IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 98-35066

ONEIDA WOOD PRODUCTS, INC.,

Debtor

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ONEIDA WOOD PRODUCTS, INC.,

Debtor

MEMORANDUM ON TRUSTEE'S APPLICATION TO EMPLOY COUNSEL

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UNITED STATES BANKRUPTCY JUDGE

Before the court is the Application to Employ Counsel and to Shorten Time for Notice (Application) filed on November 3, 1999, by the Chapter 11 Trustee, Michael H. Fitzpatrick. By this Application, the Trustee seeks authorization to employ D. Duane Cook (Cook) to represent him in the prosecution of a prepetition action filed by Cook on behalf of the Debtor in the United States District Court for the Eastern District of Tennessee against Daniel L. Billingsley, E.L. Billingsley, Oneida Wood Industries, Inc., Lumber, Inc., Oneida Farms, Inc., Don Billingsley, and First Trust & Savings Bank, Civil Action No. 3:98-CV-202 (the RICO action).[1] E.L. Billingsley, Oneida Farms, Inc., Don Billingsley, and First Trust & Savings Bank filed an Objection to Trustee's Application to Employ Counsel and to Shorten Time for Notice on November 12, 1999, Daniel Billingsley filed a Notice of Objection to Application to Employ Attorney on November 15, 1999, and on November 17, 1999, all of the defendants in the RICO action (the objecting parties) jointly filed an Objection to Trustee's Application to Employ Counsel. The objecting parties assert that the Trustee may not employ Cook, arguing that he holds or represents an interest adverse to the estate, that his employment is not in the best interest of the estate, that he has an actual conflict of interest with the estate, and that he may not accept the employment under the Tennessee Code of Professional Responsibility.

Pursuant to an Order entered on November 19, 1999, the court will consider the Trustee's Application on the basis of the January 21, 1999 Affidavit of Duane Cook appended to the

[1] The Debtor brought its action under the Racketeer Influenced and Corrupt Organization Act, 18 U.S.C.A. § 1961 to 1968 (RICO) (West 1984 & Supp. 1999).

Application to Employ Special Counsel filed by the Debtor on January 22, 1999,[2] the February 17, 1999 Supplemental Affidavit of Duane Cook filed on February 18, 1999, the November 16, 1999 Affidavit of Johnny V. Dunaway appended to the Objection to Trustee's Application to Employ Counsel filed on November 17, 1999, the December 14, 1999 Second Supplemental Affidavit of Duane Cook filed on December 15, 1999, and the December 30, 1999 Affidavit of John A. Lucas filed on January 3, 2000. On December 15, 1999, the objecting parties filed a Brief in Support of Objection to Trustee's Application to Employ Counsel, the Trustee filed a Trustee's Response to Objections to the Trustee's Application to Employ Duane Cook as Special Counsel, and Ellen Vergos, the United States Trustee, filed the U.S. Trustee's Response to Application of Trustee to the Employment of Attorney Pursuant to 11 U.S.C. § 327(e). On January 3, 2000, the objecting parties filed a Reply to Trustee's Response to Objections to the Trustee's Application to Employ Duane Cook as Special Counsel. Upon consideration of the affidavits and briefs, the court will determine whether it may resolve the issues as a matter of law without an evidentiary hearing.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A) (West 1993).

[2] The Debtor's January 22, 1999 Application to Employ Special Counsel was denied by an Order entered on April 1, 1999, on the basis that the Debtor was no longer a debtor-in-possession, after Michael H. Fitzpatrick's appointment as Chapter 11 Trustee was approved by the court on March 30, 1999.

I

THE PARTIES AND ACTIONS

Daniel Billingsley and Alvin Escue are the shareholders of the Debtor. Alvin Escue is both the majority shareholder and the president of the Debtor. Apart from his interest in the Debtor, Daniel Billingsley owns Oneida Wood Industries, Inc., a creditor of the Debtor and a defendant in the RICO action. E.L. Billingsley, Don Billingsley, Oneida Farms, Inc., and First Trust & Savings Bank are also creditors of the Debtor and defendants in the RICO action. Daniel Billingsley managed the Debtor from 1987 until September 1996 when Alvin Escue fired Daniel Billingsley from his position as the Debtor's manager. After September 1996, Alvin Escue managed the Debtor's business. Soon thereafter, Cook was hired to represent both the Debtor and Alvin Escue in multiple state court actions.

On September 13, 1996, the Debtor filed an action in the Scott County Chancery Court (Civil Action No. 7842) against Oneida Wood Industries, Inc., Lumber, Inc., and Daniel Billingsley requesting an order to prevent those defendants from removing the Debtor's inventory. On September 18, 1996, Daniel Billingsley filed an action in the Scott County Chancery Court (Civil Action No. 7845) against the Debtor and Alvin Escue requesting the appointment of a receiver for the Debtor. On November 26, 1996, Oneida Wood Industries, Inc. filed two separate actions against the Debtor in the Scott County Chancery Court for collection under two promissory notes (Civil Action Nos. 7885 and 7886), and filed an action against the Debtor in the Scott County Circuit Court for collection under a third promissory note (Civil Action No. 4573). Cook remains the counsel of record for the Debtor in all of the state court actions. In addition, he

remains the counsel of record for Alvin Escue in Daniel Billingsley's action to appoint a receiver. In the February 17, 1999 Supplemental Affidavit of Duane Cook, Cook states that he was not owed legal fees by Alvin Escue at the time of that affidavit.

