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Ethics: Is Disinterestedness Still a Viable Concept? A Roundtable Discussion

Nancy B. Rapoport

University of Nevada, Las Vegas – William S. Boyd School of Law

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ETHICS: IS DISINTERESTEDNESS STILL A VIABLE CONCEPT? A DISCUSSION

INTRODUCTION

The following panel discussion took place on December 7, 1996, at the American Bankruptcy Institute's Winter Leadership Conference. This discussion has been edited for publication in this law review. The editors express their gratitude to Professor Ayer^{*} for moderating this discussion and to all the participants for their time and effort in this project.

PROF. AYER: Most lawyers think that disinterestedness as a requirement in bankruptcy is somewhere between a root canal and a full field audit. What we may be able to do is to provoke some counter-examples this morning, some suggestions that maybe not all lawyers are as right as many lawyers think they are on this issue. To do that, we have, at my immediate right, Professor Nancy Rapoport, who is an Associate Professor of Law and Associate Dean for Student Affairs at The Ohio State University College of Law. To my left is Judge Charles Clevert, a current United States District Court Judge for the Eastern District of Wisconsin and a former Chief Judge of the Bankruptcy Court in that same District. To Judge Clevert's left is Bettina Whyte, who is a partner in charge and national director of the Business Turnaround Services Group at Price Waterhouse. Finally, there is someone with a distinctive career pattern: former Judge Joel Pelofsky was a distinguished private practitioner and is now a distinguished United States Trustee. We thought we would start with Nancy, who has agreed to sketch in the landscape for us.

I. DISINTERESTEDNESS: "ISN'TS" AND "WASN'TS"

PROF. RAPOPORT: What I'm going to do is walk you through a variety of Code provisions that you already know very well, but being as it is early on Saturday morning, we're going to do it again, slowly. First off, the two most important provisions in dealing with disinterestedness are obviously sections 327(a)¹ and 101(14).²

Section 327(a) says that a trustee may employ professional persons who (there are two separate requirements): (1) who don't hold or represent an interest adverse to the estate; and (2) (the mystery provision) who are disinterested persons.³ Then Congress, in its infinite wisdom, attempts to define "disinterestedness" for us in section 101(14) with a bunch of "isn'ts" and "wasn'ts."⁴ The first "isn't" is that a

^{*} Professor of Law, University of California at Davis; Fellow, American College of Bankruptcy.

¹ See 11 U.S.C. § 327(a) (1994) (giving trustee or debtor in possession power to hire disinterested professionals).

² See *id.* § 101(14) (defining "disinterested party").

³ *Id.* § 327(a).

⁴ *Id.* § 101(14).

"disinterested person" is not a creditor, equity security holder, or insider, each of those having their own corresponding definitions;⁵ "isn't" or "wasn't" an investment banker for outstanding securities of the debtor; "hasn't," for the past three years before the petition, been an investment banker for other securities of the debtor; "isn't" or "wasn't" a director, officer, or employee of the debtor nor an investment banker of one of those. Then my personal favorite, the "infinite loop" provision, "does not have an interest materially adverse to the interests of the estate or any class of creditors or equity security holders."⁶ So, go back to 327(a) and the first part is, "doesn't hold or represent an interest adverse,"⁷ and then the bottom part of section 101(14), "doesn't hold an interest materially adverse."⁸ So that would mean "really, really not adverse to the estate."

What we don't really know is what disinterestedness *is*.⁹ We know what it's *not*, because we have the bunch of "isn'ts." We know that, probably, if we wanted to be charitable to Congress, then "disinterestedness" must mean something different from just "not being adverse" or we're back in the "department of redundancy department." But we're really not sure what disinterestedness is. Is it that we want to make sure that disinterested people don't pick particular nits with the estate, or have particular interests? Or does disinterestedness have to be something more than that? If you look at it, you really need to go back into what Congress was trying to do with disinterestedness, because it really wasn't clear here.¹⁰ Is "disinterestedness" a special requirement different from "adverseness" and if so, what is the purpose of it? Is it to keep people looking at the overall fiduciary relationship of what professionals for the estate are supposed to do, or is it a dropped ball? If it's a dropped ball, then what we have are roadblocks to an efficient reorganization. The people who tend to know a whole heck of a lot about what happened aren't going to be able to do anything for the estate if they're disqualified on the grounds of not being disinterested. So if "disinterestedness" is a roadblock, why is it in the Code? These qualms are especially disturbing when you

⁵ See *id.*; see also § 101(10), (17) and (31).

⁶ 11 U.S.C. § 101(14).

⁷ See *id.* § 327(a).

⁸ See *id.* § 101(14)(E).

⁹ See *United States Trustee v. Bloom (In re Palm Cost, Mantanza Shores Ltd.)*, 101 F.3d 253, 257 (2d Cir. 1996) (noting at least two dissimilar interpretations of § 327(a)); *Michel v. Federated Dep't Stores, Inc. (In re Federated Dep't Stores, Inc.)*, 44 F.3d 1310, 1313 (6th Cir. 1995) (balancing risk of potential conflict of appointee with costs to estate and public); 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, 1050 (1995) (noting "definitional hole" in § 327(a)).

¹⁰ See *In re Tinley Plaza Assoc.*, 142 B.R. 272, 277 (Bankr. N.D. Ill. 1992) (noting 11 U.S.C. § 327(a) is reaction to congressional feelings that the bankruptcy system works in favor of attorneys); H.R. REP. NO. 95-595 (1978) reprinted in 1978 U.S.C.C.A.N. 5963, 6053 (describing congressional desire for proper system of checks and balances within Bankruptcy Code); S. REP. NO. 95-989 at 40 reprinted in 1978 U.S.C.C.A.N. 5787, 5826 (relating that professional standards enacted in Code were meant to guard against reoccurrence to prior misdeeds in fee rewards).

look at the fact that, for most of us who do chapter 11 work, we're not dealing with the "trustee" language in section 327(a); we're dealing with debtors in possession under section 1107.¹¹ You've got someone who's wearing the same hat postpetition that the person wore prepetition,¹² but you're saying that the professionals hired for that person can't be the same folks who worked for the DIP prepetition. So my theory is that "disinterestedness" is sort of a combination of the "department of redundancy department" and a roadblock. I'm on the extreme of this position. Who's up next?

PROF. AYER: Okay, well, I can straighten up a couple of things here—no, I'd better leave them for later. To bring us current, we're probably all aware that the ABA Business Bankruptcy Committee structure is moving toward supporting repeal of the "disinterestedness" requirement¹³ and has packaged up some very well-done materials, mostly by Susan Freedman and Gerry Smith from Lewis & Roca, with the cooperation of some other people, maybe several others in the room here. I guess many of us also heard Brady Williamson say yesterday that it is likely that the Commission¹⁴ will recommend the abolition of the "disinterestedness" requirement, at least as it is presently drafted.¹⁵ My intuition is that there are many lawyers, probably most of the people in this room, that think that the Commission has the right view. Well, one person I know who has reservations about that is Judge Clevert, who gets the floor now.

JUDGE CLEVERT: I don't have reservations. I just think—

PROF. AYER: It's wrong. [laughter]

JUDGE CLEVERT: —that it might be a mistake. A big mistake, and I'll tell you a couple of reasons why. If we look back to the political conventions of this year, and some of the rhetoric that came out, it would be clear that there is a

¹¹ Compare 11 U.S.C. § 1107(a) (1994) (giving debtor in possession same duties and rights as trustee), with Paula D. Hunt, *Bankruptcy Examiner Under Section 1104(b): Appointment and Role in Complex Chapter 11 Reorganizations of Failed LBOs*, 70 WASH. U.L.Q. 821 (1992) (remarking how most parties in interest will not request trustee's appointment), and Daniel Klerman, *Earth First? CERCLA Reimbursement Claims and Bankruptcy*, 58 U. CHI. L. REV. 795, 799 (1991) (noting that courts rarely appoint trustees in chapter 11 cases).

¹² See 11 U.S.C. § 1101(1) (1994) (stating that "debtor in possession" means "debtor" except when trustee is serving).

¹³ See Gerald K. Smith, *House of Delegates Recommendation*, 1991 A.B.A. SEC. BUS. L. REP. 8 (discussing repeal of disinterestedness requirement for debtor in possession).

¹⁴ Congress established the National Bankruptcy Review Commission to examine the bankruptcy laws and to make recommendations to Congress on necessary reform. (Pub. L. No. 103-394, 1994 U.S.C.A.N. (108 Stat. 4147) 3340, 3368 (Title VI)).

¹⁵ See *id.*

segment of the public that doesn't like us.¹⁶ They don't trust courts, and they don't trust lawyers. And why? Because they think that we're constantly scratching each other's backs. They think that people will say: "we have a rule and we're going to follow the rule," "wink-wink." And, it is because of that sentiment, that the political types, and in this case, Congress, said "we're going to tell you that you must not have an adverse interest, and we're going to tell you again, in clearer language, that we definitely don't want you to have an adverse interest."¹⁷ Indeed, the "disinterestedness" standard is somewhat redundant, but it clearly says that there is concern about people having clean hands. There is concern about people getting involved in cases where they were once involved with the operations of a debtor who made some mistakes, or a person or company who has, because of some financial misfortune, wound up in chapter 11. Congress recognizes, first of all, that a debtor is somewhat different from a debtor in possession, and that a debtor in possession has not just the interest of the prebankruptcy entity that it must be concerned about, but also the interests of creditors,¹⁸ and the interest of others whose finances they have impacted. I think it's because of the fiduciary obligation that's imposed on a debtor, who is now given some control over its future fate by acting as a debtor in possession, that Congress said, "we want to remind you that, even though you are still in charge of the day-to-day operations of the business, you have an interest other than your own that must be protected." Consequently, when you hire a professional, that professional must not only be a person without an adverse interest, but that person must also be "disinterested."¹⁹ We don't want something to come out of the woodwork that might color the way in which that professional provides advice. Furthermore, we don't want the product of any reorganization to be one that the public, which does have an impact on the judicial process, will frown upon out of a sense that everyone was a bit too cozy. I think that there is some basis for disinterestedness, notwithstanding what the ABA has suggested or what the Bankruptcy Commission may be recommending.²⁰

¹⁶ See Editorial, *Platforms Diverge on Modernizing Government*, WASH. POST, August 28, 1996, at A23 (excerpting from Republican Party platform).

¹⁷ See 11 U.S.C. § 101(14)(E); *id.* § 327(a).

