UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

ALBION DISPOSAL, INC.	Case No. 91-12805K
I & J DISPOSAL OF WESTERN NEW YORK, INC.	Case No. 91-12806K
J & I DISPOSAL, INC.	Case No. 91-12807K
11372 MAIN STREET, INC.	Case No. 91-12889K
ORLEANS SANITARY LANDFILL, INC.	Case No. 91-12878K

Debtors

There is a doctrine in product liability law under which a dealer or repairer of a product might be viewed as having turned an inherently non-dangerous product into a dangerous one by ignoring a known defect and failing to warn of it. In this case, attorneys for corporate Debtors-in-Possession ignored the defects in the representational structure they created, failed to warn of them, and turned an inherently non-dangerous proceeding (in terms of economic risk to creditors) into sheer disaster.

Just as it is the skill of the repairer that engenders reliance and places users in danger when that trust has been abused, it is the fact that this is a firm recognized for high quality representation in this Court that got the firm into trouble in this case. The firm's performance in this case was highly atypical of its work. As explained below, this is a case in which the firm suffered from the terminal euphoria that usually only afflicts clients.

The matter at bar is a request by these corporate debtors' bankruptcy counsel for payment of fees and expenses that accrued during, or incident to, the time that the corporations functioned as Chapter 11 Debtors-in-Possession. They seek approximately $159,000 in fees and $14,300 in expenses, of which $150,000 is secured by a pre-petition retainer. This is a core proceeding under 11 U.S.C. § 330.

The fee application is opposed by the Chapter 11 Trustee, the U.S. Trustee, and certain creditors. The history of these cases and the circumstances leading to the appointment of the Trustee are recounted in detail in this Court's decision in the case of *In re Albion Disposal, Inc.*, 152 B.R. 794 (Bankr. W.D.N.Y. 1993), and will not be repeated here. Since the rendering of that decision, however, there has been a stipulated settlement of the Trustee's actions against the corporate principals John and Irene Smith and against SSWS, Inc. Under the terms of the Stipulation, Waste Management of New York has taken over the operation of the landfill and has acquired the rights to seek landfill expansion. However, in the five years since the Smiths engaged in what this Court found in that earlier decision to have been a prohibited transaction (at least as to Mr. Smith) with SSWS, political changes in local government at the site of the landfill project have prevented landfill expansion. It is possible that if the prohibited transaction had not been entered into, expansion would have been approved long ago, and creditors of these corporations would be receiving a stream of payments that would likely pay them in full, eventually. Currently, the prospects are uncertain.

Although other grounds for objection have been raised, the objections to counsel's fee application principally are two: (1) it is argued that counsel did not do the things that it should have done that would have made it less likely, if not impossible, for the prohibited transaction to occur; and (2) counsel is alleged to have facilitated the prohibited transaction by allegedly giving improper advice to the principals.

At an early pre-trial conference regarding this contested fee application, the Court made it clear that an evidentiary hearing on a contested fee application is not required, and in fact is a rare occurrence in this Court (perhaps unprecedented). It gave to the firm (which has the burden of proof as to the reasonableness of the fees sought) the option of either submitting the issues on papers or instead placing its attorneys on the witness stand in support of their application. It opted for the latter. Over the course of three days, the Court heard direct testimony and cross-examination of three of the firm's attorneys. Their testimony addressed the substance of the first prong of the objectors' attack, and flatly denied the alleged communications that form the basis of the second prong of the attack. They then "rested" their presentation of proof in support of the reasonableness of their fee application.

For its side, the objectors subpoenaed the principal, John Norman Smith, and his personal attorney John Bailey, Esq. The Court heard direct testimony from John Smith, but was advised by counsel for the firm that cross-examination may enter a realm in which John Smith might assert (inappropriately, in the firm's view) attorney-client privilege. Since the firm exercised its right, under Federal Rule of Evidence 615, to exclude non-party witnesses, John Bailey, Esq. cannot be present during the testimony of his client, John Smith. Furthermore, a lawyer cannot at the same moment be both a witness and an effective advocate. Hence, a different attorney (supplemental counsel) needs to be present during John Bailey's testimony in order to protect John Smith against any possibility that Mr. Bailey might fail to succeed in protecting John Smith.

