COMMENTS

DISAGREEMENT AMONG THE DISTRICTS: WHY SECTION 327(a) OF THE BANKRUPTCY CODE NEEDS HELP

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A bankruptcy proceeding where the debtor's counsel is a creditor of the estate presents bankruptcy courts with a question which they have yet to address uniformly. Some courts have held that such a relationship is permissible, as long as the attorney's position is not materially adverse to that of the debtor.1 However, the majority of courts have held that the creditor-attorney is per se disqualified to represent the debtor under a strict reading of the Bankruptcy Code and Rules.2 Courts disagree as to whether such a relationship is


1 See, e.g., In re Microwave Products of Am., 94 Bankr. 971, 974-75 (Bankr. W.D. Tenn. 1989) (holding that a professional who is a creditor solely because of pre-petition work is not automatically disqualified); In re Viking Ranches, Inc., 89 Bankr. 113, 115 (Bankr. C.D. Cal. 1988) (noting that the disqualification exception carved out by § 1107(b) for professionals previously employed necessarily includes those who are creditors because of such prior employment); In re Best W. Heritage Inn Partnership, 79 Bankr. 736, 740 (Bankr. E.D. Tenn. 1987) (stating that in a debtor in possession case a strict reading of the statute does not make sense to require a disinterested attorney); In re Heatron, Inc., 5 Bankr. 703, 705 (Bankr. W.D. Mo. 1980) (holding that the debtor's pre-petition attorney does not have an interest adverse to the estate merely by being owed fees and is therefore not disqualified).

2 See, e.g., In re Watervliet Paper Co., 96 Bankr. 768, 770 (Bankr. W.D. Mich. 1989) (holding that the debtor's pre-petition attorney was statutorily ineligible to continue representation because prior unpaid fees rendered the attorney a creditor of the estate); In re Roberts, 75 Bankr. 402, 413 (D. Utah 1987) (en banc) (holding that a pre-petition creditor attorney does not meet the “disinterested person” criteria and is therefore disqualified from representing the debtor); In re Estes, 57 Bankr. 158, 162-63 (Bankr. N.D. Ala. 1986) (claiming that a creditor attorney is not a “disinterested person” under the Bankruptcy Code); In re Pulliam, 96 Bankr. 208, 213 (Bankr. W.D. Mo. 1986) (holding that a creditor attorney is statutorily ineligible to represent the debtor in bankruptcy); In re Patterson, 55 Bankr. 366, 372 (Bankr. D. Neb. 1985) (refusing to apply Heatron and holding that a creditor attorney is not disinterested under the Code); In re Anver Corp., 44 Bankr. 615, 618 (Bankr. D. Mass. 1984) (stating that the exception carved out by section 1107(b) is for those who would be disqualified solely for previous employment, not for those who were also owed fees).
allowable in the case in which the creditor-attorney's claim relates to
pre-petition work wholly unconnected to the current bankruptcy, and in the case in which the attorney takes a security interest in the
debtor's assets to secure bankruptcy fees. Yet courts have moved
away from a strict reading of the Code, as such a strict interpretation
would make only pro-bono attorneys eligible for employment.

The judicial inconsistency has led to unpredictable results, and
in the process the Code has become distorted. This Comment ana-
lyzes the differing treatment bankruptcy courts give a debtor's coun-
sel when the attorney is a creditor of the estate, and proposes certain
amendments to the Bankruptcy Code that will lead to more uniform
and equitable results. Part I lays out the Bankruptcy Code sections
that are the source of the confusion and controversy in the courts.
Part II exposes the differing treatment by the courts of similar factual
situations. This lack of consistency stems from the courts' various
interpretations of the interplay of several Code sections. Part III
explains why a hard line denial of representation, the majority posi-
tion, is not acceptable, and not necessary since the system's integrity
will remain intact through the ethical provisions in the Model Code
of Professional Responsibility or the Model Rules of Professional
Conduct. Part III concludes with suggested amendments to the
Bankruptcy Code, which could lead not only to more consistent
results, but to ones more acceptable to all participants in the bank-
ruptcy arena.

3 Compare supra note 1 with supra note 2 (highlighting the different treatment of a
pre-petition creditor-attorney).

4 See, e.g., In re Martin, 817 F.2d 175, 181 (1st Cir. 1987) (upholding the district
court's reversal of the bankruptcy court's invalidation of a mortgage taken as a
retainer, because § 327(a) "will not support . . . a bright-line rule" precluding all
retainer arrangements); In re Carter, 101 Bankr. 563, 565 (Bankr. E.D. Wisc. 1989)
(claiming that since a mortgage is merely a lien, and not a "right to payment," the
attorney taking a security interest in the debtor's property is not a creditor); In re
Watson, 94 Bankr. 111, 116 (Bankr. S.D. Ohio 1988) (stating that the retention of a
pre-petition security interest in the debtor in possession's assets to secure payment of
bankruptcy related fees is not per se disqualifying). But see In re Pierce, 809 F.2d
1356, 1363 (8th Cir. 1987) (relying on In re Martin, 59 Bankr. 140, 143 (Bankr. D.
Me. 1986), aff'd, 62 Bankr. 943 (D. Me. 1986), vacated, 817 F.2d 175 (1st Cir. 1987),
in stating that an attorney's pre-petition mortgage on the debtor's real estate
constitutes an "adverse interest" under § 327(a)); In re Crisp, 92 Bankr. 885, 895
(Bankr. W.D. Mo. 1988) (claiming that a security interest in the debtor's property
renders the attorney not disinterested under § 327(a)).

5 See infra note 19 and accompanying text.
I. THE CODE SECTIONS IN CONTROVERSY

The problem centers around the interaction of several sections of the Bankruptcy Code, with section 327(a) at the hub. Section 327, entitled "Employment of professional persons," states:

Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title. 6

This section applies to debtors in possession 7 through section 1107, that states in relevant part:

(a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter.
(b) Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case. 8

A controversy arises whenever a debtor in possession wishes to retain her pre-bankruptcy counsel as her attorney of record for the bankruptcy proceeding. It is important to allow the debtor to choose her own counsel freely. 9 An attorney who has worked for the debtor in the past will be more familiar with the situation at hand and need not spend as much time familiarizing herself with the business. Also, the debtor may be more willing to share records and other pertinent

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7 A debtor in possession is generally understood to be the debtor, or bankrupt herself, who is managing her own affairs without the oversight of a trustee. 11 U.S.C. § 1101(1) (1988).
8 11 U.S.C. § 1107 (1988). Subsection (a) also includes specific exceptions to the general powers granted to the debtor in possession that need not be mentioned here. For a discussion of these powers, see infra note 45 and accompanying text.
9 See In re Watson, 94 Bankr. 111, 114 (Bankr. S.D. Ohio 1988) (holding that "only in the rarest cases will the trustee [or debtor in possession] be deprived of the privilege of selecting qualified counsel since the relationship between them is highly confidential, demanding personal faith and confidence in order that they may work together harmoniously") (citing In re Market Response Group, Inc., 20 Bankr. 151 (Bankr. E.D. Mich. 1982)); In re Roberts, 46 Bankr. 815, 845 (Bankr. D. Utah 1985) (referring to the "social interest in obtaining counsel of one's choice"), aff'd in part, rev'd in part, 75 Bankr. 402 (D. Utah 1987) (en banc).
information with a lawyer she knows and trusts. These factors lead to lower administrative fees to be paid out of the estate, and thus, directly benefit the estate. Unfortunately, as with most long-term business relationships, pre-petition legal fees are rarely paid in full, and an outstanding balance often remains. This is especially true in the months immediately prior to the bankruptcy filing, when the attorney does not wish to push the client over the brink by collecting past due fees. Thus, the attorney is a pre-petition creditor of the debtor.