¹⁸ See *Canadian Pacific Forest Prods. v. J.D. Irving Ltd.*, (*In re Gibson Group, Inc.*), 66 F.3d 1436, 1442 (6th Cir. 1995) (finding that debtor in possession has duty to protect assets of estate); *Kremen v. Hartford Mut. Ins. Co.* (*In re J.T.R. Corp.*), 958 F.2d 602, 604-05 (4th Cir. 1992) (describing fiduciary duty that debtor in possession owes creditors); *In re Chapel Gate Apartments*, 64 B.R. 569, 576 (Bankr. N.D. Tex. 1986) (noting, where debtor remains in possession, she administers assets for benefit of creditor body).

¹⁹ See 11 U.S.C. § 327(a) (stating "[t]he trustee, with the court's approval, may employ one or more attorneys. . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons. . ."); see also *Mehdipour v. Marcus & Millchap* (*In re Mehdi-pour*), 202 B.R. 474, 479 (B.A.P. 9th Cir. 1996) (remarking that allowance of compensation rests on professional being disinterested and not holding adverse interests); *Casco N. Bank v. D.N. Assoc.* (*In re D. N. Assoc.*), 3 F.3d 512, 516 (1st Cir. 1993) (upholding lower courts' finding that debtor's counsel was both disinterested and held no adverse interests to estate).

²⁰ See *supra* note 14 and accompanying text.

II. DISINTERESTEDNESS—TO WHOM DOES IT APPLY?

MS. WHYTE: Wait a minute, I need to pounce on this. If the debtor in possession doesn't have to be disinterested, why should his professionals? Professionals provide advice;²¹ they don't make decisions. Therefore since the person presumably making the decisions is not disinterested, why does the person providing the advice have to be "disinterested"? Although it's clear that the professional should not have a materially adverse position or an interest in the situation, why must they have a position different than that of their client when it's their client that's making the decisions?

JUDGE CLEVERT: The professional is supposed to handle things objectively and to remind the debtor in possession of its obligation.²² So, even though the debtor in possession may make the ultimate decision, the professional is there to say, "keep in mind that you have to look out, not just for the interest of Number One, i.e., the prepetition debtor, or for the equity security holders, but also for the interests of the creditors."²³

PROF. RAPOPORT: Now, I've got to pounce on this side. Judge, the ethics rules say that if you're going to end up trying to advise something other than what's in the client's best interest, then the lawyer's not allowed to take on that representation.²⁴ The lawyer's already clearing herself by saying, "I can do this dispassionately under normal ethics rules, regardless of the Bankruptcy Code." Why do we need this additional overlay?

²¹ See *Interwest Bus. Equip., Inc. v. United States Trustee (In re Interwest Bus. Equip., Inc.)*, 23 F.3d 311, 318 (10th Cir. 1994) (noting counsel's duty to advise); *In re Brennan*, 187 B.R. 135, 150 (Bankr. D.N.J. 1995) (pointing out that attorney for debtor in possession has duty to advise).

²² See *Wolf v. Weinstein*, 372 U.S. 633, 649 (1963) (finding when debtor remains in possession, it has fiduciary obligations to creditors); *Interwest Bus. Equip.*, 23 F.3d at 316 (describing role of attorney to debtor in possession); *St. Angelo v. Sidco, Inc., (In re Sidco)*, 173 B.R. 194, 196 (Bankr. E.D. Cal. 1994) (citing fiduciary duty owed to debtor in possession by its attorney).

²³ See *Roger J. Au & Son, Inc. v. Aetna Ins., Co. (In re Roger J. Au & Son, Inc.)*, 64 B.R. 600, 606 (N.D. Ohio 1986) (finding role of counsel to debtor in possession acts as counterweight to insiders favoring interests outside reorganization jeopardized by close relationship to brother of debtor's firm); *In re Spanjer Bros.*, 191 B.R. 738, 751 (Bankr. N.D. Ill. 1996) (seeing no breach of fiduciary duty to creditors by opposing appointment of trustee).

²⁴ See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (1983) (stating lawyer shall not represent any client with interests directly adverse to another client); *In re Michigan Gen. Corp.*, 78 B.R. 479, 484 (Bankr. N.D. Tex. 1987) (noting ABA Code of Professional Responsibility requires avoidance of appearance of impropriety); see generally William I. Kohn & Michael P. Schuster, *Deciphering Conflicts of Interest in Bankruptcy Representation*, 98 COM. L.J. 127 (1993); cf. *Campbell v. Childress (In re Professional Dev. Corp.)*, 140 B.R. 467, 472 (W.D. Tenn. 1992) (noting Model Code of Professional Responsibility allows attorney to represent both entity and director or stockholder if there are no differing interests present).

MS. WHYTE: Let me take it one step further. Just because, by definition, you are not disinterested doesn't mean that you have a materially adverse interest or an adverse interest. Thus, why should a person that is not disinterested be automatically disqualified when that person may not have an adverse interest?

JUDGE CLEVERT: Well, one of the problems is that you don't know, at the beginning of the case, whether or not a problem will arise. Let's say, for example, you have outstanding securities that were issued within two years of filing. You don't know whether or not there was a problem in the issuance of those securities. Then you come into the case as an investment banker and you're giving advice. Suddenly the estate discovers that, "hey, we may have to go after this investment banker." It seems to me that you add taint by virtue of the prepetition services and the postpetition services that are being provided by that same professional. Consequently, I think the public's trust, the public's confidence, and the public's sense of whether or not this system is working correctly is going to be undermined.

PROF. AYER: I don't know if I can complicate this, or simplify it, but I know that we have one remaining voice up here who has seen this problem from all three sides in that he's been a judge, an attorney, and now a U.S. Trustee. Let's get Judge Pelofsky in here before we go much further.

JUDGE PELOFSKY: I look at it historically. One of the motivations for adopting the Bankruptcy Code was this public perception that there was misconduct in the professional ranks of the bankruptcy practice.²⁵ I think that when you start talking about doing away with disinterestedness you start sliding back into that cozy appearance of impropriety.²⁶ That's why I'm troubled by the ABA moving away from disinterestedness. Also, it seems to me that you have to assume that Congress had *something* in mind, although we do wonder from time to time what that was. But if you look at 327(a) and 101(14), you have to assume that, since subsection (E) talks about "interest materially adverse"²⁷ and it's also mentioned as one of the criteria in 327,²⁸ that "disinterested" means more than simply "free from conflict." Although it's not well stated here, and there's a lot of

²⁵ See *In re CF Holding Corp.*, 164 B.R. 799, 808 (Bankr. D.C. 1994) (noting concerns of courts to promote public confidence in system); see also *First Interstate Bank 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).

²⁶ See MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 9 (1980) (noting attorney should avoid appearance of impropriety; Victor H. Kramer, *The Appearance of Impropriety Under Canon 9: A Study of the Federal Judicial Process Applied to Lawyers*, 65 MINN. L. REV. 243, 244 (discussing application of appearance of impropriety standard).

²⁷ See 11 U.S.C. § 101(14)(E) (1994).

²⁸ See *id.* § 327(a).

rather artificial categories that they pick on, the nuance is that we are looking at *tone*. We are looking at *appearance*. We are looking at *relationship*.

III. DISINTERESTEDNESS UNDER THE BANKRUPTCY ACT— DOES IT BELONG IN THE CODE?

PROF. AYER: Judge, could I ask you to walk through the history with me? You said the drafters of the Code were concerned about the "bankruptcy ring" and concerned about the appearance of impropriety. My recollection is right, isn't it, that the disinterestedness rule was part of the Act with respect to old chapter Xs?

JUDGE PELOFSKY: Yes, but that was only one of the three reorganizations.

PROF. AYER: I understand, but was there any special perception that chapter X was a more honest, more ecumenical provision than other provisions of the Act? People said with chapter X, "at least we've got disinterestedness so we don't have the problems we did with the other chapters."

JUDGE PELOFSKY: I'm not altogether certain that was so.

PROF. AYER: Not altogether certain that was so? Okay. On the other hand, I can understand why the disinterestedness rule was in old chapter X.²⁹ You recall that under old chapter X,³⁰ with some trifling exceptions, the old debtor management was kicked out, so the managers of the estate had to be disinterested. Therefore it made sense to require that the disinterested manager have disinterested counsel. I'm right on that, aren't I? With respect to old chapter X?³¹

JUDGE PELOFSKY: That's correct.

PROF. AYER: I don't understand how you can plug that rule into a system where the manager of the estate, by definition, does not have to be disinterested, that is to say, under the new chapter 11 scheme, where typically we leave the debtor in possession with the powers and obligations of the trustee.³²

²⁹ 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).

³⁰ See *id.*

³¹ See *id.*

³² See 11 U.S.C. § 1107(a). Section 1107 states in pertinent part:

a debtor in possession shall have all the rights, other than the rights 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 securing in a case under this chapter.

Id.

JUDGE PELOFSKY: But I think you're also failing to recognize that, because the old management is not disinterested, there has to be some curb on that management's ability to go in and do whatever it wants to do for the benefit of the prepetition entity.

PROF. RAPOPORT: But we have *you* guys for that. You're the judges.

MS. WHYTE: We also have committees for that.

JUDGE CLEVERT: But I think a lot of people believe, and I think wrongly so, that the judge is "monitoring the case." The judge is not supposed to monitor the case. It's the creditors and the creditors' committee.³³ Although, in many instances there is not an active creditors' committee. When you have a creditors' committee, that committee may not want to focus on something that's going to impact on somebody else's fees, and it's up to the U.S. Trustee to step in.³⁴

PROF. AYER: Do you find that creditors are more willing to object to the fees of *disinterested* counsel than the fees of *interested* counsel?

JUDGE CLEVERT: Sometimes I'm not sure whether they're willing to scream at all.

PROF. AYER: Okay, so the problem may be with rejecting the fees, right?

JUDGE PELOFSKY: Yes, and I think from the United States Trustee's point of view, it's much easier for us to deal with a bright-line test. There are some days when we don't want to get any more unpopular than we already are. It's a difficult enough task to watch what we can see on the surface, but to get in behind it and try to probe who knows what people, and how they relate, and who plays golf with whom, and all those kinds of things [is even more difficult].

PROF. AYER: You're certainly right that bright-line tests are easier to administer, and it's worth encouraging them in the right circumstances. So let's provide that the only people who can represent debtors in possession are lawyers whose names begin with "A".

JUDGE PELOFSKY: Well, let's provide that they can only be national firms that don't have a connection with the debtor in that particular city.

³³ See *id.* § 1103 (providing powers and duties of creditors' and equity security holders' committees).

³⁴ See 28 U.S.C. § 586(a)(3)(E) (providing that U.S. Trustee shall monitor creditors' committee when appropriate).

PROF. AYER: Only national firms. Okay. I like the rule that says that only names that begin with "A", because I think it's quite administrable. And it's going to push a lot of work in my direction.

JUDGE PELOFSKY: Well, my old firm has an "S", you see, so I'd want an "S".