At the filing of the Debtor's Chapter 11 petition on November 16, 1998, the Debtor's RICO action was pending. In that suit, the Debtor claims that Billingsley and the other defendants, through a pattern of racketeering activity, defrauded the Debtor of over a million dollars during the time that Billingsley managed the Debtor; that they conspired to prevent the Debtor from discovering and prosecuting the fraud; and that they conspired to regain control of the Debtor. The Debtor values the action at $6,000,000.00 in its schedules filed on January 13, 1999.[3] Cook represented the Debtor in the RICO action and remains the attorney of record. Alvin Escue was originally a plaintiff in the RICO action, but voluntarily dismissed his claims against the defendants and withdrew from participation in the action. Cook also represented Escue in the action.

Prior to representing the Debtor and Alvin Escue in the RICO and state court actions, Cook had represented both of them in other matters involving the Debtor and its business. The most significant representations involved the refinancing of the Debtor's debt and the possible sale of the Debtor or the Debtor's assets to Michael Potter, an employee of the Debtor.

[3] In Schedule B, the Debtor notes that the figure represents the results of a January 7, 1998 appraisal and the original *ad damnum* claim in the lawsuit.

In his affidavits, Cook summarizes other representations related to Alvin Escue. Apart from the representations discussed above, he has not represented Alvin Escue personally since 1994. He has represented Multi-Page, Inc., a business owned by Escue, prior to 1996. He has also represented Frank C. Escue, Alvin Escue's brother, on unrelated matters. Cook did not specify the duration and nature of his representation of Alvin Escue prior to 1994, or his representation of Multi-Page, Inc. and of Frank C. Escue. The objecting parties have not placed those representations at issue.

In the Affidavit of Duane Cook, Cook states that he would not represent the Debtor on any matter other than the RICO action should the court approve his employment. He also will not represent "any other party, including Alvin Escue or Mike Potter (and has never represented Mike Potter) on any matter." (Cook Aff. ¶ 5.)

II

ASSERTIONS UNDERLYING THE OBJECTION

The facts underlying the objecting parties' opposition to the Trustee's employment of Cook in the Debtor's RICO action focus on two subjects: certain payments made by Alvin Escue to Cook for payment of the Debtor's legal fees and allegations of wrongdoing during Alvin Escue's management of the Debtor.

In the Supplemental Affidavit of Duane Cook filed in support of the Debtor's original application to employ him as counsel,[4] Cook discloses that within 90 days of the Debtor's petition he had been paid $16,913.08 for legal bills for his work for the Debtor. He also discloses that he received an $8,000.00 retainer from Alvin Escue which was applied to bills later owed by the Debtor. In addition, he explains that as of the petition date, the Debtor owed him $6,619.00 in unbilled legal fees and expenses and that he had incurred an unreimbursed court reporter's charge in the litigation involving Daniel Billingsley which Mr. Escue had agreed to pay. He states:

> I am willing to waive any claim against the Debtor for pre-petition fees and expenses except to the extent that there is a claim that amounts paid to me pre-petition are recoverable as a preference; in that circumstance, I will assert that the amounts still owed me by the Debtor may be offset against amounts claimed due from me.

(Cook Supp. Aff. ¶ 10.)

Cook addressed Alvin Escue's payment of the Debtor's legal fees again in an October 28, 1999 letter to the Trustee which is attached as Exhibit A to the Trustee's Application. In the letter, Cook states:

> I have received $16,913.08 from Alvin Escue with Mr. Escue's representation that those funds are not property of the estate, but may nonetheless be paid to the OWP[5] estate as necessary for the estate to engage me as special counsel. This amount equals the amounts paid to me by OWP in legal fees and expenses within the 90 days prior to its bankruptcy filing. You may accept this letter as my agreement to pay $16,913.08 to OWP upon entry of a final order by the Bankruptcy Court approving my employment as special attorney . . . . In general, I have agreed to serve as special counsel for OWP for a contingency fee of one-third of any recovery plus reimbursement of any costs I incur in the litigation. . . .

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[4] *See supra* note 2.

[5] Reference here and in other affidavits to "OWP" are to Oneida Wood Products, Inc., the Debtor.

> I will not advance major expenses . . . and these will need to be paid by OWP as they are incurred or as otherwise may be arranged with the relevant creditor.

(Letter from Cook to Fitzpatrick of October 28, 1999, at 1).

Thus, Cook has agreed to waive his claims against the Debtor for prepetition fees and expenses without limitation. In addition, he has agreed to pay to the estate the fees that it received within the preference period from Escue on the Debtor's behalf.

Second, the objecting parties assert that Cook may not represent the Debtor in the RICO action because of alleged wrongdoing during Alvin Escue's management of the Debtor. According to them, the alleged wrongdoing disqualifies Cook because it could form the basis of a claim against Alvin Escue in the RICO action and which could possibly form the basis of a claim against Cook. The objecting parties' assertions, supported by the November 16, 1999 Affidavit of Johnny V. Dunaway, are, in summary, that Alvin Escue mismanaged the Debtor and reduced its net worth by $1,450,000.00 during his 27-month management; that Alvin Escue participated with Michael Potter in a scheme to represent lumber stolen from Trinity Industries as an asset of Michael Potter; that the purpose of the scheme was to obtain financing for Potter's contemplated purchase of the Debtor's assets; that Cook participated in that scheme by writing a letter which was "contained in the financial package that [was] ultimately disseminated by Brewer, Escue and Potter to various financial institutions" (Dunaway Aff. ¶ 40); that Cook participated in covering up the theft "by designing the damage control converting the stolen merchandise to a trade-out of materials in which OWP assumed Michael Potter's indebtedness, once it [the theft] was exposed" (Dunaway Aff. ¶ 33); that Cook instructed Michael Potter to refuse to answer deposition questions

about his potential purchase of the Debtor's assets; that Alvin Escue operated a check kiting scheme that cost the Debtor $43,625.00 in bank charges for non-sufficient funds; and that Alvin Escue used the Debtor's checks outside the ordinary course of its business to pay friends, relatives and other businesses in which Escue was involved.

