

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF NEW MEXICO

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U.S. BANKRUPTCY COURT
ALBUQUERQUE, NM

IN RE:

FURR'S SUPERMARKETS, INC.
TIN: 75 2364418,

Debtor(s).

No. 11-01-10779-SA

**NON-SCANNABLE CASE AUTHORITY CITED IN MEMORANDUM IN SUPPORT
OF UNITED STATES TRUSTEE'S
OBJECTIONS AND SUPPLEMENTAL OBJECTIONS
TO EMPLOYMENT APPLICATION
OF SKADDEN, ARPS, SLATE, MEAGHER & FLOM, LLP**

The United States Trustee for the District of New Mexico hereby files copies of certain unpublished case authority cited in her memorandum in support of objections to the employment application of Skadden, Arps, Slate, Meagher & Flom, LLP. The copies of the decisions are the following:

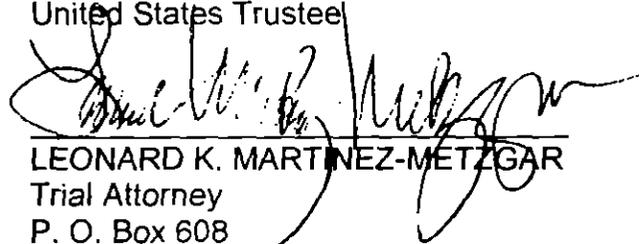
1. *In re Big V. Holding Company, et al.* No. 00-4372 (RIL) United States Bankruptcy Court for the District of Delaware (partial transcript of hearing on February 16, 2001).
2. *In re Solv-Ex Corp.* No. 11-97-14367 MA, United States Bankruptcy Court, District of New Mexico, decision dated February 10, 1998.
3. *In re Clifford Sinclair*, Number 7-94-12905 MS United States Bankruptcy Court for the District of New Mexico, decision dated April 29, 1998.

376

A copy of the partial transcript of proceeding in *In re Big V. Holding Company*, supra, was separately sent by Federal Express to Mr. Levin on April 16, 2001. The partial transcript was incorrectly designated has U.S. Trustee Exhibit 14.

Respectfully submitted,

BRENDA MOODY WHINERY
United States Trustee



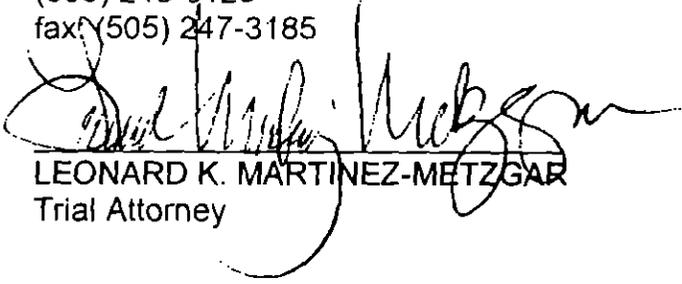
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I HEREBY CERTIFY that a true copy of the foregoing has been faxed and sent via Federal Express to Mr. Levin and sent by first-class mail to Messrs. Davis and Jacobvitz at the below listed addresses on this 18th day of April, 2001.

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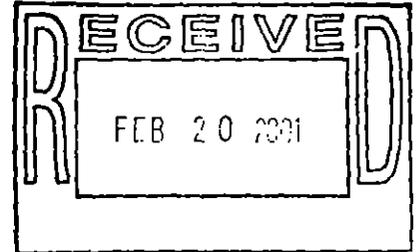
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LEONARD K. MARTINEZ-METZGAR
Trial Attorney

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE



IN RE: :
BIG V HOLDING CORP., : Case No. 00-4372 (RTL)
et al :
:

Debtors

United States Bankruptcy Court
824 Market Street - Sixth Floor
Wilmington, Delaware

February 15, 2001
2:07 p.m.

BEFORE: HONORABLE ROY T. LYONS,
United States Bankruptcy Judge

TRANSCRIPT OF PROCEEDINGS

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1 Honor's decision, well and good. Skadden can give it.
2 And Big V can then make the decisions that it has to
3 make, which at the end of the day, we'll still be in.

4 That, your Honor, is the crux of the
5 argument, that the supply relationship is central and
6 is core but that debtors' counsel's ability to advise
7 on a particular supply agreement in connection with
8 that is simply not, under the facts of this case, for
9 all the reasons that Mr. Toopes testified, this will be
10 a business and economic decision under any foreseeable
11 set of circumstances.

12 Thank you, your Honor.

13 THE COURT: Thank you. All right.

14 All right. Let's just take a short recess,
15 give everybody a break. I can tell you that I'm not
16 going to read the entire deposition of Mr. Goffman. In
17 fact, my preference at this point is to read none of
18 the deposition of Mr. Goffman so that I can make a
19 decision today.

20 All right. So let's come back at five
21 minutes to five.

22 (The proceeding was recessed from 4:47 p.m.
23 to 5:03 p.m.)

24 THE COURT: Thank you very much. Please be



1 seated.

2 All right. First of all, I want to
3 compliment all counsel on the quality of the written
4 submissions that were provided to the Court and also on
5 the quality of the oral arguments that were presented.

6 Also, I want to recognize the United States
7 Trustee for the vigilance that she has shown in this
8 case in exercising her responsibilities to monitor the
9 administration of cases under Title 11.

10 As Mr. Kenney indicated, the natural
11 tendency is to want to overlook questions of conflict
12 of interest and, particularly where there is a case
13 where all parties are well represented, it would be
14 certainly understandable if the United States Trustee
15 decided that she should allocate her scarce resources
16 to other matters and allow the parties to proceed with
17 the excellent representation that they have.

18 But I appreciate the fact that she and her
19 well qualified staff have chosen to actively
20 participate in this case. I think that everyone
21 involved here has displayed a high degree of
22 professionalism in their presentations involving this
23 matter. There was a minor amount of sniping back and
24 forth. In the scheme of things, I consider that to be



1 relatively minor. And I would just recommend to
2 counsel that they keep up that kind of professionalism
3 in this case. In fact, there is a small amount of room
4 for improvement.

5 It seems to me that the issue here is, has
6 the debtor-in-possession met its burden of
7 demonstrating that the Court should approve its
8 application to employ Skadden, the Skadden firm as its
9 counsel to the debtor-in-possession in this case. This
10 is obviously a core proceeding dealing with the
11 administration of the case.

12 Section 327(a) says that the trustee or the
13 debtor-in-possession, by implication, may employ a
14 professional that does not hold or represent an
15 interest adverse to the estate and that is that
16 disinterested person.

17 And Section 327 clarifies that a
18 professional that has represented a creditor is not
19 necessarily disqualified from representing the trustee
20 or the debtor-in-possession unless there has been an
21 objection raised by another creditor or by the United
22 States Trustee and then only therein exists an actual
23 conflict of interest.

24 Section 101, Subsection 14, defines the term



1 disinterested person.

2 And significantly, it, in subsection or
3 paragraph A of that subsection, says that a creditor
4 and an equity security holder is a disinterested person
5 and in paragraph E states that a disinterested person
6 may not hold an interest that is materially adverse to
7 the estate or a class of creditors or equity holders.

8 The leading case in the circuit that has
9 interpreted that language is the Marvel decision cited
10 by everyone that's presented a written or oral
11 submission and the Third Circuit has said that, if
12 there exists an actual conflict, there is a per se
13 disqualification of the professional from employment by
14 the debtor-in-possession.

15 If there exists a potential conflict, the
16 Court in its discretion may disqualify the
17 professional. Generally, the professional should be
18 disqualified if there is a potential conflict unless
19 there are extraordinary circumstances.

20 And, thirdly, the Marvel decision clarified
21 that if there is merely an appearance of impropriety
22 alone, that cannot form the basis for disqualification.
23 The Marvel decision followed on the prior decision of
24 the Third Circuit in the BH&P case and clarified what



1 had been stated earlier in the BH&P case. And there
2 are several other Third Circuit decisions that deal
3 with disqualification of professionals, most
4 significantly I think are the First Jersey case and the
5 PriceWaterhouse case.