IV. IS DISINTERESTEDNESS A PLOY MEANT TO PROTECT THE BOUTIQUE FIRM?

QUESTION:³⁵ Is the disinterestedness requirement really an ethical requirement or was it intended to preserve boutique bankruptcy firms? Consider that when you have large firms that represent large debtors and you have a requirement that bankruptcy work must go to a bankruptcy firm that has not previously represented that debtor, you may be forcing a split between the large national firms and the local boutique firms.

JUDGE CLEVERT: I have to disagree with that theory, and I'll tell you why. When the Code was enacted, most of the large firms were not in bankruptcy practice. It's only because bankruptcy has grown and because bankruptcy is not seen as some little back-room sort of practice that you now have the major firms doing bankruptcy work.³⁶ And it was the smaller firms in bankruptcy who created, in the minds of some folks in Washington, this view that there was a small "bankruptcy ring."

PROF. AYER: Let me see if I can clarify what I think the exchange here is about. That is, that the disinterestedness rule, as it stands now, would bar anybody who was a creditor of the debtor or who was an officer or a director of the debtor, among others.³⁷ Well, I suppose that the person who is typically barred under that rule is the person who was involved with the debtor long before the debtor was on the verge of bankruptcy, which would seem to suggest that the rule, as it's structured now, is going to bar most often the nonspecialist rather than the specialist. This suggests that the purpose of the disinterestedness rule is to protect the "bankruptcy ring." If Judge Pelofsky were really interested in making trouble for the "bankruptcy ring," he would want to abolish the disinterestedness rule. Isn't that right?

³⁵ "QUESTION" denotes audience participation to this discussion.

³⁶ See Jay Lawrence Westbrook, *Fees and Inherent Conflicts of Interest*, 1 AM. BANKR. INST. L. REV. 287, 288 (1993) (noting that bankruptcy has recently become part of large firm practice).

³⁷ See 11 U.S.C. § 101(14); *In re Bellevue Place Assocs.*, 171 B.R. 615, 626 (Bankr. N.D. Ill. 1994) (noting that "disinterested" is term of art narrowly defined in § 101).

JUDGE PELOFSKY: That sounds circular to me.

PROF. RAPOPORT: But what's so bad about a "bankruptcy ring?" Bankruptcy isn't the sort of thing you just pick up once in a while and "go for it." It's something that takes some expertise to develop, and it's no different from the "family law ring" or the "patent bar ring." So having a group of experts who know what they're doing makes it more likely that a chapter 11's going to work.

PROF. AYER: Well, if that's the case, Nancy, you want to oppose abolishment of the disinterestedness rule, because the disinterestedness rule encourages the "bankruptcy ring." You both are on the wrong side of this.

QUESTION: Although every attorney should recognize that the disinterestedness requirement was intended to insure that the estate would stand for something more than the debtor, most attorneys are having a hard time figuring out what disinterestedness is, despite what the circuits have tried to do and the kind of rules that have come down about it. How can an attorney insure that when he/she steps into a courtroom, he/she will be able to collect a fee?³⁸ The other aspect of it is that every single person who goes into that case on behalf of the estate has got an interest in the estate, and it's really hard to understand how that can't be the most motivating of factors in a person's involvement.

PROF. AYER: You're always adverse to your client at fee time so any lawyer owed ten cents has an adverse interest.³⁹

PROF. RAPOPORT: Well, why don't we just say that, if you can't operate with the best interest of your client mind, you shouldn't be a professional person for the debtor in possession?⁴⁰

V. REMOVING THE DISINTERESTEDNESS REQUIREMENT

PROF. AYER: I'm curious to ask either Judge Pelofsky or Judge Clevert how the world would look if we abolished the disinterestedness rule? What kinds of

³⁸ See 11 U.S.C. § 328(c) (allowing court to deny compensation to professional person not disinterested).

³⁹ Courts have recognized that attorneys will have self-interest in bankruptcy proceedings. See *In re Martin*, 817 F.2d 175, 180 (1st Cir. 1987) (explaining attorney becomes creditor to estate once compensable time is spent on account); see also *Electro-Wire Prods., Inc. v. Sirote & Permutt, P.C. (In re Prince)*, 40 F.3d 356, 359 (11th Cir. 1994) (holding law firm was creditor that received payment for prepetition work after chapter 11 filing).

⁴⁰ For a more full discussion of the concept of "client in chapter 11 cases, see C.R. Bowles, Jr. & Nancy B. Rapoport, *Has the DIP's Attorney Become the Ultimate Creditors' Lawyer in Bankruptcy Reorganization Cases?* 5 AM. BANKR. INST. L. REV. 47 (1997).

cases would be decided differently without disinterestedness?

JUDGE CLEVERT: I think very few.

PROF. AYER: Okay, then: what's the big deal?

JUDGE CLEVERT: I think part of it is the so-called "feel good" concern that people have now.

MS. WHYTE: The definition is so incomplete, how could you feel good with the definition as it is today?

JUDGE CLEVERT: Well, I think one of the reasons is that it says the people who are involved will not be looking over their own shoulders. When they look at whether or not there was, let's say, an improper transfer, they will be looking at folks other than themselves to determine whether or not there was gross mismanagement. They will not be assessing whether they, as directors, were responsible for the gross mismanagement.

MS. WHYTE: What about a materially adverse interest?

JUDGE CLEVERT: It may not necessarily *be* a materially adverse interest going in. At the time you take on the engagement, you don't necessarily know whether a particular transaction is going to be suspect or whether or not someone will say, "hey, this doesn't pass the sniff test."⁴¹

MS. WHYTE: Well, I hate to raise this issue as a partner in an accounting firm, but why aren't accounting firms in the not disinterested group under 101(14) when they're working for a debtor?

JUDGE CLEVERT: They can certainly be in that same position because if you look at the definition, it says, "and for any other reason."⁴²

MS. WHYTE: Well, I know. But I'm saying that the "any other reason" you might want to choose is adverse interest.

PROF. AYER: Tell me how you're better off than we are. Explain this.

⁴¹ See *In re Flanigan's Enters., Inc.*, 70 B.R. 248, 254 (Bankr. S.D. Fla. 1987) (discussing "smell test" recommended by Professor and former Judge John D. Ayer) (citation and footnote omitted).

⁴² See 11 U.S.C. § 101(14)(E) (1994) (stating disinterested person may not have "interest materially adverse to interests of the estate, or of any creditors or equity security holders by reason of any direct or indirect relationship . . . or for any other reason").

MS. WHYTE: Well, I'm just saying that currently the definition is so poor, I don't see that it provides much. First—

PROF. AYER: I thought you were going to tell me that it made your life easier in some way that we weren't supposed to know about.

MS. WHYTE: Oh, it does, because I don't have to worry about some of these things that are very specific, like an investment banker.⁴³ I mean, section 101(14) really, really focuses on investment bankers. The truth of the matter is that investment bankers shouldn't be singled out in the fashion that they are any more than are a lot of other parties.

PROF. RAPOPORT: It really comes down to not being a bright-line rule at all. It's so vague, so fuzzy, that it's no easier to apply than just a simple "adverse interest" test.⁴⁴

PROF. AYER: But adverse interest is at least as fuzzy and vague a rule, is it not?

JUDGE PELOFSKY: I think it is. I look upon "disinterestedness" as a warning. Then, when you get down to what I call the "bucket provision" in subsection (E),⁴⁵ it gives the court and the United States Trustee and whoever wants to step up, a place, a tool, that they can use to bring out these issues. You go back to something like *Leslie Fay*,⁴⁶ which is the prominent case that is so full of these kinds of issues.

PROF. AYER: Refresh our memory on *Leslie Fay*, please.

JUDGE PELOFSKY: Well, *Leslie Fay* was a situation where Weil Gotshal was the prepetition firm hired to audit the conduct of the financial aspect of the business, when there was disclosure of misconduct. It turned out that on the Board of *Leslie Fay* were people who were significant representatives of clients of Weil Gotshal. The United States Trustee raised the issue at interim fee time and went

⁴³ See *id.* § 101(14)(B)-(D) (specifying disinterestedness requirement as it applies to investment bankers).

⁴⁴ An example of the vagueness of the disinterestedness requirement is the Code's failure 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").

⁴⁵ See 11 U.S.C. § 101(14)(E).

⁴⁶ *In re Leslie Fay Cos., Inc.*, 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

through quite a lot of agony to shake out what happened. The court concluded that the real failure was *disclosure* as opposed to adverse interest.⁴⁷

PROF. AYER: You mentioned "disclosure" and you mentioned "adverse interest." Did you need "disinterestedness" to make either part of your argument?

JUDGE PELOFSKY: No, but I didn't finish—

PROF. AYER: All right.

JUDGE PELOFSKY: I don't think "adverse interest" was identified as a problem. The problem was that the relationships created suspicions that were -- it turned out, because of all the work that went on before they got to it -- unfounded. But suppose that you raise them at the very beginning. Would you have let them go forward? I think not. And it would have been primarily because there was a sense that there were too many complicating relationships in this case to allow this firm to tell you, "yes, we're going to do it right and you can trust us."

PROF. AYER: Judge, would the result have been any different if you had no disinterestedness rule? Would you have found yourself saying, "boy, I'd like to get these bums, and with disinterestedness I could get them, but I'm stuck with adverse interest, and, oh, golly gee, I can't get them with adverse interest."

JUDGE PELOFSKY: Well, my sense of "adverse interest" is that it's a much more objective test. It does not reach *relationships*.

JUDGE CLEVERT: Right, and that's one of the real problems with the definition.

JUDGE PELOFSKY: I think it goes to *conflict* as opposed to *relationships*.

MS. WHYTE: So, if there is no adverse interest, but by definition if you are "not disinterested," you should be disqualified. You might be the best person for the job, you might be the best person for the estate, you have knowledge, it's cheaper, but regardless, because there's a definition out there, you ought not to practice?

⁴⁷ The *Leslie Fay* Court held that Weil Gotshal had failed to disclose potential conflicts prior to retention and was thus in violation of Federal Rule of Bankruptcy Procedure 2014. See *Leslie Fay* 175 B.R. at 536. The Court further held that this failure warranted monetary sanction, but not disqualification. See *id.* at 538.

JUDGE PELOFSKY: Well, I think to some degree talent is fungible. I think there are a lot of people out there who are talented.

MS. WHYTE: Well, talent may be fungible, but knowledge of the case may not.

JUDGE PELOFSKY: Well, Weil Gotshal was a stranger to the case when that firm came in.

PROF. AYER: Under state ethics rules, if, independent of bankruptcy, my relationship to the debtor is so strong that it will color my judgment and incapacitate me from giving independent detached advice to the debtor, then I should not represent the debtor.⁴⁸ Is that not right?