This creates a problem, as section 327(a) clearly states that a debtor in possession may only employ disinterested persons as attorneys. A "disinterested person" is defined by section 101(13) as one who, among other factors,

- is not a creditor, an equity security holder, or an insider;
- does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor.

A strict reading of the statute indicates that an attorney to whom fees are owed prior to the filing is a creditor, and as such is not disinterested. Under this interpretation, an interested professional person is not employable by either the trustee or the debtor in possession to work on the bankruptcy proceeding. However, such a strict interpretation also leads to the situation whereby no attorney is employable because as soon as she does any preparatory bankruptcy

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10 See In re O’Connor, 52 Bankr. 892, 895 (Bankr. W.D. Okla. 1985) (stating “[a]s a result of machinations indigenous to the particular individual, from the perspective of savings to the respective estates through curtailment of administrative expenses, i.e. legal fees, it is advantageous that the same attorney, or firm, attempt to unravel the Gordian knot constructed by the debtor”).

11 Also, if a law firm were to collect the fees immediately before the client became insolvent, they might have to be refunded as a preferential transfer. See infra note 50 and accompanying text.

12 See 11 U.S.C. § 101(9) (1988) (defining "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor"); see also id. § 101(4) (defining "claim" as a "right to payment" regardless of its status).

13 Although section 327(a) uses the term "trustee," the provision also applies to debtors in possession, as noted previously. See supra text accompanying notes 7 & 8.


15 See supra note 12 and accompanying text.

16 See supra text accompanying note 14.

17 See supra text accompanying note 6.

18 See supra text accompanying notes 7 & 8.
work, prior to the order for relief, she either becomes a creditor or has an actual conflict due to her preferential cash payment. Such a result is absurd. Indeed, courts have admitted that such a strict reading is not possible, but once they have moved away from the safety of a bright line rule, they disagree as to where to draw an arbitrary one.

II. Confusion in the Courthouse

A. Generally

The disparate treatment by the courts has led to much confusion. Court interpretation of the Code directly affects the debtor’s choice of counsel. Even if the court initially approves the debtor’s choice, the attorney may subsequently be denied fees if a violation of section 327(a) is discovered. Section 328(c) allows the court to deny fees for a violation of section 327(a):

Except as provided in Section 327(c), 327(e), or 1107(b) of this

19 See In re Martin, 817 F.2d 175, 180 (1st Cir. 1987). In Martin, the court explained:

[Al]ny attorney who may be retained or appointed to render professional services to a debtor in possession becomes a creditor of the estate just as soon as any compensable time is spent on account. Thus, to interpret the law in such an inelastic way would virtually eliminate any possibility of legal assistance for a debtor in possession, except under a cash-and-carry arrangement or on a pro bono basis.

Id.

20 See In re Roberts, 46 Bankr. 815, 849 (Bankr. D. Utah 1985) (stating “the conflict of interest would not be eliminated if the law firm obtained from the client a pre-petition payment of these fees and costs because such a payment would likely constitute a preference that may be avoided for the benefit of other creditors . . .”), aff’d in part, rev’d in part, 75 Bankr. 402 (D. Utah 1987) (en banc).

21 See In re Watson, 94 Bankr. 111, 114 (Bankr. S.D. Ohio 1988) (stating that such a strict reading produces “an obviously ludicrous result”); In re Best W. Heritage Inn Partnership, 79 Bankr. 736, 739 n.2 (Bankr. E.D. Tenn. 1987) (taking it as settled that an attorney not paid in full for pre-filing bankruptcy related fees is not disqualified). In Martin, the court stated:

[S]uch a literalistic reading defies common sense and must be discarded as grossly overbroad . . . . It stands to reason that the statutory mosaic must, at the least, be read to exclude as a ‘creditor’ a lawyer, . . . who is authorized by the court to represent a debtor in connection with reorganization proceedings—notwithstanding that the lawyer will almost instantaneously become a creditor of the estate with regard to the charges endemic to current and future representation.

In re Martin, 817 F.2d at 180. See also Roberts, 46 Bankr. at 849 (claiming “these pre-petition fees and costs are recoverable as part of the fees allowed, generally, under Sections 327, 329, and 330 of the Code and Bankruptcy Rule 2014”).

22 See Roberts, 46 Bankr. at 849 (initially approving the employment of the
If the attorney cannot be sure where the court will draw the line, she cannot make rational decisions about whether to represent a prior client in a bankruptcy proceeding. Even if she discloses everything and is approved, she can later be denied compensation because the judge reconsidered the issue. Also, if the attorney inadvertently overlooked a prior connection with the debtor or an aspect of their prior relationship that the court feels is material, she can be denied fees. Because attorneys may be denied the opportunity to represent their client from the outset, many downplay their prior dealings and bury the information in the back pages of their application. Since sanctions are neither uniform nor absolute, these underhanded practices many times pay off. The need for consistency

debtor in possession's attorney based on affidavits claiming that the law firm did not hold any interests adverse to the estate, but subsequently denying all fees upon discovering undisclosed conflicts, even though the representation resulted in an uncontested reorganization plan calling for full payment to all creditors). Bankruptcy Rule of Procedure 2014 calls for the disclosure of any and all prior involvement with the debtor in an application including: “any proposed arrangement for compensation, and, to the best of the applicant’s knowledge, all of the person’s connections with the debtor . . . .” FED. R. BANKR. P. 2014. Many courts state that the attorney must explicitly lay out the potential conflicts and prior dealings directly on the application and may not bury the information in the tables or schedules, because “[i]t is not the duty of the bankruptcy judge to ferret out the falseness of such a statement . . . .” In re Estes, 57 Bankr. 158, 161 (Bankr. N.D. Ala. 1986). Other courts view the inclusion of the information, regardless of its location, as a mitigating circumstance and allow partial fees when the conflict is discovered. See Best W. Heritage Inn Partnership, 79 Bankr. at 741 (stating that a firm will not be disqualified for failure to reveal the conflict because, “[t]hose facts had already been revealed in the schedules and statement of affairs”).

23 11 U.S.C. § 328(c) (1988). The exceptions include section 327(c), which deals with the hiring of attorneys who had previously represented a creditor; section 327(e), which deals with attorneys hired to handle connected tort or criminal matters, and § 1107(b), quoted earlier, which deals with attorneys who had previously represented the debtor.

24 See In re Heatron, Inc., 5 Bankr. 703, 705-06 (Bankr. W.D. Mo. 1980) (sustaining an application to employ the attorney "subject to review from time to time and subject to reconsideration upon objection of creditors").

25 See supra note 22.

26 See id.
among the different judges and over time is critical. Courts are currently divided as to whether the attorney should be disqualified from representing the debtor in bankruptcy when the debtor has a non-bankruptcy related pre-petition unsecured claim, a non-bankruptcy related secured claim, a bankruptcy pre- and post-petition cash retainer, or a security interest, such as a mortgage on the debtor's property. Courts often avoid the issue by disallowing the fees because of the failure to disclose the potential or actual conflict, but their dicta on whether fees would be allowed if there had been full disclosure often differs markedly.