6 In this case, we have a situation that the
7 Skadden firm has a relationship with C&S Wholesalers
8 and that company wears several hats in this case. C&S
9 Wholesalers was a creditor having a \$5 million
10 pre-petition secured loan. It is also a creditor with
11 an unliquidated claim, as I learned today, based upon
12 an indemnification provision in the supplier agreement.
13 It has a potentially larger indemnification claim,
14 depending on the results of litigation here.

15 It proposes to be a supplier of goods to the
16 debtor. It may also be a lender, further lender to the
17 debtor, although Mr. Toopes testified that the
18 provision of the existing agreement, which calls for a
19 further loan going up to \$20 million, may be something
20 that disappears in the current negotiations.

21 As far as Skadden is concerned, C&S
22 Wholesalers is a past, present and ongoing client of
23 the firm. Skadden has provided representation to C&S
24 Wholesalers in connection with a transaction with the



1 debtor. It was the pre-petition supplier contract that
2 Skadden was asked to review and comment on, although,
3 according to Skadden and according to the testimony
4 from Mr. Toopes, the Skadden role was not a primary
5 role in the negotiation or drafting of that contract,
6 but, nevertheless, it did represent C&S in connection
7 with a pre-petition contract.

8 Skadden has also obtained a waiver of
9 conflict of interest from the C&S firm in connection
10 with Skadden's undertaking to act as bankruptcy counsel
11 to Big V.

12 Secondly, there is the Thomas H. Lee
13 Company. Now, the exact relationship of the Thomas
14 H. Lee Company to the debtor and Skadden's relationship
15 to Thomas H. Lee is not clear. I just make reference
16 to the -- there was an affidavit and statement of Jay
17 M. Goffman that was attached or submitted together with
18 the original application by the debtors to get approval
19 for employment of the Skadden firm. And on page 13, in
20 paragraph 25, Mr. Goffman says, Skadden, Arps currently
21 represents Thomas H. Lee Company whose subsidiaries and
22 affiliates, Thomas H. Lee Equity Partners, LP, MLE
23 Acquisition Fund II, LP, and M. L. Lee Acquisition Fund
24 Retirement Accounts II, LP, own approximately 40



1 percent, 16 percent and eight percent respectively of
2 the stock of Big V Supermarkets pursuant to a December
3 1990 management led buyout sponsored by Thomas H. Lee.

4 Mr. Goffman submitted a supplemental
5 affidavit. I don't have the date on this but it was
6 sometime in January of 2001. In which he states, in
7 paragraph 12, I previously disclosed that Skadden, Arps
8 currently represents in the matter unrelated to the
9 Chapter 11 cases Thomas H. Lee Company, whose
10 affiliates, et cetera, known as the Lee funds, own
11 approximately 40 percent, 16 percent and 18 percent
12 respectively of the stock of Big V Holdings, Inc.,
13 pursuant to a December 1990 management led buyout.

14 The Lee funds also own 16 million in
15 aggregate principal amount of the debtor's 14.14
16 percent senior subordinated notes.

17 Paragraph 13 says, Skadden, Arps does not
18 currently represent, has not represented and during the
19 pendency of the Chapter 11 cases will not represent the
20 Lee funds in any matters related to the debtors'
21 Chapter 11 cases or the acquisition of stock in the
22 debtors. Skadden, Arps does not currently represent
23 any of the Lee funds on any matters whatsoever.

24 Moreover, Skadden, Arps does not believe



1 that Skadden, Arps has ever represented any of the Lee
2 funds on any matters whatsoever.

3 Then there is a second supplemental
4 affidavit of Jay Goffman, which was just filed
5 recently. I think within the last week.

6 I'm not sure exactly. It seems to me that
7 the second supplemental affidavit states exactly what
8 was said in the first supplemental affidavit as to
9 what's referred to as the Lee funds.

10 I guess there is just more significant --
11 more detailed disclosure about the business of the Lee
12 funds in the second supplemental affidavit.

13 In any event, it's clear to me from the
14 testimony of Mr. Toopes that the Thomas H. Lee Company,
15 which is a client of the Skadden firm, has an equity
16 interest, be it direct or indirect, in the debtor and I
17 think the most telling thing is that Mr. Toopes in his
18 testimony made reference to the fact that his company
19 was acquired by the Thomas H. Lee Company.

20 Now, the technicalities that it may be
21 certain funds that were sponsored by Thomas H. Lee
22 Company that actually hold the stock and that while
23 Skadden represents Thomas H. Lee, the sponsor, it does
24 not and has not represented the funds that technically



1 hold the stock. It seems to me clear that there is a
2 direct or indirect relationship between the Thomas
3 H. Lee Company and the major equity ownership in Big V.

4 That the Thomas H. Lee Company is a past,
5 present and ongoing client of Skadden, Arps, that it
6 does not appear to be any transaction in which the
7 Skadden firm represented either the debtor or the
8 Thomas H. Lee Company or any of its affiliates in a
9 transaction between those two parties and the Skadden
10 firm has obtained a waiver from the Thomas H. Lee
11 Company. I presume from its affiliates.

12 There is also a disclosure that there are
13 numerous other creditors and other parties in interest
14 that are represented by the Skadden firm, not in
15 connection with any transactions with the debtor or the
16 bankruptcy cases, but there is a significant
17 relationship between Skadden and scores of other
18 creditors and interested parties.

19 I find in this case that the Skadden firm
20 has an actual conflict of interest in that its
21 representation of C&S Wholesalers in connection with
22 the pre-petition contract gives rise to an actual
23 conflict of interest and that that conflict has not
24 been overcome.



1 C&S is a significant creditor of the debtor.
2 It has the indemnity claim. It may have a liquidated
3 damage claim. C&S in its acquisition of Grand Union
4 may be a significant competitor to the debtor and there
5 is the three-way litigation initiated by the debtor
6 against Wakefern and then Wakefern against C&S, which
7 is a very significant, if not lynch pin, to this
8 reorganization.

9 Now, Chapter 11 is merely a negotiation
10 process. That's what Congress intended. That's why
11 there is a requirement in 1129(a) that there be at
12 least one impaired accepting class for confirmation.
13 It is because Congress wants the parties to negotiate
14 and to reach a resolution of their conflicting
15 interest.

16 To say that the decision on how Wakefern or
17 what the rights of Wakefern are, vis-a-vis the debtor,
18 depends solely on the legal advice to be given to the
19 debtor by the Court to me makes no sense whatsoever.
20 What makes sense to me is that there are three major
21 parties who have different legal positions on what
22 their contractual rights may be and that there is a
23 significant amount of money involved, a \$250 million
24 claim on one side, \$30 million a year in bottom line



1 revenues on another side, and I assume that C&S
2 Wholesalers has a significant economic stake in the
3 transaction. With that much money on the table, it's a
4 situation that cries out for resolution.

5 For counsel to the debtor to say, we are
6 going to stand back from that and let the Court make
7 the call and then we'll see where the chips fall to me
8 is an abdication of its responsibility. I don't see
9 how this negotiation can be conducted by the debtor
10 with one hand tied behind its back and that it could
11 not communicate with C&S and Wakefern at the same time
12 with one counsel representing the debtor to try and
13 make that three-way negotiation.

14 There was a decision rendered by Judge Moore
15 several years ago, more than 10 years ago. I think he
16 is dead more than 10 years. A case called Glenn
17 Electric. In which the debtor was financed
18 pre-petition by a company that was lending it money,
19 including money that was used for retainer to the
20 debtor's counsel. And I think that the debtor's -- I
21 don't remember the facts exactly. But that the
22 debtor's counsel had some pre-petition relationship
23 with the firm that was going to eventually be the
24 proponent of the plan of reorganization. At least



1 that's what everybody thought when the case was filed.

2 And Judge Moore in that case found that
3 there was an actual conflict of interest and that the
4 debtor's firm could not -- was disqualified from
5 representing the debtor and it was the type of
6 situation where the Judge recounted the old phrase that
7 if it walks like a duck and quacks like a duck, it's
8 probably duck.

9 And in this situation, the conflict of
10 interest that Skadden faces in its relationship with
11 C&S Wholesalers and the debtor-in-possession is
12 definitely a duck here. This is something that rises
13 to the level of an actual conflict of interest.

