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The Effect of Intercompany Debtor Claims on Retention Under § 327

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It is universal practice in large, complex, multi-debtor cases for the same professionals or group of professionals to be retained to represent all debtors in a jointly administered case. Common representation of the debtors makes sense because in most cases, affiliated and related debtors all share a common interest as it relates to the treatment of their estates and stakeholders. Further, from an efficiency and economic standpoint, it would be overly complicated, disorganized and extremely costly to have multiple professionals or groups of professionals retained in a case to represent each individual debtor.

As a result, case law and discussions regarding retention of professionals under § 327 of the Bankruptcy Code largely focuses on concurrent or past representations of a debtor and creditor. However, it is common in multi-debtor cases for one debtor to be a creditor of another debtor because of the nature of the business, the corporate structure or the intercompany relationships among the entities. This article explores issues related to common representation of affiliated debtors and specifically focuses on what rises to an actual conflict of interest when intercompany claims exist between debtors.

Are Intercompany Claims Between Debtors an "Actual Conflict"?

Retention of professionals by a debtor is governed by § 327 of the Bankruptcy Code. Section 327(a) provides that a debtor may employ an attorney or other professional person that does not hold or represent an interest adverse to the estate and is a disinterested person.[2] Under § 101(14) of the Bankruptcy Code, a disinterested person is one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity securityholders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or for any other reason."[3] Section 327(c) provides for an exception to the disinterestedness requirement under § 327(a) that a debtor may retain a professional that also represents a creditor if there is (1) no objection by a creditor or the U.S. Trustee to such professional's employment and (2) no actual conflict of interest.[4]

The Bankruptcy Code does not define "actual conflict" of interest,[5] but courts have almost uniformly held that simultaneous representation of related bankruptcy estates is not *per se* prohibited under § 327.[6] Instead, such representation must be evaluated on a case-by-case basis considering the facts and circumstances of the particular case.[7] "Courts have been accorded considerable latitude in

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2 11 U.S.C. § 327(a).
3 11 U.S.C. § 101(14).
4 11 U.S.C. § 327(c).
5 *See In re Boy Scouts of Am.*, 35 F.4th 149, 158 (3d Cir. 2022) (noting that "actual conflicts of interests in the § 327 context do not have a strict definition").
6 *See, e.g., In re BH & P Inc.*, 949 F.2d 1300, 1314 (3d Cir. 1991) (finding that "the existence of interdebtor claims is, therefore, no longer an automatic ground for disqualification of counsel for the trustee" when such dual representation is "absolutely necessary"); *In re Interwest Bus. Equip. Inc.*, 23 F.3d 311, 318-19 (10th Cir. 1994) (holding that simultaneous representation of related debtors is not per se prohibited and that retentions shall be evaluated on case-by-case basis); *In re Adelphia Commc'ns Corp.*, 342 B.R. 122, 128 (S.D.N.Y. 2006) ("[T]he presence of intercompany claims between debtors represented by the same counsel does not automatically warrant the disqualification of that counsel.") (*quoting In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 672-73 (Bankr. S.D.N.Y. 2005)); *In re Glob. Marine Inc.*, 108 B.R. 988, 1004 (Bankr. S.D. Tex. 1987) (acknowledging that "the mere existence of the intercompany claim" does not disqualify counsel from representing two debtors); *In re M&P Collections Inc.*, 599 B.R. 7, 11-12 (Bankr. W.D. Ky. 2019) (declining to adopt bright-line rule that dual representation of debtors is prohibited when intercompany claims exist between debtors).
7 *See Interwest Bus. Equip. Inc.*, 23 F.3d at 318-19.

using their judgment and discretion in determining whether an actual conflict exists 'in light of the particular facts of each case.'"[8] As the case law discussed in more detail herein shows, when determining whether an actual conflict prohibits the common representation of multiple debtors under § 327, courts have considered several factors, including the pre-petition relationship among the entities, the nature of the intercompany claims and the administrative costs associated with separate representation.