B. Non-Bankruptcy Related Pre-Petition Unsecured Claims

1. Representation Allowed

In the case of In re Heatron, Inc., the debtor's attorney was not disqualified even though he was one of the ten largest creditors of the estate. Section 1107 states that prior representation is not in itself disqualifying; but what of section 327(a)'s requirements that the attorney not hold an adverse interest and be disinterested? The court circumvented this hurdle by stating that "[i]t cannot be said absolutely that being an unsecured creditor creates a position adverse to the debtor." The court then concluded that "an attorney who has represented the debtor prior to the filing of the bankruptcy proceeding, who assisted in the preparation of the petition and who is a major creditor, without more, does not have an interest adverse to the debtor," noting that,

[t]he fact that the attorney is interested, in the sense of being a creditor because of prior service to the debtor, has less significance when his service to the estate will be only a continuation of that prior function. The interest does not offset the value afforded by the attorney's experience and familiarity with the affairs of the debtor.

This view, however, is the minority position, and is followed by only a handful of courts.

In In re Leisure Dynamics the court relied on the Heatron analysis of § 1107(b) in approving an accounting firm's application. The Leisure court stated that Heatron stood for the proposition that a pre-

27 5 Bankr. 703 (Bankr. W.D. Mo. 1980).
28 Id. at 705.
29 Id.
30 Id.
petition debt from previous representation of the debtor was included in the § 1107(b) exception, and accordingly allowed a creditor-attorney to represent his debtor-client in bankruptcy.\textsuperscript{32}

More recently, \textit{In re Best Western Heritage Inn Partnership}\textsuperscript{33} held that the debtor's pre-petition attorney "should not be automatically disqualified as a creditor because he is owed fees for non-bankruptcy work done before the Chapter 11 petition was filed."\textsuperscript{34} \textit{Best Western} also held, however, that "[t]he attorney should still be disqualified under § 327(a) if the claim for fees gives him an interest adverse to the bankruptcy estate."\textsuperscript{35} The court implied that it is possible to violate one prong of the test, and be interested, without being disqualified for employment. Although the court noted that the holding is at odds with a strict reading of the Code, the judge reconciled the conflicting interpretations by claiming, "§ 1107(a) should allow the court to distinguish between the rule applied to a trustee and the rule applied to a debtor-in-possession based on the fundamental difference in their relationship to the parties interested in the Chapter 11 case."\textsuperscript{36}

The \textit{Best Western} court looked to the legislative history of the Bankruptcy Code to trace the reasons for requiring a disinterested attorney, and determined that prior law had two business reorganization chapters: Chapter X, which contemplated a trustee in the majority of cases, and Chapter XI, which rarely required one.\textsuperscript{37} The court enumerated the reasons for requiring a disinterested trustee and, consequently, a disinterested attorney: when a trustee is appointed, she replaces the current management and directors of the company.\textsuperscript{38} Because this process seeks to ensure that the stockholders and creditors are treated fairly, the trustee must not be swayed by feelings of favoritism or loyalty.\textsuperscript{39} It similarly makes sense to require that the trustee's attorney be disinterested.

In passing the Bankruptcy Code, Congress extended the requirement that the trustee be disinterested from business reorganizations to other trustee cases.\textsuperscript{40} The \textit{Best Western} court stated, "[i]t

\begin{footnotes}
\footnote{32} See id. at 757.
\footnote{33} 79 Bankr. 736 (Bankr. E.D. Tenn. 1987).
\footnote{34} Id. at 741.
\footnote{35} Id.
\footnote{36} Id. at 740.
\footnote{37} See id. at 739 & n.1 (relying on 5 \textit{COLLIER ON BANKRUPTCY §§} 1101.1, 1104.1 (L. King, B. Levin & N. Klee 15th ed. 1987)).
\footnote{38} See id. at 739.
\footnote{39} See id.
\footnote{40} See Id. at 740; 11 U.S.C. §§ 701-703 & 1302 (1988).
\end{footnotes}
follows, as under old Chapter X, that a disinterested trustee should have a disinterested attorney. It does not follow that a debtor-in-possession should have a disinterested attorney." Indeed, the court noted that neither old Chapter X nor Chapter XI required debtors in possession to have disinterested attorneys, presumably because of the differences between a debtor in possession and a trustee. A current Chapter 11 debtor in possession is allowed to retain her current management team, which gets the first opportunity to file a reorganization plan. It is this interested management, not the attorney, that gets the final say on the reorganization plan: the presence of a disinterested attorney will be an "ineffective safeguard for the rights of creditors and investors." The difference between a debtor in possession and a trustee also is illustrated by the fact that the debtor in possession is not required to perform the trustee's disinterested investigative duties. The Best Western court stated that it saw "no particularly good practical reason for requiring the attorney for the debtor-in-possession to be perfectly disinterested." In fact, the court stated, "[a]utomatic disqualification [of an attorney from representing a debtor in possession against whom he has a claim for pre-bankruptcy fees unrelated to Chapter 11 filing] simply does not make sense practically or logically, unless logic is limited to cross-referencing the statutes."

A 1988 California court cited Best Western with approval in In re Viking Ranches. Although it involved an accounting firm rather than a law firm, the case's reasoning is applicable in the law firm context. The court looked at the debtor in possession's right to retain its management team and other professionals who are familiar with the business and whom the debtor trusts. Most of these people would be owed fees for prior work at the outset of the bankruptcy, and to require that they be paid in full beforehand would severely curtail

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41 Best W. Heritage Inn Partnership, 79 Bankr. at 740.
42 See id.
43 See id.
44 See id.
45 See id.; 11 U.S.C. § 1107(a) (1988) ("[A] debtor in possession . . . shall perform all the functions and duties [of a trustee], except the duties specified in sections 1106(a)(2), (3), and (4) of this title . . . ."); id. § 1106(a)(3) ("[A trustee shall] investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan.").
46 Best W. Heritage Inn Partnership, 79 Bankr. at 740.
47 Id.
48 89 Bankr. 113 (Bankr. C.D. Cal. 1988).
49 See id. at 115.
the debtor's ability to continue operations. The payment of the fees prior to filing would be voided as a preferential transfer, thereby creating more problems than it would solve. The court also claimed that the prior employment exception to section 1107(b) does not make sense if it applies only to professionals previously paid in full. The court held that "the better reasoning, and practical logic dictates, that the term 'employment' under Section 1107(b), must include, in debtor-in-possession cases, any professional who is a creditor solely because of pre-petition employment."

Just last year, the court in In re Microwave Products of America followed Viking Ranches' reasoning and held that a public relations firm that was owed fees for pre-petition work fell within the section 1107(b) exception and could continue to work for the debtor in bankruptcy. The court criticized another court's decision in which a law firm was per se disqualified under sections 327(a) and 101(13) "notwithstanding 11 U.S.C. § 327(e) and (c), which provide that a professional person's concurrent employment by or representation of a creditor does not constitute a per se reason for disqualification absent an actual conflict of interest."

In In re Stamford Color Photo, the court stated: "[I]t is clear that relationships which raise questions of professional impropriety do not necessarily require disqualification and that approval of professional employment is within the discretion of the bankruptcy court."