14 Not only the litigation, but the whole
15 reorganization process itself cannot be conducted
16 without impacting on C&S Wholesalers. And I see no way
17 that a debtor's counsel can advise its client on a
18 reorganization process without taking into account what
19 the impact will be on C&S, even if it is that the
20 debtor wants to join forces with C&S, which is what the
21 debtor wants to do now. Skadden must be pulled in two
22 directions by this relationship and it rises to an
23 actual conflict.

24 With regard to the Thomas H. Lee Company.



1 It seems to me that there is a natural and unavoidable
2 antipathy between equity and creditors in the case
3 which is in Chapter 11 for a company that is or may be
4 insolvent. Even for one that is not insolvent, there
5 is certainly a competition for the going concern value
6 of the debtor in the process of reorganization.

7 The counsel to the debtor-in-possession has
8 a fiduciary duty to all of the competing interests for
9 the value of the debtor and the impact on the Thomas
10 H. Lee Company from this negotiation process is actual.
11 Whether their investment becomes worthless or whether
12 they are able to retain a valuable equity interest is
13 crucial.

14 Now, I think it is too facile for the
15 Skadden firm to say, well, we represent Thomas H. Lee
16 Company but we don't represent its affiliates that are
17 the nominal holders of the equity in this company and
18 also to say that Thomas H. Lee Company is so big, in
19 essence what they are saying is, whether they get any
20 equity out of this or not, it is really insignificant
21 to them.

22 Mr. Toopes I think testified that when a
23 significant event happened in this case, he called --
24 he named an individual at Thomas H. Lee Company that he



1 reported to. Obviously Thomas H. Lee Company, whether
2 it was directly or indirectly, has a stake in the
3 outcome of this case. I think it's indicative that the
4 Hutchins, Wheeler firm had the good sense to call Mr.
5 Toopes as soon as there was a bankruptcy filing and
6 inform him that because of their client relationship
7 with Thomas H. Lee Company, that Hutchins, Wheeler
8 could no longer represent the debtor. It seems to me
9 that the same problem arises with Skadden, Arps. And I
10 find that there is, in fact, an actual conflict of
11 interest in Skadden's representation of this equity
12 holder and the debtor.

13 Now, as to the other creditors and parties
14 in interest. That circumstance gives rise to a
15 potential conflict of interest. Without going through
16 all the parties, I know that there were several
17 institutional lenders that were named who have fairly
18 significant loans to Big V. And there is clearly a
19 potential conflict of interest that those transactions
20 need to be scrutinized, as they must be. And where
21 there is a potential conflict of interest, the Court
22 has to exercise discretion. It seems to me in light of
23 the relationship with C&S Wholesalers, with Thomas
24 H. Lee and with the numerous other creditors involved



1 here, that, in the exercise of discretion, Skadden,
2 Arps should be disqualified from representing the
3 debtors.

4 Now, in the event that my assessment of the
5 relationship of the Skadden firm to C&S and/or Thomas
6 H. Lee is incorrect, I think I should evaluate this as
7 if C&S and Thomas H. Lee do arise only to a potential
8 conflict of interest; and, in doing so, in exercising
9 my discretion, I find that Skadden should be
10 disqualified even if those conflicts are only
11 potential.

12 It is unduly burdensome on the estate for
13 Skadden to attempt to avoid dealing with the C&S
14 relationship and/or the relationship to equity holders
15 and substituting the Cole, Schotz firm whenever those
16 subject matters come up. I find that it is not in the
17 best interests of the estate or the other interested
18 parties in the estate for the debtors to retain a firm
19 that is so disabled from acting on behalf of the debtor
20 and the estate in these crucial matters.

21 Now, Skadden has several responses to the
22 objections that were raised.

23 One is that it has received a waiver. And I
24 believe the law is that the waivers of conflicts of



1 interest are not effective for counsel to a debtor-in-
2 possession, that as the objectors have pointed out,
3 there are too many interests that are represented by
4 the nominal fiduciary, the debtor-in-possession as a
5 client, to get an effective waiver.

6 Skadden also says, well, its relationship to
7 these other parties such as C&S Wholesalers and Thomas
8 H. Lee Company is really de minimis. The amount of
9 fees that Skadden earns from these other clients is
10 less than one hundredths of one percent of their gross
11 revenues in a year. I think it's notable that when it
12 suits their argument, Skadden discloses the actual
13 dollar amount of fees that they received in a
14 particular transaction. And that was that Skadden was
15 paid roughly \$6,100 for its review of the C&S supply
16 document. But, otherwise, Skadden has used percentages
17 because it seems to be relatively small in amount. But
18 they disclosed that the firm has 1,600 attorneys so
19 that the gross revenues of the firm are going to be a
20 very significant number. I have no -- I can only
21 imagine that it must be somewhere in excess of \$500
22 million.

23 So that even a million dollars is, on a
24 percentage basis, a relatively small amount. But as



1 Senator Dirkson one time said, a million here, a
2 million there and pretty soon you're talking about a
3 lot of money.

4 What may not be significant as a percentage
5 to the firm as a whole is maybe significant to a
6 particular attorney who is involved as the billing
7 attorney and who I'm sure would like to retain a
8 relationship. And I agree with Mr. Kenney that there
9 really is no de minimis exception when it comes to an
10 actual conflict of interest.

11 As to the ethical wall. I don't believe
12 that the problems in this case can be solved by
13 creating an ethical wall nor that it is in the best
14 interests of the debtors to attempt to operate with the
15 restrictions that are necessarily imposed by having an
16 ethical wall.

17 One of the reasons for the debtor to retain
18 the firm with such eminent capabilities as the Skadden
19 firm, it can rely upon all of the expertise of the
20 1,600 lawyers who are in the firm and to wall off a
21 significant portion of them doesn't do the debtor a
22 service and doesn't -- it effectively eliminates one of
23 the main reasons for hiring such a well-qualified firm.

24 I don't believe that special counsel in this



1 case can solve the problem. I believe that there are
2 circumstances where it is appropriate to hire special
3 counsel and even hire special counsel in order to
4 resolve a relatively minor conflict that general
5 bankruptcy counsel may have for a debtor-in-possession.
6 So if there was a discreet piece of litigation that was
7 not a lynch pin to the reorganization process, that may
8 work. But in this case, the relationship with C&S and
9 litigation with C&S and Wakefern are the keys to the
10 reorganization. The debtor has stated that itself on
11 the record. To attempt to use special counsel to solve
12 the problem of conflict would be making the exception
13 swallow the rule.

14 As to the allegation that the objections are
15 the result of bad motives on behalf of the committee
16 who was allegedly dominated by Wakefern and on behalf
17 of Fleet who has some other nefarious purpose, I think
18 that not only is it denied by these parties, but even
19 if it were true, we have the objection of the United
20 States Trustee, who has no ax to grind in this case;
21 and, in fact, is extremely apologetic about having to
22 object to retention of debtor's counsel. It is with
23 great reluctance that the United States Trustee
24 interferes with the important right of a debtor to



1 select its own counsel. So I think those alleged bad
2 motives can be overlooked.

3 And, lastly, Skadden says, well, there is
4 really no conflict because Big V and C&S are on the
5 same side. The management of Big V has made its
6 business decision that it wants to go with C&S. It
7 makes imminent economic sense and Mr. Toopes has
8 obviously thought long and hard about this. I'm sure
9 it was not without a lot of consternation that he and
10 his colleagues made the decision to terminate their
11 relationship with Wakefern, which was over 40 years at
12 this point, and to go down another path. And it may
13 very well be that the salvation of Big V, for the
14 benefit of everybody, is that it side with C&S and it
15 be able to exit from the Wakefern Cooperative without
16 incurring a large punitive damage. But that's no
17 solution to the actual or even potential conflict of
18 interest that exists here between C&S and the other
19 constituencies in this case.

