

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In Re:)
Level Propane, Gases, Inc., et. al.) Case No. 02-16172
)
) Ch. 11
)
) Hon. Randolph Baxter
)

**MOTION OF WILLIAM H. MALOOF TO DISQUALIFY DEBTORS' COUNSEL
PURSUANT TO 11 U.S.C. Sec. 327**

Now comes William H. Maloof, shareholder, by and through counsel undersigned, and for his Motion to Disqualify Debtors' Counsel pursuant to 11 U.S.C. Sec. 327, states as follows:

1.) This Court expressly excluded from the scope of the Examiner's investigation the retention of Debtor's Counsel, Benesch, Friedland, Coplan and Aronoff (BFCA) when gave its Instructions to the Examiner appointed in this case (Docket No. 1356) on April 30, 2003. In excluding this matter from the scope of the Examiner's investigation, this Court observed at p. 2 of its Order:

"The appointability of a professional in bankruptcy cases, including the requirement of disinterestedness and inherent good faith, is always before the Court and can be considered by the Court at any time."

Your Movant has alluded in previous pleadings to BFCA's compromised position and want of disinterestedness as well as stated that these issues would be addressed in due time. That time has come.

2.) The facts supporting the Motion are set out in the argument below. The references to the Interviews are to those conducted by the Examiner in this case,

transcripts of which were submitted as Exhibits to his Report and docketed with the Report. The extracts are attached as Motion Exhibit "A."

-1-

**DEBTORS' COUNSEL,
LACKING THE DISINTERESTEDNESS REQUIRED BY 11 U.S.C. Sec. 327 FOR
ITS APPOINTMENT, MUST BE DISQUALIFIED UNDER 11 U.S.C. Sec.327**

3.) When BFCA filed its Verified Statement of Proposed Attorneys and Disclosure in support of its "Application for Order pursuant to section 327(a) of the Bankruptcy code authorizing Employment and Retention of William E Schonberg of Benesch, Friedlander, Coplan & Aronoff LLP as Attorneys for Debtors and Debtors in Possession," Docket No. 83, it was fully aware that 11 U.S.C. Sec. 327 requires any professionals appointed "do not hold or represent an interest adverse to the estate, and they are disinterested persons," Sec. 327(a). The Verified Statement is careful to name prior and present engagements that might be seen to conflict with its proposed appointment, all in support of its claim of disinterestedness, see Paragraph 15, Motion Exhibit "B (1)."

4.) At the time of the Application and the Verified Statement, the Examiner had yet to be appointed and his work had yet to be done. Since that time, no party has, based on the record created by the Examiner, moved this Court to determine whether, indeed, BFCA was disinterested and therefore qualified to serve as Debtors' Counsel in light of that evidence. This circumstance might readily be explained by the fact that by the time the Examiner submitted his report on June 6, 2003 (Docket No. 1546), a motion for a Global Settlement had already been made on April 28, 2003 (Docket No. 1343),

consequently there were no parties with any but scant reason to pursue the issue. In recent months, that issue has resurfaced, and with it, this Motion.

5.) The Courts in this Circuit have spoken with one voice to the firm and exacting standard of disinterestedness to which professionals are held when appointed under 11 U.S.C. Sec. 327, *In re: Georgetown of Kettering, Ltd.* 750 F.2d 536 (6th Cir., 1984), *In re: Federated Department Stores* 44 F.3d 1310 (6th Cir., 1995), *In re: Lew H. Thompson* 54 B.R. 311 (USBC, NDO, 1985), *In the Matter of: Roger j. Au & Son, Inc.* 71 B. R. 238 (USBC, NDO, 1986), *In re: Fretter, Inc.* 219 B.R. 769 (USBC, NDO, 1998), *In re: Greystone Holdings, L.L.C.* 305 B.R. 456 (USBC, NDO, 2003), which standard comports with the standard in other circuits, see, e.g. *In re: AroChem Corp.* 181 B.R. 693 (USBC, D. Conn, 1995), *Buckley v. TransAmerican, Inc. (In re: Southern Kitchens, Inc.)* 216 B. R. 819 (USBC, D. Minn., 1998), *In re: Roberts* 46 B.R. 815 (USBC, D. Ut., 1985).

6.) The disinterestedness of a professional appointed by the Court must leave that professional free to exercise his fiduciary obligation to that court: which states “The standard imposed on fiduciaries seeking compensation in a bankruptcy court is a high one,” *In re: Roger J. Au & Son, supra*, at 241 It requires of the fiduciary that “his primary loyalty was not weakened by the pull of a secondary one,.” that is to say, the fiduciary must act with “*undivided loyalty* owed to those whom the claimant purport[s] to represent” *In re: Roger J. Au & Son, supra*, at 242 emphasis supplied. Such undivided loyalty demands that a professional be free of any adverse interest, which may be either to possess

“(1) an economic interest that would lessen the value of the estate or create an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate.” *In re: Fretter’s Inc., supra* at 777, quoting *In re: Roberts, supra*, at 827.

