SO ORDERED,

Judge Neil P. Olack
United States Bankruptcy Judge
Date Signed: May 7, 2015

The Order of the Court is set forth below. The docket reflects the date entered.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

HERITAGE REAL ESTATE INVESTMENT, INC.,	**CASE NO. 14-03603-NPO**
DEBTOR.	**CHAPTER 7**

ORDER DENYING MOTION TO EMPLOY SPECIAL COUNSEL

This matter came before the Court for hearing on April 29, 2015 (the "Hearing") on the Motion to Employ Special Counsel (the "Motion") (Dkt. 97) filed by the standing chapter 7 trustee, J. Stephen Smith (the "Trustee"), the Objection to Employment of Special Counsel (Dkt. 104) filed by Bruce Johnson ("Johnson") and William Harrison ("Harrison"), and the Objection of Debtor to Application to Employ Special Counsel (Dkt. 112) filed by the debtor, Heritage Real Estate Investment, Inc. (the "Debtor"), in the above-referenced bankruptcy case (the "Bankruptcy Case"). At the Hearing, Eileen N. Shaffer ("Shaffer") represented the Trustee; Pat. A. Catchings represented Johnson and Harrison; and Craig M. Geno ("Geno") represented the Debtor. After considering the testimony, evidence, and arguments of counsel, the Court ruled from the bench denying the Motion. This Order memorializes and supplements that bench ruling.

Jurisdiction

The Court has jurisdiction over the parties to and the subject matter of this proceeding pursuant to 28 U.S.C. § 1334. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). Notice of the Motion was proper under the circumstances.

Facts

The issue before the Court is whether Stephen B. Porterfield and Rodney E. Nolen ("Nolen") of the law firm Sirote & Permutt, PC ("Sirote")[1] and Derek A. Henderson ("Henderson") are qualified for employment as special counsel ("Special Counsel") for the Trustee under 11 U.S.C. § 327.[2] Also at issue is whether the Motion and attached affidavits are adequate under Rule 2014 of the Federal Rules of Bankruptcy Procedure ("Rule 2014").

1. The Debtor is one of six related entities under the organizational umbrella of the Christ Temple Apostolic Church. The Debtor was established in 1989 as a for-profit corporation to serve as a holding company for multiple businesses. As a result of a downturn in the economy and other factors, many of these businesses were foreclosed upon between 2006 and 2012. Bayview Loan Servicing, LLC ("Bayview") and IB Property Holdings, LLC ("IB," or together with Bayview, "Bayview/IB") foreclosed on two of these properties in 2007 and obtained deficiency judgments of approximately $800,000.00 against the Debtor in the U.S. District Court for the Northern District of Alabama, Western Division, in case number 7:07-CV-352-UWC. A Certificate of Judgment was entered in favor of Bayview/IB on July 28, 2008 (the "Bayview/IB

[1] For clarity, and because the disqualification of an attorney is imputed to the attorney's law firm, the Court refers to Stephen B. Porterfield and Nolen together as "Sirote." *See Stanley v. Krogstad (In re Petro-Serve Ltd.)*, 97 B.R. 856, 861 (Bankr. S.D. Miss. 1989).

[2] Hereinafter, all code sections refer to the U.S. Bankruptcy Code found at Title 11 of the U.S. Code unless specifically noted otherwise.

Judgment").

2. On August 25, 2011, Johnson and Harrison obtained a default judgment of approximately $7 million against the Debtor in the Circuit Court of Greene County, Alabama, in case number CV 2010-32. After an appeal, a Certificate of Judgment was entered by the Supreme Court of Alabama on January 10, 2014 (the "Johnson/Harrison Judgment").