20 Now, both sides rely on the Marvel decision
21 to support their decision. I would note that the
22 decision in the Marvel case, that the Gibbons firm in
23 that case had never represented Chase in any
24 transaction with regard to the debtor. In this case,



1 Skadden has represented the debtor in a transaction
2 with C&S pre-petition. And in the Marvel case, the
3 Gibbons firm severed all attorney-client relations with
4 Chase. And so that at the inception of the
5 representation of the trustee or shortly thereafter,
6 the Gibbons firm had no ongoing relationship with the
7 Chase firm. And I think the Court did make note of the
8 fact that its prior relationship with Chase was on an
9 isolated transaction involving financing of the New
10 Jersey Performing Arts Center, which was not
11 significant to Gibbons and was essentially a community
12 investment by Chase.

13 But in this case, Skadden was continuing its
14 client relationship with both C&S Wholesalers and
15 Thomas H. Lee Company, admittedly not with regard to
16 the interests of the debtors, but with other clients.

17 Now, I recognize that I -- though someone
18 else could disagree. Some other Judge could disagree
19 with this decision. I really doubt that any other
20 Bankruptcy Judge would come out differently on this
21 decision. And it is with much reluctance and without
22 any relish that I make the decision that I do
23 recognizing also that my status is only as a visiting
24 Judge in this Court.



1 But I think that the Skadden firm would
2 itself be taking an undue risk if it were successful in
3 convincing the Bankruptcy Court that it was not
4 disqualified because, as the counsel learned in the
5 First Jersey case and I think also PricewaterHouse
6 learned, that an Appellate Court may sometime down the
7 road determine that the decision to authorize a
8 director or trustee to employ professionals was
9 incorrect and that would result in a retroactive
10 disqualification and a disgorgement of a significant
11 amount of fees. And I don't think it's a risk that --
12 frankly, I'm surprised that it's a risk that Skadden
13 was willing to take on itself.

14 I don't think that this means that all large
15 firms are disqualified from representing debtors in
16 Chapter 11 cases. I think this, as Mr. Kenney says,
17 this is a circumstance which is beyond ordinary and
18 cries out for disqualification.

19 I do want to say that if I have not
20 mentioned here an argument that was raised by either
21 the United States Trustee, the committee or Fleet, that
22 I adopt those arguments because I think all of their
23 arguments were well taken.

24 Lastly, as to the harm to the debtor. It



1 may be that there is harm to the debtor in
2 disqualifying its chosen counsel at this point in time.
3 Unfortunately, I believe that was brought on by the
4 Skadden firm in not properly assessing their own
5 conflict of interest in this case and not declining to
6 represent Big V initially similar to what the Hutchins,
7 Wheeler firm did.

8 I would note that I believe the first
9 objection was filed by the United States Trustee early
10 on, sometime in December, I think, wasn't it, Mr.
11 Kenney?

12 MR. KENNEY: Yes, your Honor.

13 THE COURT: So the issue was out on the
14 table early on. It should have been addressed early
15 on. It should not have gotten to the stage where we
16 are now at February 15th, to have the Court now decide
17 that the Skadden firm is disqualified to the detriment
18 of its client and to the detriment of the other parties
19 in interest in this case.

20 Now, I don't think that the issues in this
21 case are rocket science, that there are other attorneys
22 who can get up to speed very quickly. I'm sure that
23 counsel to the committee grappled initially with trying
24 to get its arms around the relationships here but



1 within a few days was able to find out what's going on.

2 I'm sure that there are other well-qualified
3 debtor's attorneys who can be retained by the debtor
4 and get up to speed in a relatively short period of
5 time. Hopefully it will not be such harm that
6 precludes a successful reorganization in this case.

7 Mr. Toopes, I'm sorry that you find your
8 firm in this position now. It's regrettable. But I
9 think it's unavoidable. And I hope that you will act
10 swiftly to retain counsel that can represent you
11 adequately and I wish you success in reorganizing your
12 company for the benefit not only of yourself, your
13 co-employees, people that you do business with, your
14 shareholders and your creditor constituencies.

15 All right. In terms of a form of order.
16 Mr. Kenney, will you submit a form of order?

17 MR. KENNEY: Yes, your Honor.

18 THE COURT: All right.

19 Mr. Allingham, anything else we need to
20 discuss?

21 MR. ALLINGHAM: No, your Honor.

22 THE COURT: All right. Mr. Ecstein,
23 anything else?

24 MR. ECSTEIN: The only issue that I think



1 needs to be considered, and it may not be today, maybe
2 the next day or so, is how to accomplish the transition
3 in an efficient and smooth manner. I don't know if
4 your Honor has any comments on this issue now.

5 THE COURT: No. Not now.

6 Mr. Kenney, anything else?

7 MR. KENNEY: No, your Honor.

8 THE COURT: Thank you.

9 Ms. Sacksteder?

10 MS. SACKSTEDER: No. Thank you, your Honor.

11 THE COURT: All right. Thank you. Good
12 night.

13 (Proceeding adjourned at 5:43 p.m.)

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6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

INDEX TO WITNESSES

DIRECT CROSS REDIRECT RECROSS

James A. Toopes

13

42 - Ecstein

71 - Sacksteder

70



1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

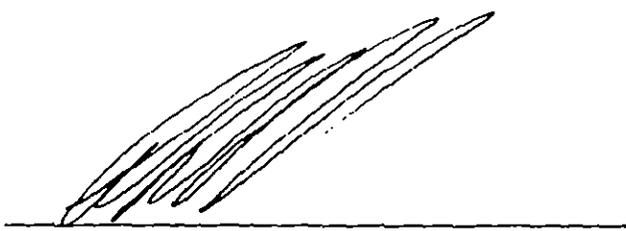
State of Delaware :

County of New Castle :

C E R T I F I C A T E

I, Allen S. Blank, Registered Merit Reporter and Notary Public, do hereby certify that the foregoing record, pages 1 to 160 inclusive, is a true and accurate transcript of my stenographic notes taken on Thursday, February 15, 2001, before ROY T. LYONS, Bankruptcy Judge.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 19th day of February, 2001, at Wilmington.



Allen S. Blank, RMR



FILED

at _____ o'clock ____ M

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

FEB 10 1998

U.S. TRUSTEE

United States Bankruptcy Court
Albuquerque, New Mexico

In re:

FEB 13 2 53 PM '98

SOLV-EX CORPORATION,
85-0283729

ALBUQUERQUE, NM

Case No. 11-97-14361 MA

Debtor-in-Possession.

MEMORANDUM OPINION

THIS MATTER came before the Court on the Application by Solv-Ex Corporation to Employ Hinkle, Cox, Eaton, Coffield & Hensley, L.L.P. as Attorneys. After having a hearing on the merits, having read the motion, briefs and responses thereto, and being otherwise fully informed, the Court finds that the application to employ Hinkle, Cox, Eaton, Coffield & Hensley, L.L.P. as attorneys for the debtor-in-possession should be DENIED.

FACTUAL BACKGROUND

A thorough discussion of the facts and circumstances in this case is warranted. Solv-Ex Corporation and Solv-Ex Canada Limited filed Chapter 11 petitions on August 1, 1997. Both are debtors-in-possession. Solv-Ex Corporation is a New Mexico based corporation. Solv-Ex Canada Limited, which is a separate debtor, is a wholly-owned subsidiary of Solv-Ex Corporation based in Alberta, Canada. Solv-Ex Canada Limited was incorporated by Solv-Ex Corporation to serve as the general partner in a Canadian limited partnership, created primarily to develop oil sand leases using Solv-Ex Corporation's technology. On the day of the filing of their bankruptcy petitions, Solv-Ex Corporation (Solv-Ex) and Solv-Ex Canada Limited (Solv-Ex Canada) filed applications to employ Hinkle, Cox, Eaton, Coffield & Hensley, L.L.P. (Hinkle,

Cox) as general Chapter 11 counsel for the estates.

