UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
ULTRA-LITH PRINTERS, INC.,	)	CASE NO. BK78-L-442
	)	
BANKRUPT	)	

MEMORANDUM OPINION

Before me is the motion filed by Stan Loomis and Kent Brobst to compel John S. Pierce to withdraw as counsel for the trustee in bankruptcy in this bankruptcy proceeding. Mr. Loomis and Mr. Brobst are former stockholders of the bankrupt corporation who may have personal liability for nonpayment of withholding taxes due the Internal Revenue Service if the tax liability is not paid from the assets of this bankruptcy estate. As such, they have an interest in the administration of this proceeding and have standing to bring the motion.

The basis for the motion is that Mr. Pierce's representation of the trustee in bankruptcy in this proceeding and his former pre-bankruptcy representation of Hammermill Paper Company, a creditor of this estate, presents a potential conflict of interest.

Prior to bankruptcy, the bankrupt corporation owed money to Hammermill Paper Company on an unsecured indebtedness. Prior to bankruptcy, Mr. Pierce was retained by Hammermill Paper Company to represent it regarding the indebtedness owed to it. As a result of negotiations in which Mr. Pierce took part on behalf of Hammermill, on July 17, 1978, the bankrupt corporation executed to Hammermill a promissory note in the original sum of approximately $93,519.30. Although the original note is not in evidence before me, I gather from testimony before me that the promissory note called for the now bankrupt corporation to make payments under the note and, if it failed to do so, the now bankrupt corporation was to execute and deliver to Hammermill a real estate mortgage on the building in which the corporation did business, this being a major asset of the corporation with what appears to be significant equity. In fact, the real estate mortgage was never executed and delivered by Ultra-Lith to Hammermill. The promissory note was apparently executed within four months prior to the filing of the Chapter XI petition. So that the record is clear, the Chapter XI was filed on September 28, 1978. The Chapter XI proceeding aborted on February 28, 1979, when an adjudication was entered by this Court. Subsequently Mr. Pierce was retained as the attorney for the trustee in bankruptcy in this proceeding.

After adjudication, on March 8, 1978, Hammermill filed an adversary proceeding in this Court against Ultra-Lith through separate counsel not affiliated with Mr. Pierce seeking a determination that this Court decree Hammermill to be the owner of an equitable mortgage against the real estate based upon the promissory note previously described. As noted, that action was begun against Ultra-Lith and not against the trustee in bankruptcy and, according to testimony before me, was begun by separate counsel without knowledge of the adjudication. The result is that there is no viable adversary proceeding pending against the trustee which may bring the matter to trial. As it now stands, a separate adversary proceeding against the trustee would have to be brought.

The substance of the position of the movants here is that it is improper for Mr. Pierce to represent the trustee in litigati against Hammermill having represented Hammermill in the very transaction which gives rise to the dispute. I should make it clear at the outset that Mr. Pierce has not engaged in any formal litigation with Hammermill on behalf of the trustee, there being no actual litigation by Hammermill against the trustee pending at this time. Apparently, Mr. Pierce has had some negotiations with the separate attorney for Hammermill in which Mr. Pierce has taken the position that Hammermill has no good cause of action against the trustee. Nevertheless, Mr. Pierce has not engaged in any formal litigation on behalf of the trustee against Hammermill. I make that clear to insure that, in my view, Mr. Pierce cannot be said to be guilty of any conduct which at this time might be considered improper.

Initially, the primary problem is that if litigation develops Mr. Pierce will be required to attack documents which he drafted on behalf of his former client. More importantly, it seems to me is the potential that Mr. Pierce may be called as a witness on behalf of the trustee to prove certain elements by way of defense. One of the contentions which the trustee undoubtedly will make is that the agreement to give the real estate mortgage within the four months before bankruptcy would constitute a preference even if an equitable lien could be established by Hammermill. One of the elements of proof required to sustain a finding of a preference under the present Bankruptcy Act is that the creditor when it obtained the advantage over other unsecured creditors had reasonable cause to believe that the debtor was insolvent. See §60b. Given the evidence before me that Mr. Pierce participated in negotiations on behalf of Hammermill, it is entirely possible that the trustee may be required to call him as a witness to prove knowledge on behalf of Hammermill sufficient to show reasonable cause to believe the insolvency. It is also possible that Mr. Pierce might have to be called as a witness on other matters which, at this point in time, are not visible. This potential exists both on behalf of Hammermill and on behalf of the trustee.

Given the foregoing potential (and it is at this time only a potential because of the lack of pending litigation) it is this Court's conclusion that Mr. Pierce should not represent the truste in any litigation which is brought by Hammermill on the foregoing-described contention against the trustee in bankruptcy. In genera see DR 5-102.

The foregoing is not to say that Mr. Pierce should be disqualified from representing the trustee in bankruptcy in matters not related to the foregoing. I see no reason to disqualify Mr. Pierce from representing the trustee in matters not related to the foregoing and decline to do so. In addition, so the matter is not obscured, there are affidavits on file by representatives from Hammermill and by the trustee which indicate that full disclosure has been made to Hammermill and to the trustee of Mr. Pierce's prior representation of Hammermill and of his representation of the trustee which appears to be with the concurrence of Hammermill. I point these out only so that it will not be forgotten.

A separate order is entered in accordance with the foregoing.

DATED: May 11, 1979.

BY THE COURT:

Bankruptcy Judge

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