3. On June 18, 2014, Johnson, Harrison, Bayview/IB and Michael L. King filed a Complaint for Fraudulent Transfer of Real Estate and for an Injunction (the "Complaint") (Trustee Ex. 1) against the Debtor and others in the Circuit Court of Sumter County, Alabama (the "Alabama Circuit Court") in case number 60-CV-2014-900049 (the "Alabama Fraudulent Transfer Action"). In the Complaint, Bayview/IB alleges that the Debtor transferred all of its real estate to a related entity, Dynasty Group, Inc., in an effort to defraud its creditors. According to the signatures on the Complaint, Sirote represented Bayview/IB and another attorney represented Johnson and Harrison. The nature and scope of their joint plaintiffs' agreement[3] apparently is set forth in a letter, but a copy was not produced to the Court at the Hearing.

4. On November 6, 2014, the Debtor filed a voluntary petition for relief (Dkt. 1) under chapter 11 of the Bankruptcy Code (the "Bankruptcy Case"). The Alabama Fraudulent Transfer Action was stayed by the Alabama Circuit Court upon the commencement of the Bankruptcy Case. On January 21, 2015, the Bankruptcy Case was converted to a chapter 7 case. (Dkt. 75).

5. On March 17, 2015, the Trustee filed the Motion to employ Sirote and Henderson as Special Counsel. In the Motion, the Trustee alleges that their employment is necessary "to

[3] Generally, it consisted of an agreement among the attorneys for the different plaintiffs regarding, among other matters, the post-judgment collection of assets in the Alabama Fraudulent Transfer Action.

investigate and pursue fraudulent transfer claims related to certain parcels of real property located in the state of Alabama." The Trustee discloses that these same attorneys currently represent Bayview/IB as creditors in this Bankruptcy Case and that Bayview/IB will be responsible for paying their attorney's fees and expenses. The Trustee reveals, however, that in the event a fraudulent transfer action is successful, Special Counsel will file applications requesting attorney's fees and expenses as administrative expenses of the bankruptcy estate. The Trustee does not disclose in the Motion the pending Alabama Fraudulent Transfer Action or Sirote's joint plaintiffs' agreement among Bayview/IB, Harrison, and Johnson in the Alabama Fraudulent Transfer Action.

6. In support of the Motion, Henderson and Sirote signed nearly identical affidavits (the "Affidavits") (Dkt. 97). All of the affidavits contain the same language regarding their connection to Bayview/IB: "Note that he represents Bayview Loan Servicing, LLC and IB Property Holdings, LLC which are creditors of the estate." This sentence represents the only disclosure of any potential or actual conflict of interest with regard to Special Counsel's proposed employment by the Trustee.

7. On April 10, 2015, Bayview/IB filed proofs of claim (POC 7-1, 8-1) based on the Bayview/IB Judgment of $883,195.77. Both proofs of claim were filed by Sirote.

8. Johnson and Harrison object to the employment of Special Counsel on the ground that Bayview/IB are judgment lien creditors and their ongoing representation of Bayview/IB in connection with their judgment liens creates an actual conflict of interest that precludes their representation of the Trustee. (Dkt. 104).

9. Similarly, the Debtor objects to the employment of Special Counsel on the ground that they currently represent Bayview/IB in the Bankruptcy Case and the validity of Bayview/IB's

judgment liens, among other issues, are subject to attack by the Trustee and/or Debtor.[4] (Dkt. 112). The Debtor also points out that Henderson recently raised a conflict of interest issue in another bankruptcy case in which Henderson opposed the employment of Geno on essentially the same grounds that Debtor now opposes the employment of Henderson. *See* Objection to Application of Trustee to Employ Attorneys for Special Purpose, *In re Hall*, Case No. 11-03139-EE (Bankr. S.D. Miss. Mar. 17, 2015), Dkt. 624.[5] At the Hearing, the Debtor challenged the adequacy of the disclosures given that the Motion and Affidavits do not mention the pending Alabama Fraudulent Transfer Action.

10. At the Hearing, the Court asked the Trustee whether there was any written waiver of the attorney-client privilege. After the Court raised the possibility of shared confidences, Nolen left the Hearing to contact Bayview/IB by telephone. When he returned near the end of the Hearing, Nolen reported to the Court that Bayview/IB had verbally agreed to the dual representation proposed by the Trustee.