The Chapter 11 Trustee has waived the corporations' attorney-client privilege, and there cannot be, therefore, any confusion about the competency of testimony regarding communications between the firm at bar (which represented the corporations) and Mr. Smith or Mr. Bailey. However, supplemental counsel for Mr. Smith vigorously asserts the attorney-client privilege on behalf of Mr. Smith as to any communications between Mr. Smith and Mr. Bailey, and he also warns about the absence of counsel for Mrs. Smith. Counsel for the firm has convinced the Court that he cannot competently represent the firm if he cannot examine Mr. Smith and Mr. Bailey as to the communications between them, so long as the objectors assert the second prong of their argument, which prong has now been referred to as the "causality" prong. So long as the objectors claim that the alleged communications between the firm and Mr. Smith or Mr. Bailey played some role in Mr. Smith's decision to go ahead with the prohibited transaction, the Court is convinced that the firm must be permitted to examine all sources of information and advice that caused Mr. Smith to engage in the transaction with SSWS. The question presented then becomes, if the Court cannot permit that examination to occur, may the Court permit the objectors to press the second prong of the objection? In light of the weight of the issues presented and the absence of apparent solutions, the Court adjourned the hearing *sine die*.

The Court has now decided that it must revoke the leave that it previously granted to the firm to elect an evidentiary hearing. There will be no further hearing, and there is no need for further submissions because the firm has rested its case-in-chief and because I hereby now strike (and will permanently seal) the only evidence thus far introduced by the objectors in their case-in-chief -- the direct testimony of John Smith.

The nature of the allegations against the firm as to the causality prong are the stuff of which trials are made - trials addressing liability and damages. But all that is before the Court is the reasonableness of fees - a matter committed to the sound discretion of the Court under 11 U.S.C. § 330, to be tested under Lodestar analysis and the *Johnson* factors. The firm would like to vindicate its good name. The objectors would like to lay the blame at someone's feet for the unquestionably grotesque and disastrous results in this case (compared to what would have been achieved had the prohibited transaction not been entered into). But the Court does not need to answer, in this proceeding on a $160,000 fee application, the ultimate issues that would be presented in a multi-million dollar lawsuit.

This fee proceeding has taken on a life of its own, and has swollen beyond recognition. It has taken on a mantle of major litigation, together with appurtenant expense. No rational interpretation of the Bankruptcy Code and Rules permits a process that costs more than the amounts at issue. Let the parties fight over damages in a different action, somewhere else at some other time, if they have the stomach for it. For present purposes, who said what to whom, though dramatic, is not critical because although Debtors' counsel is not an insurer of what results from competent work that is reasonably undertaken, it cannot be compensated for a job very poorly done.

Even assuming, as the Court now must and does, that the firm did not play any active role in the decision of John or Irene Smith to enter into the transaction with SSWS, the firm's work in these cases was characterized by disarray, inattention, a cavalier attitude towards the dangers lurking in the complex facts and issues in their charge, and a totally unjustified (almost delusional) confidence that nothing could go wrong, that everything would go as counsel envisioned. Despite this firm's well-earned reputation for quality work in this Court, it did not evince here the slightest hint of the kind of prevention and preparedness that forms a large part of the reason that we insist that every Chapter 11 Debtor be represented here by capable counsel. Most importantly, the firm disassembled the proper role of counsel for the Debtors-in-Possession, and failed to warn others of the limited steps it had taken in the case.

One recent true example demonstrates how such a scenario could be handled. In a recent corporate Chapter 11 case in which the controlling individual was the subject of ongoing criminal investigation pertaining to whether proper corporate books and records had been maintained, the corporation's bankruptcy counsel had no difficulty in representing to the Court that the Disclosure Statement was accurate, because counsel, as a condition of his willingness to represent the corporation, had elicited personal control over the corporation's receipts and disbursements. That example might be isolated and extreme, but it offers a useful contrast to the facts at bar.

Let us examine a hypothetical that is not far removed from the facts at bar. Assume that you represent a corporation whose sole officer/director/stockholder owns a critical asset, essential to the corporation, and has licensed it to the corporation. The corporation is in Chapter 11.

You know that the principal wants to license the asset to others, but that to do so might violate her fiduciary duties and will absolutely injure your client, the corporation. Of course, you insist that she obtain her own counsel as to her own self-interests, and she does so. In performing your duties as counsel to the corporate Debtor-in-Possession, the precautions you might take to protect your client's creditors (the corporation's creditors) against the only person that you can deal with (the sole agent of the corporation) might range from a stern admonition to her to avoid self-dealing, to obtaining the assurance of her counsel that the principal will not engage in self-dealing, to obtaining a consensual order from the Court to that effect (which might be of no help as to bona fide - good faith licensee without knowledge of the order), to registering or recording an assignment of the ownership rights, in trust, and so on.

