UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

HOTEL SYRACUSE, INC.	CASE NO. 90-0292l
Debtor	Chapter 11

APPEARANCES:

SHAW, LICITRA, ESERNIO & SCHWARTZ, P.C. Attorneys for Debtor l0l0 Franklin Avenue Suite 200 Garden City, New York ll530	STUART I. GORDON, ESQ. Of Counsel
HAROLD P. GOLDBERG, ESQ. Attorney for Creditors' Committee l408 W. Genesee Street Syracuse, New York l3204	
MENTER, RUDIN & TRIVELPIECE, P.C. Attorneys for Manufacturers Hanover Trust Co. 500 South Salina Street Syracuse, New York l3202	PETER HUBBARD, ESQ. Of Counsel
HISCOCK & BARCLAY, ESQS. Attorneys for City of Syracuse, et al Financial Plaza Syracuse, New York l3202	LAURA HARRIS, ESQ. Of Counsel
ANTHONY J. FAZIO, ESQ. Attorney for Niagara Mohawk Power Corporation 300 Erie Boulevard W. A-3 Syracuse, New York l3202	
RICHARD CROAK, ESQ. Office of U.S. Trustee l0 Broad Street Utica, New York l350l	

STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

On November 5, l99l the Debtor's attorneys, Shaw, Licitra, Esernio & Schwartz, P.C. ("SLES"), filed its Second Interim Allowance of Compensation ("Second Application") seeking a fee of $245,665.00, and reimbursement of expenses in the sum of $l9,349.23. The Second Application covered the period March 3, l99l through September 30, l99l.

A hearing on the Second Application was scheduled before this Court

at Syracuse, New York on November 26, l99l. At or prior to the hearing, opposition to the Second Application was filed by the attorneys for Manufacturers Hanover Trust Co. ("MHTC"), City of Syracuse ("City"), City of Syracuse Industrial Development Authority ("SIDA"), Syracuse Economic Development Corporation ("SEDCO") and the Official Creditors' Committee. Also appearing at the hearing on November 26, l99l and/or at subsequent adjourned hearings, were the United States Trustee ("UST"), as well as the attorney for Niagara Mohawk Power Corp., Apple Bank and the County of Onondaga.

As indicated, a final hearing on the Second Application was consensually adjourned from time to time and it was finally submitted for decision following a hearing before this Court held on June l6, l992.

FACTS

SLES was appointed to act as Debtor's counsel by virtue of an Order executed by the Hon. Cornelius Blackshear, United States Bankruptcy Judge, on November l3, l990, with appointment effective October 26, l990.[1]

In support of its request for appointment of SLES, the Debtor submitted an application to Judge Blackshear dated October 26, l990 in which it alleged at paragraph 6

> To the best of Applicant's knowledge, Shaw, Licitra, Esernio & Schwartz, P.C., or any of its members or any of its employees has no connection with the creditors of the Debtor or any party-in-interest or their respective attorneys, except that Applicant may have represented certain parties on matters unrelated to this proceeding."

On or about March 2l, l99l, SLES filed its Application for a First Interim Allowance ("First Application") seeking a fee of $ll9,336.25 and reimbursements of expenses in the sum of $l0,30l.55. After a hearing at which only the UST and the Creditors' Committee filed a written objection, generally contending that SLES's hourly rates were excessive, the Court issued a written decision awarding SLES the requested fee and reimbursement of expenses. See

[1] This case was originally filed as a voluntary petition pursuant to Chapter ll of the Bankruptcy Code (ll U.S.C. §101-1330) ("Code") in the United States Bankruptcy Court for the Southern District of New York and was thereafter transferred to this Court by an Order dated November l4, l990.

Order dated May l0, l99l.

On November 5, l99l, SLES filed the Second Application previously referred to. While the objecting parties raise several objections to the Second Application, the most significant objection is that SLES is not disinterested within the meaning of Code §328(c).

ARGUMENTS

MHTC, SIDA, SEDCO and the City contend that SLES has personally represented and/or currently represents Joseph M. Murphy, Sr. ("Murphy"), the principal officer and shareholder of the Debtor, in a pending bankruptcy case venued in the United States Bankruptcy Court for the Southern District of New York entitled In re Grant Associates, (Case No. 90-B-l236l), without disclosing that fact to the Court at the time of SLES's application for appointment as Debtor's counsel.

It is further alleged that SLES itself is a creditor of the Debtor and SLES likewise failed to make that disclosure prior to appointment. The objecting creditors assert that SLES has undertaken actions allegedly on Debtor's behalf, but which in fact were intended to protect Murphy from any personal liability arising out of his guarantee of the Debtor's obligations.

Additionally, SIDA, SEDCO and the City assert that SLES is seeking compensation for services rendered in connection with litigation commenced in the United States District Court for which they were to be compensated only on a contingency basis.

SLES contends that it has advised the Court that it "does not and will not represent Murphy in this Chapter ll proceeding." (See Reply SLES dated Dec. l0, l99l at ¶ll). It goes on to assert that Murphy is represented in this Chapter ll proceeding by Irving R. Seidman, P.C. ("Seidman"). Further, SLES argues that the Court has previously passed upon its disinterestedness during a hearing which occurred in this Court on September 3, l99l.