See id. (stating that the seeking of fees whenever the firm is in financial difficulty would taint the relationship and cause adverse interests to arise when the fees must be recovered as preferential); In re Roberts, 46 Bankr. 815, 849 (Bankr. D. Utah 1985) (stating that "such a payment would likely constitute a preference that may be avoided for the benefit of other creditors, thus involving the law firm in a conflict of interest as the holder of an interest adverse to the estate in violation of Section 327(a)"), aff'd in part, rev'd in part, 75 Bankr. 402 (D. Utah 1987) (en banc). An extreme example of such a situation can be seen in the case of In re Michigan General Corp., 77 Bankr. 97, 101-02 (Bankr. N.D. Tex. 1987), aff'd in part, 88 Bankr. 773 (N.D. Tex. 1988), where the law firm had its client execute a wire transfer and cashier's check for more than $340,000.00 one day before filing, in order "to eliminate any possible conflict of interest between such law firm as a creditor of the Company and its counsel . . . ." Id. The court viewed this as a preferential transfer and subsequently denied all fees. See id.

See Viking Ranches, 89 Bankr. at 115 (claiming that if the professional had been paid in full, disinterestedness would not be at issue unless the employment had placed the professional in a materially adverse position, in which case the section 1107(b) exception would not apply anyway).

Id.


See id. at 974-75.

Id. at 973 (criticizing In re Patterson, 53 Bankr. 366 (Bankr. D. Neb. 1985)).

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The court went on to say that "[a] court must balance the right to freely choose counsel, the need to maintain ethical standards, the interests of justice, evidence of actual impropriety, and its own ability to continuously control its officers and use the remedy of disqualification if called for."58

2. Representation Disallowed

The majority view, however, is to disallow representation if the attorney is owed prior fees. Many courts hold that by being owed fees the attorney is a creditor and therefore statutorily disqualified from representing the debtor. This is the result obtained if one reads section 101(13), defining disinterested as "not a creditor," in conjunction with section 327(a), stating that the attorney must be disinterested. Although the judge in In re Anver Corp.59 wished to apply Heatron and allow the representation, he stated: "it is not the province of the courts to rewrite the statutes when they disagree with the policy, or non-policy, behind a statute."60 He continued, "[a]s the courts have noted: 'it is not the responsibility or function of this court to perform linguistic gymnastics in order to upset the plain language of Congress as it exists today.'"61 The court looked at the plain language of the statute sections and found no ambiguity.62 Similarly, the court found that "there is no purpose or policy, in the Code or its legislative history, that is contrary to the plain meaning of the statute's words."63 The judge thus denied the debtor's application to employ its pre-petition attorneys, stating "[the fact] that I personally disagree with the policies behind the statute, is... irrelevant. As long as the choice was clearly expressed, it was up to Congress and not the Court to determine policy."64

The court in In re Estes65 also refused to apply Heatron. Judge Watson believed that both the case and the court would be "impermissibly tainted with an impropriety" if the pre-petition attorney was

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57 Id. at 136-37.
58 Id. at 137.
60 Id. at 619.
61 Id. (quoting Alabama v. Marshall, 626 F.2d 366, 369 (5th Cir. 1980), cert. denied sub nom., Donovan v. Alabama, 452 U.S. 905 (1981)).
62 See id. at 620 & n.3 (stating that if §§ 1107(b) and 327(e) seem contradictory or duplicative "it is only because the House adopted § 1107 (b) of the Senate amendments to clarify a point not covered by the House bill").
63 Id. at 621.
64 Id. at 622.
allowed to represent the debtor. The court also held that a bankruptcy judge has the power "to revoke an order approving counsel's employment by the debtor, without a request from any party in interest and even when opposed by all parties represented by counsel." The judge concluded that *Heatron* erroneously relied upon decisions that predated section 327(a) and treated disinterestedness "as a redundancy to the requirement that no conflict of interests exists."

Similarly, the court in *In re Patterson* disallowed fees because of a per se violation of the statute. The judge reasoned that even if there were evidence that the general practice was to allow representation in these types of cases, he still had the duty to read the plain language of the statute and look at the legislative history. The court also found the debtor's awareness of the conflict to be irrelevant, claiming "there is nothing in the Bankruptcy Code that permits the debtor to consent to the conflict."

Other courts also have held that an attorney's pre-petition creditor status is a per se violation of section 327(a). *In re Roberts* held that "[t]he law firm, as a pre-petition creditor of the corporation, did not qualify as a 'disinterested person' and therefore was statutorily ineligible for employment." *In re Pulliam* also denied fees because of a per se violation, relying heavily on *Roberts*. In a more recent case, *In re Watervliet Paper Co.*, the court stated, "[n]ot only a strict reading, but... the only reading of Sections 327 and 101(13) of the Bankruptcy Code renders [a creditor] Applicant not 'disinterested'"
and thus ineligible for appointment.”

Quoting Judge Spector in In re Gray, Judge Stevenson wrote: “[t]he rule of disqualification is to be rigidly applied; it cannot be waived because of the integrity or ability of the particular person or firm involved.”

The Watervliet court further stated that a firm will be allowed to represent a debtor only if it first waives its pre-petition claim, thus becoming “disinterested.”

The disagreement over whether an attorney with pre-petition unsecured claims should be disqualified on a strict basis or on a case-by-case analysis has resulted in unnecessary confusion. Yet the disparate treatment and resultant confusion does not end there. Courts that reject a per se disqualification rule disagree on whether the conflict in question must be actual, hypothetical, theoretical, or potential. Their explanations, and their reasoning, do not clarify the matter. As one court stated: “[d]isqualification should be mandated when an actual, as opposed to hypothetical or theoretical, conflict is present. This in no way precludes disqualification for a potential conflict. The test is merely one of a potential actual conflict.”

On the other hand, the Roberts court stated that “[dual representation] may be potentially conflicting. While a potential conflict may justify further inquiry by the court . . . it does not by itself warrant a blanket denial of all legal fees incurred by the law firm in its representation. . . . [T]he court must determine that a conflict actually existed.”

Another court held, however, that “[t]he concept of potential conflicts is a contradiction in terms. Once there is a conflict, it is actual—not potential.”

The confusion is also not limited to unsecured pre-petition claims, but extends to retainers and fee arrangements of the debtor’s bankruptcy counsel as well.

C. Pre-Petition Secured Claims

Courts are in agreement that a secured non-bankruptcy related pre-petition creditor is a per se interested person, thereby disquali-

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77 Id. at 770.
79 Watervliet, 96 Bankr. at 773 (quoting Gray, 64 Bankr. at 507).
80 See Watervliet, 96 Bankr. at 774 (stating that the “waiver of this claim would render the firm disinterested and thus in compliance with Section 101(13)(A)”).
84 See infra notes 85-124 and accompanying text.
fied under section 327(a). But for some time, there has been disagreement as to whether the filing attorney may take a security interest in the debtor's property as a condition of representation.

1. Bankruptcy Cash Retainers

The debtor's attorney becomes a secured creditor upon receiving a cash retainer due to perfection by possession. The courts explain the seeming contradiction of allowing attorneys to accept retainers by claiming that, although they are secured creditors, the cash remains property of the estate until fees are approved. The court in *In re Burnside Steel Foundry Co.* stated that "there is nothing per se wrong with a debtor's attorney taking security for fees." In fact, the court described the practice as beneficial because it guarantees the availability of cash when fees are ultimately approved.