Hinkle, Cox has served as general legal counsel for Solv-Ex since July of 1992, handling specific litigation and general employment matters. Marshall G. Martin (Martin), a partner of Hinkle, Cox, served as general counsel for Solv-Ex. In addition, Robert P. Tinnin (Tinnin), another partner of Hinkle, Cox, assisted Solv-Ex in some employment matters. At some point, both Martin and Tinnin became shareholders in Solv-Ex. On January 15, 1997, Martin left Hinkle, Cox to serve as the Vice President and General Counsel for Solv-Ex. Martin also became a holder of options in Solv-Ex. Another member of Hinkle, Cox, Stephanie Landry (Landry), took over as lead counsel of Solv-Ex when Mr. Martin left the firm to work for Solv-Ex. Landry is currently representing the debtor in the bankruptcy and in other matters. On June 30, 1997, Martin resigned as Vice President and General Counsel of Solv-Ex and his options in the corporation expired on September 30, 1997. Martin resumed employment with Hinkle, Cox upon his departure from Solv-Ex. Both Martin and Tinnin are currently shareholders in Solv-Ex. The applications for employment seek to have John Phillips, another partner in Hinkle, Cox, to serve as lead counsel in the Chapter 11 proceedings.

Various Hinkle, Cox attorneys have appeared as counsel or assisted other counsel in matters relating to securities fraud involving the Debtor and individual officers of the Debtor. A few of these matters are still pending before other courts. Hinkle, Cox states in their applications that if the Court should grant the Debtors' applications for employment, the attorneys will cease participation in these other lawsuits and formally withdraw from the representation of individual officers of the Debtor in those pending matters.

Hinkle Cox is currently employing their standard "Chinese wall" mechanisms in

screening Martin and Tinnin from the bankruptcy matter. These mechanisms include:

- a. Martin and Tinnin are to have no connection with the Solv-Ex bankruptcy proceeding.
- b. Attorneys and staff are prohibited from discussing the Solv-Ex bankruptcy case with either Martin or Tinnin.
- c. Attorneys and staff are to prevent any case documents from reaching either Martin or Tinnin. Correspondence, faxes or legal documents relevant to the bankruptcy proceeding should be forwarded to John Phillips.
- d. All Solv-Ex pleadings, correspondence, memoranda or other documents generated on the computer network are to be coded as "private" with access restricted from Martin and Tinnin, and their secretaries.
- e. All Solv-Ex files are to be kept in a locked file cabinet with the keys controlled by John Phillips, Stephanie Landry and Rose Scraglino. Keys will be issued to Attorneys and Staff on a "need to know" basis.

(Adapted from Hinkle, Cox interoffice memo attached to applications.)

In June 1997, Solv-Ex paid \$46,000 to Hinkle, Cox for services rendered prior to and unrelated to the bankruptcy. This payment was within the preference period as provided by 11 U.S.C. §547(b). At the time the bankruptcy petition was filed, the Debtor owed Hinkle, Cox a balance of \$13,500 for services rendered. Hinkle, Cox stated in their applications the intention to waive that claim upon appointment as counsel for the Debtors. Furthermore, Solv-Ex deposited a retainer of \$65,000 with Hinkle, Cox in contemplation of the reorganization. Hinkle, Cox, as of the date of the applications to employ, had withdrawn \$29,518 as payment for services rendered prior to and in preparation for the filing of the reorganization case.

Soon after the filing of the petition, it became apparent to Solv-Ex that it needed an immediate injection of capital in order to effectuate its reorganization. It was decided that one of the major assets of the estate, Solv-Ex's interest in the oil sands project in Canada, would be sold free and clear of liens. The Court approved a bid solicitation process for the sale of this asset. The successful bidder for this asset was Koch Exploration. The joint hearing approving the sale

of the oil sands interest took place before this Court and the Queen's Bench in Canada on November 19, 1997. Thereafter, Hinkle, Cox submitted an amended affidavit to their employment application for Solv-Ex Canada on November 24, 1997, after discovering that Hinkle, Cox has "from time to time in the past, represented United States affiliates of Koch, including its parent corporation, Koch Industries, Inc., and its parent's subsidiaries Koch Oil Company and Koch Exploration US." In addition, Hinkle, Cox recently undertook representation of Koch's parent, Koch Industries, Inc., in Texas, regarding certain specific legislative and governmental affairs and routine Railroad Commission issues. However, Hinkle, Cox maintains that this representation is wholly unrelated to Koch and its contemplated transactions with Solv-Ex. This information, however, was never directly presented to the Court prior to or during the negotiations of the sale of the oil sands interest.

As previously noted, Hinkle, Cox has also applied to concurrently represent Solv-Ex Canada in their bankruptcy proceeding. In the supplemental brief in support of the employment of Hinkle, Cox, it is stated that Solv-Ex Canada has never operated independently and thus has no existence or identity of its own. In addition, it is asserted that all the assets of Solv-Ex Canada were contributed by Solv-Ex in exchange for 100% of the stock, and that Solv-Ex Canada has no separate interests from Solv-Ex. Currently pending before this Court is a motion to substantially consolidate the two bankruptcy proceedings. However, some creditors are opposed to the consolidation on the basis that it is possible that the rights of creditors of Solv-Ex Canada may be adversely effected by the consolidation. More importantly to the current proceeding is the argument raised by some creditors that Solv-Ex Canada may potentially have intercompany claims against Solv-Ex.

The United States Trustee, as well as several creditors, filed objections to the applications for employment of Hinkle, Cox. However, all objections except the US Trustee's have since been withdrawn. The creditors are of the impression that even though there seem to be inherent conflicts and an apparent lack of disinterestedness on the part of Hinkle, Cox, that it would be cost-prohibitive and too time consuming to bring another firm up to speed on the case at this time. Therefore, the creditors feel it would be in the best interests of the estate for the Court to approve the applications. The US Trustee argues that Hinkle, Cox fails to meet the disinterestedness test provided by 11 U.S.C. §327(a), and as such the Code prohibits the approval of the applications.

ISSUE

This Court must decide whether or not it is appropriate to approve the applications to employ Hinkle, Cox as counsel to represent the Debtors' estates. Thus the issue is whether the facts and circumstances in this particular case present such a lack of disinterestedness or such apparent conflicts that the Court should deny approval of the applications of Hinkle, Cox under the applicable provisions of the Code.

DISCUSSION

Case law concerning disqualification of professionals provides that courts, in general, have declined to formulate bright-line rules regarding the criteria for disqualification, but instead have tended to favor an approach which gives the bankruptcy court discretion to evaluate each case on its facts, taking all circumstances into account. *See In re BH & P Inc.*, 949 F.2d 1300, 1315 (3rd Cir. 1991). While recognizing that a bankruptcy judge has a certain level of discretion in these matters, those powers "must be exercised within the confines of the Bankruptcy Code."

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988). After examination of the applicable Bankruptcy Code sections, it seems apparent that a bankruptcy judge has the responsibility to ensure that professionals are disinterested and do not represent interests adverse to the estate.

The Bankruptcy Court also has the responsibility to police those who practice before it in order to preserve the Court's integrity and maintain public confidence. See In re Anver Corp., 44 B.R. 615, 617 (Bankr. D.Mass. 1984). As one court has noted, "[t]he Court must be concerned with the appearance of accommodation among the members of the bankruptcy bar and its effect on maintaining public confidence in the bankruptcy system." Id.

Other courts have noted the policy considerations inherent in the bankruptcy scheme which allows the debtor deference in the selection of counsel. See Vergos v. Timber Creek, Inc., 200 B.R. 624, 628 (W.D.Tenn.1996) *aff'g* In re Timber Creek, Inc. 187 B.R. 240 (Bankr.W.D.Tenn.1995); In re Creative Restaurant Management, Inc., 139 B.R. 902, 909-910 (Bankr.W.D.Mo.1992). These courts cite to authority that asserts that "only in the rarest of cases" will the debtor be deprived of the privilege of selecting counsel of their choice, as the relationship between attorney and client is highly confidential, demanding personal faith and confidence. 3 King et al., Collier on Bankruptcy ¶327.04[1], at 327-25 (15th ed. rev. 1997). Thus, while the Court has the duty to look at all the facts and circumstances surrounding the particular case, and analyze whether the particular professional satisfies the requirements as set forth in the Code, at the same time the Court must respect the debtor's freedom to choose qualified counsel to represent its interests.

In order to determine whether a particular attorney or law firm is qualified to represent a debtor, a two-step analysis is required. See Creative, supra, at 909. First, the attorney must make a determination that there is no inherent conflict of interest which would prohibit representation under the applicable ethical rules governing the conduct of attorneys. See id. Second, the Court must make the determination whether the Bankruptcy Code makes the attorney or firm ineligible due to the particular facts and circumstances involved. See id.