Assume that you select the stern admonition and the assurance of her counsel, but she sells the license anyway. Assume further that even though the transaction eventually is set aside by a Trustee, substantial damage has occurred to the corporate creditors.

Now the question: Should the court reduce your § 330 fee allowance in light of your failure to protect your client against its principal?

Now let us add an additional fact, in two contrary permutations: (1) You had filed schedules that showed that the license is terminable or assignable at will; (2) You had filed schedules that were silent as to the fact that the asset is licensed from the principal.

11 U.S.C. § 330 is a creditor protection device. It assures that monies that otherwise would go to creditors will be paid to Debtor's counsel only to the extent that counsel fees are reasonable. If your schedules showed that the license was terminable or assignable at will, the issue becomes one of the extent to which creditors, whom you have arguably warned, are expected to protect themselves as opposed to their expecting protection from the Court at the expense of Debtor's counsel. If the schedules were silent as to the fact that the asset is licensed from the principal, how are creditors supposed to know what to investigate to protect

themselves?

In the case at bar, the evidence is overwhelming that the firm felt that the protection of corporate creditors was everybody's job but their own, and that the firm felt that it had no obligation to broadly proclaim that fact and to disclose its own deliberate omissions.

Three attorneys did most of the work for the firm on this case. One was on the "corporate" side and acted principally as liaison between the prospective bidders, who were performing their due diligence, and the corporate debtors. Another worked on the schedules and statements, and another worked on putting together the structure for the sale of assets. The Smiths had been known to the firm only for about a month prior to the firm's retention of the firm in connection with threatened involuntary bankruptcy proceedings and it is safe to say that the firm had no reason to consider them to be sophisticated and above reproach.[1]

We will begin with an examination of the work done by the attorney who worked on the schedules and statements. By his testimony, the corporate books and records were bad. There were allegations that Irene Smith's title to the land had been obtained in a fraudulent transfer. He saw some maps and deeds and at some time became aware that the corporate operations encroached on the expansion lands. But the schedules were silent regarding the fact that the Smiths had never granted to the corporations any stated "interest" in the lands titled to Irene

[1]Mr. Smith claims to be illiterate; he had violated environmental laws and suffered the imposition of fines. Mrs. Smith's title to lands had been recently fraudulently acquired from an entireties ownership. Within weeks of the retention, she was incapacitated by emotional or mental distress.

Smith. He "relied on the clients to tell [him] what was there." He knew that many parties wanted to buy the permit applications but did not examine the permit applications to determine the nature of the corporate interest therein. Rather, he asked the consultant, Alan Singer, to look into those things.

By his testimony, the absence of any reference to the landfill license or the expansion application in the OSL schedules was an "inadvertent omission." By September 4, 1991, the United States Trustee had been seeking a limitation on the ability of the Smiths to contract. By October 17, 1991, the attorney considered Mr. Smith to be "untrustworthy," but felt reassured by the presence of John Bailey. On the day of the signing with SSWS, October 29, 1991, he was told by Mr. Bailey that Mr. Smith was going to sign, but did not demand to talk directly to Mr. Smith as the officer of his client, the corporate debtor. Furthermore, though this attorney believed that the issue of fraudulent transfers was the responsibility of Jack Getman (as discussed later) and not of his own firm, he did not tell Mr. Bailey to contact Mr. Getman, and in fact took no action at all in the face of the imminent disaster.

The attorney on the "corporate" side repeatedly told Mr. Bailey and/or Mr. Smith that "any attempt to deal with personal assets would undercut the value of the corporations." He thought that he had an "agreement" with the Smiths and with Mr. Bailey that they would not self-deal. He never told the Smiths that self dealing was forbidden, prohibited and would be heavily punished. Rather, it was his understanding from his partner that bidders could discuss anything they wanted to with the Smiths. He thought that his partner had made sure that all bids would come back through the Court. He met extensively with Mr. Singer regarding bids from

SSWS, Waste Management, C.I.D., Laidlaw and others to determine the best bid, and then would talk with bidders to improve the bids and though he knew that various bidders had ongoing discussions with the Smiths and that the Smiths were not necessarily keeping the firm apprized of those discussions, he did not raise alarm anywhere. He was on the conference call talking to Mr. Bailey when Mr. Bailey indicated that Mr. Smith was about to sign with SSWS, but merely admonished Mr. Bailey not to let Mr. Smith sign any "definitive" agreement. It was his belief that the firm had "no power" to say to any bidder that it could not talk to the Smiths. He did not instruct the bidders to refrain from trying to bind John and Irene; rather he felt that "John understood" that his job was to maximize the value of the corporation. He did know that John was "unpredictable, on occasion," and indeed "There was concern on our part about his behavior." Nonetheless, it seems that the sternest admonition he gave to Mr. Bailey or to the Smiths about self-dealing is that it would "jeopardize the value of the corporate assets and the understanding reached in Court," and that "probably a lawsuit" would result. He testified that he did not ask to see the documents that were "on the table" as to SSWS because SSWS' counsel "didn't want to show them." He believes that it is only hindsight that shows that that would be all the more reason to have demanded to see the documents.