Discussion

Under § 327(a), a trustee may employ, with court approval, one or more professional persons to assist him in carrying out his duties provided they satisfy two (2) requirements: (1) the

[4] The Trustee does not question and, therefore, the Court does not address the standing of the Debtor to be heard on the Motion. *See* 11 U.S.C. § 327(c) (contemplating objections by "another creditor or the United States trustee").

[5] In *In re Hall*, Case No. 11-03139-EE (Bankr. S.D. Miss. Mar. 17, 2015), Geno represented the debtors in their chapter 7 bankruptcy case, and Shaffer, as the chapter 7 trustee, sought to employ him as special counsel to pursue a claim against a creditor. *Id.* at Dkt. 624. Henderson, who represented that creditor, opposed Geno's employment on the ground that the application failed to disclose Geno's involvement as counsel for the debtors in a state court matter and also because Shaffer had initiated adversary proceedings against the debtors. *Id*. The bankruptcy court denied Shaffer's application. *Id*. at Dkt. 639.

employed professional may not hold or represent an interest adverse to the estate, and (2) the employed professional must be a disinterested person.[6] Section 101(14) defines a disinterested person as someone who is not a creditor, equity security holder, or insider of the debtor and who is not, and was not within the past two (2) years, a director, officer, or employee of the debtor. 11 U.S.C. § 101(14)(A)-(B). A disinterested person is also defined in the statute as someone who "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." 11 U.S.C. § 101(14)(C). This latter prong of the definition includes the adverse interest language that appears in § 327(a).

Holding an interest adverse to the estate for purposes of both § 101(14) and § 327(a) means, in pragmatic terms, "to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate that would create either an actual or potential dispute in which the estate is a rival claimant" or "to possess a predisposition under circumstances that render such a bias against the estate." *I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, 432 F.3d 347, 356 (5th Cir. 2005) (citing *In re Roberts*, 46 B.R. 815, 827 (Bankr. D. Utah 1985)). The reason for this provision is to preclude the employment of a professional "who in the slightest degree might have some interest or relationship that would color the independent and impartial

---

[6] Section 327(a) provides in full:

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

11 U.S.C. § 327(a).

attitude required by the Code." *Pierson & Gaylen v. Creel & Atwood (In re Consol. Bancshares, Inc.)*, 785 F.2d 1249, 1256 (5th Cir. 1986) (quoting another source).

Section 327(c) contains a limited exception to the general rule set forth in § 327(a). Section 327(c) governs the engagement of an attorney who currently represents a creditor of the debtor's bankruptcy estate. Although that attorney may not be considered "disinterested" for purposes of § 327(a), he is not disqualified *per se* from employment under § 327(c) unless an objection to the representation is filed by another creditor or the U.S. Trustee and an examination of the particular facts reveals an actual conflict of interest. 11 U.S.C. § 327(c). The Code does not define the term "actual conflict of interest," but one has been held to exist when there is "an active competition between two interests, in which one interest can only be served at the expense of the other." *In re BHPP, Inc*., 103 B.R. 556, 563 (Bankr. D.N.J. 1989), *remanded by* 119 B.R. 35 (D.N.J. 1990), *aff'd*, 949 F.2d 1300 (3d Cir. 1991).

Section 327 is implemented by Rule 2014, which imposes certain procedural requirements for a proper employment application. The application must set forth "to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the office of the United States trustee." FED. R. BANKR. P. 2014(a). The application must include an affidavit from the person to be employed setting forth this same information. FED. R. BANKR. P. 2014(a).