Dunaway speculates about a cashier's check in the amount of $14,555.00 payable to AFP Associate, concluding that the check somehow "raises an issue as to whether this was an additional check being transmitted to Dwayne [sic] Cook through some other entity. Why the secrecy? Depositions of Cook and Escue are needed to determine this issue." (Dunaway Aff. ¶ 80.) Dunaway's suspicion appears to be based on the fact that on a single day Alvin Escue issued two checks in the total amount of $ 30,377.00, which, from Dunaway's understanding of the Debtor's financial accounts, he believes to be related to the Debtor's legal and professional fees; that Escue converted those checks to cashier's checks; that one cashier's check was made payable to Cook's then co-counsel, Gentry, Tipton, Kizer and McLemore, P.C., in the amount of $15,000.00; and that the other cashier's check was made payable to AFP Associate in the amount of $14,555.00.[6]

Cook responded to those assertions and the Affidavit of Johnny V. Dunaway in his Second Supplemental Affidavit of Duane Cook. To begin, he states that he disagrees with most of the statements in the Dunaway affidavit, but will respond directly only to those which address him specifically. He acknowledges that Potter retained James Brewer to assist him in obtaining financing for his proposed purchase of the Debtor's assets; that Cook wrote a letter describing the

[6] Mr. Dunaway does not account for the $822.00 remaining after the two cashier's checks were deducted from the $30,377.00.

Debtor's litigation with Daniel Billingsley at the request of James Brewer; and that the purpose of the letter was to inform potential lenders about the Debtor's litigation. Cook states that he was not aware of and did not participate in any alleged scheme involving the inclusion of his letter in a false financial package and that he does not know whether his letter was used in such a scheme. In addition, he states that he has no knowledge of a theft of lumber from Trinity Industries. He states that he was aware, however, that Michael Potter had inventory from Trinity Industries delivered to the Debtor's property; that Potter acquired the inventory with the expectation of purchasing the Debtor's assets; that Trinity Industries did not invoice the inventory for several months; that Michael Potter was unable to obtain the financing necessary to purchase the Debtor's assets and consequently did not need the Trinity inventory; that he suggested to the Debtor and Michael Potter that Michael Potter assign his rights in the Trinity Industries' inventory to the Debtor, who would then pay Trinity Industries; that the Debtor began making payments to Trinity Industries; that Mr. Dunaway requested an injunction in state court to prevent the payments; and that after a two-day hearing in the Scott County Chancery Court, the court concluded that the Debtor was not harmed by the Trinity Industries' transactions and authorized the Debtor to continue the payments to Trinity Industries. In addition, Cook acknowledges advising Michael Potter not to answer deposition questions regarding his potential purchase of the Debtor's assets. He explains that he believed that the negotiation details were not material to the issues in the state court litigation and that it was in the Debtor's interest, as the prospective seller, that Michael Potter not answer such questions. Cook has never represented Michael Potter. Finally, Cook states that he never accepted a $14,555.00 payment from Alvin Escue through AFP Associate and has never heard of AFP Associate.

Finally, John Lucas, counsel for First Trust & Savings Bank and Don Billingsley, filed an affidavit in which he addresses two facts. First, he disagrees with Cook's characterization of the Trinity Industries' inventory issue in the Second Supplemental Affidavit of Duane Cook when Cook states that "[a]t worst, there was sloppy record keeping." (Lucas Aff. ¶ 5.) Second, John Lucas states that he was informed by the Trustee on December 22, 1999, that "a litigation attorney or attorneys in his firm had advised him that in their opinion it would be preferable for the debtor simply to bring its state law claims in state court, as opposed to pursuing the RICO claims in federal court, due to the additional expense and complexity associated with the RICO claims." (Lucas Aff. ¶ 6.)

III

EVIDENTIARY HEARING

Upon examining the affidavits, the court concludes that it may resolve the issues surrounding Cook's employment without an evidentiary hearing. The court need not conduct a miniature trial of Alvin Escue for his alleged wrongdoing during his management of the Debtor in order to dispose of this matter. Those allegations would form the basis of litigation separate and distinct from the RICO action. The function of the court in this matter is only to determine whether Cook may be employed in the RICO action. *See Shaw & Levine v. Gulf W. Indus., Inc. (In re Bohack Corp.)*, 607 F.2d 258, 262 (2d Cir. 1979) ("[I]t is not our function to decide the merits of the state court action. Our concern is whether the Shaw firm was the proper counsel to

undertake the investigation of the alleged conspiracy and to decide whether litigation was justified.").

With regard to Cook's involvement in alleged wrongdoing, the court sees no significant factual discrepancy between the Cook affidavits and the Dunaway affidavit. In total, the Dunaway affidavit accuses Cook of three acts. The first is the accusation that Cook may have accepted a payment from Escue through AFP Associate. Cook denies accepting such payment or any knowledge of AFP Associate. No further inquiry is necessary there. The second act is the writing of a letter that was included in a financial package. Cook does not deny that he wrote a letter. Cook states that he does not know whether the letter was actually included in a financial package or whether any such financial package contained false information. Mr. Dunaway does not state that Cook in fact had such knowledge, although that is his implication. The Cook and Dunaway affidavits are therefore not contradictory regarding the letter and the court does not need an evidentiary hearing related to it. The third act that Dunaway accuses Cook of is designing a deal between the Debtor and Michael Potter in which the Debtor would accept Michael Potter's rights in the Trinity Industries' inventory and would pay for it. Cook does not deny this. The two affidavits differ in their characterizations of the plan. Dunaway characterizes the deal as a cover up for what he believes to be Potter's theft of the inventory. He does not, however, state that Cook knew that the inventory was stolen. Dunaway's affidavit is also weakened in that it is, in significant part, grounded on his hearsay summary of depositions taken on behalf of defendants in the RICO and state court actions. (Dunaway Aff. ¶¶ 16, 21-30, 39-43, 49, 55-57, 69, 79.)