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85 See e.g., *In re Automend, Inc.*, 85 Bankr. 173, 176 (Bankr. N.D. Ga. 1988) (stating that an attorney with a security interest in the debtor's property for non-bankruptcy pre-petition work is per se disqualified from representing the debtor in possession); *In re Flying E Ranch Co.*, 81 Bankr. 633, 636-37 (Bankr. D. Co. 1988) (questioning "who represented the interests of the unsecured creditors and the Debtor" in dealing with the security interest taken by the debtor's own attorney); *In re Watson*, 94 Bankr. 111, 116 (Bankr. S.D. Ohio 1988) (holding that although taking a security interest to secure payment of bankruptcy fees is permissible, a security interest for non-bankruptcy work will result in the attorney's disqualification).

86 See, e.g., *In re Pierce*, 809 F.2d 1356, 1363 (8th Cir. 1987) (noting that attorney's fees may be denied if the attorney holds an interest adverse to the estate, but that this issue is left to the trial court's discretion); *In re Crisp*, 92 Bankr. 885, 894-95 (Bankr. W.D. Mo. 1988) (stating that fees may be denied if attorney's interest is adverse to that of the estate); *In re Martin*, 59 Bankr. 140, 143 (Bankr. D. Me. 1986) (noting that an attorney must not hold an interest adverse to the estate), aff'd, 62 Bankr. 943 (D. Me. 1986), vacated and remanded, 817 F.2d 175 (1st Cir. 1987) (holding that a mortgage in the debtor's property taken as a retainer is not per se invalid, but rather required a finding as to whether potential conflict between attorney and debtors rendered attorney's interest materially adverse to estate or creditors).

87 See UCC § 9-305 (1989) ("A security interest in . . . money . . . may be perfected by the secured party's taking possession of the collateral.").


89 Id. at 944.

90 See id. However, because the cash remains property of the estate, it is available for use by the trustee or debtor with consent of the court. Therefore, an opposite conclusion may be reached and the cash may not exist at the conclusion of the bankruptcy proceeding. Also, if the cash is spent by the trustee, the attorney no longer has possession, and therefore no longer has a secured claim. See generally United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) (discussing the elements of the estate and maintaining that the trustee's authority to use, sell, or otherwise convert assets extends even to property subject to a security interest). If a secured party with an interest in the cash collateral is uncomfortable with the debtor's use of the cash, she can file a motion under § 363(e) requesting the court to "prohibit or condition such use . . . as is necessary to provide adequate protection of such
Furthermore, in the event of a conversion to a Chapter 7 liquidation, the attorney's claim, as a secured transaction, does not get subordinated to administrative expenses. However, what effect the secured status of this claim will have on the attorney's ability to help the trustee in the Chapter 7 liquidation proceeding is questionable.

Courts do not recognize a conflict of interest between the attorney and trustee in Chapter 11 proceedings because the attorney does not have a "claim" for fees until the judge approves the fee statement. Therefore, the security interest in the fees actually arises after the bankruptcy proceeding is over. The use of a retainer would not constitute a claim either. A retainer for expenses is only allowed if disclosed and approved; its use is treated as the awarding of interim fees. Yet interim fees are not considered final until the final fee application is approved by the judge. Thus, if the retainer is excessive, it is subject to turnover pursuant to Bankruptcy Code section 329 and rule 2017. Furthermore, it is critical that the court regard the retainer as security for future fees rather than a flat fee payment in advance. A flat fee agreement would be avoided as a preferential transfer, and disqualify the attorney from representing the debtor. Because of these clearly detrimental results, the wording of a fee arrangement is crucial. The complexity inherent in regarding an attorney's retainer as a secured claim is even more apparent when the security interest is not in cash, but in real estate or other assets.

interest." In re Cropper Co., Inc., 35 Bankr. 625, 633 (Bankr. M.D. Ga. 1983) (quoting 11 U.S.C.A. § 363(e) (West 1979)). But if the secured party is the debtor's attorney, such a motion would constitute a conflict of interest.

See Burnside Steel Foundry, 90 Bankr. at 944.

The court in Burnside Steel does not question this, but under a per se rule, the attorney will be a creditor of the estate, and therefore unemployable by the trustee.

See In re Fidelity Mortgage Investors, 12 Bankr. 641, 644 (S.D.N.Y. 1981) (stating that an attorney's right to payment "accrued only when the Bankruptcy Judge made the determination as to what sum represented fair and reasonable compensation for such services").

See Burnside Steel Foundry, 90 Bankr. at 944.

Section 329(b) states in relevant part: "[i]f the attorney's] compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive . . ." 11 U.S.C. § 329(b) (1988). Rule 2017, entitled "Payment or Transfer to Attorney Before Commencement of Case," provides that upon motion by any party or the court, the court may determine whether any payment of fees or transfer of property to the debtor's attorney was excessive. See Bankr. R.P. 2017.

See Burnside Steel Foundry, 90 Bankr. at 945 n.1 (explaining the Code's differing treatment of a flat fee and a retainer and the resultant consequences).

See supra notes 69-79 and accompanying text.
2. Other Security Interest Retainers

The seminal case discussing the use of a mortgages claimed as a security interest is In re Martin.\textsuperscript{98} The Martin court reversed a lower court's determination that a mortgage in the debtor's property was per se invalid. The bankruptcy court held that the mortgage had to be voided.\textsuperscript{99} However, the appeals court held that "§ 327(a) will not support, either by its terms or by its objectives, a bright-line rule precluding an attorney at all times and under all circumstances from taking a security interest to safeguard the payment of his fees."\textsuperscript{100} The court drew a distinction between the always present danger of the lawyer's judgment being clouded by his own economic interests, and the extreme case where a lawyer sets aside the most promising assets of the debtor as a precondition of representation.\textsuperscript{101} The appeals court reasoned that determination of the propriety of such a fee arrangement should be made on a case by case basis.\textsuperscript{102} The court noted that "the Code is less than explicit in mapping the contours of the disinterestedness requirement."\textsuperscript{103} Moreover, the court posited that although a security interest ties up much needed assets, debtors are often short of cash, and "[r]eason requires that a balance be struck" in allowing some security arrangements.\textsuperscript{104}

In so holding, the Martin appeals court strayed from the strict definition of disinterestedness, seeing the "twin requirements of disinterestedness and lack of adversity"\textsuperscript{105} as a single issue—whether the attorney had an incentive to act contrary to the best interests of the estate or the reasonable perception of such an interest.\textsuperscript{106} The court stated that "[t]he naked existence of a potential for conflict of interest does not render the appointment of counsel nugatory, but makes it voidable as the facts may warrant."\textsuperscript{107} The important question is "whether a potential conflict, or the perception of one, renders the lawyer's interest materially adverse to the estate or the creditors."\textsuperscript{108} Thus, the court managed to work its way through the

\textsuperscript{98} 817 F.2d 175 (1st Cir. 1987).
\textsuperscript{100} In re Martin, 817 F.2d at 181.
\textsuperscript{101} See id.
\textsuperscript{102} See id. at 181-82.
\textsuperscript{103} Id. at 181.
\textsuperscript{104} Id.
\textsuperscript{105} Id. at 180.
\textsuperscript{106} See id.
\textsuperscript{107} Id. at 182.
\textsuperscript{108} Id.
issue of disinterestedness without clarifying the criteria that would trigger disqualification. In essence, the court claimed that the attorney will only be disqualified if he is actually adverse; however, adversity can arise from a potential conflict of interest or the perception of one. Accordingly, the court also stated that while "[not] every conceivable conflict must result in sending counsel away to lick his wounds . . . doubts are to be resolved in favor of invalidation." 