I. DISINTERESTEDNESS

Section 327(a) of the Code provides:

(a) Except as otherwise provided in this section, the trustee¹ . . . may employ one or more attorneys . . . and 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.

11 U.S.C. §327(a)(emphasis added). Thus, section 327(a) of the Code provides that an attorney may represent a Chapter 11 debtor as long as the attorney (1) is a "disinterested person" and (2) holds no interest adverse to the estate.

Section §101(14) defines a "disinterested person" as one who-

¹Section 327 governs a trustee or debtor in possession's employment of attorneys. See 3 King et.al., Collier on Bankruptcy ¶327.01 at 327-6 (15th ed. rev. 1997). "While section 327 explicitly governs employment by a trustee, it is applicable to the employment of professional persons by a debtor in possession because section 1107(a) of the code provides a debtor in possession . . . with all of the rights and powers of a trustee serving in a case under chapter 11..." Id. at ¶327.02 at 327-9.

(A) is not a creditor, an equity security holder, or an insider²;

...
...

(D) is not and was not, within two years before the date of the filing of the petition, a director, officer or employee of the debtor. . . ; 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)(D)(E). Because both section 327(a) and the definition of a “disinterested person” require that the professional not have an interest materially adverse to the estate, the Court’s inquiry thus focuses on whether the disinterested test is met. See Creative, supra, at 910-911.

In looking at the facts in the present case, there is no question that Martin and Tinnin are both disqualified from representing Solv-Ex’s interests in the bankruptcy proceeding by the Bankruptcy Code. Both Martin and Tinnin are currently shareholders of Solv-Ex, and as such are equity security holders, holding interests materially adverse to the estate. Moreover, Martin was an officer and employee of Solv-Ex within the last two years. Therefore, both Martin and Tinnin are *per se* not disinterested and are disqualified from representing the Solv-Ex’s interests in the bankruptcy proceedings.

²“Insider” is defined as

- a. If the debtor is a corporation -
- b. (i) director of the debtor
- c. (ii) officer of the debtor
- d. (iii) general partner of the debtor
- e. (iv) partnership in which the debtor is a general partner

11 U.S.C. §101(31).

Given that Martin and Tinnin are not disinterested, the next question is whether their lack of disinterestedness is imputed to the entire firm so as to preclude Hinkle, Cox from serving as counsel to the Debtors. Courts in the past have imputed ineligibility to a firm based on the ABA Code of Professional Responsibility. New Mexico has adopted the Rules of Professional Conduct, in which imputed disqualification is addressed in Rule 16-110. The Comment to Rule 16-110 states that the prior notions of *per se* imputed disqualification contained originally in Canon 9 of the ABA Model Code of Professional Responsibility have been replaced by a more functional approach. See Comment to Rule 16-110, NMRA 1997. The rule regarding vicarious disqualification is now based on a functional analysis of two aspects of representation - confidentiality and avoidance of representing interests adverse to a former or current client. See id.

Rule 16-110 is not applicable in this case, primarily because the general screening mechanisms instituted by Hinkle, Cox are sufficient in the Court's estimation to prevent any imputed disqualification of the firm.³ Therefore, under the New Mexico Rules of Professional Conduct, Hinkle, Cox is not disqualified because Martin and Tinnin are *per se* ineligible to

³There are several factors that courts have used to evaluate whether sufficient screening mechanisms have been implemented by a particular firm to insure that no violation of client confidence or representation of adverse interests occurs. This has been commonly referred to as the "Chinese Wall" concept. These factors include:

"the size and structural divisions of the law firm, the likelihood of contact between the 'infected' attorney and the specific attorneys responsible for the present representation, the existence of rules which prevent the 'infected' attorney from access to relevant files or other information pertaining to the present litigation, or which prevent him from sharing in the fees derived from such litigation."

Vergos v. Timber Creek, Inc., *supra*, 200 B.R. at 629, quoting Manning v. Waring, Cox, James, Sklar and Allen, 849 F.2d 222, 225-26 (6th Cir. 1988).

represent the Debtors.

Furthermore, case law supports the proposition that no provision in the Bankruptcy Code requires the *per se* imputation of ineligibility to an attorney's firm when that attorney is disqualified due to lack of disinterestedness. See United States Trustee v. S.S. Retail Stores Corporation (In re S.S. Retail Stores Corp.), 211 B.R. 699, 704 (B.A.P. 9th Cir. 1997); Vergos v. Timber Creek, Inc., *supra*, at 628; In re Capen Wholesale, Inc., 184 B.R. 547, 551 (Bankr. N.D.Ill.1995); In re Timber Creek, 187 B.R. 240, 244(Bankr.W.D.Tenn. 1995); Creative, *supra*, at 913.

However, even though there is no automatic imputation of ineligibility to the entire firm, the Court must still look at whether or not Hinkle, Cox, as a firm, is disinterested. To be disinterested a firm must 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. 11 U.S.C. §101(14)(E). An adverse interest 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," or "a predisposition under circumstances that render such bias against the estate." Collier on Bankruptcy, *supra* at ¶327.04[2][a] at 327-7. Again, the test of whether the firm holds an interest materially adverse to that of the debtor's creditors or equity holders is one based upon all the facts and circumstances.

Armed with knowledge of all the relevant facts, the bankruptcy court must determine, case by case, whether the [alleged basis for ineligibility] can be tolerated under the particular circumstances. In so doing, the Court should consider the full panoply of events and elements. . .

Creative, *supra*, at 914, quoting In re Martin, 817 F.2d 175, 182 (1st Cir. 1987).

A case which contains facts similar to the one at bar is Creative Restaurant Management.⁴

As in the present case, at issue in Creative was whether or not the particular law firm involved was sufficiently disinterested such that the court could approve their employment application to represent the debtor in the debtor's bankruptcy proceedings. In Creative, the factors that made the law firm's disinterestedness questionable included: the firm had received from the debtor a substantial retainer in preparation of filing the bankruptcy petition, the firm had received payments from the debtor for services rendered prepetition during the preference period, and one of the law firm's attorneys had been a former officer of the debtor. The court reasoned that none of these factors were issues that would amount to the firm being disqualified under the Code as holding interests materially adverse to the estate. See Creative at 915-919. The Creative court also placed much emphasis on the fact that the firm had represented the debtor for years, and deferred to the debtor's right to their choice of counsel. Other cases with similar facts have adopted the reasoning in Creative. See United States Trustee v. S.S. Retail Stores Corporation (In re S.S. Retail Stores Corp.), 211 B.R. 699 (B.A.P. 9th Cir. 1997); Vergos v. Timber Creek, Inc., 200 B.R. 624 (Bankr. W.D. Tenn. 1996); In re Capen Wholesale, Inc., 184 B.R. 547 (Bankr. N.D. Ill. 1995); In re Timber Creek, 187 B.R. 240 (Bankr. W.D. Tenn. 1995).

⁴139 B.R. 902 (Bankr. W.D. Mo. 1992).