In summary, the Cook and Dunaway affidavits do not present contradictory facts as to Cook's alleged actions. The primary differences between the affidavits are that Cook's affidavits are based on his own knowledge while Dunaway's affidavit is grounded on speculation and hearsay. The court may proceed without an evidentiary hearing.

IV

LEGAL THEORIES UNDERLYING THE OBJECTION

The objecting parties oppose the employment of Cook to represent the Debtor in its RICO action on three grounds. First, they claim that 11 U.S.C.A. § 327(c) (West 1993) prevents the employment of Cook because he has an actual conflict of interest with the Debtor. Specifically, they cite his acceptance of funds from Alvin Escue to pay the Debtor's legal fees and the fact that he has represented Alvin Escue. Second, the objecting parties claim that 11 U.S.C.A. § 327(e) (West 1993) prevents the employment of Cook because he has an interest adverse to the estate and because the employment is not in the best interest of the estate. Specifically, they cite as adverse interests Cook's prior representation of Alvin Escue, the possibility that the Debtor may have a claim against Alvin Escue in the RICO action and in state court, and that the Debtor may have a claim against Cook himself regarding the alleged theft of lumber from Trinity Industries. Finally, the objecting parties argue that Cook must decline the Trustee's offer of employment under the Tennessee Code of Professional Responsibility, citing his acceptance of payment from Alvin Escue on behalf of the Debtor and his prior representation of Alvin Escue.

V

§ 327 GENERALLY

The trustee may employ professionals under § 327(a) of the Bankruptcy Code, which provides:

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

11 U.S.C.A. § 327(a) (West 1993). That provision states two substantive requirements for the employment of professionals, the first being that the professional be a disinterested person, and the second being that the professional not hold or represent an interest adverse to the estate. *See id.* The purpose of those requirements is to promote "'"the important policy of ensuring that all professionals appointed [to represent the trustee] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."'" *Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 621 (2d Cir. 1999) (quoting *In re Leslie Fay Cos.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994) (quoting *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994))).

As provided by the terms of § 327(a), its general rule "is subject to variations authorized by § 327(c) and (e)." *In re Statewide Pools, Inc.*, 79 B.R. 312, 314 (Bankr. S.D. Ohio 1987). The court will first consider the application for employment under § 327(e) because it deals specifically with employment of an attorney for a special purpose.

VI

§ 327(e)

Subsection 327(e) permits the trustee to employ a professional for a special purpose and sets forth the requirements for approving the professional, providing that

> 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.A. § 327(e) (West 1993). The "disinterested person"[7] requirement of § 327(a) is eliminated in § 327(e) to permit the trustee to employ, for a special purpose, an attorney who has represented the debtor. *See id.*; *Buckley v. Transamerica Inv. Corp. (In re Southern Kitchens, Inc.)*, 216 B.R. 819, 826 (Bankr. D. Minn. 1998); *In re F & C Int'l, Inc.*, 159 B.R. 220, 222 (Bankr. S.D. Ohio 1993).

Subsection 327(e) permits the ongoing employment by a trustee of a debtor's attorney in order to avoid the probable delay and expense to the estate that would accompany the replacement of that attorney with one who is disinterested. *See Southern Kitchens*, 216 B.R. at 826. By its terms, that subsection places three conditions on the employment. *See id.* First, the employment must be for a specified special purpose and not for the general management of the debtor's bankruptcy. *See id.* n.13. Second, the employment must be in the best interest of the estate, meaning that pursuit of the claim is justified by its merit and value and that the proposed attorney

[7] "Disinterested person" is a defined term under the Bankruptcy Code. *See* 11 U.S.C.A. § 101(14) (West 1993).

has expertise and familiarity with the claim. *See id*. Third, and most disputed in the matter now before the court, is the condition that the attorney to be employed must 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.A. § 327(e); *Southern Kitchens*, 216 B.R. at 826. The third requirement "prevents the employment of special counsel who, on any matter of substance, represent or have represented a client that is an actual or potential opponent of the estate in the dispute for which the counsel would be engaged." *Id*.

In the absence of a definition of "interest adverse to the debtor or to the estate" in the Bankruptcy Code, the following definition has been recognized by courts:

> "(1) to possess . . . an 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 (2) to possess a predisposition under circumstances that render such a bias against the estate."

AroChem, 176 F.3d at 623 (quoting *In re Roberts*, 46 B.R. 815, 827 (Bankr. D. Utah 1985), *aff'd in relevant part and rev'd and remanded in part on other grounds*, 75 B.R. 402 (D. Utah 1987)); *In re Fretter*, *Inc*., 219 B.R. 769, 777 (Bankr. N.D. Ohio 1998); *Southern Kitchens,* 216 B.R. at 826.

The assessment of an attorney's adverse interest is a factual one. *See AroChem*, 176 F.3d at 621; *Statewide Pools*, 79 B.R. at 314. No bright line test exists for detecting an adverse interest; the circumstances of each case must be evaluated "based on a common-sense divination of adversity or commonality." *Southern Kitchens,* 216 B.R. at 827; *Fretter*, 219 B.R. at 778.