JUDGE PELOFSKY: But in *Leslie Fay*,⁴⁹ it wasn't the relationship with the debtor, it was the relationship with *all the other people* who were involved.

PROF. AYER: Perhaps I should have said "with the client?"

MS. WHYTE: What do you think would have happened if in fact they had really disclosed all those things? Part of the problem in that whole situation of *Leslie Fay* is that they knew these problems existed up front, and they did not disclose them up front.⁵⁰ Weil Gotshal is not a novice in this area.

VI. PREVIOUS REPRESENTATION AND DISINTERESTEDNESS

QUESTION: Does previous representation automatically make you not disinterested? Consider the following scenario. Let's say that a company has an appraisal done every year (possibly for a loan and/or for tax situations). Since there is no vested interest for the appraiser, ethics suggests that the appraiser must be disinterested and a certificate is signed to that effect. But let's say the appraiser is then called by a trustee in bankruptcy to prepare a final appraisal and testify. Now, there may be a potential conflict of interest since work had been performed for the company for several years prior to the bankruptcy. Assuming the appraiser wished to accept the work, would the appraiser then be subject to disqualification based on his previous relationship with the company? Does the prior representation make the appraiser not disinterested?

⁴⁸ MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(b) (1983).

⁴⁹ See *Leslie Fay Cos.*, 175 B.R. at 525.

⁵⁰ See *id.* at 538.

PROF. AYER: Do we know? Nancy, is this man disqualified here under the bankruptcy rules?

PROF. RAPOPORT: I would say probably not. This illustrates an important point: the appraiser has been operating all along as not having a particular position one way or another. The appraiser's report says, "I'm going to, to the best of my ability, say what I think the valuation of this property is." It's no different—the only thing different is that the client who's hiring you now has a different responsibility. Now the responsibility is to the creditors, and not necessarily the shareholders. But the client who is hiring you isn't asking you to *change* anything.

MS. WHYTE: I'm not sure that an appraiser, whatever side they're on, doesn't try very diligently to determine whether it should be a high or a low value and affect you thus.

JUDGE CLEVERT: But let's say, for example, that the appraiser took on that engagement and came up with a significantly different number. Aren't they going to drag him through the mud?

PROF. AYER: I'm not with you, who's going to drag him through the mud?

JUDGE CLEVERT: Well, whoever doesn't like the valuation.

PROF. AYER: That could be anybody.

PROF. RAPOPORT: Anyone in the case.

JUDGE CLEVERT: Yes, it could be anybody, but the point is there are so many ways of attacking an appraisal in the first place.⁵¹ Then, if the appraiser has a history and then all of a sudden changes all the foundations of his opinion, it seems to me that he opens himself to a great deal of criticism.

PROF. AYER: Judge Pelofsky, do you have a position as to whether he ought to be barred from having previously represented and/or counseled the debtor.

JUDGE PELOFSKY: It doesn't make a lot of sense to hire him in the postpetition situation because of the problems, but I don't think he's disqualified under the statute as I read it.

⁵¹ See Elliott W. Weinstein, *The Art of the Testimony: The Real Estate Appraiser, the Appraisal and the Expertise of the Expert Witness*, AM. BANKR. INST. J. Oct. 1996, at 32, 32-33 (discussing various methods of valuation and their potential weaknesses).

JUDGE CLEVERT: But you may be disqualified under the so-called "bucket provision," 101(14)(E),⁵² which just says "for any other reason." I think, basically, it's fact-driven. If, going into the engagement, your prior findings are clearly going to be at issue, and people have shown by the applications that have been filed in the past that they are attacking the integrity of your previous work, then of course, there would be very good reason to exclude you. But it seems to me that it is not clear by definition that you would be debarred.

PROF. AYER: But, Judge Clevert, we can't go too far with these bucket rules, though, can we? I mean the professionals in this room have some right to expect *some* sort of predictability out of the system, don't they?

JUDGE CLEVERT: I certainly agree. But unfortunately, or fortunately, depending on how you view it, that's part of the statute. Until such time as Congress says "we want to loosen the standards and we want to make it very clear," not just a bright-line definition. This is what we have. The thing of it is that if you try to do something more than have some general guidance, you're going to end up with pages and pages of definitions. I mean, look at what's happened to [section] 330.⁵³ It started out with a very simple test—it has to be a reasonable and actual expenditure for fees. Now they've got about six different criteria. They don't trust the case law any more. Soon we'll get to the Johnson Twelve and then there'll be 18 and then there'll be 25, and then it will look like the U.S. Trustee Guidelines!⁵⁴

PROF. AYER: That's always the trade-off: that a bright-line rule is easy to administer and easy to make look silly.

VII. IS THERE A SIMPLE SOLUTION?

QUESTION: Can you define the problem you are seeking to avoid and find a simple, easily applied rule?

PROF. AYER: No. I assumed that was somewhat rhetorical, wasn't it? I mean, it's true that a number of people over the last few years have been working on trying to come up with an articulate definition of adverse interest,⁵⁵ and as

⁵² See 11 U.S.C. § 101(14)(E) (1994).

⁵³ See 11 U.S.C. § 330 (discussing compensation of officers).

⁵⁴ See United States Trustee: Guidelines Relating to the Bankruptcy Reform Act of 1994, 61 FED. REG. 24,889 (1996) (establishing guidelines for reviewing applications for compensation and reimbursement of expenses under § 330).

⁵⁵ See *In re Roberts*, 46 B.R. 815, 826-27 (Bankr. D. Utah 1985) (acknowledging that neither Code nor legislative history defines "adverse interest"), *aff'd in part, modified in part, rev'd in part on other grounds*, 75 B.R. 402 (D. Utah 1987).

Nancy and Joel are both suggesting, it turns out to be terribly difficult.

PROF. RAPOPORT: I don't think we should use a "smell test."⁵⁶ The least important reason we should be worried about disinterestedness is that the public will think that it matters who's representing whom. It can't be the smell test.

PROF. AYER: If we're worried about the appearance of impropriety, we ought to outlaw the wearing of \$2,200 suits in the bankruptcy court.

VIII. DISCLOSURE

QUESTION: "Disinterestedness" has to do with what's driving the case, whose interests are actually being represented, and what is the proper fiduciary view point. Many of the cases that are out there came up because there was no disclosure at the beginning. The problem with predictability is that, even if you disclose it at the beginning, you may still be on the hook later on. If you disclose at the beginning, should you remain subject to the disinterestedness requirement as the bankruptcy case develops?

PROF. AYER: Once you've disclosed and once the rules are set forth, you ought to be able to rely on them. Nancy, wouldn't your view be that most of the really scary fee disallowance cases on close scrutiny turn out to be "disclosure" cases and not "substance" cases?

PROF. RAPOPORT: Yes, that's absolutely true. The courts get really resentful when they haven't been told something. They would rather make the decision: "You tell me, I'll decide if it's going to drive the case or not, and I'll go from there." I think that's the right result. If you disclose to the court, the court should make the call and that should be it.

PROF. AYER: Am I right to say that, in some of these nondisclosure cases, they also put in some pretty scary rhetoric as to what the substantive law might be?

PROF. RAPOPORT: Yes.

MS. WHYTE: I've had situations where the judges have said, "if this becomes an issue, you will have to step back at that point and you will not be able to be part of this issue." It's agreed to up front. It all goes back to disclosure up front. Then, people say if there's not an active creditors' committee, they [the unsecured

⁵⁶ See *In re Flanigan's Enters., Inc.* 70 B.R. 248, 254 (Bankr. S.D. Fla. 1987) (discussing simplified standard for determining whether law firm is disqualified under § 327(a)).

creditors] don't care enough to worry about the situation, and frankly, neither do I. But I do believe that you have creditors' committees,⁵⁷ you've got equity committees,⁵⁸ you've got U.S. Trustees,⁵⁹ you've got a body of people who are out there watching every single move you make, and if you've disclosed it up front, then everybody knows it could become a problem, but it's not currently. A lot of issues can actually be resolved up front.

JUDGE CLEVERT: The question is whether or not the concept of disinterestedness is still viable.

MS. WHYTE: The real problem has been the lack of candor early on in the case.⁶⁰ The disinterestedness standard, or I should say, rule,⁶¹ is there to let people know that there is not just an initial obligation to disclose, but an ongoing obligation to disclose.⁶² Often times you don't know all of the relationships and all of the problems that could come up or affect the outcome of the case.⁶³

PROF. AYER: I think I know one reason why this occurs and you know what I'm going to say, Judge Clevert, because you and I have done these panels before, but I think one of our problems with a lawyer's duty of loyalty in DIP cases⁶⁴ is that we can't make up our minds about what the client should be permitted to do. Right? Until we can decide how aggressive the DIP ought to be able to fight to protect the interest of the old residuary owners,⁶⁵ we're going to have a lot of trouble getting certainty with respect to the lawyer's role.

⁵⁷ See 11 U.S.C. §§ 341, 705, 1102(a)(1) (1994) (requiring meeting of creditors and establishment of creditors' committee); see also 11 U.S.C. § 1103 (granting powers and duties of creditors' committee).

⁵⁸ See 11 U.S.C. §§ 341, 1102(a)(2) (establishing equity holders' committee); see also 11 U.S.C. § 1103 (granting powers and duties of equity committee).

⁵⁹ See 11 U.S.C. § 322 (regarding duties, requirements, and rights of trustee); see also 11 U.S.C. § 1106 (regarding chapter 11 trustee).

⁶⁰ See, e.g., *In re Leslie Fay Co.*, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994) (discussing importance of full disclosure relating to matters of disinterestedness and finding responsibility lies with attorney, not with court, to ensure all potential conflicts are disclosed).

⁶¹ See 11 U.S.C. § 327(a).

⁶² See FED. R. BANKR. P. 2014 (requiring disclosure of all connections with debtor, creditor and other interested party); see also *In re Sauler*, 191 B.R. 402, 408-10 (Bankr. D. Neb. 1995) (finding implicit requirement, under § 327(a), to "continuously comply" and make "ongoing, full and complete disclosure" of any facts relating to disqualification); *In re Wilde Horse Enters., Inc.*, 136 B.R. 830, 843 (Bankr. C.D. Cal. 1991) (finding disqualification appropriate if at any time attorney held adverse interest to estate).

⁶³ See, e.g., *In re Roberts*, 75 B.R. 402, 411 (D. Utah 1987) (stating attorney has duty to disclose all actual and potential conflicts and court may exercise judgment whether potential conflict may disqualify attorney).

⁶⁴ See *Wilde Horse Enters.*, 136 B.R. at 840 (explaining nature of attorney's fiduciary duty owed to estate).