In a supporting affidavit sworn to by Murphy on June 22, l992, he concedes that he was previously represented by SLES in matters unrelated to the

Chapter ll case, and that that fact was fully disclosed to the Court in SLES's application for appointment by the assertions contained in its October 26, l990 application.

Murphy alleges that he is personally represented in both this Chapter ll case and In re Grant Associates by Seidman, and/or the firm of Sive, Pagent & Reisel. Murphy does concede that SLES represents a corporate general partner of Grant and that he is the president and sole shareholder of that corporate general partner, a well as an individual limited partner of Grant.

DISCUSSION

Before the Court can consider what sanctions, if any, should be imposed on SLES, it must conclude that SLES is not in fact disinterested and that it failed to adequately disclose such lack of disinterestedness to the Court at the time of its appointment.

It must be kept in mind that a professional's pre-petition representation of a debtor is not grounds for disqualifying that professional from appointment post-petition. See Code §1107(b). Likewise, absent an actual conflict of interest, a professional is not prohibited from representing a debtor simply because that professional represented a creditor of the debtor pre-petition. See Code §327(c).

In summary, SLES contends that it had in fact disclosed that it previously represented Murphy and it continues to represent Murphy on matters unrelated to this Chapter ll case, to wit: In re Grant Associates, by incorporating in its application for appointment the phrase

> to the best of applicant's knowledge, Shaw, Licitra, Esernio & Schwartz, P.C. or any of its members or any of its employees has not connection with the creditors of the Debtor or any party-in-interest or their respective attorneys, except that applicant may have represented certain parties on matters unrelated to this proceeding.

SLES contends that this Court has already passed upon the adequacy of its disclosure, as well as its disinterestedness at a hearing held before this Court on September 3, l99l. However, a review of the pertinent portion of the transcript, as set forth in SLES's Reply filed with this Court on December l2,

l99l, leads to the conclusion that the alleged conflict being raised by the City, SIDA and SEDCO at that time dealt with SLES's representation of Murphy in a pre-petition state court action also involving the City. It is equally clear that the alleged conflict being presently asserted by MHTC, the City, SIDA and SEDCO arises out of SLES's alleged representation of Murphy in a contemporaneous bankruptcy proceeding in another court.

SLES asserts that it does not presently represent Murphy, and Murphy under oath asserts that he is represented by Seidman. The Court notes, however, that Seidman is, or was, apparently affiliated with SLES as "counsel to the Firm" and that said affiliation was in existence during the post-filing period. Additionally, while the affirmations of SLES that they "may have represented certain parties on matters unrelated to this proceeding" may have been true at the time it was made, the subsequent affirmations made in connection with SLES's application for appointment as attorney for debtor in In re Grant Associates clearly acknowledged that as of February l99l SLES was representing Murphy individually. SLES did not advise this Court at that time of this potential conflict.

It is apparently SLES's contention that so long as it does not personally represent Murphy in this Chapter ll proceeding, no conflict is created by their representation of Murphy personally and simultaneously in another bankruptcy proceeding. Even assuming that SLES is correct in that position, it would seem that it nevertheless had a duty to disclose such an arrangement when it undertook the representation of Murphy in February of l99l.

It is difficult for the Court to believe that SLES can avoid a conflict of interest in representing Murphy personally in another bankruptcy proceeding while simultaneously representing herein a Debtor corporation of which Murphy is the principal officer, director and stockholder, as well as a significant pre-petition creditor by simply contending that in this case Murphy is personally represented by an attorney who is, or was, affiliated with SLES on an "of counsel" basis.

Likewise, the Court does not believe that phraseology such as "except applicant may have represented certain parties on matters unrelated to this proceeding" is sufficient disclosure so as to comply with Federal Rule of

Bankruptcy Procedure ("Fed.R.Bankr.P.") 20l4(a).

In commenting on the necessity for full disclosure in seeking the appointment of a professional in a bankruptcy context, the Second Circuit has made it abundantly clear that appropriate disclosure is full disclosure.

In the Matter of Futuronics Corp., 655 F.2d 463, 469 (2d Cir. l98l), the Second Circuit, considering Bankruptcy Rule 2l5 (the predecessor of Fed.R.Bankr.P. 20l4), and quoting from its earlier decision of In re Rogers-Pyatt Shellac Co., 5l F.2d 988, 992 (2d Cir. l93l) stated that "lawyers 'who seek appointment as counsel for an officer of the court owe the duty of complete disclosure of all facts bearing upon their eligibility for such appointment ... If the rule is to have vitality and the evils against which it is aimed are to be eliminated, it should be enforced literally.' Indeed it has long been the practice in this Circuit to deny compensation to counsel who fail to comply with the disclosure contained in Rule 2l5 ..." See also Bohack Corp. v. Gulf & Western Industries, Inc., 607 F.2d 258 (2d Cir. l979). A conflict that may not exist at the inception of the case, but which arises thereafter, is no less a conflict and certainly there is a continuing duty of disclosure.