Finally, when considering adverse interests, some courts have rejected the distinction between actual and potential conflicts, finding that both are equally disqualifying. *See Southern Kitchens*, 216 B.R. at 827; *In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 866 (Bankr. N.D. Ill. 1992); *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742, 754 (Bankr. N.D. Texas 1988) ("The concept of *potential* conflicts is a contradiction in terms. Once there is a conflict, it is *actual—not potential*."); *Statewide Pools*, 79 B.R. at 314. In evaluating potential conflicts, however, "'courts must be sensitive to the possibility of strategic abuse of disqualification motions.'" *AroChem*, 176 F.3d at 625 (quoting *Southern Kitchens*, 216 B.R. at 826). Courts must use judicial discretion when making the decision and consider that

> "'The 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. It is for the court to decide whether the attorney's proposed interest carries with it a sufficient threat of material adversity to warrant prophylactic action.'"

Id. at 627 (quoting *National Westminster Bank USA v. Yeager (In re RPC Corp*.), 114 B.R. 116, 119 (M.D.N.C. 1990) (quoting *In re Martin*, 817 F.2d 175, 182 (1st Cir. 1987))).

VII

STATUS AS *PER SE* ADVERSE INTEREST

The objecting parties assert that "[c]ourts have repeatedly found that an attorney who represents or has represented a shareholder, officer, or director of the debtor holds an interest adverse to the debtor and cannot represent the debtor under 11 U.S.C. § 327(e)." In support of that proposition, they cite *Shaw & Levine v. Gulf & Western Industries, Inc. (In re Bohack Corp.)*, 607 F.2d 258, 263 (2d Cir. 1979); *Colorado National Bank of Denver v. Ginco, Inc. (In re Ginco,*

Inc.), 105 B.R. 620, 621 (D. Colo. 1988); *Southern Kitchens,* 216 B.R. at 827; *In re Mican Homes, Inc.*, 179 B.R. 886, 888 (Bankr. E.D. Mo. 1995); *F & C International, Inc.,* 159 B.R. at 223; and *In re Interstate Distribution Center Assocs. (A), Ltd.*, 137 B.R. 826, 832 (Bankr. D. Colo. 1992).

All of those decisions are distinguishable from the present matter because they involved an attorney who represented a shareholder, officer or director of the debtor in a matter related to the special subject of the application for employment under § 327(e) such that the shareholder, officer or director was either a potential defendant in the subject of the employment or had an interest in it that was adverse to the debtor. *See Bohack*, 607 F.2d 258, 262-63; *Ginco*, 105 B.R. at 621; *Southern Kitchens*, 216 B.R. at 828; *Mican Homes*, 179 B.R. at 888; *F & C Int'l,* 159 B.R. at 222; *Interstate Distrib.*, 137 B.R. at 832. Those decisions do not stand for the proposition that a shareholder, officer, or director of the debtor holds an interest adverse to the debtor by virtue of that status alone.

In addition, *Ginco*, *Mican Homes*, *F & C International*, and *Interstate Distribution* are distinguishable from the present matter because the attorney to be employed intended to represent simultaneously the debtor in the special matter and the shareholder, officer or director whom the attorney was already representing. *See Ginco*, 105 B.R. at 621; *Mican Homes*, 179 B.R. at 888; *F & C Int'l,* 159 B.R. at 222; *Interstate Distrib.*, 137 B.R. at 832. Here, Cook will not continue to represent Alvin Escue.

VIII

AROCHEM

The Trustee directs the court to the recent opinion of the Second Circuit in *AroChem*, a decision under § 327(a) and (c) involving facts similar to those now before the court. In *AroChem*, the trustee sought to employ a law firm to represent the estate in pursuing federal court litigation in which the defendants were shareholders and the largest creditors of the debtor. *See AroChem*, 176 F.3d at 613. Although the law firm had not previously represented the debtor, it had represented one shareholder, Wells, in litigation against the same defendants on the same claims in state court, including fraud and mismanagement of the debtor. *See id.* 615-16. Unable to find another attorney willing to represent the estate, the trustee arranged for Wells' attorney to represent the estate in its federal litigation on a contingency fee basis. *See id.* at 615. The firm stopped its representation of Wells. *See id.* at 626. At the time of the application to employ the firm, Wells was also a defendant in derivative claims initiated by another shareholder on behalf of the debtor and was "a potential target of other claims that could be brought by the Estates." *Id*. at 616. The defendants in the subject litigation objected to the employment of the firm, citing among other things, the status of its client Wells as a creditor of the Estates, his status as a defendant in the derivative suits and his potential status as a defendant in a future action by the Estates. *See id.*

The objecting parties in the matter now before the court distinguish *AroChem* from this matter because it was decided under § 327(a) and (c), unlike this matter which is governed by § 327(e). They are correct. As the Second Circuit explained, § 327(e) did not apply directly

because the law firm had not represented the debtor. *See id.* at 622. Regardless, the court's analysis is helpful in the instant matter for two reasons. First, § 327(a) and (e) both prohibit employment of an attorney who holds an interest adverse to the estate. *See* 11 U.S.C.A. § 327(a) and (e). Second, the court, "in accordance with a number of other courts," decided that § 327(e) applied by analogy to the facts before it in that the trustee sought the employment of an attorney for a specified purpose. *See AroChem*, 176 F.3d at 622 (citing *Stoumbos v. Kilimnik*, 988 F.2d 949, 964 (9th Cir. 1993), *cert. denied*, 114 S. Ct. 190 (1993), and *Fondiller v. Robertson* (*In re Fondiller)*, 15 B.R. 890, 892 (B.A.P. 9th Cir. 1981)); *see also Nisselson v. Wong (In re Best Craft Gen. Contractor and Design Cabinet, Inc.)*, 239 B.R. 462, 468 (Bankr. E.D.N.Y. 1999); *Statewide Pools*, 79 B.R. at 314; *Altenberg v. Schiffer (In re Sally Shops, Inc.)*, 50 B.R. 264, 266 (Bankr. E.D. Pa. 1985).

