In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

LEBLANC INC.	Bankruptcy No. 99-01033S
Debtor(s).	Chapter 7

ORDER GRANTING TRUSTEE'S MOTION TO EMPLOY SPECIAL COUNSEL

The matter before the court is the Chapter 7 trustee's motion to employ the law firm of Jenner & Block as special counsel. Hearing on the motion was held September 8, 1999 in Sioux City. Appearing were Wil Forker, Chapter 7 trustee, for himself, Robert R. Peterson, designated counsel for Jenner& Block, and Frank Wendt for objector LeBlanc, Ltd., a creditor and affiliate of the debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). The court finds and concludes that the motion should be granted.

Factual & Procedural Background

The debtor filed a Chapter 11 petition on April 23, 1999. The case was converted to one under Chapter 7 on May 4, 1999. The Chapter 7 trustee has retained Donald H. Molstad as general counsel.

On August 11, 1999, the trustee filed a motion to employ Jenner & Block as special counsel to investigate affiliates of the debtor, determine whether the estate has claims against the affiliates, and, if so, prosecute those claims (doc. 52). The trustee states there are potential claims for breach of fiduciary duty and avoidance of transfers. The trustee also wishes special counsel to determine whether the affiliates' claims against the debtor should be subordinated pursuant to 11 U.S.C. § 510 (c).

LeBlanc, Ltd. objects to the trustee's motion to retain Jenner & Block on the ground that the law firm represents disqualifying adverse interests (doc. 58). LeBlanc, Ltd. also argues that the trustee's proposed employment of the firm is impermissibly broad.

Jenner & Block currently represents Marconi Communications Radio Systems, Inc. In February, 1998, Marconi filed an action in Fairfax County, Virginia (the "state court action") against the debtor and LeBlanc, Ltd. Marconi's claims related to a contract to design, build and install radio towers in Sri Lanka. Debtor was a subcontractor of Marconi. After jury trial, Marconi prevailed against the debtor but not against defendant LeBlanc, Ltd. On March 26, 1999, judgment in the amount of $5.48 million entered against the debtor. Marconi appealed the decision relating to its claim against LeBlanc, Ltd. LeBlanc, Ltd. states that debtor filed its bankruptcy petition before its right to appeal the Marconi judgment expired.

In July, 1998, the debtor filed a related action against Marconi in the U.S. District Court for the Eastern District of Virginia (the "federal court action"). Debtor asserted a claim for payment under a number of theories. Marconi brought as a counterclaim the same claim made in the state court action. The federal court action is pending.

Discussion

The trustee's employment of professionals is governed by 11 U.S.C. § 327, which provides, in relevant part:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys . . . 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.
> . . .
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> (c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
> . . .
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> (e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327(a), (c), (e).

The trustee has taken the position that the standard for employment of Jenner & Block is set out in § 327(e), and that
§ 327(a) is not applicable. The analysis of § 327 must begin with the language of the statute itself. United States v. Ron Pair Enterprises, Inc., 109 S.Ct. 1026, 1030 (1989); In re Marvel Entertainment Group, Inc., 140 F.3d 463, 475 (3d Cir. 1998). Section 327(e) applies only when the proposed attorney "has represented the debtor." Because there is no evidence that Jenner & Block has ever represented the debtor, it is not applicable in this case. Bank Brussels Lambert v. Coan (In re AroChem Corp.), 176 F.3d 610, 622 (2d Cir. 1999). The provisions of § 327 applicable in this matter are § 327(a) and § 327(c). Id.; Marvel Entertainment, 140 F.3d at 475-76; Roberts v. Harris (In re Harris), 101 B.R. 210, 212-13 (Bankr. E.D. Cal. 1989).

Because the parties' briefs devoted considerable space to a discussion of the standards of § 327(e), the court will first examine the argument that § 327(e) applies by analogy when the trustee seeks to employ creditor's counsel for a special purpose. An early case, Fondiller v. Robertson (In re Fondiller), 15 B.R. 890 (B.A.P. 9th Cir. 1981), is frequently cited for this proposition. See e.g., In re AroChem, 176 F.3d at 622 (citing Stoumbos v. Kilimnik, 988 F.2d 949, 964 (9th Cir. 1993), which, in turn, cites Fondiller).

On the date of the Fondiller decision, § 327(c) read as follows: "[A] person is not disqualified for employment under this section solely because of [his] employment by or representation of a creditor, *but may not, while employed by the trustee, represent, in connection with the case, a creditor*." Fondiller, 15 B.R. at 892 (emphasis added). The court in Fondiller believed it was unfair to require creditor's counsel to cease representation of the creditor, when debtor's counsel was not similarly required to withdraw as debtor's counsel under § 327(e). In the court's view, the trustee's employment of creditor's counsel posed less risk of adversity of interest than employment of debtor's counsel. Id. The court then concluded that the above-italicized phrase does not apply when the trustee seeks to employ attorneys for a "special limited capacity that presents no conflict of interests between the trustee and the creditor clients of the attorneys."[(1)] Id.