In an effort to clarify this ambiguous standard, the court noted the relevant issues to be considered in determining the propriety of counsel’s taking a security interest in a mortgage:

[T]he court should consider the full panoply of events and elements: the reasonableness of the arrangement and whether it was negotiated in good faith, whether the security demanded was commensurate with the predictable magnitude and value of the foreseeable services, whether it was a needed means of ensuring the engagement of competent counsel, and whether or not there are tell-tale signs of overreaching. The nature and extent of the conflict must be assayed, along with the likelihood that a potential conflict may turn into an actual one. . . . Perceptions are important; how the matter likely appears to creditors and to other parties in legitimate interest should be taken into account.

The court admitted that this list of factors was not all-inclusive, and emphasized that the most important concern is that “the matter not be left either to hindsight or the unfettered desires of the debtor and his attorney, but that the bankruptcy judge be given an immediate opportunity to make an intelligent appraisal of the situation.”

The reasoning of Martin has been followed in subsequent cases. One court elaborated on Martin, claiming that an order approving a security interest should be obtained before taking it. The court in In re Shah International, Inc. agreed that a security interest to secure fees was permissible, but noted that this was always the case, as the security interest, like a cash retainer, remained the property of the estate. The court claimed that “[t]he granting of the mortgages will have little, if any, impact on pre-petition unsecured creditors because the expenses of administration must be paid.

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109 See id. at 183.
110 Id.
111 Id. at 182.
112 Id.
before the pre-petition unsecured creditors receive any distribution. It matters not to unsecured creditors whether the expenses of administration are secured.” The court found that there was no legally significant difference between the mortgage and a cash retainer, and that the attorneys were disinterested persons under sections 101(13) and 327(a).

Other courts, however, have relied upon the lower Martin court’s reasoning, and have held that an attorney’s pre-petition mortgage on the debtor’s real estate, as security for bankruptcy fees, constitutes an “adverse interest” under section 327(a). The lower Martin court, after setting forth the applicable Code sections (sections 327(a), 1107(a), and 101(13)) reasoned that the attorneys held an adverse interest and were not disinterested. The court essentially followed the same line of reasoning as the In re Roberts opinion by holding that pre-petition non-bankruptcy creditors were per se disqualified. The court stated that a law firm “should not have been employed as attorneys for the debtors in possession with the court’s approval without divesting itself of its interest in the debtors’ property. In future cases employment under such circumstances will not be approved.” The court pointed out that “[t]he potential for conflicting loyalties are many . . . . The Code does not permit such potential conflicts.” But the court then stated that “[i]t does, however, permit a retainer, subject to review by the court under Section 329 . . . .” The court did not explain the relevance of this last sentence, although it had found that the mortgage was executed to serve as a retainer.

The widespread confusion and varying interpretations of what is allowable under section 327(a) makes it unworkable. The interaction of the sections creates a convoluted mess that leads to problematic results if read literally, and uncertain results if interpreted with a sense of reality. The Code, therefore, needs revision. I shall now

116 Id. at 137.
117 See id. at 138.
118 See In re Pierce, 809 F.2d 1356, 1363 (8th Cir. 1987). Pierce relied on In re Martin, 59 Bankr. 140, 143 (Bankr. D. Me. 1986) (claiming that a security interest in the debtor’s property renders the attorney not disinterested under section 327(a)), aff’d, 62 Bankr. 943 (D. Me. 1986), vacated, 817 F.2d 175 (1st Cir. 1987).
119 See Martin, 59 Bankr. at 142-43.
121 Martin, 59 Bankr. at 144.
122 Id. at 143.
123 Id.
124 See id. at 141.
turn to the results that make practical sense to the courts, attorneys, creditors, and debtors, and that should be promoted by the Bankruptcy Code.

III. REVISING THE CODE

A. The Problem

Courts to date have been at odds over the importance of the debtor’s right to representation by counsel of her choice. Courts that permit the creditor-attorney’s representation believe that the debtor’s right to choose counsel is a most important consideration. Those that disallow representation give the right mere lip service, and conclude that the interests of the estate are more important. Yet these latter courts fail to recognize that the two concerns are not mutually exclusive. As stated earlier, the debtor’s prior counsel is in the best position to understand the complex financial situation that faces the creditors and the court. Not only does the attorney understand the debtor’s business and its financial history, but the attorney has the debtor’s confidence as well. This is not to be taken lightly. If the debtor is not comfortable with her counsel, critical disclosures may not be made in a timely manner, and this may lead to wasted time and funds. Non-disclosure could also lead to irreparable harm by causing a failure to meet non-bankruptcy deadlines.

In many cases, the unsecured status of the attorney’s past fees will cause counsel to work harder to devise the best possible plan.

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125 See, e.g., In re Stamford Color Photo, 98 Bankr. 135, 137 (Bankr. D. Conn. 1989) (finding that there were no allegations of misconduct sufficient to overcome the debtor’s right to choose its counsel); In re Watson, 94 Bankr. 111, 114 (Bankr. S.D. Ohio 1988) (noting that in only the rarest cases will a debtor in possession be deprived of the privilege of selecting her own attorney).


127 See supra note 10 and accompanying text.

128 Missed bankruptcy deadlines do not usually lead to irreparable damage, because nunc pro tunc orders will often be granted when the equities of the case so demand; but these orders are ineffectual against outside forces, such as when a delay causes a missed purchasing option in the marketplace.

129 See In re Anver Corp., 44 Bankr. 615, 619 (Bankr. D. Mass. 1984) (stating that “an equity security holder/counsel would appear to be in the best position to represent the debtor vigorously”). This, of course, is not always the case. A law firm may be tempted to raid the estate when faced with the prospect of being paid only a fraction of its past due fees, as occurred in In re Michigan General Corp., 77 Bankr. 97, 101-02 (Bankr. N.D. Tex. 1987), aff’d in part, sub nom., In re Diamond Lumber, 88 Bankr. 773 (N.D. Tex. 1988), discussed supra note 50. In this case the law firm
As an unsecured creditor, the attorney will strive for a plan that will pay off the claims of the secured creditors and leave the most funds possible remaining for the general unsecured creditors. This, in essence, is the goal of all bankruptcy plans. If the attorney is a secured creditor, however, she may not have this incentive. The attorney will get paid if the secured creditors are paid, but it matters not at all to the attorney if the unsecured creditors receive anything. It is in such a situation that conflicts can occur. Therefore, the unsecured creditor-attorney should generally be allowed to represent a debtor. If the attorney is a secured creditor, however, she must make the choice of either refusing employment and maintaining her secured status, or representing the debtor and having her claim automatically converted to an unsecured one. Under current Code interpretations the secured creditor-attorney does not have this option, and must always abstain from representing the debtor.

The situations in which an attorney with an unsecured claim would not act in the best interests of the estate can be handled under the Professional Ethics standards which govern the conduct of all attorneys. Bankruptcy attorneys are generally subject to the ethics standards of the Model Code or Model Rules through provisions made by the state supreme courts. Perhaps the best discussion of bankruptcy ethics is Judge Clark's opinion in the 1985 case of In re Roberts. He sets forth the applicable Canons from the ABA Code of Professional Responsibility, starting with Canon 1. Canon 1 states: "A Lawyer Should Assist in Maintaining the Integrity and Competence of the Legal Profes-

violated many of the anti-conflict provisions of the Bankruptcy Code and the Model Rules, in that it accepted a transfer of funds from the debtor-client with the knowledge that the debtor's checks were likely to be returned for insufficient funds, was an insider under § 101(25), represented more than one of the debtors, and initially failed to disclose many of these facts in clear violation of rule 2014. Such abuses will occasionally occur regardless of the wording of rule 327(a), but can be handled best through more demanding disclosure requirements and corresponding sanctions.