The court began its analysis by noting that the verbs used in § 327(a) in the phrase "do not hold or represent" are in the present tense. *See AroChem,* 176 F.3d at 623. It reasoned that the usage demonstrated that "counsel will be disqualified under section 327(a) only if it presently 'hold[s] or represent[s] an interest adverse to the estate,' notwithstanding any interests it may have held or represented in the past." *Id.*; *cf. Southern Kitchens*, 216 B.R. at 827 (finding it irrelevant that the representation was in the past rather than in the present). The court concluded that, for the purposes of § 327(a), the law firm did not have an adverse interest to the estate relative to Wells because it no longer represented Wells. *See id.*

Likewise, § 327(e) uses present tense verbs in the phrase "does not represent or hold any interest adverse to the debtor." *See* 11 U.S.C.A. § 327(e). Thus, for the purposes of § 327(e),

Cook does not have an adverse interest to the estate with regard to his prior representation of Alvin Escue because he no longer represents Escue.

The *AroChem* court went on to explain that even if § 327(a) did require consideration of an attorney's previous representations, the law firm's representation of Wells would not disqualify the firm for employment in the subject litigation. *See id.* at 624-28. Applying § 327(e), again by analogy, the Second Circuit cited the decision in *Southern Kitchens*. *See id.* at 625. The *Southern Kitchens* court explained that § 327(e) prohibits employment of "special counsel who, on any matter of substance, represent or have represented a client that is an actual or potential opponent of the estate in the dispute for which counsel would be engaged." *Southern Kitchens*, 216 B.R. at 826. In *AroChem*, the court explained that the opposing parties "failed to offer any evidence that any potential claims against Wells are relevant to the matters to be litigated . . . so as to create an interest that is adverse to the Estates with respect to that action." *AroChem*, 176 F.3d at 625. The *AroChem* court also rejected the objecting parties' argument that potential claims against Wells would be lost if the law firm represented the trustee, both because the firm no longer represented Wells and because the Estates could employ separate counsel to litigate those claims should they ever be pursued. *See id.* at 626.

Finally, the *AroChem* court found support for the trustee's employment of the law firm in the fact that the estate and Wells had an identity of interest with respect to the subject litigation. *See id.* at 627. Specifically, it found:

> [E]ach seek [sic] to establish the same set of predicate facts in order to prevail over many of the same defendants. To the extent that Wells has interests adverse to the

> Estates, by virtue of his status as a defendant in the derivative or other potential claims . . . those interests are not within the scope of [the firm's] representation.

Id.

In the matter now before this court, as in *AroChem*, the opposing parties have not shown or even alleged any interest adverse to the estate held by either Cook or Alvin Escue that is relevant to the RICO action. The opposing parties contend that Alvin Escue may be made a defendant in the RICO action, however, all of the alleged factual bases for that argument are related to the period of Alvin Escue's management of the Debtor. The pending RICO litigation deals with alleged wrongdoing during the period of Daniel Billingsley's management of the Debtor. Thus, there is no factual overlap between the pending action and any potential claims against Alvin Escue on the bases set forth in the objecting parties' briefs and supporting affidavits. Further, the objecting parties have not demonstrated, even in the most basic terms, how the facts that they assert may translate into an action under RICO such that Alvin Escue could be a defendant in the action for which the Trustee seeks to employ Cook.

In fact, if the Trustee decides to bring an action against Alvin Escue on the factual basis advanced by the objecting parties, FED. R. CIV. P. 20 would probably prevent the Trustee from joining Alvin Escue as a defendant in the pending RICO action. Rule 20 provides in material part as follows:

> (a) **Permissive Joinder**. . . . All persons . . . may be joined in one action as defendants if there is asserted against them jointly, severally, or in the alternative, any right to relief in respect of or arising out of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all these defendants will arise in the action.

FED. R. CIV. P. 20. Under Rule 20, there must be both an identity in the transaction or occurrence or a series of transactions or occurrences and a common question of law or fact. *See Hanley v. First Inv. Corp.*, 151 F.R.D. 76, 78-9 (E.D. Tex. 1993). The presence of both requirements creates a logical relationship between the claims, which makes their joinder permissive. *See id.* Alvin Escue could not be joined as a defendant in the RICO litigation because the requirement of involving the same transaction, occurrence or series of occurrences is lacking.

In addition, as in *AroChem*, employment of Cook would not prevent the Trustee from pursuing claims against Alvin Escue. Cook no longer represents Alvin Escue and the Trustee may employ separate counsel to pursue claims against him if he decides to do so.

The court concludes that Cook does not hold or represent any interest adverse to the Debtor or to the estate with respect to the RICO action.

IX

BEST INTEREST OF THE ESTATE UNDER § 327(e)

Finally, the objecting parties maintain that employment of Cook is not in the best interest of the estate. First, they assert, through the Affidavit of John Lucas, that an attorney from the Trustee's firm at some point told the Trustee that the complexity of a RICO action weighed in favor of pursuing the estate's claims in the state court forum alone. Second, the objecting parties assert that the Trustee's inability to find other counsel to represent the estate in the RICO action shows that the action lacks merit. Third, they argue that if Cook represents the estate in the RICO

action, the estate must hire another attorney if it pursues claims against Alvin Escue. They cite *AroChem* in support of their position.