In 1984, § 327(c) was amended to read: "[A] person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, *unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.*" 11 U.S.C. § 327(c) (emphasis added). This change eliminated the "absolute proscription against concurrent representation of a trustee and creditor in connection with the case." 3 Collier on Bankruptcy (15th ed. rev. 1999) ¶ 327.LH[7]. Thus, the amendment resolved the problem perceived by the court in Fondiller; the comparison to § 327(e) became unnecessary.

Notwithstanding the court's conclusion in AroChem that § 327(e) is inapplicable when the trustee's proposed attorney has not represented the debtor, the Second Circuit in that case cited with approval the cases of Fondiller and Stoumbos v. Kilimnik. AroChem, 176 F.3d at 622. The court in AroChem may have used the analogy to § 327(e) as a method to analyze the proposed employment, applying a standard of actual conflict rather than a mere potential for conflict. In any event, the court did not apply § 327(e) directly to the case before it. It used § 327(e) to narrow the inquiry with respect to conflicts, to determine that trustee's counsel satisfied the requirements of § 327(a) "with respect to the matter for which special counsel is retained." Id.

Thus, assuming for argument that § 327(e) applies whenever the trustee wishes to hire special counsel, a court analogizes to § 327(e) to examine whether any conflict exists relating to the purpose of the proposed special employment. The other portions of § 327(e), whether the special counsel will be "conducting the case" or whether the proposed attorney "represents an interest adverse to the debtor," do not enter into the analysis.[(2)] A number of the cases cited by the parties suggesting otherwise are cases in which § 327(e) was literally applicable. See, e.g., In re Neuman, 138 B.R. 683 (S.D. N.Y. 1992) (law firm with extensive history of representing debtor was a prepetition creditor with actual conflict of interest); In re American Avia Associates-SEA, 150 B.R. 24 (Bankr. S.D. Tex. 1992) (Chapter 11 corporate debtors had entered into a pre-petition contingent fee agreement with law firm to be hired as special counsel). Every attorney representing a creditor represents an interest adverse to the debtor. Treating representation of a creditor as an automatic disqualifying interest is in conflict with § 327(c). Therefore, LeBlanc, Ltd.'s argument that Jenner & Block represents Marconi, which has an interest adverse to the debtor, is irrelevant. The same is true of its argument that Jenner & Block will be "conducting the case" for the trustee. Although a trustee's attorney risks denial of fees for performing the routine work of the trustee, and trustee's special counsel risks denial of fees for duplicating work done by the trustee's general counsel, § 327(a) itself does not place particular limits on the purpose for which the trustee may employ attorneys. Moreover, Jenner & Block's proposed employment appears to be the type of legal work that would be performed by a trustee's special counsel.

The court will now address whether the trustee's application may be granted under §§ 327(a) and (c). Jenner & Block must be a "disinterested person," and must not "hold or represent an interest adverse to the estate." 11 U.S.C. § 327(a). The firm is not disqualified solely by reason of its representation of Marconi unless its representation of Marconi and the trustee is an actual conflict of interest. 11 U.S.C. § 327(c).

A "disinterested person" is a person that--

> (A) is not a creditor, an equity security holder, or an insider;
> . . . and
>
> (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor . . . or for any other reason.

11 U.S.C. § 101(14)(A), (E). An "interest adverse to the estate" has been defined as

> any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or ... a predisposition under circumstances that render such a bias against the estate.

In re AroChem, 176 F.3d at 623 (quoting In re Roberts, 46 B.R. 815 (Bankr. D. Utah 1985)).

Section 327(c) makes disapproval of employment mandatory when there is an actual conflict. The court in In re Marvel Entertainment stated that § 327(a) gives bankruptcy courts discretion to disapprove employment "in situations not yet rising to the level of an actual conflict," depending on circumstances such as the likelihood that the conflict will become actual. 140 F.3d at 476. Regardless of whether a conflict is labeled "potential" or "actual," the court should examine any facts that could affect Jenner& Block's ability to represent both clients effectively. SeeBH & P, Inc., 949 F.2d 1300, 1315 (3d Cir. 1991) (the "actuality" of a conflict for purposes of § 327(c) is that "counsel will be tempted to neglect its duties to the estate") (quoting the district court decision); see also In re Martin, 817 F.2d 175, 180 (1st Cir. 1987) (requirements of disinterestedness and lack of adversity may be expressed as issue of whether counsel has incentive to act contrary to interests of estate and creditors); Committee on Prof. Ethics & Conduct of the Iowa State Bar Assn. v. Jackson, 492 N.W.2d 430, 434 (Iowa 1992) (professional responsibility requires disqualification when attorney has "differing interests . . . that will adversely affect either the judgment or loyalty of a lawyer to a client").