⁶⁵ See Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 20-30 (1989) (discussing obligations of DIP to different parties in bankruptcy case).

JUDGE PELOFSKY: That's one reason why these disqualifications work. Because you have somebody, other than this bunch who is together prior to the petition, looking at the issue of how much the debtor ought to protect the old relationships.⁶⁶

MS. WHYTE: Well, wait a minute. You don't think that the new bunch falls into that same prey?

JUDGE PELOFSKY: Well, they've got a different set of problems.

IX. WHO HAS THE FIDUCIARY DUTY?

PROF. AYER: Judge Pelofsky, let me give you my favorite one. I'll lay this on the table and I hope I can get some various opinions on this. My easy one is the one where the debtor has assets that will liquidate tonight for a million dollars. And he has claims of a million dollars. And if he liquidated tonight all the creditors would get paid and equity would go away empty. And if he keeps the money and rolls the dice, he may have two million dollars or he may have nothing. And I'll make you counsel for the DIP. Give me some help on deciding how the DIP and the DIP's counsel together decide whether they can roll the dice in that way.

JUDGE PELOFSKY: I think the answer is fairly easy. I think they roll the dice because that's the whole thrust of the reorganization.⁶⁷ And I think hardly anybody goes into a reorganization with the ecumenical or humanitarian notion that, "yes liquidate, and pay everybody who's invested in me."

PROF. AYER: Well, then you're accepting the idea that the DIP is not a fiduciary to creditors,⁶⁸ aren't you? Because, if you're a fiduciary to creditors, you'd liquidate tonight.

JUDGE PELOFSKY: You're a fiduciary to creditors but what you say is, "I'm going to pay you 100% plus interest if you give me six months to reorganize."

⁶⁶ See *supra* notes 55-57 (noting Code provisions outlining powers of creditors and equity holders committees).

⁶⁷ See *Equitable Life Assurance Soc'y of United States v. James River Assocs. (In re James River Assocs.)*, 156 B.R. 494, 498 (E.D. Va. 1993) (stating debtor in possession has duty to maximize value of estate (quoting *Louisiana World Exposition v. Federal Ins., Co.*, 858 F.2d 233, 245-46 (5th Cir. 1988))).

⁶⁸ See *First Union Nat'l Bank v. Tenn-Fla Partners (In re Tenn-Fla Partners)*, 170 B.R. 946, 969 (Bankr. W.D. Tenn. 1994) (finding debtor in possession is fiduciary to creditors and discussing duties that debtor in possession owes).

PROF. AYER: That is, if this dice roll works out, but if it doesn't work, you won't get a thing.

JUDGE PELOFSKY: But there's more to it than that, because there's also the employee community, there's the product community, there are a lot of interests that don't show up on the schedules necessarily, but that have to be looked at.

PROF. AYER: So you're a fiduciary to a whole bunch of interests, which are adverse to each other.

JUDGE PELOFSKY: Yes, but I think the incoming counsel who has not represented the corporation prepetition has an easier set of adverse interests to balance than the prepetition counsel who is prepetition and who also may be a creditor.

PROF. RAPOPORT: Even though "equity" is signing the checks.

JUDGE PELOFSKY: Even though equity is signing the checks. But it's a new equity.⁶⁹

PROF. AYER: Okay, Nancy, do you want a shot at this one?

PROF. RAPOPORT: I think that it's a very short representation under your thesis. If I were a counsel for the debtor in possession in that hypothetical, I would say, "you must liquidate, and thank you and I'll take my administrative fee for a dollar now."

PROF. AYER: I'll get my certainty fee now because my fees may *also* be at risk if we take this gamble.

QUESTION: The professional is owed some money for its prepetition services. In *Price Waterhouse*,⁷⁰ the Third Circuit said that if a professional is owed money for its prepetition services, it is not disinterested.⁷¹ Consequently, it must be disqualified.⁷² Could you help clarify this situation?

⁶⁹ See 11 U.S.C. §§ 1121-29 (1994) (allowing creditors right to control reorganizing business); see also J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 269-71 (1991) (discussing role and authority of creditors committee under Code to investigate and participate in formulation of plan and do "whatever is necessary to protect" their interest).

⁷⁰ *United States Trustee v. Price Waterhouse*, 19 F.3d. 138 (3rd Cir. 1994).

⁷¹ See *id.* at 141.

⁷² See *id.* at 142.

PROF. AYER: There cannot be much question that that is what the Code provides. The remedy, of course, is to change the Code, which we cannot do, but if professionals who were owed money for prepetition services were not disqualified, we could eliminate that one big issue.

MS. WHYTE: Price Waterhouse tried something similar in *Sharon Steel*.⁷³ We said, "we will not vote our claim."⁷⁴

PROF. AYER: Now, walk us through this. What happened in *Sharon Steel*?

MS. WHYTE: In *Sharon Steel*, Price Waterhouse put in an \$850,000 prepetition claim for accounting services.⁷⁵

PROF. AYER: Okay, clearly not disinterested.

MS. WHYTE: We agreed not to vote our claim, thus allowing the committee to do whatever it wanted. We would completely ignore that that claim existed.⁷⁶

JUDGE CLEVERT: Why not just waive the claim?

MS. WHYTE: Let me tell you why we did not. In this case, the attorneys actually wanted to see if they could take this all the way up to the Supreme Court and make law on it. So Price Waterhouse agreed to allow them to do that. As long as we were retained, we were willing to waive our fee. This was a test.

PROF. AYER: So you retained your claim as your contribution to the public interest here.

MS. WHYTE: The judge approved the application.⁷⁷

PROF. AYER: So you were going to stay in there as sort of a general accountant?

⁷³ *In re Sharon Steel Corp.*, 152 B.R. 447, 450 (Bankr. W.D. Pa.), *aff'd*, 154 B.R. 53 (W.D. Pa. 1993), *rev'd* 10 F.3d 138 (3d Cir. 1994).

⁷⁴ *See id.* at 448.

⁷⁵ *See id.* at 448.

⁷⁶ *See id.* at 450.

⁷⁷ *See In re Sharon Steel Corp.*, 152 B.R. 447, 450 (Bankr. W.D. Pa.) (accepting Price Waterhouse's agreement not to participate in chapter 11 case) (*aff'd sub nom* 154 B.R. 53 (W.D. Pa. 1993), *rev'd* 10 F.3d 138 (3d Cir. 1994)).

MS. WHYTE: We were staying in as accountants and I think we also did some advisory work on the case. To be honest with you, in a case like *Sharon Steel*, \$850,000 is a drop in the bucket.

PROF. AYER: But your stipulation was that you would not vote your claim in the case.⁷⁸

MS. WHYTE: We would not vote our claim. As a result, we went up to two courts. Two courts said, "you are not disinterested, and if you go back and waive your claim, you are fine."⁷⁹ We obviously waived our claim. We tried to take it to the Supreme Court, but the Supreme Court would not hear it.

PROF. AYER: You say "of course" you waived your claim, meaning that the ongoing representation was more valuable to you than what you would get on the claim.

MS. WHYTE: Yes, we agreed all the way around.

PROF. AYER: Someone in the audience suggested that this situation was further complicated by the fact that the law firm in the case, who filed a similar application as Price Waterhouse, but with a different judge, was determined to be "not disinterested." So two judges in the same case decided the issue differently. There seems to be a general view in the room that there is something wrong with this situation. Maybe there is. It may be because \$850,000 is not much money between men of the world or in ten cent bankruptcy dollars. I want to imagine what the world would be like if there was no disinterestedness rule. Imagine that we have a local counsel on a local case, owed \$60,000, which happens to be half a month's gross for that law firm. All right, let us start with Nancy. You have thought about these a lot. No disinterestedness rule. Have we got an adverse interest⁸⁰ problem if that lawyer has by local standards, a humongous fee outstanding?

PROF. RAPOPORT: And he does: he has a huge claim. If the reorganization craters, he has a claim on zero assets, and if the reorganization succeeds, he

⁷⁸ See *id.* at 448 (stating by affidavit will not participate as unsecured creditor or vote on claim relating to reorganization plan).

⁷⁹ See *id.* at 450 (allowing employment of prepetition accounting firm as financial advisor); *United States Trustee v. Price Waterhouse (In re Sharon Steel Corp.)*, 154 B.R. 53, 55 (W.D. Pa. 1993) (affirming Bankruptcy Court decision allowing appointment). *But see* *United States Trustee v. Price Waterhouse*, 19 F.3d 138, 142 (3d Cir. 1994) (reversing lower court in that prepetition creditor is not disinterested person under § 327(a)).

⁸⁰ See 11 U.S.C. § 327(a) (1994).

actually has a chance of getting some of that money back. He is on the same side as the creditors.

PROF. AYER: That's a powerful incentive to try to see this debtor reorganize. Therefore, that lawyer's adverse interest problem may be that he doesn't have his debtor client's best interest at heart.

PROF. RAPOPORT: Right, but if the debtor in possession is the fiduciary of the creditors [or the estate as a whole],⁸¹ he's [the lawyer is] fine.

PROF. AYER: That's fine if the debtor in possession is fiduciary of the creditors; however, the U.S. Trustee to your right said he's not.

JUDGE PELOFSKY: I did not say he was not a fiduciary of the creditors. I said that is only part of his fiduciary obligations.

PROF. AYER: You said he is a fiduciary to everybody.⁸²

JUDGE PELOFSKY: Yes.

PROF. AYER: Okay, okay. Let's give everybody a first priority claim while we are at it.⁸³

MS. WHYTE: I think there's something important here. Many times creditors get stock in a company as part of their return. Even if the majority of the return is cash and the minority of the return is stock, the existing equity may not necessarily get anything. Furthermore, if the capital structure going out of bankruptcy is a raw capital structure, because somebody had a prepetition claim and wanted more cash

⁸¹ See 11 U.S.C. § 1107(a). The Code provides in relevant part, "a debtor in possession shall have all the rights . . . and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter." 11 U.S.C. § 1107(a). See *Gumport v. China Int'l Trust and Inv. Corp.* (*In re Intermagnetico Am. Inc.*), 926 F.2d 912 (9th Cir. 1991) (noting that officers of debtor in possession have responsibility to act in fiduciary capacity with best interests of estate); *In re Michelson* 141 B.R. 715, 726 (Bankr. E.D. Ca. 1992) (stating DIP has fiduciary obligations while acting as a representative of the estate); see also *Frankel v. Frankel* (*In re Frankel*), 77 B.R. 401, 404 (Bankr. W.D.N.Y. 1987) (stating most important obligation of debtor in possession is to its creditors).

⁸² See *In re B & W Tractor Co.*, 38 B.R. 613, 614 (Bankr. E.D.N.C. 1984) (noting that DIP acts on behalf of debtors, owners, and creditors).