He too refrained from taking any action having been told over the phone by Mr. Bailey that the Smiths appeared to be about to sign.

Lastly, there is the attorney who focused on structuring a sale. As the senior bankruptcy attorney on the case, he decided that he did not want the firm to have the responsibility of investigating or pursuing the principals of the corporation with regard to alleged past fraudulent transfers. Nor did he want to be involved in determining an appropriate allocation of values as between the corporate assets and those titled to the individuals. He claims that he pushed for appointment of special counsel to serve that purpose, and in fact Jack Getman, Esq. was retained as special counsel to analyze the relationship between the corporations and the Smiths. Further, he left the matter of the evaluation of the bids to the financial consultant Alan Singer. He repeatedly emphasized to the Smiths the need to “lock in” on a price for their interest in the project, but does not claim to have emphasized that “lock in” was absolutely forbidden, and punishable, if not first approved by the Court.

By October 23 of 1991, he decided in his own mind that John Bailey had the assignment of getting the Smiths’ lock-in figure. On that day he participated in a meeting that included an attorney for Fleet Bank, and other creditors and suitors, Mr. Bailey, and an attorney for New York State. At that meeting theories were discussed by which the corporations had claims against the land titled to the individuals, and Mr. Bailey was to take that into account in working with the Smiths towards setting their price. It was left, by this senior counsel, to the other attorneys and to Mr. Singer to determine whether Irene Smith was a fiduciary. At no time, apparently, did senior counsel say, “Look folks, we’ve done nothing at all to absolutely insulate the Debtors from the chance that the Smiths might alienate their lands.” He testifies that he did not take any active steps to insulate the corporations from harm because he felt that the best protection for the corporation was to get a sale closed and get creditors paid in full from that sale. He did not ask for a deed or a lease of the expansion lands, despite knowing from prior counsel that creditors had been bandying-about the issue of corporate claims against the private lands.

In his view everyone knew about the claims and every creditor was capable of pressing the matter. Protection of the estate, in his view, involved (1) getting someone else to address the matter of the allocation; (2) admonish the Smiths against self-dealing (though not threaten them with punishment); (3) convince them to offer their private holdings as part of the sale; and (4) secure the appointment of Mr. Getman to address any wrongdoing by the Debtors or by the Smiths. Indeed, he believes that even post-petition wrongdoing was Mr. Getman's target, not just earlier wrongdoing.

After the date Mr. Getman was appointed (September 23, 1991), this lead attorney felt that it was not the firm's job to determine whether the opportunity to develop the expanded landfill was a "corporate opportunity." He considered himself to be a "spectator" with regard to the negotiations between the Smiths and the other parties regarding the Smiths' lock-in price, and upon learning of the prohibited transaction he felt that it was a "done deal" that he could do nothing about, despite his belief that the Smiths had violated a stipulation they made in open court on September 11, 1991.

In sum, the three attorneys working on the case were not coordinating with one another at all. The "corporate" attorney had the most dealings with the Smiths, and is a skilled attorney, but had a mistaken impression that the lead bankruptcy attorney had made certain that any offers would be coming back through the Court and that it therefore was perfectly appropriate for bidders to talk to the Smiths about anything they wanted to talk about. The attorney working on the schedules and statements only had some notion of the kinds of allegations (regarding earlier fraudulent transfers, corporate opportunities, and the like) that were well known to the other two attorneys and that were very much the crux of the legal claims the debtor corporations had against their principals. He was told to rely on the principals' own statements for the contents of the schedules and other documents. While it may be true that the major participants would not have been looking to the schedules and statements for answers to their questions, this is a skilled attorney, and fuller communication to him of the severity and seriousness of the allegations might have prompted him to recommend or seek better protection for the corporate creditors.

To the lead bankruptcy counsel, it appeared that protection of creditors was everybody else's job but the corporations' own bankruptcy counsel. He did not believe that the firm should be involved in determining an allocation of value, and he did not feel it proper for the firm to be investigating the corporations' principals. It seems that he felt that the job of controlling his clients (the corporations) could be deflected to the personal attorney for the corporate principals.