Regarding the Trustee's decision to pursue the RICO action, they cite *AroChem* for the court's reference to the trustee's decision to pursue the special litigation. In that case, the court noted that the trustee hired a law firm to investigate the estate's potential claims and briefly summarized the people and entities with whom the investigating firm consulted. *See AroChem*, 176 F.3d at 615. The court then stated that "[u]ltimately, counsel analyzed the relative merits of the . . . causes of action and presented its recommendations to the Trustee. . . . As a result of the investigation, the Trustee concluded that he should pursue the claims . . . ." *Id*. The *AroChem* court did not state whether the trustee followed the investigating counsel's recommendations, did not second guess the trustee's decision to pursue the claims, and did not apply a legal standard for evaluating a trustee's decision to pursue a claim. *See id*. Likewise, this court need not delve into those matters. Indeed, if such inquiry was warranted, the objecting parties have given the court a scant factual basis and no legal basis to support a challenge to the Trustee's decision. Furthermore, as the defendants to the RICO action, the objecting parties' position on this issue can hardly be considered objective. That it may not be in their best interests to pursue the action differs substantially from whether it is in the best interest of the Debtor's estate.

The objecting parties also argue that the Trustee's inability to find other counsel demonstrates the fact that the RICO action is not in the best interest of the estate. This argument lacks merit as seen in *AroChem*. There, the court approved the continued employment of the law

firm where, after a diligent search, the trustee was unable to find another qualified counsel willing to represent the estate on terms "even remotely as favorable." *Id*.

Finally, the objecting parties argue that employment of Cook in the RICO action will force the Trustee to hire another attorney to represent the Debtor in a possible action against Alvin Escue. For that reason, they argue that the employment is inefficient and, therefore, is not in the best interest of the estate. Again, the court need look no further than *AroChem* to reject this argument. There, the court approved the employment of the law firm that had previously represented a party whom the objecting parties identified as a potential defendant in future litigation by the estate. *See id.* at 626. The court had no difficulty in allowing the firm to undertake the subject employment and, in the event that the potential litigation was pursued, approving another counsel to represent the estate. *See id.* In the present matter, Cook has experience in the pending action at issue and the estate will benefit from employing him rather than paying another attorney to become familiar with the action and then proceed. Any future action against Alvin Escue is conjectural at this point. Denying Cook's employment on that basis is not the more efficient option.

The employment of Duane Cook as special counsel in the RICO action is in the best interest of the estate.

X

§ 327(c)

The objecting parties also argue that the employment of Cook as special counsel may not be approved under § 327(c). Subsection 327(c), which sets forth an exception to the disinterestedness requirement in § 327(a), provides in material part:

> [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.A. § 327(c) (West 1993).

The objecting parties contend that § 327(c) applies because Cook has represented Alvin Escue, a creditor of the Debtor, because Cook accepted a $16,913.08 payment from Escue for the Debtor's legal fees, and because Cook's payment of the $16,913.08 to the estate upon approval of his employment would constitute a funding of the RICO action by Escue.

Both past and present representation of creditors must be considered under § 327(c). The court must consider whether Cook's past representation of Escue creates an actual conflict of interest barring Cook's employment in the Debtor's RICO action. *See* 11 U.S.C.A. § 327(c). Although § 327(c), by its terms, specifically applies to only actual conflicts, some courts have rejected the distinction between actual and potential conflicts, as seen with § 327(e).[8]

[8] *See supra* at 17-18.

The objecting parties argue that the court should not confine its analysis under § 327(c) to conflicts relating to the subject of the special employment. The crux of their argument is that "[b]ecause creditors [sic] interests naturally conflict with the estate, § 327(c) prevents an attorney from representing the estate at any time such representation would affect the interests of a creditor that the attorney has represented." In effect, they argue that if an attorney has represented a creditor of the Debtor and that representation presents a potential conflict of interest with the estate on any matter, then the attorney cannot represent the estate for a completely unrelated special purpose. They offer no authority for that position and the court rejects it. Limiting the scope of the § 327(c) analysis to conflicts related to the subject of the special employment is clearly supported by the decisions of several courts. *See AroChem*, 176 F.3d at 622 (citing *Stoumbos v. Kilimnik*, 988 F.2d 949, and *Fondiller*, 15 B.R. at 892); *see also Best Craft Gen. Contractor and Design Cabinet*, 239 B.R. at 468; *Statewide Pools*, 79 B.R. at 314; *Sally Shops,* 50 B.R. at 266.

In the instant matter, Cook's representation of Escue cannot create a conflict of interest with regard to the RICO action because Escue is not a plaintiff in that action and cannot become a defendant in that action. Further, the subject of the RICO action is distinct from the allegations of wrongdoing against Escue so that the determinations in the RICO action should have no impact on any future action against Escue.

In addition, nothing in the affidavits of Cook, Dunaway, or Lucas suggests that Cook ever represented Alvin Escue in his capacity as a creditor. For that matter, Alvin Escue's interest as an unsecured creditor holding a nonpriority claim is aligned with the Debtor in the RICO matter because any recovery by the Debtor will enhance the estate. Alvin Escue's $16,913.08 payment

to Cook for the Debtor's legal bills and the payment of that amount by Cook to the estate has no relation to the substance of the RICO action and cannot create a conflict of interest for Cook. The letter in which Cook agrees to pay that amount to the estate evidences a desire to avoid any issue under § 327 related to whether the payment constituted a preferential transfer. There is no indication that Cook's payment to the estate is an attempt by Escue to influence the RICO action.