⁸³ See 11 U.S.C. § 726(a)(6); see also *Razorback Ready-Mix Concrete Co. v. United States* (*In re Razorback Ready-Mix Concrete Co.*), 45 B.R. 917, 924 (Bankr. E.D. Ark 1984). The court discusses Code's provision of distribution of assets of the estate. See *id.* The section "distributes property of the estate first to priority claims; second to timely unsecured claims; third to untimely secured claims. . . ." See *id.*; see also *United States v. Vecchio* (*In re Vecchio*), 20 F.3d 55, 557 (2d Cir. 1994) (stating statutory scheme provides for orders of priority for distribution of claims).

than equity, and that company cannot survive for another two years, a major disservice has been done.

PROF. AYER: But again we're back to the point where a lawyer who is too deeply involved with his client should not represent that client for court matters outside of bankruptcy.⁸⁴

X. DOES THE DISINTERESTEDNESS REQUIREMENT REMOVE
THE MOST QUALIFIED? — THE PREPETITION PROFESSIONAL.

QUESTION: The majority of professional disqualification issues arise by virtue of the status of the prepetition creditor.⁸⁵ Accounting disqualification is a good example of that. There are cases where you have a prepetition accounting firm, which is clearly the best qualified, both in terms of knowledge and efficiency, to continue representing the debtor, but the judge holds, consistent with the statute, that the firm is disqualified.⁸⁶ Therefore, isn't it a disservice to have the status of the creditor be the primary criterion for disinterestedness?

PROF. AYER: Of course, that's always the devil's bargain, isn't it? This "best qualified" stuff. You say, "your Honor, I'm the best qualified to do this because I did it before. I'm best qualified to manage this debtor in bankruptcy because I ran these bums into debt in the first place."

JUDGE CLEVERT: I think one of the problems with putting the creditor interest aside is that you never know how that professional's claim impacts that professional, or how that prepetition relationship between the professional and the debtor affects that professional.

PROF. AYER: You do not know how bad he needs the money.

⁸⁴ See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (providing an attorney should not represent client if there is conflict of interest).

⁸⁵ See *In re Siliconix*, 135 B.R. 378, 379 (N.D. Cal. 1991) (holding prepetition accounting firm creditor is "per se" interested and barred from employment); *In re Gray*, 64 B.R. 505 (Bankr. E.D. Mich. 1986) (accounting firm disqualified after failing to disclose prepetition services rendered). But see *In re Heatron, Inc.*, 5 B.R. 703, 705 (concluding that attorney who represented debtor prepetition and is also a creditor does not have interest adverse to estate).

⁸⁶ See *Siliconix*, 135 B.R. at 379-80 (disqualifying accounting firm that had prepetition claim to avoid appearance of impropriety); *In re Eastern Charter Tours, Inc.*, 167 B.R. 995, 997 (Bankr. M.D. Ga. 1994) (stating accountant who is also creditor may not be employed by estate); *In re Fulgham Enterprises, Inc.*, 181 B.R. 139, 140 (Bankr. N.D. Al. 1995) (discussing § 101(14) in detail).

JUDGE CLEVERT: So, if you are owed \$10,000 dollars, you may not be the attorney for debtor X. But if you're owed \$1,000 dollars, you *may* be, because it's not material.

PROF. AYER: A previously existing relationship has to be disclosed⁸⁷ or it will be grounds for disqualification. Failure to disclose could be materially adverse to the estate.⁸⁸ This is a very, very fuzzy test, isn't it? I'm not sure we understand the radicalism of Judge Clevert's proposal because it seems to me that he believes the fact that the attorney was involved with the debtor, and knew about the debtor, is an argument against his continued participation. It also seems to me, Judge Clevert, that you are arguing for the proposition that the attorney for the debtor in possession in the case should be a *de facto* trustee, for example, somebody independent of the debtor and in some sense adverse to the debtor.⁸⁹

JUDGE CLEVERT: In some sense, I think that the key lies in the fact that the attorney has to recognize that the debtor in possession is not the debtor. Furthermore, the debtor in possession has an additional obligation, that is, a concern for the estate.⁹⁰ The attorney must remind the debtor of that status.

PROF. AYER: And your view is that a person who has previously represented the debtor cannot grasp that position?

JUDGE CLEVERT: No, I'm not saying that they cannot, but I think it's going to be suspect.

⁸⁷ FED. R. BANKR. P. 2014(a). Federal Rule of Bankruptcy Procedure 2014(a) has been interpreted by courts to contain a disclosure requirement before the retention of professionals. Rule 2014(a) states in relevant part "[t]he application shall state . . . the name of the person to be employed, the reason for the selection, the professional services to be rendered . . . all of the person's connections with, the debtor, creditors, any other party in interest . . ." FED. R. BANKR. P. 2014(a). See, e.g., *In re Brennan*, 187 B.R. 135, 144 (Bankr. D. N.J. 1995) (stating that Rule 2014(a) and case law provide that any party that creates disqualifying conflict must disclose); *In re BH & P, Inc.*, 103 B.R. 556, 567 (Bankr. D. N.J. 1989) (requiring disclosure for all facts relating to actual or potential conflict).

⁸⁸ See *Neben & Starrett, Inc. v. Chartwell Financial Corp. (In re Park-Helena Corp.)*, 63 F.3d 877 (9th Cir. 1995). The court explains that its role is to determine that persons (i.e. attorneys) do not have adverse interests to the estate. See *id.* at 880. To assist the court in properly making this determination the Code and the Federal Rules of Bankruptcy Procedure imposed disclosure requirements. See *id.* A failure to disclose may be cause for disqualification since there is a possibility that non-disclosed information may be adverse to the estate. See *In re Film Ventures Int'l*, 75 B.R. 250, (B.A.P. 9th Cir. 1987) (requiring attorney to disclose payments made or promised even if these payments are not sought); *In re EWC, Inc.*, 138 B.R. 276, 280-81 (Bankr. W.D. Okla. 1992) (stating court must ensure that attorneys do not have an interest adverse to the estate).

⁸⁹ See *St. Angelo v. Sidco, Inc. (In re Sidco, Inc.)*, 173 B.R. 194, 196-97 (E.D. Col. 1994) (stating that debtor in possession, not attorney, is estate's trustee); see also 11 U.S.C. § 1107(a) (providing that debtor in possession has all rights, powers and duties of trustee under chapter 11).

⁹⁰ See *supra* note 84 (explaining role of debtor in possession and its fiduciary obligations).

PROF. AYER: Okay.

PROF. RAPOPORT: More so for the attorney than for the business.

QUESTION: Are you suggesting that if one sees that his client, the debtor in possession, is doing something wrong, he should call the creditors' committee?

JUDGE CLEVERT: No.

QUESTION: Well, where does one draw this line between the responsibility to creditors, the responsibility to the estate, the responsibility to equity, the responsibility to professional rules of ethics, and the responsibility to the wallet?

PROF. AYER: Hey, that's why you get the big bucks.

XI. "DISINTERESTEDNESS CREDIT RULE" AND THE PRIORITY LADDER

QUESTION: How do you differentiate your inherent interest as an administrative creditor with a higher priority claim than that of an unsecured creditor? You have an interest right there, and one might argue that you would be willing to take a position that would assure that an administrative claim got paid but not assure the source for the unsecured creditors' claims.

PROF. AYER: Take the money that is on the table rather than taking the gamble.

JUDGE CLEVERT: I can only say therein lies the Achilles' heel.

JUDGE PELOFSKY: On the other hand, the thing about the postpetition administrative creditor is that he is visible. You know precisely what that situation is—that there are competing interests between the creditors' committee and other people who are knocking on that door. So there is a balance that is open and obvious, whereas the prepetition issues are not necessarily obvious.

QUESTION: If the size of the claim is such that it is material, then there's a problem, unless you say that it's not a claim. If there is an issue about whether it's going to get paid, why should the standards for bankruptcy lawyers be different from other lawyers? Under the canopy of ethics, if you are representing a client, and the size of the claim in your practice becomes material, you have to withdraw.

Other lawyers are held to this rule.⁹¹ What is the premise to holding bankruptcy lawyers to a higher standard?

PROF. AYER: I guess we all agree that there are cases that say the disinterestedness credit rule is not a per se rule.⁹² I do not have a quarrel with those cases except for the fact that I think they're wrong! [laughter] But aside from that, no real difficulty, right?

QUESTION: Let's also think about what kind of prepetition activity the disinterestedness requirement encourages. You are supposed to be extending credit to the debtor in the long slide toward bankruptcy and that is why you have got the ordinary course of business exception to preferences. However, what you're doing is saying that, if somebody comes in and believes there is a problem, and you have a fee outstanding, you are going to look to see whether you can get it handled so that you will not be disqualified as disinterested.

PROF. RAPOPORT: Right; up until the time you get the preference problem.

PROF. AYER: Well, what you do is you get that appealed and then you get ahead of the curve by having a retainer that you bill out in an ordinary course of business, which you disclose.⁹³ So while the debtor is having liquidity problems and running up his trust or tax bill, you're bringing your fees current and waiting 91 days, so you've solved your preference problem. All right.

XII. DISINTERESTEDNESS AND CHAPTER 7

QUESTION: Why doesn't the disinterestedness standard apply in chapter 7?

PROF. AYER: It *does* apply in chapter 7. There's no debtor in possession in

⁹¹ See, e.g., MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (comments) (conflicting interests of attorney and client, such as attorney's need for income over best interests of his client, are not permitted).

⁹² See, e.g., *In re Palumbo Family Ltd.*, 182 B.R. 447, 466 (Bankr. E.D. Va. 1995). The court refused to follow decisions that upheld a per se rule for disqualification. A "fact-intensive" inquiry was perceived as a more appropriate for of determining disqualification factors. See *id.* The Fourth Circuit "discourages the use of per se rules when evaluating disinterestedness." See *id.*; see also *Harold & Williams Dev. Co. v. United States Trustee (In re Harold & Williams Dev. Co.)*, 977 F.2d 906, 909-10 (4th Cir. 1992) (refusing to follow a per se rule); *In re Missouri Mining, Inc.*, 186 B.R. 946, 948 (Bankr. W.D. Miss. 1995) (following Palumbo and noting courts should not "fashion absolute prohibitions").

⁹³ See Goldstein, *supra* note 4 at 497 ("As generally interpreted, Bankruptcy Rule 2014(a) requires disclosure of all facts, including the payment of a retainer . . .").

chapter 7,⁹⁴ but the disinterested standard would apply to the professional who represented the trustee.

JUDGE PELOFSKY: The disinterestedness problem is for the person representing the estate, so the chapter 7 trustee has to be concerned about disinterestedness.⁹⁵ In the chapter 7, the debtor's lawyer obviously doesn't represent the estate.