A. Disclosures & Rule 2014

The Debtor's contention at the Hearing that the Motion fails the disclosure standard under Rule 2014 warrants discussion before turning to whether an actual conflict issue arises under

§ 327(c) by virtue of the proposed dual representation of the Trustee and Bayview/IB. Courts have held that Rule 2014 requires an attorney to disclose all connections regardless of whether they rise to the level of a disqualifying conflict. *Waldron v. Adams & Reese, LLP (In re Am. Int'l Refinery, Inc.)*, 436 B.R. 364, 379 (Bankr. W.D. La. 2010); *see also In re eToys, Inc*., 331 B.R. 176, 189 (Bankr. D. Del. 2005) ("[T]he duty to disclose under [Rule 2014] is considered sacrosanct because the complete and candid disclosure by an attorney seeking employment is indispensable to the court's discharge of its duty to assure the attorney's eligibility for employment under section 327(a)."); *In re Peoples Savs. Corp.*, 114 B.R. 151, 154 (Bankr. N.D. Ill. 1990) (holding that the burden is upon the person making the statement to make full, candid, and complete disclosure). These holdings are consistent with the purpose behind Rule 2014(a), which is to provide bankruptcy courts and the U.S. trustees with sufficient information to determine *de novo* whether an attorney's employment is in the best interest of the estate. *In re The Leslie Fay Cos.*, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994). To lessen the disclosure obligation because of an attorney's personal belief that no disqualifying conflict exists would vitiate this purpose. *See In re Huddleston*, 120 B.R. 399, 401 (Bankr. E.D. Tex. 1990); *see also West Delta Oil Co.*, 432 F.3d at 355 (recognizing that full disclosure under Rule 2014 is a continuing responsibility); *Smith v. Marshall (In re Hot Tin Roof, Inc*.), 205 B.R. 1000, 1003 (B.A.P. 1st Cir. 1997) (holding that attorneys "cannot pick and choose which connections are irrelevant or trivial") (quoting another source).

The Court agrees with the Debtor that the Motion and Affidavits are grossly inadequate. Neither the Motion nor the Affidavits disclose the Alabama Fraudulent Transfer Action initiated against the Debtor by Sirote on behalf of Bayview/IB. Also, neither the Motion nor the Affidavits

disclose the letter agreement for joint plaintiffs' agreement by Sirote and others in the Alabama Fraudulent Transfer Action. The duty under Rule 2014 to disclose is broad, and all facts that may be relevant to a determination of whether an attorney holds an interest adverse to the bankruptcy estate must be disclosed. *West Delta Oil Co.*, 432 F.3d at 355. Here, the disclosure in the Motion and Affidavits is inadequate because it is limited to Special Counsel's role in the Bankruptcy Case.

Moreover, the lack of objectivity and impartiality in the Trustee's selection of Henderson concerns this Court for an additional reason. The Trustee is not an attorney but is an accountant by trade. He relies on the advice of his counsel, Shaffer, in this case. Henderson, however, serves as counsel for the Trustee in other bankruptcy cases, and the Trustee serves as Henderson's accountant as well. These relationships or "connections" as specified in Rule 2014 are too close not to be disclosed in Henderson's Affidavit. For the above reasons, the Court finds that the inadequacy of the disclosures is independent grounds for denying Special Counsel's employment. *See In re C&C Demo, Inc*., 273 B.R. 502 (Bankr. E.D. Tex. 2001).

Before turning to the conflict issue, the Court pauses here to address a related matter. The parties did not obtain Bayview/IB's written consent to represent the Trustee. This failure is another reason for denying the Motion, assuming such consent is appropriate under these circumstances. To address the potential ethical violation of shared confidences, a written waiver from Bayview/IB should have been attached to the Motion. A verbal waiver obtained over the telephone during the Hearing is too late, does not adequately indicate Bayview/IB's informed consent, and should have been disclosed in the Affidavits. Moreover, as the Debtor pointed out, there is an issue as to whether any actual conflict under § 327(c) would be capable of being

waived. 3 COLLIER ON BANKRUPTCY ¶ 327.04[7][a]; *see In re Am. Printers & Lithographers, Inc.*, 148 B.R. 862 (Bankr. N.D. Ill. 1992) (disallowing a waiver of a conflict).