130 Cf. In re O'Connor, 52 Bankr. 892, 896 (Bankr. W.D. Okla. 1985) (stating that although the court did not doubt that the debtors would "enjoy seeing a... plan of reorganization which maximizes the potential for return in favor of the equity security holders, to imply that the reorganization efforts... will be channeled in favor of equity security holders to the exclusion of all other creditors ignores the practical reality of 11 U.S.C. § 1129").


132 See id.
Disciplinary Rule 1-102 clarifies this tenet by stating that it is misconduct for a lawyer to violate a disciplinary rule or "[e]ngage in conduct that is prejudicial to the administration of justice." This compliments Canon 9, which states: "A Lawyer Should Avoid Even the Appearance of Professional Impropriety."

Bankruptcy courts have placed much emphasis on the idea of maintaining public respect for, and confidence in, the bankruptcy system, many times referring to the "appearance of impropriety." In *In re Philadelphia Athletic Club, Inc.*, the court stated, "the avoidance of a real appearance of impropriety is of chief concern to a court of bankruptcy . . . . It is not sufficient that the trustee and his counsel actually be disinterested; the appearance of [interestedness] must also be avoided." Similarly, another court stated, "[i]t becomes the duty of the trustee and of his attorneys not only to be impartial and free from the influence of any secured holder, but the other security holders must have faith and confidence in their impartiality and independence."

However, if one agrees with the reasoning of *Heatron* and its progeny, then the attorney of the debtor in possession does not need to be completely impartial, and can be a creditor of the debtor. The court in *In re Stamford Color Photo* stated, "it is clear that relationships which raise questions of professional impropriety do not necessarily require disqualification. . . ." This degree of self-interest should not greatly affect the confidence level of the other parties,

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134 *Id.* at DR 1-102(A)(5).  
135 *Id.* at Canon 9.  
136 See, e.g., *In re Estes*, 57 Bankr. 158, 161 (Bankr. N.D. Ala. 1986) (explaining that it is the role of the courts rather than the bar to maintain the integrity of the legal system); *In re Roberts*, 46 Bankr. 815, 844-46 (Bankr. D. Utah 1985) (disqualifying law firm under Canon 9 for its failure to disclose conflict to corporate debt client), *aff'd in part, rev'd in part*, 75 Bankr. 402 (D. Utah 1987) (en banc); *In re Philadelphia Athletic Club, Inc.*, 20 Bankr. 328, 335-37 (E.D. Pa. 1982) (emphasizing the court's duty to consider whether the reputation of the bar would be lowered in the eyes of an informed and concerned private citizen if the representation were allowed to continue).  
138 *Id.* at 335 (quoting *In re Perry, Adams & Lewis Securities*, 5 Bankr. 63, 64 (Bankr. W.D. Mo. 1980)).  
139 *In re Perry, Adams & Lewis Securities*, 5 Bankr. 63, 64 (Bankr. W.D. Mo. 1980) (quoting *In re Chicago Rapid Transit Co.*, 93 F.2d 832, 838 (7th Cir. 1937)) (emphasis omitted).  
140 See supra text accompanying notes 27-58.  
because the attorney's concern for fees is ever-present. Consider, for example, the common case of a contingent fee arrangement. Here the lawyer is swayed by her own interests and may be tempted to go for the big payoff or the quick settlement, depending upon her own needs rather than those of the client. The attorney, however, is bound by her duty of loyalty to represent the client's best interests, not her own.

The "appearance of impropriety" standard has often been criticized as vague and unworkable. It is important to note that it is not a disciplinary rule. In fact, the ABA warned that "if the 'appearance of impropriety' language had been made a disciplinary rule, 'it is likely that the determination of whether particular conduct violated the rule would have degenerated ... into a determination on an instinctive, or even ad hominem basis . . . .'

Similarly, the Rules reject the "appearance of impropriety" test. The drafters thought that it was too loose and vague; it gave no fair warning and it allowed, if not encouraged, instinctive judgments. Also, one can not begin to define "appearance of impropriety" unless one first defines "impropriety," and the purported "test" does neither.

But Judge Clark did not recognize this difference between the Model Code and the Model Rules, claiming instead that, "the new Rules of Conduct do not greatly alter the present law on conflicts of interest." Judge Clark thought that the impact of the new rules would be minimal because "the Bankruptcy Code and Rules contain their own anticonflict provisions . . . independent of any requirements set forth in the Code of Professional Responsibility." However, this ignores the confusion as to what these anticonflict provisions actually mean, and how far they extend.

The Model Code's anticonflict provisions are set out in Canons
WHY SECTION 327(a) NEEDS HELP

4, 5 and 6. Of these, the most applicable is Canon 5, which states: "A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client." Complementing this Canon is Disciplinary Rule 5-101, entitled "Refusing Employment When the Interests of the Lawyer May Impair His Independent Professional Judgment." Subsection (A) provides, "[e]xcept with the consent of his client after full disclosure, a lawyer shall not accept employment if the exercise of his professional judgment on behalf of his client will be or reasonably may be affected by his own financial, business, property, or personal interests." This is also the approach taken by the Model Rules.

However, in Bankruptcy, courts have stated that the client’s consent is irrelevant, as is the consent of all the creditors. This differing treatment of attorneys when they are in Bankruptcy as opposed to other courts is unwise. ‘The very concept of a professional ethic precludes the varying of ethical principles when applied to different areas of the law.’ Applying more rigid ethical standards to attorneys practicing in bankruptcy courts could foster the belief that bankruptcy proceedings and bankruptcy attorneys need closer scrutiny.

A critical difference between a debtor’s attorney and an attorney in any other legal battle is that the bankruptcy attorney is working for the benefit of the estate, rather than for any particular person. Since the estate, when insolvent, is in fact owned by parties other than the debtor, the attorney is working for the creditors of the estate as well. It is for this reason that mere consent to the conflict by the debtor is not enough. However, there should be no reason for a court to deny the debtor her choice of counsel when none of

149 See MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canons 4-6 (1989).
150 Id. at Canon 5. Canon 4 states: “A Lawyer Should Preserve the Confidences and Secrets of a Client.” Canon 6 states: “A Lawyer Should Represent a Client Completely.”
151 Id. at DR 5-101.
152 Id. (emphasis added).
153 See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (1989) (providing general rule in instance of conflict of interest similar to Model Code DR 5-101).
154 See supra note 67 and accompanying text; see also In re Roberts, 75 Bankr. 402, 404 (D. Utah 1987) (involving court denial of all fees upon discovery of undisclosed conflicts, even though the representation led to an uncontested reorganization plan calling for full payment to all creditors).
155 Note, supra note 148, at 323-24 (quoting Stranko, Attorney Conflicts of Interest in Bankruptcy Proceedings, 9 J. LEGAL PROF. 229, 229 (1984)).
156 See In re Roberts, 46 Bankr. 815, 822 (Bankr. D. Utah 1985) (stating that an important consideration is that the attorney’s employment be ‘ ‘in the best interest of the estate.’ ” (citation omitted)), aff’d in part, rev’d in part, 75 Bankr. 402 (D. Utah 1987) (en banc).
the creditors object.\textsuperscript{157} The court should even be able to allow representation over the objections of creditors when these objections are not made in good faith.\textsuperscript{158}

B. The Solution

In order to implement these suggestions and to provide consistency to future bankruptcy decisions, the Bankruptcy Code should be amended. The author proposes the following:

(1) Carve out a special exception from 327(a) for the debtor in possession's pre-bankruptcy attorney. This should apply only to attorneys, since other professionals are not subject to bar associations' ethical standards concerning conflicts of interests.