PROF. AYER: Yes, that's right. The corollary is that the chapter 11 attorney does not need to be disinterested as long as he's representing the debtor and not the DIP.⁹⁶ There are people, probably some in this room, that say we should take that distinction more seriously and we should bill some of this representation to the debtor individually and not to the DIP.

QUESTION: Doesn't the debtor's attorney in chapter 7 have fiduciary duties to the creditors?

PROF. AYER: Sure, he has *fiduciary* duties, but he doesn't have the *disinterestedness* duty.⁹⁷ You have duties to make sure that the schedules are honest.⁹⁸

JUDGE PELOFSKY: He has a duty to make sure that the debtor fulfills the debtor's obligations.

⁹⁴ See *Carpenters Health and Welfare Trust Funds v. Robertson (In re Rufener Constr. Inc.)*, 53 F.3d 1064, 1067 (9th Cir. 1995) (stating debtor in possession is concept of chapter 11, not chapter 7).

⁹⁵ See 11 U.S.C. § 701(a)(1) (requiring that person appointed by United States Trustee chapter 7 trustee be "disinterested person"); see also *In re Neuman*, 138 B.R. 683, 686 (S.D.N.Y. 1992) (stating disinterestedness is required for anyone representing chapter 7 trustee); *In re BH & P, Inc.*, 119 B.R. 35, 41-43 (D. N.J. 1990) (finding trustee's dual role for two chapter 7 estates constituted conflicts in violation of Bankruptcy Code requiring trustee be disinterested).

⁹⁶ Section 327(a) of the Code, in conjunction with § 1107, empowers a debtor in possession to employ general counsel meeting the § 101(14) definition of a "disinterested person." See 11 U.S.C. § 101(14) (defining "disinterested person"); 11 U.S.C. § 327(a) (providing trustee should employ professionals who are disinterested and who do not hold adverse interests to estate); 11 U.S.C. § 1107 (stating debtor in possession shall have generally all rights and powers of trustee and perform all functions and general duties of trustee). The relevant Code provision requiring professionals involved in bankruptcy proceedings to be disinterested, however, do not impose such requirements for professionals employed by the debtor. See, e.g., 11 U.S.C. § 327. *Contra In re Sauer*, 191 B.R. 02 (Bankr. D. Neb. 1995) (holding Bankruptcy Code requires same degree of disinterestedness on part of attorney employed by debtor that is required of chapter 11 trustee).

⁹⁷ See, e.g., *In re Barrie Reed Buik-GMC, Inc.*, 164 B.R. 378, 381 (Bankr. S.D. Fla. 1994) (holding attorney for debtor has fiduciary duty to debtor as well as fiduciary obligation to act in best interest of entire estate, including its creditors).

⁹⁸ See *id.* at 381 (stating that if debtor is not fulfilling its fiduciary obligation to estate, it is responsibility and duty of debtor's attorney to bring such matters to attention of court).

MS. WHYTE: That's the only duty.⁹⁹

PROF. AYER: That's great. But the debtor, the DIP, and the debtor's attorney surely have the duty to make sure that the schedules are honest and the statements of affairs are filed¹⁰⁰ and that the debtor, as you say, otherwise meets his obligations. But the debtor's attorney has no continuing fiduciary duty because he has no continuing involvement in the case.

XIII. RECOMMENDING CHANGES TO THE "DISINTERESTEDNESS" REQUIREMENT

PROF. AYER: Well, it sounds like the system as created isn't perfect. It also sounds like it couldn't be a perfect system unless there was a provision where every DIP attorney was up front, took a set amount of money, handled the case for that amount no matter how long the case took, and provided that no fees would be taken if the case was finished in one day. But even that wouldn't be perfect. The wrong incentives would be there. So what we have here is a set of issues with some strengths and some weaknesses. What changes would you make? What result would there be? It would be a different set of strengths and weaknesses. So, if you want to take out the disinterestedness in this test, where does that leave us?

JUDGE CLEVERT: Well, I think you can sort of bifurcate even that and focus on two different things. One is this objective notion of the character of the debtor's professionals, who are also prepetition creditors.¹⁰¹ Under the Act, that was permitted in some instances. Dealing with that doesn't trouble me very much, because that's a very identifiable phenomenon; you can watch it. You can watch how people behave in light of the fact that they have a claim.

⁹⁹ See *In re Office Prods. of Am. Inc.*, 136 B.R. 964, 974 (Bankr. W.D. Tex. 1992) (implying debtor's attorney should limit tasks performed directly associated with debtor's duties in chapter 7); *In re Vlachos*, 61 B.R. 473, 482 (Bankr. S.D. Ohio 1986) (stating attorney for debtor in chapter 7 has obvious duty to maximize exempt property of client).

¹⁰⁰ See 11 U.S.C. § 521 (listing debtor's duties to provide list of creditors, schedule of assets and liabilities, cooperate with trustee, and surrender to trustee all property of the estate); *In re Matthews*, 154 B.R. 673, 678 (Bankr. W.D. Tex. 1993) (explaining debtor has duty to complete documents accurately and with due diligence).

¹⁰¹ See 11 U.S.C. § 101(14)(a) (1994) (providing that a disinterested person "is not a creditor, an equity security holder, or an insider"); *First Interstate Bank v. CIC Inv. Corp.* (*In re CIC Inv. Corp.*), 175 B.R. 52, 55-56 (9th Cir. B.A.P. 1994) (finding Code unambiguously precludes employment of professional with prepetition claim against estate); *In re Hub Bus. Forms, Inc.*, 146 B.R. 315, 322 (Bankr. D. Mass. 1992) (holding debtor may not employ counsel who holds prepetition unsecured claims for legal services); Scott E. Blakely, *Of Plain Meaning, Economic Realities and "Disinterestedness,"* 22 Cal. Bankr. J. 248 (1995) (noting courts are divided on whether debtor may employ professional holding prepetition claims). Compare *In re Brennan*, 187 B.R. 135, 152 (Bankr. D.N.J. 1995) (holding attorney's prepetition waiver of balance of prepetition claim against chapter 11 debtor upon receipt of partial prepetition claim on eve of filing was absolute relinquishment of rights in connection with such claim and thus attorney was not disqualified from representing debtor in bankruptcy).

PROF. AYER: So you're saying you would allow the professional, in some cases, even though he was an existing prepetition creditor.¹⁰² Is that right?

JUDGE CLEVERT: All I'm saying is that it's an issue that you can attack and deal with very simply.

PROF. AYER: So you want to do away with the per se rule in 101(14)¹⁰³ and leave it to adverse interest?

JUDGE CLEVERT: That would be an idea that I think we could deal with and leave the rest of it alone, even though it's fuzzy and has difficulties.¹⁰⁴ I think it's an area that is fuzzy. There is no way to define in a statute how you would disqualify a person because of relationships. It's a case by case thing.¹⁰⁵

PROF. AYER: Would you do the same with a director, an officer, or a shareholder? Would you strike that out of the per se test?

JUDGE CLEVERT: One of the big complaints I think that drives this movement [to do away with "disinterestedness"] at this point is dissatisfaction with the Delaware Corporate Secretary result where an attorney has 7,000 corporations. He's the corporate secretary for everyone of them. He also represents them as local counsel in the Delaware filing.

¹⁰² See *In re Financial News Network Inc.*, 134 B.R. 732, 734-35 (Bankr. S.D.N.Y. 1991) (recognizing limited exception permitting retention of professionals having prepetition claim).

¹⁰³ See generally *In re Pierce*, 809 F.2d 1356, 1362 (8th Cir. 1987) (holding that if professional is creditor, he will not be "disinterested" under § 101 and will be subject to disqualification under § 327(a)); *In re EWC, Inc.*, 138 B.R. 276, 279 (Bankr. W.D. Okla. 1992) (noting that evidence demonstrating that attorney for debtor in possession did not cause harm and acted in best interests of DIP would not change existence of conflict); *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742, 753 (Bankr. N.D. Tex. 1988) (holding professionals automatically disqualified when conflict is found). Compare *In re Caldor, Inc.*, 193 B.R. 165, 172 (Bankr. S.D.N.Y. 1996) (stating most courts eschew per se rule in favor of analysis premised on totality of facts and circumstances); *In re Timber Creek, Inc.*, 187 B.R. 240, 243 (Bankr. W.D. Tenn. 1995) (noting there was no language in Bankruptcy Code itself requiring a per se rule for lack of disinterestedness); *In re Decor Corp.*, 171 B.R. 277, 282 (Bankr. S.D. Ohio 1994) (stating courts generally refuse to follow per se rule that counsel is disqualified because of lack of disinterestedness under § 101(14)).

¹⁰⁴ See Harold D. Jones, *Suggestions to Commission and Congress, Revising Disinterestedness Standard*, in SUGGESTIONS FOR THE NATIONAL BANKRUPTCY REVIEW COMMISSION, 4 AM. BANKR. INST. L. REV. 487, 527 (Winter 1996) (recommending elimination of disinterestedness standard).

¹⁰⁵ See, e.g., *In re Martin*, 817 F.2d 175, 182 (1st Cir. 1987) (adopting case-specific approach); *Michel v. Carter (In re Carter)*, 116 B.R. 123, 126-27 (E.D. Wis. 1990) (stating courts generally disqualify counsel on a case-by-case approach).

PROF. AYER: So he's an officer and not disinterested.¹⁰⁶

JUDGE CLEVERT: Yes, because he's the type of officer that nobody is really concerned about.

JUDGE AYER: It sounds like you'd do away with the per se rule with respect to both fees and with respect to directors, officers, and shareholders.

JUDGE CLEVERT: Well, it gets more complicated with directors and officers, because they may be part of the people that brought the debtor where it is now, which is in bankruptcy.¹⁰⁷

PROF. AYER: Oh, sure, and maybe they shouldn't represent them, but could we deal with that under an "adverse interest" test?

JUDGE CLEVERT: Well, not necessarily "adverse interest," but certainly in terms of some nuance of the relationship.

PROF. AYER: No, I meant assimilating state law. Several people in the audience have pointed out that in a lot of situations where there is a director, officer or a large creditor, they ought to be debarred under ethics rules independent of bankruptcy, which probably gets carried into bankruptcy via "adverse interest."¹⁰⁸

JUDGE CLEVERT: Well, that means you have 52 standards of conduct,¹⁰⁹ and I don't know that we want to encourage that either.

¹⁰⁶ See 11 U.S.C. § 101(14)(A) (providing a disinterested person is not an insider); 11 U.S.C. § 101(14)(D) (providing a disinterested person is not and was not, within two years before filing petition, a director, officer, or employee of debtor).