The U.S. Bankruptcy Court for the Southern District of New York in *In re JMK Construction Group Ltd.*[9] found that the right of contribution and intercompany claims among related debtors was sufficient to disqualify a professional from being retained to jointly represent the debtors.[10] The cases were related but not jointly administered, and each debtor filed for bankruptcy protection after a jury verdict was entered against them as joint defendants.[11]

As a result of the judgment against each debtor, the court found that under applicable state law, the debtors had the right to seek contribution from one another, and that such right was sufficient to disqualify the proposed law firm from being retained under § 327(a) by more than one debtor.[12] The court also found that the intercompany claims among the debtors presented a disabling conflict because the law firm would represent both the debtor and a creditor in the same matter.[13]

The proposed professionals argued, among other things, that the facts of the case weighed in favor of finding no adverse interest because joint representation could simplify the administrative expenses of the cases.[14] The court acknowledged that joint representation might keep costs of case administration to a minimum, but that the relationship among the debtors was "too intertwined to permit one law firm to represent more than one debtor," including the existence of the contribution claims and potential avoidance actions among the debtors.[15] The court also found that the "paramount interest of creditors ... would be better served if more than one law firm was retained to represent the [d]ebtors."[16]

Conversely, in *In re Easterday Ranches Inc.*, the U.S. Bankruptcy Court for the Eastern District of Washington found that the proposal of certain versions of a chapter 11 plan that purportedly favored one debtor's estates over the other did not give rise to an actual conflict of interest that would be disqualifying under § 327(a).[17] The U.S. Trustee objected to the final fee application of debtors' counsel, arguing that the negotiation and proposal of certain iterations of the plan impermissibly subordinated the interests of one debtor's stakeholders to those of the other debtor.[18] In overruling the U.S. Trustee's objection, the court found that the filing of the offending plans was part of a "dynamic, multiparty, multifactor negotiating framework for the purpose of pressuring certain parties to bridge the remaining gaps with other case participants."[19]

Further, the court found that a consensual resolution and finality to the bankruptcy cases was in the interests of both debtors.[20] Finally, and importantly, the court contrasted the filing of affirmative litigation to determine the merits of the claim to negotiating a settlement or release of a claim, including through the plan process.[21] The court found that the latter does not rise to an actual conflict and differs "both substantively and procedurally from affirmative litigation prosecuted via an adversary complaint."[22]

In *In re KLE Equipment Leasing LLC*, when considering whether the existence of intercompany claims of jointly administered debtors was a disabling conflict, the U.S. Bankruptcy Court for the Eastern District of Wisconsin recently found that there was no actual conflict of interest that disqualified the firm from representing the debtors jointly, and that the interests of the jointly administered debtors' estates and creditors were best served by common representation, because it avoided unnecessary administrative costs associated with separate representation.[23]

In support of the retention of the single law firm to represent all jointly administered debtors, the debtors presented evidence that the business had operated as a single enterprise and that each debtor was codependent on the other debtors.[24] Further, the debtors represented to the court that they intended to propose a reorganization plan that would pay the creditors in full.[25] Based on this evidence, the court found that the conflict of interest between the related debtors remained only a potential, rather than an actual, conflict, and that such conflict may never arise and thus was not a disabling conflict under § 327(c).[26] In reaching its decision, the court acknowledged that although potential conflicts are generally disfavored, a court should consider the totality of the circumstances, including whether joint representation was more likely to maximize the value of all the estates.[27]

The Use of Conflicts Counsel in Intercompany Debtor Disputes

One solution used by debtors is to retain conflicts counsel to handle intercompany disputes that could give rise to