However, the case at bar is distinguishable from Creative.⁵ While this case has contains facts that were also present in the Creative case, this case also has several facts that were not present in Creative. These include:

- the fact that Hinkle, Cox received approximately \$111,000 ^{or \$46,000} during the ninety day preference period preceding the filing of the bankruptcy petition;
- the fact that Hinkle, Cox has represented affiliates of a major creditor of the estate, Koch Exploration, in the past as well as current representing Koch's parent corporation;
- the fact that various Hinkle, Cox attorneys have in the past and are currently representing individual officers of the Debtor in matters relating to securities fraud; <sup>Novell + Miller - but never entered affidavit
J.B. - now representing</sup>
- the fact that Hinkle, Cox is attempting to concurrently represent two Debtors who may potentially have intercompany claims against each other;
- the fact that two members of Hinkle, Cox are current shareholders in the Debtor;
- and the fact that one of those shareholders was an employee and officer of the Debtor, until his abrupt resignation on the eve of bankruptcy. (*1 month prior to petition*)

Each of these facts, when looked at individually, are not in and of themselves reasons to disqualify a firm. However, the facts in the present case, when taken together, lead the Court to the conclusion that Hinkle, Cox is an interested party and is thus disqualified from representing

⁵In addition, it is evident from the Court's reading of the Creative opinion that the Creative court had much more evidence before it from which to determine whether or not the firm held an interest materially adverse to the estate. In the present case, the only evidence before the Court is the verified statements by the attorneys that were attached to the applications. However, even if more evidence had been presented to this Court, it would not have changed this Court's conclusion that the facts present in this case, when taken together, show that Hinkle, Cox is an interested party and is thus disqualified from representing the Debtor.

the Debtors. In weighing the Debtors' right to choose counsel as well as the fact that Hinkle, Cox has represented the Debtors for years against the fact that Hinkle, Cox has a lack of disinterestedness, the Court finds on balance that the lack of disinterestedness outweighs the other considerations. After reviewing all the facts and circumstances in the present case, as well as the unambiguous language of the Code, and the tendency of the courts in this circuit to view the requirements of the Code strictly,⁶ this Court is led to the conclusion that Hinkle, Cox is not disinterested as required by the Code, and as such is disqualified from representing the Debtors as general counsel in their bankruptcy proceedings.⁷

II. ACTUAL CONFLICT OF INTEREST

Although the Court has found that Hinkle, Cox is not disinterested, and is therefore disqualified from representing the Debtors for that reason alone, the Court feels that there is another important reason why Hinkle, Cox is disqualified from representing the Debtor in their bankruptcy proceeding. The Court must also consider whether, under all the facts and circumstances of this particular case, Hinkle, Cox is disqualified because of an actual conflict of interest.

Section 327(c) of the Code provides:

⁶See In re Smitty's Truck Stop, Inc., 210 B.R. 844 (B.A.P. 10th Cir. 1997); Interwest Bus. Equip., Inc., (In re Interwest Bus. Equip.), 23 F.3d 311 (10th Cir. 1994).

⁷This Court is not alone in finding that under similar facts and circumstances like those present in this case amount to the disqualification of the applying firm and/or professional. See Interwest Bus. Equip., Inc., (In re Interwest Bus. Equip.), 23 F.3d 311 (10th Cir. 1994); U.S. Trustee v. Price Waterhouse, 19 F.3d 138 (3rd. Cir. 1994); In re Southern Diversified Properties, Inc., 110 B.R. 992 (Bankr.N.D.Ga.1990); In re Wells Benrus Corp., 48 B.R. 196 (Bankr.D.Conn.1985); In re Anver Corp., 44 B.R. 615 (Bankr.D.Mass.1984).

(c) [a] person⁸ 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).

There is no question that Martin and Tinnin have an actual conflict of interest, being that they are shareholders of Solv-Ex. Therefore they are *per se* disqualified. Again, nothing in the Code supports a *per se* disqualification of the individual attorney's firm when the attorney is found to be ineligible. See United States Trustee v. S.S. Retail Stores Corporation (In re S.S.Retail Stores Corp.), 211 B.R. 699, 704 (B.A.P. 9th Cir. 1997); Vergos v. Timber Creek, Inc., *supra*, at 628; In re Capen Wholesale, Inc., 184 B.R. 547, 551 (Bankr. N.D.Ill.1995); In re Timber Creek, 187 B.R. 240, 244(Bankr.W.D.Tenn. 1995); Creative, *supra*, at 913.

However, the Court has the duty to look at whether Hinkle, Cox, as a firm, has an actual conflict of interest that would necessarily disqualify it under Section 327(c). The term "actual conflict of interest" is not defined in the Code. Courts have found that the term "actual conflict of interest" has been given meaning largely through a case-by-case analysis of each particular fact situation appearing before the bankruptcy court. See In re BH & P Inc., 949 F.2d 1300 at 1315 (3rd.Cir. 1991). "Courts have been accorded considerable latitude in using their judgment and discretion in determining whether an actual conflict exists 'in light of the particular facts of each case.' *Id.*, quoting In re Star Broadcasting, Inc., 81 B.R. 835, 844 (Bankr. D.N.J.1988); see

⁸"Person" is defined by the code as including "individual[s], partnership[s], and corporation[s]..". 11 U.S.C. §101(41). Therefore, Courts, in considering whether there are problems with disinterestedness or conflicts of interests must necessarily look at both the individual attorney as well as the attorney's firm.

United States Trustee v. Price Waterhouse, 19 F.3d 138(3rd Cir. 1994)(“bankruptcy court should have discretion in determining whether an actual conflict exists ‘in light of the particular facts of each case’”); In re Hoffman, 53 B.R. 564, 566 (Bankr. W.D.Ark.1985)(“Whether... an actual disqualifying conflict exists must be considered in light of the particular facts of each case.”); In re Guy Apple Masonry Contractor, Inc., 45 B.R. 160, 166 (Bankr. D.Ariz.1984)(“question is not whether a conflict exists but whether that conflict is materially adverse to the estate, creditors, or equity security holders”).

A review of all the facts and circumstances in this particular case reveal a number of conflicts which, although perhaps not rising to the level of an “actual” conflict, are nevertheless clearly “potential” conflicts. As one court has noted, “[d]enomination of a conflict as ‘potential’ or ‘actual’ and the decision concerning whether to disqualify a [firm] based upon that determination in situations not yet rising to the level of an actual conflict are matters committed to the bankruptcy court’s sound exercise of discretion...” In re BH & P, Inc., 949 F.2d 1300, 1316-1317 (3rd. Cir. 1991). Again, to reiterate the potential conflicts in this case, Hinkle, Cox has:

- received approximately \$111,000 during the ninety day preference period preceding the filing of the bankruptcy petition;
- represented affiliates of a major creditor of the estate, Koch Exploration, in the past as well as current representing Koch’s parent corporation;
- in the past and are currently representing individual officers of the Debtor in matters relating to securities fraud;
- attempted in the present case to concurrently represent two Debtors who may potentially

have intercompany claims against each other;

- two members which are current shareholders in the Debtor,
- a member of the firm who was an employee and officer of the Debtor within the past six months.

It seems to the Court in looking at all the facts in the present case that an actual conflict of interest exists between Hinkle, Cox and the Debtor. Thus, the Court is of the opinion that Hinkle, Cox is disqualified from representing the Debtors as general counsel in their bankruptcy proceedings because Hinkle, Cox has an actual conflict of interest with the Debtors.

CONCLUSION

While other courts under similar circumstances have gone out of their way to fashion an exception to the provisions of section 327⁹, this Court refuses to go down that proverbial slippery slope. If this Court were to find that firms under similar circumstances could nevertheless be appointed as counsel for the debtor, the Court would be carving out an exception to section 327 that does not exist.¹⁰

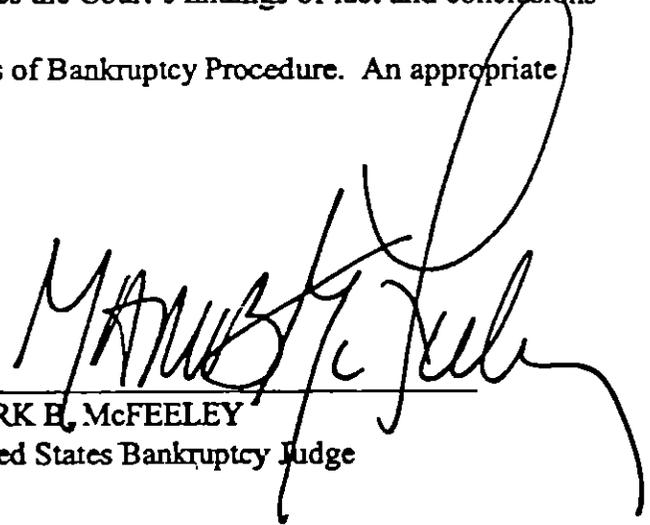
Finally, the Court is aware that this decision comes some six months after the filing of the

⁹The cases which have under very similar circumstances, have deftly crafted ways around the wording of §327, and which were heavily relied upon by Hinkle, Cox, include: While this Court has the upmost respect for these judge's opinions, nevertheless the cases are not of this district, nor are precedent which this Court must follow. In fact, the precedent of the 10th circuit has been to traditionally read the provisions of 327 very strictly.