¹⁰⁷ See *In re Leslie Fay Cos.*, 175 B.R. 525, 534-35 (Bankr. S.D.N.Y. 1994) (finding Leslie Fay senior management directly responsible for accounting irregularities and outside directors were found to be potentially liable for the problems that led to bankruptcy filing).

¹⁰⁸ See *supra* notes 47-49 and accompanying text.

¹⁰⁹ All 50 states and the District of Columbia have adopted their own codes or rules of professional responsibility. In 1908, the American Bar Association first issued Canons of Professional Ethics. See Charles W. Wolfram, *MODERN LEGAL ETHICS*, 54 n.21 (1986) (stating Canons of Professional Ethics were largely taken from 1887 Alabama State Bar Association). The Canons of Professional Ethics was superseded in 1969 by the Model Code of Professional Responsibility. See Sutton, *Introduction to Symposium -- The American Bar Association Code of Professional Responsibility*, 48 TEX. L. REV. 255, 255 (1970) (examining adoption of 1969 Model Code). The American Bar Association eventually adopted Model Rules of Professional Conduct in 1983. See BROOKE WURNICKE, *ETHICAL COMPLIANCE FOR BUSINESS LAWYERS*, 2 (1986). A majority of states today 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).

PROF. AYER: I think that might be right. A problem with "disinterestedness" is that it's a bright-line goofy rule. A problem with "adverse interest" is that it's a very slushy, very hard to administer rule. Nancy, how would you amend that statute if you got your shot?

PROF. RAPOPORT: What I think we're doing wrong is that we're trying to patch something up rather than determine why we have "disinterestedness" to begin with. I just don't buy that it's because of public distress about the system, because they don't hate *us* any more than they hate any *other* lawyers. So it can't just be that.

JUDGE PELOFSKY: I would agree, it's lawyers in general.

PROF. RAPOPORT: Yes, but I don't think we should build a system where everyone starts off on day one already losing a little bit of money, and create a bar to representing a DIP based on those few people who follow bankruptcy cases in the news, or the few people who are concerned with a particular bankruptcy case. So I don't think we should do it in terms of deciding "disinterestedness" based on public interest.¹¹⁰ I think we should determine it based on who is going to get the debtor *in possession* to an endpoint that's positive.

PROF. AYER: Would you leave the per se rule in disinterestedness?

PROF. RAPOPORT: I'd take it absolutely out, use "adverse interest," and use the state ethics rules. There's actually not 52; there's just two and then a blend of varieties.¹¹¹ And I would just say, "if you can't carry out the ultimate goal, which is to take this person through bankruptcy, you shouldn't be representing that person, and if you can, you can."¹¹²

¹¹⁰ See *In re Lee Way Holding Co.*, 100 B.R. 950, 958 (Bankr. S.D. Ohio 1989) (recognizing that court ensures integrity of bankruptcy process and maintains public confidence in bankruptcy system by scrutinizing "disinterestedness" of professionals); *Barton v. Chrysler (In re Paine)*, 14 B.R. 272, 275 (W.D. Mich. 1981) (noting that awarding fees to attorneys who had conflicts would create undesirable effect undermining public confidence in integrity of judicial process).

¹¹¹ See *supra* note 114. Individual states have adopted either the Model Code or the Model Rules with some variance. Thirty-six states have adopted the Model Rules although actual versions may differ. See Kohn & Schuster, *supra* note 114 at 127.

¹¹² See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105(A) (1980) (providing lawyer should decline preferred employment if it would be likely to involve lawyer in representing differing interests); *In re Philadelphia Athletic Club, Inc.*, 20 B.R. 328, 334 (E.D. Pa. 1982) (relying on Model Code's "appearance of impropriety" standard, stating professional engaged in bankruptcy cases should exercise detached judgment in determining whether involvement would impair best interests of debtor's estate).

PROF. AYER: We seem to assume that it is hard to write a clear rule on adverse interest. Would you buy that?

PROF. RAPOPORT: No, I don't think so. I think the state codes of ethics do a decent job. If you can't do your job for a particular client, without getting confused on your way, you shouldn't be doing it.

PROF. AYER: Judge Clevert, how would you change the Code?

JUDGE CLEVERT: I don't legislate. [laughter]

PROF. AYER: And you don't give advisory opinions either. [laughter] Bettina, do you want to write some law?

MS. WHYTE: No, I don't. But I really do agree exactly with Nancy's position. I really like the disclosure statement that the ABA recommended¹¹³ because I think so much of this really goes, not just to the *first* disclosure, but to *ongoing* disclosure.¹¹⁴ And I guess I also feel that the creditors, the equity holders, and the bond holders should never have responsibility to live up to a disinterestedness standard when they feel that any conflict is not great enough to overrule what is the best result for the estate.

PROF. AYER: I won't attempt to itemize the areas of disagreement, but I think there is fairly general agreement on this panel that a lot of these problems are

¹¹³ See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1983). Rule 1.7 provides:

(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 lawyer's responsibilities to another client or to a third person or by the lawyer's own interests, 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.

¹¹⁴ See *In re Southmark Corp.*, 181 B.R. 291, 295 (Bankr. N.D. Tex. 1995) (noting the continuing disclosure and obligation imposed by court pursuant to the Code implicates public policy interest justifying relief from judgment); see also *In re National Liquidators, Inc.*, 171 B.R. 819 (Bankr. S.D. Ohio 1994) (holding all compensation was denied for law firm's inadequate disclosure and failure promptly to supplement initial disclosures of adverse interests).

disclosure problems and professionals do have a right to some kind of dependability and predictability in this system. Right?

MS. WHYTE: That's why I like the idea of being able, up front, to say, if this becomes a problem, you will be carved out of whatever the issue is. Or, if it feels like you can't be carved out, then I think a decision needs to be made up front. One of the things that I would suggest, and I don't know if it resolves all the problems, is a sort of two-step approval process of professionals. One is the immediate one by the judge,¹¹⁵ and the second takes place sixty days out, when you know who more of the parties of interest are, etc., and that you don't just serve your applications on the few parties that you know the first day of the case or the second or third. You do it sixty days out again, and that there's a court hearing.

PROF. AYER: And the lenders lose the protection of section 364¹¹⁶ that says that we're protected on moneys that we lend before this decision is overruled on appeal.

QUESTION: As I see the statute that exists right now, there is apparently some sort of evil out there that they're trying to remedy.¹¹⁷ And they're trying to describe what causes this evil. It seems to me that we should really try to find out what it is that they're trying to cure or remedy. If they would define or build in to the statute what it is they're trying to accomplish, what the goal is, what the remedy is, what they're trying to cure, and then place guidelines in the statute as to the things that might violate those goals, as opposed to being hard and fast rules, we could eliminate some of these problems.

PROF. AYER: Professor Rapoport, do you know what we're trying to accomplish in the bankruptcy system?

PROF. RAPOPORT: Well, a variety of different things, depending on which side you're on. The problem is, we don't *really* know what the goal of the

¹¹⁵ See FED. R. BANKR. P. 2014 (requiring verified statement from professional to be submitted to court prior to employment of professional detailing professional's "connections with the debtor, creditors, and any other party in interest . . ."); *Rome v. Braunstein*, 19 F.3d 54, 59 (1st Cir. 1994) (noting although bankruptcy court has affirmative duty to exercise vigilance in avoiding impermissible conflicts of interest of court appointed counsel, normally professionals with knowledge of competing interests, must present conflicts to court).

¹¹⁶ See 11 U.S.C. § 364(e) (1994) (permitting lender to retain priority although authorization given to debtor to obtain credit has been reversed or modified).

¹¹⁷ *In re EWC, Inc.* 138 B.R. 276, 279 (Bankr. W.D. Okla. 1992) (noting argument of U.S. Trustee that representation of both debtor and its sole shareholder in actions where attorney must take positions adverse to one of the clients is exactly the evil to be avoided by the disinterestedness and disclosure requirements).

Bankruptcy Code is—whether it's to protect the creditors or whether it's to protect someone else.¹¹⁸

PROF. AYER: I think we *do* know what the goal of the bankruptcy system is. The goal is to permit us to achieve inconsistent things in different cases under the pretense of a consistent body of law. Right? [laughter] The system doesn't make any sense and it's not supposed to make any sense.

QUESTION: Because it's not about getting into the case and getting paid. When you make the DIP's lawyer disinterested, you give him a responsibility to satisfy every one of those objectives that you can't even define.¹¹⁹

PROF. AYER: Oh, I can *define* them, I just can't *reconcile* them. But as long as we get paid as well as we do, nobody's going to cry about us.

JUDGE PELOFSKY: If you apply the state rules then essentially what you're doing is insisting upon having local counsel, or making it so difficult that a person from New York going to, say—Wyoming, would then have to join the Wyoming Bar and become familiar with the Wyoming rules. I think that also flies in the face of the requirement that there be uniform bankruptcy laws.

PROF. AYER: I'm going to take the prerogative of the Chair and declare us closed before the audience disappears. Thank you all and thanks to my co-panelists here.

¹¹⁸ See, e.g., *United Sav. Ass'n. v. Timbers of Inwood Forest Assocs., Ltd.* (*In re Timbers of Inwood Forest Assocs., Ltd.*), 808 F.2d 363, 372 (5th Cir. 1987) (stating goals of Bankruptcy Code provisions in reorganizations is to protect creditors); *In re Realty Trust Corp.*, 143 B.R. 920, 930 (N. Mar. I. 1992) (providing among the goals of bankruptcy system are providing a fresh start, putting an end to litigating old debts, rehabilitating debtors, protecting investors and creditors, and distributing assets fairly); *Margell v. Bouguet Inv.* (*In re Bouguet Inv.*), 32 B.R. 988, 990 (Bankr. C.D. Cal. 1983) (noting bankruptcy law as collective remedy is designed to serve creditors and provide debtor with fresh start).

¹¹⁹ For the purposes of section 327(a), "trustee" is synonymous with "debtor in possession." Therefore, section 1107(a) confers most of the rights and responsibilities of a trustee upon a debtor in possession. See 11 U.S.C. § 1107(a) (1994) (providing that debtor in possession shall have all the rights, powers, and shall perform duties and functions of a trustee serving in chapter 11 case). It is inferred, therefore, that the attorney for the debtor in possession shall assist the DIP to fulfill the duties and perform the functions; see also *In re Porter Co.*, 183 B.R. 96 (Bankr. W.D. Pa. 1995) (holding DIP could enforce rights of creditor by employing power granted to trustee); *Shuck v. Seminole Oil & Gas Corp.* (*In re Seminole Oil & Gas*), 963 F.2d 368 (4th Cir. 1992) (stating that DIP has same powers as trustee unless otherwise ordered by court).