8 *In re BH & P Inc.*, 949 F.2d at 1315 (internal citations omitted).
9 441 B.R. 222 (Bankr. S.D.N.Y. 2010).
10 The debtors consisted of an entity and three individuals who each owned an equity interest in the entity. *Id.* at 225; 226; *see also In re Coal River Res. Inc.*, 321 B.R. 184, 188-89 (Bankr. W.D. Va. 2005) (affirming bankruptcy court's decision denying law firm's application for joint representation of related debtors when there was, among other things, discrepancies among reporting of intercompany debts between entities).
11 *JMK Constr. Grp. Inc.*, 441 B.R. at 226.
12 *Id.* at 231-33, 238.
13 *Id.* at 234-37.
14 *Id.* at 236-37.
15 *Id.* at 237.
16 *Id.* at 234.
17 647 B.R. 236, 254 (Bankr. E.D. Wash. 2002). At the outset of the case, the U.S. Trustee objected to the retention of the same law firm to represent both debtors, citing the divergent interests between the creditors. *Id.* at 242. The court overruled the objection, finding that the intercompany disputes were theoretical at the time and that the common professionals "could appropriately serve as the proverbial 'honest broker' to mediate and facilitate a resolution of issues among the various stakeholders." *Id.*
18 *Id.* at 244. The versions of the plan that the U.S Trustee took issue with were proposed plans that had been filed during negotiations between the parties. *Id.* at 250. The debtors ultimately solicited votes on a version of the plan that included a global settlement between the parties, including the official committees of unsecured creditors for each of the debtors' estates. *Id.* at 243.
19 *Id.* at 251.
20 *Id.* at 253.
21 *Id.* at 253-54.
22 *Id.* at 254.
23 672 B.R. 756, 766 (Bankr. E.D. Wis. 2025).
24 *Id.*
25 *Id.*
26 *Id.* at 767.
27 *Id.* at 766.

an actual conflict of interest among debtors. At least one court has found that the retention of conflicts counsel to handle issues related to intercompany claims is preferred over depriving debtors of their preferred counsel.[28] That being said, if the dispute involving the intercompany claims is central to the reorganization, then the retention of conflicts counsel might not be an effective strategy because courts have found that conflicts counsel "cannot be used as a substitute for general bankruptcy counsel's duties."[29] For example, in *In re Samys OC LLC*, the U.S. Bankruptcy Court for the District of Kansas held that the transfers and intercompany claims among debtors was so central and extensive to the reorganization that the retention of conflicts counsel was inappropriate.[30]

Conclusion

As illustrated by the case law, in most multi-debtor jointly administered cases, the existence of intercompany claims among debtors will not result in disqualification under § 327 of common counsel retained by all debtors. Courts have taken a pragmatic approach when evaluating whether such claims result in an actual conflict among the debtors and recognize both the economic and administrative efficiencies in common representation. However, if such actual conflict exists, including when debtors may have to pursue litigation against one another, then attorneys should evaluate whether the debtors should retain conflicts counsel or separate general bankruptcy counsel for each debtor. abi

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28 *See In re Caesars Ent. Operating Co. Inc.*, 561 B.R. 420, 435-36 (Bankr. N.D. Ill. 2015) (holding that hiring conflicts counsel is "better solution … than depriving [a debtor] of its choice of counsel").

29 *See In re Enviva Inc.*, No. 24-10453-BFK, 2024 WL 2795274, at *8 (Bankr. E.D. Va. May 30, 2024) (noting that conflicts counsel is useful for "discrete" issues); *In re WM Distrib. Inc.*, 571 B.R. 866, 873 (Bankr. D.N.M. 2017) (noting that "use of conflicts counsel is not appropriate where the adverse interests of the debtors represented by the same general bankruptcy counsel are central to the reorganization efforts of either debtor or to other resolutions of the chapter 11 case or where the adverse interests are so extensive that each debtor should have its own independent general bankruptcy counsel").

30 Nos. 24-11166, 24-11167, 24-11168, 2025 WL 791442, at *15-16 (Bankr. D. Kan. March 11, 2025) (holding that conflicts counsel could not "fix the problems identified by single representation").