

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

FILED DISTRICT OF NEBRASKA AT _____ JUL 19 1985 BK 80-905 CV 84-0-727 William L. Olsen, Clerk Deputy
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IN RE:)
)
ARTHUR HEIM AND MELVA G. HEIM,)
)
Debtors.)

BK 80-905
CV 84-0-727
William L. Olsen, Clerk
Deputy
MEMORANDUM AND ORDER

This matter is before the Court on appeal from a final order of the Bankruptcy Court, dated October 23, 1984, allowing appellee Philip K. Kelly, Esq.'s amended application for attorney's fees and expenses, totaling \$2,224.23. Mr. Kelly served as co-counsel to the official creditors' committee in this Chapter 11 case from April 15, 1983, until September 7, 1983. Having carefully considered the record on appeal and the briefs submitted by the parties, the Court finds that the decision of the Bankruptcy Court should be reversed.

I.

On May 1, 1980, debtors filed for bankruptcy under Chapter 11. Thereafter, on June 4, 1980, the Bankruptcy Court entered an order appointing an official creditors' committee of unsecured creditors, pursuant to 11 U.S.C. § 1102. This committee continued in existence without activity and without legal counsel for over two years.

In early spring of 1983, appellee Kelly was approached by Hiner Implement Company (Hiner), an unsecured creditor, concerning their pre-petition debt in debtors' Chapter 11 case. Kelly advised Hiner that the best avenue for attempting to collect on the debt was to become a member of the creditors' committee and to get the committee active. On April 13, 1983, Kelly filed a motion

for appointment of an additional member to the creditors' committee, requesting that Hiner be appointed to the committee. While such motion was pending, on April 15, 1983, the creditors' committee applied to the Bankruptcy Court for authority to hire Kelly and Eric W. Kruger, Esq. as counsel for the committee in debtors' bankruptcy case. The committee's request was approved that same day. Hiner was later added to the creditors' committee on or about July 14, 1983.

During the period in which Kelly was employed as counsel for the committee, Hiner and the debtors privately came to an agreement for the payment of Hiner's pre-petition debt and debtors' purchase of additional equipment. When Kelly learned of this agreement, he advised Hiner that this transaction may constitute a preference, and indicated that he would have to withdraw as counsel for the committee because of a potential conflict of interest. On September 7, 1983, almost five months after his appointment to the committee, Kelly filed a motion to withdraw as counsel to the committee on the grounds of conflict of interest. This motion was sustained, and Eric Kruger continued to serve as counsel to the committee. Thereafter, Kruger resumed representation of creditor Hiner.

On December 8, 1983, Kelly filed an application for fees and expenses. The matter was heard by the Court and the application was denied without prejudice. Thereafter, on August 21, 1984, Kelly filed an amended application for fees and expense. At a hearing held on October 23, 1984, the Bankruptcy Court sustained

the amended application over debtors' objection. On the record, the Court found that Kelly represented Hiner as a pre-petition creditor, that he then quit such representation in order to represent the creditors' committee, and that after having withdrawn as counsel for the committee he represented Hiner as a post-petition creditor. Based on these findings, the Court determined that 11 U.S.C. § 1103(b) of the Bankruptcy Code was not violated, and that the application for compensation was acceptable under 11 U.S.C. §§ 327 and 328.

II.

On appeal, debtors argue that the Bankruptcy Court erred in allowing compensation to appellee on three separate grounds. First, they assert that a conflict of interest existed under 11 U.S.C. § 1103(b), and that appellee was not a "disinterested person" while representing the creditors' committee, as required by 11 U.S.C. § 328. Second, debtors assert that the services for which compensation was sought did not meet the criteria set forth in 11 U.S.C. § 330. And third, debtors argue that there is insufficient evidence to support the award of compensation in this case.

Appellee Kelly argues that he represented no other entity while he was attorney for the committee, and that his representation of the creditors' committee was in compliance with 11 U.S.C. § 1103(b), as amended. He states that "[he] felt it was necessary . . . to seek permission of the Court to withdraw as attorney for the committee because there might have been some

appearance of a conflict of interest, if not an actual conflict of interest[,] if he continued to represent the committee with Hiner Implement Company having had their pre-petition claim resolved in some way." Brief at 3. He also argues that his application for fees was in compliance with section 328, and that the record sufficiently supports the award of fees and expenses.

III.

At the outset, this Court recognizes that the Bankruptcy Court's findings of fact are entitled to stand unless clearly erroneous. Matter of American Beef Packers, Inc., 457 F. Supp. 313, 314 (D. Neb. 1978); Bankr. Rule 8013. However, it was well established that the Court is not bound by the Bankruptcy Court's conclusions of law. Matter of American Beef Packers, Inc., 457 F. Supp. at 314; In Re Urquhart, 303 F. Supp. 39, 41 (D. Neb. 1969), aff'd, 427 F.2d 492 (8th Cir. 1970).

With regard to the Bankruptcy Court's finding of fact that appellee Kelly represented creditor Hiner before and after he was employed as counsel for the creditor's committee, but not during such employment, this Court concludes that such finding is sufficiently supported by the record on appeal and not clearly erroneous. Given this factual determination, the Court now turns to the issue of whether the Bankruptcy Court correctly concluded that there was no violation of 11 U.S.C. § 1103(b) in this instance.

During the period in which appellee served as counsel to the creditors' committee, section 1103(b) of the Bankruptcy Code read as follows:

A person employed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity in connection with the case.¹

Looking to pertinent legislative history, courts have generally held that this section was designed not only to avoid actual conflicts of interest, but also to avoid potential conflicts of interest and even the simple appearance of impropriety. See, e.g., In Re Broadcast Management Corp., 36 B.R. 519, 520 (Bankr. S.D. Ohio 1983); In Re Saxon Industries Inc., 29 B.R. 320, 321-22 (Bankr. S.D.N.Y. 1983). See also Senate Report No. 95-989, 95th Cong., 2d Sess. 114 (1978), U.S. Code Cong. & Admin. News 1978,

¹Section 1103(b) of the Bankruptcy Code was recently amended on July 10, 1984, by P.L. 98-353, to read as follows:

An attorney or accountant employed to represent a committee appointed to represent a committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

Although appellee urges the Court to apply the amended version of section 1103(b) to the case at bar, the Court declines to do so, because there is no indication in the statute itself or its legislative history that Congress intended the amended version to be given retroactive effect. Therefore, the Court finds that section 1103(b), as written prior to the 1984 amendment, should be applied in this case.

p. 5787. Therefore, where there is an alleged violation of section 1103(b) the test to be applied is whether, under the circumstances, there is a potential for conflict or even the appearance of conflict or impropriety.


Under the facts of the present case, it remains unclear whether appellee's alternate representation of creditor Hiner and the creditors' committee constituted an actual conflict of interest. It is sufficiently clear to this Court, however, that such representation in fact created a potential for conflict and that there was an appearance of impropriety in this instance. The Court must conclude that there was a violation of section 1103(b) under the circumstances and that compensation should have been disallowed pursuant to section 328(c) of the Bankruptcy Code.

Accordingly,

IT IS ORDERED that the Bankruptcy Court's October 23, 1984, order, allowing appellee Kelly's amended application for compensation, should be and the same is hereby reversed.

DATED this 19th day of July, 1985.

BY THE COURT:



C. ARLEN BEAM
UNITED STATES DISTRICT JUDGE