It is clear to the Court that the firm managed, by its own will, to put itself in a position in which it was not truly acting as counsel for the Debtors-in-Possession; rather, it acted as a facilitator of the sale transactions it hoped would occur, just as a broker might do. It was a cheerleader and a spectator. It believed that protecting the estate against the possibility of collapse at the hands of the corporate principals was everybody else's job.

It is not necessary for the Court to determine whether that posture is ever correct for a debtor-in-possession's attorney to adopt, for even if it is assumed for the sake of argument that it is a defensible posture, it is inescapably indefensible to maintain that posture while denying to others the information they need to protect themselves.

Going back to the hypothetical raised earlier, if counsel decides (as it did here) to rely only on administering a stern admonition and obtaining the assurance of the principal's personal counsel, it has an absolute obligation to tell all other interested parties that that is all it has done -- that it is spinning responsibilities off to others and has done little or nothing, and that if anybody felt that any further protections were required they would have to seek them themselves.

Further, all of the attorneys representing the estate should be on the same wavelength in that regard. The attorney who is dealing the most with prospective suitors should not be under the false impression that the suitors have all been bound to a stipulation to bring all bids back through the Court. The attorney who is studying the assets of the corporation for purposes of compiling the schedules and statements should be warned not to base his findings on the statements of the principals, and should be told to make his own assessment of what might constitute assets of the corporations that can be protected by suitable order of the Court or other device, if necessary.

Perhaps most damaging of all is the fact that the firm believed that Mr. Getman was responsible for any actions against the Smiths, and yet the firm did not refer Mr. Bailey to Mr. Getman when Mr. Bailey called with forewarning of the prohibited transaction. If the two attorneys who spoke to Mr. Bailey on that day were aware of the firm's position in that regard, they should have communicated that to Mr. Bailey and told Mr. Bailey that it was Mr. Getman's point of view that he needed to obtain in that regard, not the firm's. Perhaps more to the point is this: If the firm thought that the Smiths' conduct was the responsibility of Mr. Bailey and Mr. Getman, why wasn't that clear to Mr. Bailey, or at least made clear to him at that moment?

In its effort to choreograph a sale that it thought would occur like a beautiful ballet, the firm deconstructed its proper role. Its picking and choosing of what it did and did not want to do in the case, and its failure to raise full and fair warning to others of the limits of what it had done and what it considered to be its responsibility (so that others could protect themselves) instead resulted in their choreographing the kind of fire drill that cannot be referred to in politically correct terms. To use other imagery, the ship was in iceberg-strewn seas and it was there on the firm's watch, but no one was at the wheel. Though that may have been an unintended state of affairs, it cannot be said that was not the result of the firm's own conscious, intricate design.

The firm believes that it is only 20-20 hindsight that discloses any blemishes on its performance here. The Court finds the opposite. It is only with 20-20 hindsight that creditors have been able to see the clear and present danger that the firm created not only by its lack of internal coordination, but by its disassembly and disbursal and derogation of the traditional role of counsel for corporate Debtors-in-Possession. Counsel for a Debtor-in-Possession has a special relationship to corporate creditors. It is counsel's skill and attentiveness that engenders reliance. The more that counsel wants creditors to rely on someone else, the greater the duty to (1) tell them all that; (2) point out the risks that remain unaddressed; and (3) provide continuing information to those who need it. (There is no doubt in the Court's mind, for example, that if lead counsel had even once said to the assembled creditors and suitors, "Look, I have elected to rely on the Smiths' and Mr. Bailey's good faith and understanding alone, and anybody who thinks that's not enough is on his own," the creditors and suitors would have been tripping over one another trying to get the suitable protections from the Smiths or the Court that they otherwise had every right to believe the Debtors' counsel would have obtained.) Like the repair person who fails to warn of a known defect in an inherently safe product, even more of a hazard is created than an inherently hazardous situation would have been.

The firm is entitled to no compensation in this case above a basic fee for the filing of routine documents and for the making of routine appearances. The Court believes that in these cases, that amount is $7,500.00 per case or a total fee, for the five cases, of $37,500.00. Expenses of $14,395.23 are also allowed. The rest of the retainer account shall be paid to the Trustee. The Clerk shall retain the transcript of the John Smith testimony of August 16, 1996 under seal, apart from the public record, until disposition of the entire case file is carried out by destruction, in accordance with the Records Disposition Schedule. The subpoenaed witnesses are discharged.

SO ORDERED.

Dated: Buffalo, New York
September , 1996

/s/ MICHAEL J. KAPLAN
U.S.B.J.