(2) Allow the pre-bankruptcy attorney to represent her client upon disclosure and consent, similar to Rule 1.7 of the Model Rules of Professional Responsibility. However, since the attorney is actually representing the estate, consent of other parties in interest must also be obtained.

(3) Objections to the representation by any party other than the debtor in possession may be overruled by the Bankruptcy judge if the objection is not made in good faith or if the equities of the case so demand. For example, if the majority of the creditors approve, the judge may overlook the objections if she believes that the interests of those dissenting creditors will not be seriously impaired.

(4) A claim that is not disclosed should be deemed automatically waived. Material non-disclosure may still subject the attorney to forfeiture of fees for a violation of Bankruptcy Rule 2014.

(5) A secured claim should be deemed automatically converted to an unsecured claim upon approval of counsel by the parties or the judge. This will remove the conflict of the attorney having to void her own security interest. If the attorney does not want to lose the secured status, she must choose not to represent the debtor.

(6) Retainers may be taken in any form, although they remain the property of the estate until the final decree. Certain commonsense rules must apply to keep the attorney from working in oppos-

\textsuperscript{157} See Roberts, 46 Bankr. at 825 n.19 (noting that "in rural areas, the cure for the potential conflict has been at great cost and is in all likelihood worse than the disease").

\textsuperscript{158} See In re Best W. Heritage Inn Partnership, 79 Bankr. 736, 741 (Bankr. E.D. Tenn. 1987) (ignoring the objection of a creditor because the court was "not so gullible as to believe that [the creditor wanted the] lawyers fired for the protection of the bankruptcy estate as a whole").
tion to the reorganization effort. The attorney cannot gather the most promising assets, since they will need to be used in the reorganization process. Similarly, the attorney must gain the court's approval before foreclosing upon a mortgage, just as she needs approval for interim fees.

C. The Application

Through these rule changes, the Bankruptcy Code will properly balance the rights of debtors in possession to choose their own counsel against the actual concerns of the estate. The proposed rules are clear enough to lead to predictability, yet flexible enough to weigh the individual equities on a case-by-case basis. Of course, full disclosure of conflicts is still required under Bankruptcy Rule 2014, but the incentive and the ability of attorneys to bury the facts are lessened under this plan. Attorneys will not be in the position of being either automatically disqualified from representation because of a claim or having to waive the claim completely. Thus, they can rest assured that they can represent their client and still collect a disclosed past fee, barring creditor objections. Creditor objections must be well-founded. The judge may overrule an objection if the situation so demands.

If the debtor's attorney fails to disclose a prior claim it will be void and no longer payable out of the estate: an attorney must disclose in order to be paid. Without disclosure, the attorney will know in no uncertain terms that the claim is lost. Thus, no conflict will arise because there is, in effect, a waiver of the past claim. Without a past claim, the attorney is no longer a creditor of the estate, and objections by the other creditors are of no weight.

The question as to what qualifies as "disclosure" is also satisfied by the proposed changes. The attorney, instead of having to sign a blanket statement that she is "disinterested under the meaning of § 327(a)," must prominently state the approximate amount of her claim, which of course will be unsecured. The amount of the attorney's claim may not be hidden in schedules, but must appear in

159 See supra note 22.
160 See Note, supra note 148, at 321.
161 See supra text accompanying note 109.
162 See supra note 67 and accompanying text.
163 This is a result of the proposed amendments in which all secured claims of the debtor's attorney are automatically converted into unsecured ones upon acceptance by the court of the attorney's application for employment.
them if appropriate.\textsuperscript{164} The situation surrounding the past claim need not be included in the statement, although attorneys will probably wish to present the facts in order to quell possible objections by the other attorneys.\textsuperscript{165}

If the situation surrounding the past fees is unfavorable and would actually bias the attorney's representation, professional ethics rules apply to prohibit representation. This removes the concern that unfavorable fact patterns will be unknown to creditors, since sanctions may be imposed by the bar association, under Rule 1.7 of the Model Rules of Professional Conduct, if there was in fact an undisclosed conflict of interest.\textsuperscript{166} Similarly, fees can be denied for a violation of rule 2014 of the Bankruptcy Code.\textsuperscript{167}

Bankruptcy retainers are clarified by the proposed amendments as well. Under the amendments, there is technically no such thing as a secured retainer, although the bankruptcy fees are given a priority over other secured creditors.\textsuperscript{168} Since retainers of any kind are considered property of the estate until the final decree,\textsuperscript{169} it does not matter what the parties call them. The cash from the retainer may be reclaimed and disposed of for purposes of reorganization,\textsuperscript{170} and a mortgage can have no effect if the property is necessary for an equitable distribution.\textsuperscript{171} However, if a mortgage is taken in property that will probably not be liquidated in the proceeding, the mortgage may stand to insure that the fees can be paid at the conclusion of the case.\textsuperscript{172} A foreclosure on the mortgage before the final decree can only be executed if approved by the court.\textsuperscript{173} These interim fees are

\textsuperscript{164} For example, the claim must be included in the schedule of the 20 largest creditors if it is applicable.

\textsuperscript{165} Since other attorneys can object if they are uncomfortable or unsure of the situation, it would be wise for the debtor's attorney to provide as much information concerning the circumstances of the debt as possible.

\textsuperscript{166} See Model Rules of Professional Conduct Rule 1.7 (1989).

\textsuperscript{167} See supra note 22.

\textsuperscript{168} Expenses from administration of the estate are given priority under §§ 726, 507 and 502 of the Bankruptcy Code.

\textsuperscript{169} See supra note 88 and accompanying text.

\textsuperscript{170} See supra note 87 and accompanying text.

\textsuperscript{171} See In re Automend, Inc., 85 Bankr. 173, 177 (Bankr. N.D. Ga. 1988) (disapproving of a situation in which, "the security interest in accounts in this case took a prime bite out of one of the 'most promising assets of the estate'" (quoting In re Martin, 817 F.2d 175, 181 (1st Cir. 1987))).

\textsuperscript{172} See supra note 100 and accompanying text.

\textsuperscript{173} For example, in In re Whitman, 51 Bankr. 502, 507 (Bankr. D. Mass. 1985), the attorney foreclosed on the debtor's property, thus depriving "the debtor of his ability to sell his major asset . . . and depriving his creditors of the hope of receiving
subject to forfeiture at a later date, because orders approving interim fees are not final until the bankruptcy proceeding is over.\textsuperscript{174}

\textbf{CONCLUSION}

These proposed amendments to the Bankruptcy Code, along with the explanations offered in this Comment, could settle the confusion and conflict between what the Code actually says and what courts have claimed it actually means. They strike the proper balance in most cases between the conflicting interests at stake, and lead to predictable results. The uncertainty of how a court would rule on the issue has led to intentional and unintentional semantic games by "interested" attorneys. After implementation of the proposed changes, the Bankruptcy arena would no longer resemble a circus arena, and the courts and attorneys would no longer be forced to perform linguistic gymnastics.