LeBlanc, Ltd. contends that Jenner & Block is disqualified for employment because of the potential for conflict if either of two situations arises. First, the trustee could assert the debtor's right to appeal Marconi's judgment in the state court action. If that were to happen, both parties in the case would be clients of Jenner & Block. The second possibility is that Marconi could prevail on appeal of its state court claim against LeBlanc, Ltd., putting Marconi and the trustee in competition to recover their claims from the same defendant.

The court concludes that neither of the two possibilities justifies denial of the application for employment. The first argument emphasizes that Jenner & Block, as counsel for a judgment creditor, is disqualified under § 327(e), because it represents an interest adverse to the Chapter 7 debtor. As discussed above, this standard is irrelevant in this case, even if the court were to assume that § 327(e) applies by analogy. Moreover, it fails to distinguish Marconi from every other creditor whose claim is

subject to challenge by the trustee. LeBlanc's position is in conflict with § 327(c). See In re Pappas, 216 B.R. 87, 93 n.4 (Bankr. D. Conn. 1997) ("If the mere possibility that some entity might object to [creditor's] proof of claim provides a ground to deny the trustee the opportunity to retain [creditor's] counsel, then . . . that would read § 327(c) out of the Bankruptcy Code.") It is speculative to assume that it would be in the best interest of the estate to appeal the state court judgment. There was no evidence of the costs that would be incurred or the delay created by an appeal, nor was there evidence of the trustee's likelihood of success in the litigation. Similarly, it is speculative to argue that the trustee would wish to pursue the debtor's claim against Marconi in the federal court action.

LeBlanc, Ltd.'s second argument is that Marconi could prevail on appeal of its state court claim against LeBlanc, Ltd. The trustee contends that the procedural posture of Marconi's appeal makes the potential for conflict so remote as to be illusory. Brief, doc. 64, at 6-7. The mere possibility of future competition for recovery is not sufficient to disqualify Jenner& Block for employment. The likelihood that the situation will ever occur is uncertain. LeBlanc, Ltd. has not identified anything about the nature of the state court action that would interfere with Jenner & Block's representation of the trustee. It has not shown that the firm has an incentive to act contrary to the best interest of the estate. The court finds persuasive counsel's arguments that Marconi's and the trustee's interests are aligned and that the firm has an incentive to vigorously represent the trustee. Marconi and the trustee have similar interests in enlarging the estate.

The analogy to the standards discussed in Sheftelman v. Jones, 667 F.Supp. 859, 864-65 (N.D. Ga. 1987), a class action case, is apt. There, the issue was whether counsel could adequately represent the plaintiff class. Defendants argued plaintiffs' counsel had a conflict of interest because the attorneys sought to represent competing classes against common defendants. The court termed the alleged conflicts "speculative" and "illusory." If actual conflicts were to arise, the court said, procedural safeguards were in place to ensure the adequacy of representation of the class. Id. at 865. Similar procedural safeguards are in place in bankruptcy cases to ensure that the trustee's employment of professionals operates in the best interests of the estate. Professionals have a continuing duty to advise the court if circumstances arise that would disqualify them from employment. Matter of CF Holding Corp., 164 B.R. 799, 806 (Bankr. D. Conn. 1994); 11 U.S.C. § 328(c). The court oversees the approval of fees and has authority to deny fees if a professional becomes disqualified during his employment by the trustee. 11 U.S.C. § 328(c).

In this case, the trustee has general counsel, and seeks to employ Jenner& Block for a special purpose, minimizing the potential for conflict. Jenner & Block advised the court that Marconi will employ separate counsel in the event of contested matters between Marconi and the estate. Counsel also represented that Marconi has agreed to pay Jenner & Block's fees and will seek reimbursement from the estate only in the event counsel is successful in recovery of money for the trustee. LeBlanc, Ltd's objection to the trustee's application to employ Jenner & Block should be overruled.

IT IS ORDERED that the trustee's application for employment of Jenner& Block as special counsel is approved.

SO ORDERED THIS 12th DAY OF OCTOBER 1999.

William L. Edmonds
U.S. Bankruptcy Judge

1. Judge George, dissenting, stated that "only corrective legislation can properly achieve the practical results sought by the majority" given the plain terms of the statute. 15 B.R. at 893. Id.

2. The court in Moore v. Kumer (In re Adam Furniture Industries, Inc.), 191 B.R. 249 (Bankr. S.D. Ga. 1996), appeared at first to hold that § 327(e) is directly applicable whenever the trustee hires special counsel; but it ultimately reduced the issue to whether the proposed attorneys held "any interest adverse to the debtor or to the estate *with respect to the matter on which such attorney is to be employed*." Id. at 258-59.