The breadth of the disinterestedness required of professionals appointed under Sec. 327 is emphasized in *Greystone Holdings, supra*, at 460-461 where the Court, citing the definition of disinterested person in 11 U.S.C. Sec. 101(14)(e) as one who “does not have an interest materially adverse to the estate . . . by reason of any direct or indirect relationship to . . . the debtor . . . or for any other reason.” This definition

“is sufficiently broad to include any professional with an ‘interest or relationship that would even faintly color the independence and impartial attitude required by the Code. *Crivello*, 134 F.3d at 835 (7th Cir., 1998).”

The evidence gathered by the Examiner altogether undercuts BFCA’s claim to the disinterestedness demanded of professionals appointed as fiduciaries by the Court under Sec. 327. It is clear that on any number of factual bases BFCA cannot possibly escape the conclusion that it has been utterly compromised in its loyalties since before any petition was filed and that it never qualified as a disinterested professional under Sec. 327.

7.) Turning to BFCA’s Verified Statement, critical statements of past fact are simply false: in Paragraph 21, it states that the Debtor made payments totaling \$554,204.50. In James Hill’s Interview he stated unequivocally that during the time that John Rudd was CRO, BFCA’s fees were assured because Rudd would pay them immediately upon the Bank Group’s approval, that Rudd would have to obtain the Bank Group’s approval because it was not Level’s money, but the banks’, Hill Interview at 94.7-95.18 (conducted by the Examiner and appearing on the Docket in this case in Exhibit Vol. B to the Examiner’s Report. The passages from this and the other Interviews referenced are attached as Exhibits to this Motion.) That payment of BFCA’s fees were made by the banks is made emphatic by Brian Salvagni’s statement that responsibility for review of outside counsel fees was taken from him by Mr. Rudd as soon as he was made

CRO, Salvagni Interview at 16, ll.8-16. The internal controls in place at Level regarding attorney fees were thereby substituted by the control of the banks through their agent, John Rudd, who were regarded by BFCA as the party genuinely in control of the companies and their money. Thus, Level having turned into an alter ego of the banks, it was the banks, and not the Debtors, who paid these staggering pre-petition fees.

8.) Further, in Paragraph 23 of the Verified Statement, BFCA states that it has received no promises as to compensation, when Jeffrey Schwartz of the firm, then chairman of its Business Reorganization Practice, testified in his interview unequivocally that he received specific promises from Jeff Marwil of Jenner & Block, the bank group's counsel, that BFCA's professional fees would be protected by a carve-out and that carve-out would have no cap, Schwartz Interview at 64, ll.1-4; 91, ll.19-25. It is a well worn adage that "He who pays the piper calls the tune." It was likewise a well-worn observation in this case that Jeff Marwil always got his way, Schlachet Interview at 195.21-25, Brokemon Interview at 9.1-22.

9.) As attorneys seeking appointment as counsel for the Debtors in Possession, BFCA failed to discharge its "affirmative duty of *prior and unsolicited full disclosure of all facts* bearing upon [its] eligibility for appointment as general counsel for the trustee [Debtor in Possession]" *Thompson, supra* at 317, emphasis supplied. The *Au* court observed that any circumstance that would "dilute the undivided loyalty owed" by counsel would disqualify it *In Re: Roger J. Au & Son, supra*, at 242, citing *In Re Georgetown of Kettering, supra*.

10.) The issues of BFCA's loyalty that turn on fees are especially obvious, and in their gross display are akin to the bold display that led to counsel's disqualifications in

Fretter, Inc., supra, when disqualified counsel failed to disclose pre-petition mortgages for fees that later put counsel in sharp conflict with the very debtor they were appointed to represent. Here, BFCA failed to disclose that the true source of their pre-petition fees for work done on behalf of the Debtors in Possession *pre-petition on bankruptcy issues that arose as a result of the ongoing conflict with the bank group* was the very bank group that was contending for control of the Debtors.

11.) These observations concerning the pre-petition fees and the promises concerning post-petition fees are reflections of the essential conflict over corporate control, see Marwil Interview at 31, ll.8-20, that was played out at BFCA, see Schonberg Interview at 37, l.15-38, l.7, Schlachet Interview at 115, ll.2-11, at 116, ll.20-25, Salvagni Interview at 40, ll.22-24. The choice presented to BFCA in the months running up to the bankruptcy case was simple: whether to represent the interests of the bank group, the main creditor of the Debtors, or to represent the Debtors themselves, and follow the lawful instructions of its sole voting shareholder, sole director and CEO. The resolution of that conflict by BFCA in favor of the bank group, Schonberg Interview at 37, l.15-38, l.7, Schlachet Interview at 115, ll.2-11, at 116, ll.20-25, accounted for conduct that would be otherwise inexplicable: the procurement of Level's signature on the March 7, 2002 Forbearance Agreement by which corporate control was all but entirely surrendered to the banks Examiners Exhibits, Docket 1618, Exhibit Vol. A, Tab 86A, Exhibit No.101, when members of the firm acknowledge that the sole source of Level's financial distress was its conflicts with the bank group, Schwartz Interview at 95, ll.7-11, Schonberg Interview at 125, ll.3-6; the seizure of the pretext of the pre-buy dispute as a basis for a precipitous withdrawal as counsel, Hill Interview at 112, l.20-114,