Another factor eliminating any conflict under § 327(c) is that Cook will no longer represent Escue, and therefore Cook does not rely on good relations with Escue for future employment and payment. *Cf. American Printers & Lithographers, Inc.*, 148 B.R. 862 (Bankr. N.D. Ill. 1992) (disapproving debtor-in-possession's application to employ law firm under § 327(a) and (c) because ten percent of the total gross annual revenues of the firm came from its long-standing representation of a creditor, the firm represented the creditor in negotiating debtor-in-possession financing, the creditor's "security interest and DIP financing permeate[d] every aspect of the case," and the court determined that the firm "would be severely hurt if [the creditor] took its business out of that firm due to any dissatisfaction with [its] conduct in [the] case").

Cook is not disqualified for employment under § 327(c).

XI

TENNESSEE CODE OF PROFESSIONAL RESPONSIBILITY

The objecting parties also protest the Trustee's employment of Cook to represent the Debtor in the RICO action under the Tennessee Code of Professional Responsibility, DR 5-105, EC 5-18, and DR 5-107 (1999).[9]

Disciplinary Rule 5-105 governs an attorney's ethical ability to accept or continue representation of a client where that representation will or is likely to adversely impact the attorney's professional judgment in behalf of another client or where it may "involve the lawyer in representing differing interests." TENN. CODE PROFESSIONAL RESPONSIBILITY DR 5-105(A) and (B). That rule is not implicated here because under the proposed employment Cook would represent the Debtor and would not represent Alvin Escue. Further, should the Trustee pursue claims against Alvin Escue in the future, Cook would not be employed for that purpose.

Disciplinary Rule 5-107 governs the influence upon an attorney by persons other than the client. Specifically, the objecting parties cite DR 5-107(A)(1) which provides that "[e]xcept with the consent of the client after full disclosure, a lawyer shall not . . . [a]ccept compensation for legal services from one other than the client." The objecting parties argue that DR 5-107(A)(1) prevents Cook from accepting employment by the Trustee because he accepted $16,913.08 from Alvin Escue in payment of the Debtor's legal fees. It is not clear whether the $16,913.08 payment

[9] The Tennessee Code of Professional Responsibility has been adopted by this court "to the extent [it] relate[s] to matters within this court's jurisdiction" pursuant to E.D. Tenn. LBR 2090-2.

was made with the consent of the Debtor after full disclosure. The objecting parties do not argue that the payment was made without the proper consent. Presumably, Alvin Escue, as manager and majority shareholder of the Debtor at the time of the payment, consented to the payment on the Debtor's behalf. The issue has been resolved, however, by Cook in his letter to the Trustee, wherein he agrees to pay $16,913.08 to the estate upon this court's approval of his employment in the RICO action, thus removing any potential influence that may have stemmed from that payment.

Finally, the objecting parties cite Ethical Consideration 5-18 which provides:

> A lawyer employed or retained by a corporation or similar entity owes allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interests and the lawyer's professional judgment should not be influenced by the personal desires of any person or organization. Occasionally, a lawyer for an entity is requested by a stockholder, director, officer, employee, representative, or other person connected with the entity to represent that person in an individual capacity; in such case the lawyer may serve the individual only if the lawyer is convinced that differing interests are not present.

That ethical consideration is not implicated in the present matter because Cook will represent only the Debtor and not Alvin Escue.

Cook's acceptance of the Trustee's offer of employment as counsel in the Debtor's RICO case is not prohibited by Tennessee Code of Professional Responsibility DR 5-105, EC 5-18, or DR 5-107.

XII

CONCLUSION

In summary, this matter may be resolved without an evidentiary hearing on the basis of the affidavits and briefs. Cook's employment as special counsel for the Debtor in its RICO action may be approved under § 327(e) because he does not hold or represent an interest adverse to that of the Debtor or the estate with respect to that action and because his employment is in the best interest of the estate. His employment is permitted under § 327(c) because, although he has represented a person who is also a creditor of the estate, that past employment creates no disqualifying conflicts. Finally, Cook's acceptance of the employment in the Debtor's RICO action is not prohibited by Tennessee Code of Professional Responsibility DR 5-105, EC 5-18, or DR 5-107. The court will approve the Trustee's Application to employ Cook.

An appropriate order will be entered *nunc pro tunc* to November 3, 1999, the date the Trustee filed his Application to Employ Counsel.

FILED: January 24, 2000

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 98-35066

ONEIDA WOOD PRODUCTS, INC.,

Debtor

O R D E R

For the reasons stated in the Memorandum on Trustee's Application to Employ Counsel filed this date, the court directs the following:

1. The Objection to Trustee's Application to Employ Counsel and to Shorten Time for Notice filed by E.L. Billingsley, Oneida Farms, Inc., Don Billingsley, and First Trust & Savings Bank on November 12, 1999, the Notice of Objection to Application to Employ Attorney filed by Don Billingsley on November 15, 1999, and the Objection to Trustee's Application to Employ Counsel filed by Daniel L. Billingsley, E.L. Billingsley, Oneida Wood Industries, Inc., Lumber, Inc., Oneida Farms, Inc., Don Billingsley, and First Trust & Savings Bank on November 17, 1999, are OVERRULED.

2. The Application to Employ Counsel and to Shorten Time for Notice filed by the Chapter 11 Trustee, Michael H. Fitzpatrick, on November 3, 1999, seeking approval under 11 U.S.C.A. § 327(e) (West 1993) to employ D. Duane Cook for the specified special purpose of pursuing a prepetition action, Civil Action No. 3:98-CV-202, brought by the Debtor in the United States District Court for the Eastern District of Tennessee against Daniel L. Billingsley, E.L. Billingsley, Oneida Wood Industries, Inc., Lumber, Inc., Oneida Farms, Inc., Don Billingsley,

and First Trust & Savings Bank under theories of civil RICO and state law rights, is GRANTED. The employment is authorized pursuant to the terms of the Trustee's Application.

ENTER: January 24, 2000, *nunc pro tunc* for November 3, 1999.

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE