THIS OPINION IS NOT INTENDED
FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 04-12595
	)	
THE CAPITAL CREATION CO., INC.,	)	Chapter 11
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**

Chapter 11 debtor The Capital Creation Co., Inc. has applied to retain Benesch, Friedlander, Coplan & Aronoff LLP as its counsel in this case. (Docket 12, 15). Creditors The Coventry Group, Inc. and Allyne Gottlieb, together with the United States trustee, object. (Docket 28, 30, 31). For the reasons set forth below, the debtor's application is granted and the objections are overruled.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2).

FACTS[1]

The Capital Creation Co. (Capital or the debtor) is an insurance brokerage firm, formed in 1977, that sold insurance policies to individuals and companies. Joshua L. Gottlieb is the

[1] The court held a hearing on the application on May 13, 2004. Counsel submitted the issue for decision on the papers, without an evidentiary hearing. Therefore, certain undisputed facts are gleaned from the pleadings. Additional findings are based on the affidavits submitted by Joshua Gottlieb and Benesch in support of its application, the affidavit of Joshua Gottlieb which was submitted in connection with first day motions, the case file, and exhibits submitted by the objectors.

president and sole shareholder. In late 2003, Capital terminated its employees as the result of financial setbacks. The debtor's current revenues come from commissions on existing insurance policies. Just before filing the chapter 11 petition, Capitol outsourced all of its operations to a non-debtor affiliate, J.L. Gottlieb Agency, Inc.

The debtor wishes to hire Benesch, Friedlander, Coplan & Aronoff, LLP (Benesch) as its bankruptcy counsel. The objections are based on these facts: (1) Benesch previously represented creditor Allyne Gottlieb in a lawsuit against his son, Joshua Gottlieb; and (2) Benesch received a $35,500.00 retainer in connection with the chapter 11 filing that came from two affiliates of the debtor. Allyne Gottlieb and Coventry contend that Benesch has a conflict of interest that prevents it from serving as counsel. The UST also argues that Benesch is not disinterested and has interests that are materially adverse to the debtor.

The Retainer

The retainer paid to Benesch came from two non-debtor entities: J.L. Gottlieb Agency, Inc. and J. Gottlieb Companies, LLC. Joshua Gottlieb is the president of both entities, which are affiliates of the debtor.[2] The debtor borrowed the money from the affiliates and signed promissory notes reflecting the debt. The notes are secured by a perfected junior blanket lien on the debtor's assets. The debtor has represented that its property is totally encumbered by the secured claims of senior lenders.

From the retainer, Benesch applied $17,185.00 to Capital's prepetition bill for legal fees relating to the decision to file the bankruptcy case and to prepare the necessary documents.

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[2] The UST asserts that Joshua Gottleib owns or controls these entities as well as numerous other unidentified corporations, but has provided no factual basis for that assertion.

Benesch is holding the remaining $18,315.00 for compensation to be awarded in connection with the chapter 11 case.

Benesch's Earlier Representation of Allyne Gottlieb

Starting in 1995, Benesch represented Allyne Gottlieb in district court litigation against his son Joshua Gottlieb arising from a sales agreement. *See Allyne Gottlieb v. Joshua Gottlieb*, case no. 95-235 (D. Ct. N.D. Ohio). Capital was not a party to that lawsuit. Benesch remained as Allyne Gottlieb's counsel until November 1996 when it had a fee dispute with Gottlieb. At that point, the district court permitted Benesch to withdraw.

Allyne Gottlieb retained other counsel and eventually obtained a judgment against Joshua Gottlieb. That judgment has now been satisfied.[3] *See* Exh. A to Objection of Coventry Group (noting that Allyne Gottlieb filed a satisfaction of judgment as to Joshua Gottlieb on January 28, 2004). (Docket 31).

Five Benesch attorneys billed time to Allyne Gottlieb in the district court litigation: Richard Phillips, Jeremy Gilman, Mark Phillips, Gary Bilchik, and Sheila Ninneman. Richard Phillips, the lead attorney, is now retired. Benesch has 12 practice groups and approximately 120 attorneys. The attorneys who represented Allyne Gottlieb are not members of the business reorganization practice group which is representing the debtor. The firm has established a

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[3] Coventry's objection attempts to connect this litigation and judgment with later state court litigation between Capital and Allyne Gottlieb. *See The Capital Creation Co., Inc. v. Allyne Gottlieb*, case no. CL 98-001023 (Fla. Cir. Ct.). That state court case resulted in a $1,954,000.00 judgment in Allyne Gottlieb's favor, which judgment is the basis for the claim he asserts in the chapter 11 case. *See* Exh. B to Objection of Coventry Group. (Docket 31). Although it appears that Capital, Joshua Gottlieb, and Allyne Gottlieb entered into a settlement agreement in February 2003 which dealt with both judgments, it is clear that Joshua Gottlieb's judgment liability to Allyne Gottlieb in the district court case has been satisfied.

"'quarantine' or 'Chinese wall'" to restrict attorneys Gillman, M. Phillips, Bilchik, and Ninneman from working on, assessing or discussing files or any other matter related to the firm's representation of the debtor. *See* Affidavit of H. Jeffrey Schwartz, Exh. A to amended application at ¶6 (Docket 15). In addition, the debtor has retained another firm as special counsel to pursue an avoidance action against Allyne Gottlieb. *See* Docket 85, 106.

The debtor scheduled Allyne Gottlieb as a disputed secured creditor. *See* Docket 46. Allyne Gottlieb asserts that he is owed about $2.3 million.

DISCUSSION

I. 11 U.S.C. § 327

Bankruptcy code § 327(a) explains who a debtor may hire as general bankruptcy counsel:

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

11 U.S.C. § 327(a).[4] "Section 327(a) serves to insure that 'the undivided loyalty and exclusive allegiance required of a fiduciary to an estate in bankruptcy is not compromised or eroded'." *In re Dev. Corp. of Plymouth, Inc.*, 283 B.R. 464, 468 (Bankr. E.D. Mich. 2002) (quoting *In re Prudent Holding Corp.*, 153 B.R. 629, 631 (Bankr. E.D. N.Y. 1993)). To be retained under this section, a law firm must be disinterested and must not hold an interest adverse to the estate. A firm that does not meet this standard may not be retained. *See Michel v. Federated Dep't Stores, Inc. (In re Federated Dep't Stores, Inc.)*, 44 F.3d 1310 (6th Cir. 1995).

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[4] By its terms, § 327(a) refers to the trustee. Section 1107(a) makes § 327(a) applicable to attorneys for the debtor in possession.

A"disinterested person" is one who "does not have an interest materially adverse to the interest of the estate or of any class of creditors . . . 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)(E). A debtor's bankruptcy counsel "may not have a 'material adverse' interest to any party to the bankruptcy 'for any . . . reason either at the time of appointment or during the course of the bankruptcy'." *In re Big Rivers Electric Corp.*, 355 F.3d 415, 433 (6th Cir. 2004) (citations omitted). This is sufficiently broad to include any firm that "'in the slightest degree might have some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules'." *In re BH & P, Inc.*, 949 F.2d 1300, 1309 (3d Cir. 1991) (quoting *In re Glenn Elec. Sales Corp.*, 99 B.R. 596, 601 (D. N.J. 1988)).

Although the term "adverse interest" is not defined by the bankruptcy code,

> [a]n oft-cited definition of "to hold an adverse interest" is:
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> '(1) to possess . . . an economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.'

In re Fretter, Inc., 219 B.R. 769, 777 (Bankr. N.D. Ohio 1998) (quoting *In re Roberts*, 46 B.R. 815, 827 (Bankr. D. Utah 1985), *rev'd in part on other grounds*, 75 B.R. 402 (D. Utah 1987)).

These two statutory requirements for employment "serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." *Rome v. Braunstein*, 19 F.3d 54, 58 (1st Cir. 1994). The requirement that a firm must not hold an adverse interest focuses on the firm's economic interest or potential bias and the disinterestedness

requirement focuses on the firm's relationships and personal interests. *See In re Mundo Custom Homes, Inc.*, 214 B.R. 356, 360 (Bankr. N.D. Ill. 1997). However, with respect to the requirement that debtor's counsel not have an adverse interest, the two requirements of § 327(a) are essentially duplicative. *See In re Martin*, 817 F.2d 175, 179 at n. 4 (1st Cir. 1987). "The test is whether holding or representing the interest in question 'created either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors – an incentive sufficient to place those parties at more than acceptable risk – or the reasonable perception of one'." *In re Water's Edge Ltd. P'ship*, 251 B.R. 1, 10 (Bankr. D. Mass. 2000) (quoting *In re Martin,* 817 F.2d 175, 180 (1st Cir. 1987)).

Section 327(c) deals specifically with a debtor's employment of a law firm that previously represented a creditor:

> (c) In a case under chapter . . . 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

11 U.S.C.A. § 327(c). This section "clarifies that despite the strictures of sections 327(a) and 101(14)(e), a professional is not disqualified from employment based on [its] representation of both the [debtor] and a creditor." *In re BH&P, Inc.*, 949 F.2d 1300, 1314 (3d Cir. 1991). The basic requirements of § 327(a) must be met even if § 327(c) is implicated. *See Interwest Bus. Equip., Inc. v. United States Trustee (In re Interwest Bus. Equip., Inc.)*, 23 F.3d 311, 316 (10th Cir. 1994).

II. The Objections

All three objectors argue generally that the firm should not be retained based on its earlier representation of Allyne Gottlieb. Coventry and Allyne Gottlieb argue that the firm has a conflict of interest. The UST's objection focuses on § 327(a) and contends that the firm is not disinterested and has interests which are adverse to the debtor's estate. The UST also argues that the circumstances regarding the firm's retainer preclude its retention.

A. Benesch's Earlier Representation of Allyne Gottlieb

Allyne Gottlieb and Coventry argue that Benesch cannot represent the debtor in this case because it has an actual conflict of interest arising out of its representation of Allyne Gottlieb. They cite § 327(c), which states that a firm is not disqualified from representing a debtor based "solely" on its representation of a creditor unless there is an objection, in which case the employment shall be disapproved if there is an actual conflict of interest. Arguably, this section does not apply here because the objections are not based solely on the earlier representation of Allyne Gottlieb. The issue of whether Benesch has an actual conflict of interest is, however, relevant both to § 327(c) and to whether the firm is eligible for employment under § 327(a) and will be addressed.

The term "actual conflict of interest" is not defined by the bankruptcy code and is largely determined by the facts of each case. *See BH&P, Inc.*, 949 F.2d at 1315. Coventry proposes to apply the three part test for attorney disqualification based on a previous attorney-client relationship, and no party opposes using that as the standard. The three factors under that test are: (1) the party moving for disqualification is a former client of the adverse party's attorney; (2) the subject matter of those relationships was or is substantially related; and (3) the attorney

acquired confidential information from the party seeking disqualification. *See Dana Corp. v. Blue Cross & Blue Shield Mutual of Northern Ohio*, 900 F.2d 882, 889 (6th Cir. 1990). Although Coventry does not meet the first part of the test, Allyne Gottlieb does. The second question is whether the subject matter of the earlier representation and the issues of this case are substantially related. There was insufficient evidence to prove such a connection. The earlier lawsuit arose out of a sales agreement. The debtor was not a party to that action and Benesch withdrew as counsel midway through the litigation. The lawsuit is resolved and no longer represents a claim against Joshua Gottlieb. Moreover, the claim which Allyne Gottlieb asserts against the debtor arises from an entirely different lawsuit. Therefore, although Allyne Gottlieb holds a substantial claim against the debtor, the facts presented do not show that the claim is related to the lawsuit which Benesch prosecuted on his behalf. Consequently, the firm does not have an actual conflict of interest.

Additionally, even if the subject matter of the first lawsuit was found to be related to the chapter 11 case, the firm has taken steps to insure that confidential information does not flow from the attorneys who represented Allyne Gottlieb to the attorneys who represent the debtor. These measures rebut any presumption that confidences acquired by members of the firm while representing Allyne Gottlieb will be passed on to those Benesch attorneys now representing the debtor. *See Manning v. Waring, Cox, James, Sklar and Allen*, 849 F.2d 222, 225 (6th Cir. 1988) (noting the efficacy of such screening devices to avoid disqualification under appropriate circumstances). There was no evidence to the contrary. Benesch does not, therefore, have an actual conflict that would prevent its employment as debtor's counsel.

These same considerations lead the court to conclude that the firm does not hold or represent an adverse interest. Benesch ended its representation of Allyne Gottlieb several years ago and the judgment which Allyne Gottleib won in that litigation following the firm's withdrawal has been satisfied. Benesch will not be counsel in this case on the debtor's claims against Allyne Gottlieb. Benesch has not sued Allyne Gottlieb for the unpaid fees and there is no evidence that they have ever taken any collection efforts against him.

The UST raises an additional point, which is that the perception exists that the firm has switched sides in a familial dispute. This is so. There are, however, things that the law permits even when they seem wrong when viewed from other angles. In this case, Benesch represented a father in his suit against his son, then withdrew because it was not being paid. Now, Benesch has chosen to represent the son's business in a bankruptcy filing that will again result in litigation between the father and the son. Such a switch may not promote the public's confidence in the bankruptcy system or in how lawyers conduct their business. That is not, however, the legal test. The facts presented do not show that the firm's representation of Allyne Gottlieb creates any meaningful incentive for it now to act contrary to the best interest of the debtor's estate and creditors. Under the applicable law, Benesch is not precluded from changing sides in this family dispute, no matter how that looks to others.[5]

B. The Retainer

The debtor borrowed the money for Benesch's retainer from its affiliates. The UST argues that "the economic interests of [Benesch] are now enmeshed with [the Gottlieb entities]"

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[5] That the law permits the representation does not, of course, mean that is the better course. *See* Elihu Root's advise to a client: "The law lets you do it, but don't . . . ". The rest of the quotation is also instructive.

[and] [t]he firm is not divested of that scintilla of conflicting interest noted in the case law." UST objection at ¶ 14. (Docket 30). The court, however, does not find that to be so.

Courts have taken two different approaches when addressing the issue of third party funding for a debtor's proposed counsel. *See generally, In re Lotus Props., LP*, 200 B.R.388, 391-93 (Bankr. C.D. Calif. 1996) (discussing the restrictive approach which announces a *per se* rule prohibiting the retention of counsel where counsel's fees have been contributed by a principal or insider of the debtor versus the analytical approach which considers the specific circumstances of the proposed retention). The better approach is the analytical one because the decision as to whether a firm has a materially adverse interest is necessarily case specific. *See In re Martin,* 817 F.2d 175, 182-83 (1st Cir. 1987); *In re Rabex Amuru of North Carolina, Inc.*, 198 B.R. 892, 895-96 (Bankr. M.D. N.C. 1996).

Benesch's retainer was funded by J.L. Gottlieb Agency, Inc. and J. Gottlieb Companies, LLC which are affiliates and, therefore, insiders of the debtor. *See* 11 U.S.C. § 101(31)(E) (defining the term "insider" to include an affiliate). When an insider funds the retainer, the relevant questions are whether: (1) the arrangement has been fully disclosed to the debtor and to the insider; (2) the debtor has expressly consented; (3) the third-party payor/insider has retained independent legal counsel; (4) the factual and legal relationships relevant to the retention have been fully disclosed to the court at the outset of the bankruptcy proceeding; and (5) the debtor's attorney has demonstrated the absence of facts which would otherwise create non-disinterestedness, actual conflict, or an impermissible potential for conflict of interest. *See In re Lotus Props., LP*, 200 B.R. at 393 (citing *In re Kelton*, 109 B.R. 641, 658 (Bankr. D. Vt. 1989)).

The circumstances here do not preclude Benesch from serving as counsel based on these

factors. The debtor consented to the arrangement for the payment of the retainer. The terms of the retainer and the insider relationships were fully disclosed to all parties at the outset of the case. Joshua Gottlieb, J.L. Gottlieb Agency, Inc. and J. Gottlieb Companies, LLC are represented by separate legal counsel.[6] Finally, the facts do not demonstrate either an actual conflict or the potential for a conflict of interest which would make the retention inappropriate. The UST's assertion that Benesch's economic interests are now inappropriately enmeshed with the affiliates is not shown in the evidence. Although the debtor borrowed the funds from insiders, Benesch's fee arrangement is solely with the debtor. Moreover, Benesch does not have a client relationship with Joshua Gottlieb individually or the insider lenders. Based on these facts, Benesch may serve as counsel despite the fact that the retainer was paid by insiders.

CONCLUSION

For the reasons stated, the debtor's amended application to retain Benesch, Friedlander, Coplan & Aronoff LLP as chapter 11 counsel is granted and the objections are overruled.

Date: 19 June 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center on:
Jeffrey Schwartz, Esq.
Andrew Vara, Esq.
Alan Hochheiser, Esq.
Breaden Douthett, Esq.

[6] At the May 13, 2004 hearing, H. Jeffrey Schwartz of Benesch stated that Joshua Gottlieb is represented by Charles Hall and J.L. Gottlieb Agency, Inc. and J. Gottlieb Companies, LLC are represented by Rotatori, Bender, Gragel, Stoper & Alexander Co., L.P.A.

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In re:	)	Case No. 04-12595
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THE CAPITAL CREATION CO., INC.,	)	Chapter 11
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**ORDER**

For the reasons stated in the memorandum of opinion issued this same date, the debtor's amended application to retain Benesch, Friedlander, Coplan & Aronoff LLP as chapter 11 counsel is granted and the objections are overruled. (Docket 15, 28, 30, 31).

IT IS SO ORDERED.

Date: 29 Jun 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center on:
Jeffrey Schwartz, Esq.
Andrew Vara, Esq.
Alan Hochheiser, Esq.
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