UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

VINCENT J. ROBERTO — Case No. 93-12694 M
NORA L. ROBERTO
d/b/a OAKWOOD PROPERTIES

Debtors

The Robertos ("Debtors") have moved under 11 U.S.C. § 327, by their counsel Damon & Morey, for approval of the retainer agreement between counsel and the Debtors. Damon & Morey has already been paid an $11,500 retainer, but as part of the motion, the Debtors ask the Court to approve a blanket mortgage of up to $35,000 on the Debtors' properties to secure counsel's fees in this case. The United States Trustee objects to the mortgage on the grounds that it creates an interest in favor of Damon & Morey, adverse to the Debtors, that disqualifies it from representation. On January 4, 1994, the Court heard argument on the issue, and took the matter under submission.[1]

ANALYSIS

Section 327(a) of the Bankruptcy Code states that the

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[1] I am aware of my colleague's decision in *In re City Mattress* 93-13767 B and concur wholeheartedly in the result. In that case, the mortgaged land is not owned by the Debtor; the Debtor does not deal in real estate, and the land in question is but one of ten or more leased retail locations. Furthermore, there is, or will likely be, a creditor's committee to monitor the debtor's operations.

Court may authorize the employment of professionals that "do not hold an interest adverse to the estate ..." This section seeks to advance the goal that a debtor-in-possession be advised by professionals who can advance the best interests of the estate, without harming their own interests.

This Court agrees with the holding in *In re Martin*, 817 F.2d 175 (1st Cir. 1987), that no per se rule exists to bar the Court from approving a mortgage on an estate's property to secure counsel fees. Judge Selya noted in that decision, however, that inquiry must proceed on a case by case basis as to whether a potential for conflict may occur. A number of factors must be considered in determining whether to allow such a fee arrangement. Weighing heavily in opposition to those facts is the absolute need to avoid the appearance and potential for impropriety. *Id.* at 182. Here the potential exists and there is no showing of need that would justify the risk.

The taking of a mortgage does not automatically create an adverse interest as contemplated by Section 327(a) of the Bankruptcy Code. It is not difficult, however, to imagine a scenario where the risk might be very real, or at least sufficiently "apparent" to be of serious concern. For example, a firm could open itself up to charges of self-dealing, when property subject to the mortgage were offered for sale. There might be pressure on the debtor (however subtle) to pass up a lower sale price that would reduce debt overhead, but wipe out the attorney's

security, for a speculative future prospect at a higher price. Such "horrible imaginings" might not come to pass: however when there is doubt, it should be resolved in favor of prudence. *Martin* at 183.

Without a showing of need similar to that required under Section 364(d)(1)(A) -- that less problematic terms are not available elsewhere -- I will not place innocent creditors who rely on this Court for fundamental protections, in the position of having to exercise constant and costly vigilance as to the debtors' ongoing relationship with their counsel, in light of changing business prospects. Here we have no showing beyond the fact that the Robertos favored Damon & Morey, Damon & Morey was willing to represent the Robertos, Damon & Morey insists on a $35,000 mortgage over and above the $11,500 cash retainer, and Damon and Morey is a competent firm. Debtors should not expect the Court to bend the statute in order to permit them their chosen firm. In quoting the famous words of Justice Cardozo, Judge Selya stated that "a fiduciary must be held to something stricter than the morals of the marketplace ..." *Martin* at 183 (quoting *Mienhard v. Salmon*, 164 N.E. 545, 546 (1928). The Debtors are fiduciaries and we are here talking about legal counsel for them as fiduciaries, not their private and personal counsel. The Court will not approve such applications without a showing by the Debtors that despite their best efforts, competent representation is unavailable other than on

such a problematic basis.[2]

There may be other law firms available to represent the Debtors on more traditional terms.[3] That portion of the Debtors' motion to approve a Damon & Morey mortgage on the Debtors' property is denied without prejudice to renewal if an appropriate showing can be made.

Dated: Buffalo, New York
February , 1994

/s/Michael J. Kaplan
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U.S.B.J.

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[2]Although cash retainers may deny the Debtor the use of sorely needed cash, cash retainers that are not excessive are less problematic because everyone understands from the start that those funds are not "in play" in the reorganization, and creditors may make decisions accordingly. A blanket mortgage on all real estate of debtors who are in the business of buying, managing and selling real estate leaves creditors constantly guessing the extent to which any particular piece of real estate is "in play" -- which is to say a piece around which a reorganization could be accomplished -- as opposed to being held (consciously or subconsciously) principally as the attorneys' "insurance policy." Twice already in this young case, potential conflicts between the firm and the estate have lurked in the background of matters coming on the record: (1) the need for the firm to negotiate with a mortgagee who opposed this fee arrangement unless agreement could be reached regarding the mortgagee's rights if the firm had to foreclose its mortgage; (2) the debtor's efforts to obtain a release of one parcel from a different blanket mortgage, without having to remit all of the net proceeds to that mortgagee.

[3]Even if competent representation cannot be obtained without a mortgage, another firm might be willing to take a mortgage on only one parcel, leaving only that parcel "out of play" in the reorganization effort.