy Review Commission (Aug. 22, 1996) (on file with the American Bankruptcy Institute Law Review) [hereinafter Review Commission]. T he proposal contained in this memorandum has been adopted by the Commission as of October 19, 1996.] The legislative history surrounding section 327 suggests that while Congress intended for attorneys working under the trustee to be disinterested, there was no intent for there to be disinterestedness for attorneys employed by debtors in possession. [*FN:* See id at 3 (discussing that imposition of disinterestedness requirement on the attorney for the debtor in possession in chapter 11 cases "seems to have been an error in the original promulgation of the Bankruptcy Code in 1978"); s ee also ABA Recommendation supra note 108, at 7 (noting lack of legislative history suggesting a disinterestedness requirement for counsel for the debtor in possession).] Section 327(a) states that "the *trustee* . . . may employ [persons] that do not hold or represent an interest adverse to the estate and that are disinterested persons, to represent and assist the *trustee* in carrying out the *trustee's* duties." [*FN:* See 11 U.S.C. § 327(a) (1994) (emphasis added).] There is no mention in section 327 that the disinterestedness requirement should also apply to the counsel for the debtor in possession. [*FN:* The source of using disinterestedness for debtor in possession counsel is most likely 11 U.S.C. § 1107(b), which states that "[n]otwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case." 11 U.S.C. § 1107 (b) (1994) (emphasis added). It has been noted that this section was not intended to apply disinterestedness to counsel for the debtor in possession, but rather was intended to negate the possibility that prefiling counsel for the debtor might be considered having a materially adverse interest, and thus be disqualified . See Aba Recommendation, supra note 108, at 7; s ee also Review Commission , supra note 139, at 3 (noting that imposition of disinterestedness standard on attorney for debtor in possession seems to have been error in original promulgation in Code).] Furthermore, the precursor to the Bankruptcy Code, the Bankruptcy Act, did not require that counsel for a debtor in possession be disinterested. [*FN:* See Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898), amended by Act of June 22, 1938, ch. 575, 52, Stat. 883 (1938) (repealed 1978).] Because this has never been expressly changed, the presumption follows that the rule under the Bankruptcy Act is still valid. [*FN:* A presumption invoked by the Supreme Court is that provisions of the Bankruptcy Act continue unless expressly repealed or modified. Aba Recommendation, supra note 108, at 7. See also Kelly v. Robinson, 479 U.S. 36, 45−48 (1986) (explaining presumption); Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Protection, 474 US 494, 494, 501 (1986) (noting "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.") (citation omitted).] The use of a disinterestedness requirement for attorneys employed by the debtor in possession has resulted in disqualification of counsel in a number of circumstances. [*FN:* See ABA Recommendation , supra note 108, at 8 (stating use of disinterestedness requirement in respect to counsel for debtor has resulted in disqualification in a number of cases); s ee also Review Commission , supra note 139, at 4 (recognizing the inconsistent application of the disinterestedness requirement has lead to wasteful and unnecessary litigation).]

For this reason, this Note proposes that the interpretation should be changed. While a "single hallmark" [*FN:* See supra note 30 and accompanying text.] approach should still be utilized, counsel for the debtor in possession should only be disqualified when they have interests materially adverse to the estate. [*FN:* See Review Commission , supra note 139, at 7 (proposing material adverse interest standard as the "operative threshold" for disqualification of professionals retained by a debtor in possession.); See ABA Recommendation, supra note 108, at 10 (recommending that the Code be amended to provide counsel for the debtor in possession need not be disinterested, but must not hold or represent a materially adverse interest to the estate); s ee also Harold D. Jones, Revising Disinterestedness Standard , Suggestions to Commission and Congress , 4 Am. Bankr. Inst. L. Rev . 527 (Winter 1996) (recommending elimination of disinterestedness standard in employment of professional person representing trustee).] The counsel for the debtor in possession is there to serve the interests of his client, and the broad disinterestedness standard should not be dispositive. [*FN:* See ABA Recommendation, supra note 108, at 9 (explaining counsel for debtor in possession has obligation to follow direction of his own client); s ee also Model Rules of Professional Conduct Rules 1.2(a), 1.4(b), 1.13 (1983) (requiring lawyers to abide by clients' decisions).]

Conclusion

By bringing predictability to section 327 of the Bankruptcy Code, professionals will be better able to provide the debtor with the best possible service, free of future litigation. Moreover, this standard will allow bankruptcy professionals to work free and clear of this disqualifying potential.

In today's market, professionals need more of a concrete approach to business dealings. While understanding the delicate nature of the bankruptcy process, courts should be better equipped with a uniform standard. One which recognizes the many interests that are unique to the bankruptcy process, such as the interests of the debtor, the creditor, and other professionals is necessary. This proposed model would seem to accomplish these goals.

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