¹⁰As stated by one court, "bankruptcy courts cannot use equitable principles to disregard unambiguous statutory language'. . . [i]f it is thought that section 327. . . should allow trustees and debtors in possession under some circumstances to employ professionals who are not 'disinterested,' an amendment of that provision should be sought from Congress." U.S. Trustee v. Price Waterhouse, 19 F.3d 138, 142 (3rd Cir. 1994)(citations omitted).

Debtors' Chapter 11 petitions and the filing of the Debtors' motions to employ. The final hearing on the motion to employ was not heard until December 8, 1997. The attorneys, having practiced before this Court for many years, are quite aware of the limited resources and time constraints placed upon this Court. Moreover, counsel was well aware of the mechanisms and procedures available to have an expedited hearings in matters. The attorneys for Hinkle, Cox, being well versed in the Code, were aware of all the conflicts of interests and disinterestedness issues from the inception of these bankruptcy proceedings. However, in this case it appears that counsel chose to take a calculated risk and continue employment absent necessary authorization. While the situation seems inequitable, it is the result clearly supported by the Code.

For the foregoing reasons, the Court concludes that Hinkle, Cox is disqualified from representing the Debtor under section 327, and as such Hinkle, Cox's application for employment is DENIED. This opinion constitutes the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure. An appropriate order will be entered.



MARK E. McFEELEY
United States Bankruptcy Judge

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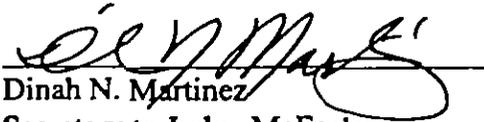
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**UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO**

FILED
at _____ o'clock _____ M
APR 29 1998

United States Bankruptcy Court
Albuquerque, New Mexico

In re:
ALBUQUERQUE
**CLIFFORD R. SINCLAIR and
KATHRYN S. SINCLAIR,**

Debtors.

No. 7-94-12905 MS

MEMORANDUM OPINION

THIS MATTER came before the Court upon the Motion for Expedited Approval of Employment of Special Counsel for Trustee and for Permission for Special Counsel to Appear *Pro Hac Vice*, filed by the Trustee on November 1, 1996. Following hearing on the merits, having considered the argument of counsel and being otherwise fully informed, the Court finds that the Order Approving the Employment of Special Counsel should be revoked and the Motion for Expedited Approval of Employment as Special Counsel for the Trustee should be denied.

FACTUAL BACKGROUND

On November 1, 1996, the Trustee, Yvette Gonzales, filed her Motion for Expedited Approval of Employment of Special Counsel ("Motion for Employment of Special Counsel"), seeking the employment of Steven L. Hoard and Larry G. Adams of the law firm of Mullin Hoard & Brown, L.L.P., for the special purpose of filing and prosecuting a turnover action under 11 U.S.C. §542 to recover estate assets from The Clifford Ray Sinclair Trust, The Kathryn S. Sinclair Trust, and Snowcap, Ltd. (the "turnover action"). On the basis of the Motion for Employment of Special Counsel and the supporting affidavits, this Court granted that employment on an expedited basis by order dated November 1,

1996, pending notice and hearing on objections to the Motion. The Trustee served all creditors and parties in interest with a copy of the Motion and notice of entry of the Order and an objection thereto was filed by Snowcap, Ltd, on November 15, 1997.¹

As part of her motion for the employment of special counsel, the Trustee submitted the affidavits of Steven L. Hoard and Larry G. Adams. In paragraph 5 of his affidavit (Exhibit C to the Motion), Steven L. Hoard, proposed lead counsel in this turnover action, states that the "law firm of Mullin Hoard & Brown, L.L.P., is disinterested and has no connection with the Debtor, creditors of the estate, any party in the United States Trustee's office or any other parties that have interests adverse to this bankruptcy estate, *except that prior to the commencement of the instant bankruptcy proceeding, Mullin Hoard & Brown, L.L.P., provided, and continue to provide, legal services to the FDIC with respect to its claims against Clifford Ray Sinclair.*" (Emphasis added.) The Hoard affidavit provides no detail concerning the nature of the legal services which have been and continue to be provided to the FDIC or the fee arrangement for legal services to be provided during the firm's proposed contemporaneous representation of the FDIC and the Trustee. Neither does the affidavit make any further disclosures concerning this relationship or any other connections.

Notwithstanding the disclosure concerning representation of the FDIC by Mullin Hoard & Brown, L.L.P., the Hoard Affidavit failed to disclose any other material connections. In his testimony in court in this matter, Steven Hoard stated that he did not disclose the FDIC's

¹ The objection was erroneously filed in a related adversary proceeding on November 15, 1997, rather than in the bankruptcy case. The error was corrected by the filing of an Errata Notice Regarding Objection to the Motion and Order for the Employment of Special Counsel, with the Objection attached, in the bankruptcy case on May 21, 1997.

assertion of a constructive trust or lien claimed by the FDIC in the assets of the debtors because the claim “had been abandoned by the FDIC, pursuant to an agreement reached with the -- for practical purposes, the only other creditor in this case, the IRS.” Hoard admitted that “with the benefit of hindsight,” he would have disclosed this detail in his disclosure of the firm’s connections with parties related to this bankruptcy case. Hoard also testified that the FDIC, through Mullin Hoard & Brown, L.L.P., and the IRS entered into an agreement, the effect of which was that the IRS would subordinate certain of its claims to the FDIC in exchange for the FDIC waiving its constructive trust claim with respect to the estate assets. Hoard stated that he did not believe that it was necessary to disclose the existence of this agreement to the Court.

DISCUSSION

Bankruptcy Code §327 authorizes the trustee, subject to court approval, to employ attorneys and other professionals “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.” The procedural mechanism for enforcement of §327 is Fed.R.Bankr.P. 2014(a), which requires disclosure of the connections between the professional seeking to be employed and the debtor, the debtor’s creditors, and any other parties in interest in the bankruptcy case.

Here, the attorneys which the Trustee seeks to employ as special counsel failed in their obligation to make adequate disclosure of their connections with creditors and other parties in interest in this bankruptcy case. This, standing alone, is sufficient to deny the motion for employment. Coupled with the attorneys’ conflict of interest, however, it is doubly clear that the Motion for Employment of Special Counsel must be denied.

to disqualify that professional and deny compensation, whether the undisclosed connections were material or *de minimis*. *Id.*³ Such strict compliance is necessary to maintain the integrity of the bankruptcy system.

Steven Hoard does not appear to challenge that he should have provided greater disclosure to the Court about the connections between his law firm and relevant parties in this case.⁴ Lack of hindsight at the time of the disclosures, however, does not excuse the failure of disclosure. *See, In re Michigan General Corporation*, 78 B.R. 479, 482 (Bankr. N.D.Tex. 1987) (“Unfortunately, the burdens of the Bankruptcy Code are not met by a white heart. Negligence does not excuse the failure to disclose a possible conflict of interest.”); *In re Fjeldheim*, 1993 WL 590145, 6 (Bankr.Mont. 1993) (“a negligent failure to disclose all facts required by [Rule] 2014(a) does not relieve the professional of the consequences of failing to make a complete disclosure.” quoting *In re Hathaway Ranch Partnership*, 116 B.R. 208, 219 (Bankr. C.D.Cal. 1990).

The failure of the law firm of Mullin Hoard & Brown, L.L.P. to make a complete and timely disclosure of all of its connections in this case, as required under Fed.R.Bankr.P. 2014(a), alone renders the firm ineligible for employment under Bankruptcy Code §327.

³ “Though this provision allows the fox to guard the proverbial hen house, counsel who fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation. *In re Crivello*, 134 F.3d 831 (7th Cir. 1998).

⁴ The failure of disclosure in this case is unfortunate. There is no evidence of any intent to deceive the Court by Mullin Hoard & Brown, L.L.P. Nor is there any evidence that Mullin Hoard & Brown, L.L.P. has acted other than the best interests of the estate.