B. Actual Conflict under § 327(c)

The Trustee maintained at the Hearing that the same attorneys can represent the Trustee and Bayview/IB because they share the same objective of recovering the real estate transferred by the Debtor to the Dynasty Group, Inc. The Trustee indicated that Special Counsel intended to file a new fraudulent transfer lawsuit in Alabama rather than substitute the Trustee for the Debtor in the pending Alabama Fraudulent Transfer Action. Indeed, the alignment of the parties in the Alabama Fraudulent Transfer Action is such that a mere substitution of the Trustee for the Debtor would mean that the same attorneys would represent both the plaintiffs (Bayview/IB) and the defendant (the Trustee), an absurd result. The Court is concerned, however, that the Trustee has not fully considered the nature and scope of a new state court action. The Trustee initially stated at the Hearing that Bayview/IB would be named as defendants along with the Debtor. When Henderson interjected, "We won't sue ourselves," the Trustee revised his position and stated that Bayview/IB would be named as plaintiffs along with the Trustee. But Johnson and Harrison are also judgment creditors, and they oppose the Motion.

The Debtor raised other issues about the proposed new lawsuit that the Trustee had not previously considered. Would Bayview/IB have to assert compulsory counterclaims or cross-claims against the Trustee to preserve their judgment liens? Would the state court consolidate any new lawsuit with the Alabama Fraudulent Transfer Action filed by Bayview/IB against the Debtor on June 18, 2014? (Trustee Ex. 1). To flesh out these issues, the Trustee should have provided the Court with a copy of the complaint he proposed to file in Alabama or he

or his attorney should have been in a position to provide more thoughtful and complete answers to the questions raised by the Debtor. Yet the Trustee's only response to these issues was to state that he would bring any objection to the Bayview/IB Judgment and Johnson/Harrison Judgment before this Court. In other words, the Trustee contends that any conflict of interest could be avoided by limiting the scope of the proposed new lawsuit in Alabama to the recovery of the fraudulently transferred assets. As the Court pointed out at the Hearing, however, by the time any assets are recovered, confidential information regarding the competing claims already would have been shared with the Trustee. *See* MODEL RULES OF PROF'L CONDUCT R. 1.6 (confidentiality of information).

The Court finds that the best course of action is to resolve all issues in one lawsuit rather than piecemeal litigation. Although a conflict may not exist at time of the commencement of a new lawsuit, it is clear that the interests of the Trustee, Bayview/IB, Johnson, and Harrison will diverge at some point because of the competing liens encumbering the assets they seek to recover. Pigeonholing the fraudulent transfer action to the recovery of assets would perhaps serve the narrow purpose of accommodating the lawyers selected by the Trustee as Special Counsel but would not serve the best interests of the estate.

The Court also agrees with the Debtor, Harrison, and Johnson that there are numerous conflicts of interest that are actual and not merely potential, as suggested by the Trustee. The representation of the Trustee by Special Counsel would result in their representation of at least two (2) clients with current competing and adverse interests. What if the Trustee objects to the attorney's fees and expenses sought by Special Counsel? What if the Trustee objects to the proofs of claim filed by Bayview/IB? What if the Trustee objects to the judgment lien asserted by

Bayview/IB? What if Bayview/IB objects to a settlement of the fraudulent transfer action? *See, e.g., The Cadle Co. v. Moore (In re Moore)*, 739 F.3d 724, 727 (5th Cir. 2014) (noting that conflict of interest arose as the result of dual representation of debtor and its largest creditor in fraudulent transfer action but finding that evidence of the creditor's bad faith did not support dismissal of adversary proceeding). All of these "what ifs" may actually occur. The Court finds that these conflicts are too important and numerous to be precluded by limiting the scope of the employment of Special Counsel and obtaining a written waiver from Bayview/IB and others.

Conclusion

For the reasons set forth above, the Court finds that the Motion and Affidavits do not comply with Rule 2014 and, in addition, there is an actual conflict that precludes Sirote and Henderson from representing the Trustee. Accordingly, the Court finds that the Motion should be denied.

IT IS, THEREFORE, ORDERED that the Motion hereby is denied.

##END OF ORDER##