Here, while it is true that SLES may have disclosed a pre-petition representation of Murphy in a state court action, and the Debtor may have arguably put the Court and the creditors on notice of SLES's representation of certain parties in interest on unrelated matters, it appears to the Court that both the Debtor and SLES were purposefully vague and misleading.

Further, the retention of Seidman as Murphy's personal counsel in this case hardly removes the taint of conflict given Seidman's relationship to SLES.

When one views SLES's conduct as pointed out to the Court in the objections filed by MHTC and the City, SIDA and SEDCO, it becomes of greater concern in light of the revelation that SLES is representing Murphy personally in another pending bankruptcy case.

The City, SIDA and SEDCO have alleged that 1) Debtor, through SLES sought to assume equipment leases with General Electric Credit Corporation and Fleet Bank on which Murphy was a personal guarantor so as to elevate the future lease payments to an administrative expense status under Code §507(a)(l), when

in fact the leases were actually security agreements; 2) the Debtor's proposed plan of reorganization prepared by SLES permits Murphy to retain his equity interest in the Debtor without providing for full payment to unsecured creditors; 3) the Debtor has kept its payroll taxes current and has sought to pay pre-petition health benefits to its employees, both obligations for which Murphy would have statutory pass-through liability, while failing to pay most other post-petition obligations; 4) SLES, on behalf of the Debtor, has failed to commence preference actions, the most notable of which is against Apple Bank and its predecessors to recover payments allegedly made within one year prior to filing on a mortgage debt, which debt was personally guaranteed by Murphy and which payments would allegedly be recoverable under the so-called "Deprezio" doctrine; 5) Debtor, through SLES, has failed to attempt collection of a $350,000 debt allegedly due from Warren Street Franchise, a company which operates a fast food franchise within the Hotel Syracuse and is allegedly wholly owned by Murphy; it is further alleged that with regard to Warren Street Franchise, that Debtor's accountants have done work on its behalf and have included those charges in fee applications prepared by SLES on Debtor's behalf; 6) the Debtor sought and obtained approval for a post-petition loan of $l00,000 from Prudential Ellinghouse Real Estate, thus giving rise to an administrative expense claim without disclosing to creditors or this Court that the lender was owned by Murphy's wife; 7) SLES has commenced groundless litigation against the City, SIDA and SEDCO so as to create significant legal expenses in the nature of administrative claims so as to prevent any creditor from filing and gaining acceptance of a competing plan.

While SLES have responded to these allegations, it paints its response with a rather broad brush to the effect that while many of these actions may have directly benefited Murphy, they were justified because they also were of benefit to the Debtor.

It is well settled that a very real potential for a conflict of interest arises where an attorney represents both the debtor-in-possession and its principals. See In re Rusty Jones, Inc., 22 BCD 306 (Bankr. N.D.Ill. l99l); In re Grabill Corp. , ll3 B.R. 966, 969 (Bankr. N.D.Ill. l990); In re Star Broadcasting, Inc., 8l B.R. 835 (Bankr. D.N.J. l988); In re Kendavis Industries

Int'l, Inc., 9l B.R. 742 (Bankr. N.D.Tex. l988); In re McKinney Ranch Associates, 62 B.R. 249 (Bankr. C.D.Cal. l986); In re Watson Seafood & Poultry Co. Inc., 40 B.R. 436 (Bankr. E.D.N.C. l984); In re Chou Chen Chemicals, Inc., 3l B.R. 842 (Bankr. W.D.Ky. l983); In re Philadelphia Athletic Club, Inc., 20 B.R. 328 (E.D.Pa. l982).

This case is further complicated by the fact that SLES has already applied for and been granted authority for payment of a significant interim fee for services rendered to the Debtor between October 26, l990 and February 28, l99l. It is clear, however, that neither this Court nor the creditors were aware of SLES's ongoing representation of Murphy individually at that time.

There exists at present, however, in the opinion of this Court, a very real conflict of interest on the part of SLES; a conflict which may well result in the denial of the current Second Application in its entirety and disgorgement of any fees already paid.

This Court will require that SLES immediately cease all representation of Murphy, either individually or on behalf of any entity of which he is a principal, officer, director, stockholder or partner, excepting, of course, the Debtor herein. Further, Murphy shall no longer be represented by any member of SLES, or any attorney otherwise affiliated with SLES.

This Court will require the cessation of such representation and proof thereof to be filed with this Court within thirty (30) days of the date of entry of this Order.

Additionally, given the uncertainty of the Debtor's future in Chapter ll, this Court will withhold further consideration of the Second Application at this time, pending the outcome of the Debtor's motion for summary judgment in Adversary Proceeding No. 9l-60166, as well as the UST's motion seeking conversion or dismissal of this case pursuant to Code §1112(b), both of which are presently under submission.

IT IS SO ORDERED.

Dated at Utica, New York
this day of October l992

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STEPHEN D. GERLING
U.S. Bankruptcy Judge