1.23, Schonberg Interview at 22, ll.8-15, at 121, ll.21-25, Schlachet Interview at 135, ll.5-9, ll.21-25; the failure to surrender the Chapter 11 Petition papers to the Debtors on June 5, 2002, when they were properly requested by the proper person, Schonberg Interview 137, l.14-138, l.9, these papers were ready in March, 2002, Salvagni Interview at 18, ll16-18, Schlachet Interview at 128, ll.3-17 and BFCA gave no good reason to the Debtors for their refusal to turn over the Chapter 11 Petition papers, Salvagni Interview at 21, l.15-22, l.3, 24, ll.17-25, l.11, when the involuntary Ch. 7 Petition was filed and the voting rights seized the next day by the bank group, Primrose Interview at 91, l.21-92.1.11, which BFCA acknowledged was an unheard-of act of equitable subordination, Primrose Interview at 91, l.25-92, l.3; the collaboration of BFCA and the bank group to a mutual purpose of the negotiation of the conversion agreement that surrendered Maloof's rights to contest the bank group's seizure of the voting rights to secure control of the bankruptcy, Marwil Interview at 77, ll.9-14, Schwartz Memo to File (cc. Schonberg), June 22, 2002, Examiner's Exhibits, Docket No. 1621, Vol A, Tab 174; the utter failure of the September 23, 2002 auction without the benefit of a stalking horse bidder (at the behest of the bank group's counsel, Brokemon Interview at 19, ll.1-22) and without bid deposits because BFCA was so tardy in providing wiring instructions, Brokemon Interview at 21, ll.4-20; and the collaboration of BFCA and bank group counsel in concealing the leased tanks in January, 2003, email sequence between Steven Sues and Jeff Marwil, Motion Exhibit "B (3)."

12.) The pre-petition conduct of BFCA is shot through with such thorough-going corruption that one must look to BFCA's predisposition toward the bank group in general as analogous to the shameless disregard of conflict of interest by the disqualified counsel

in *Buckley, supra*. In *Buckley, supra*, Fafinski & Wallrich, P.A (F&W) served as special counsel to the trustee, pursuant to a routine application of the trustee, to prosecute an action against various parties with a history of prior involvement and litigation for corporate control with the corporation now in bankruptcy, with a view toward recovering funds from them for the estate. These parties, which had been involved in the corporate control contest of the Debtor, had been previously represented by F&W. The action was filed by F&W on behalf of the estate naming one of the parties which had been involved in the corporate control litigation, TransAmerica. TransAmerica, in defending the action, asserted that the Debtor was forced into insolvency by the conduct of two other parties, one Gunberg and one Reiser. Gunberg had been previously represented by F&W in the lawsuit over corporate control ultimately won by TransAmerica, whose success in the lawsuit allowed it to seize Southern Kitchens' receivables and thereby drive Southern Kitchens into liquidation bankruptcy. Once the issues were joined, TransAmerica moved to disqualify F&W as special counsel, because it had previously represented Gunberg.

The Court disqualified F&W, observing:

“The record manifests a meritorious dispute over the reason for the reorganized Debtor's failure, *in which a persisting struggle for control of a troubled company was a central incident*. Resolution of this issue is inherently fact-bound, and the process may well be complicated. If it is found that the Debtor failed due to buccaneering on the part of Gunberg and Rieser, regardless of any breach of the Defendants' duties under the plan, the adverse interest would be proven. This finding, however, would come only after long litigation and trial. In the meantime, *the estate's fortunes in this lawsuit would have been in the hands of counsel whose judgment might have been affected by the intangible but persisting influence of past loyalty*. Even were the estate to establish its theory of causation, the result could be tarnished by a persisting suspicion that Gunberg's role was covered up” at 829, emphasis supplied.

The facts in this case bear an uncanny likeness to those in *Buckley*. There is a long-term struggle for control of a corporation, here, between its single largest creditor, the bank

group, and its sole shareholder, director and CEO. The law firm, BFCA, that represents these Debtors in Possession was hired by its sole shareholder, director and CEO pre-petition, in November, 2001, Schlachet Interview at 12, ll.2-15, at 15, l.16-16, l.8, but soon began to shift its loyalties to the bank group, in January, 2002, Schlachet Interview at 42, ll.15-25, Schwartz Interview at 31, ll.3-9, a shift that continued as the Forbearance Agreement was negotiated, Hill at 89, l.25-90, l.2, and strengthened in March, 2002, when Mark Schlachet was removed as billing attorney, Schlachet Interview at 57, ll. 4-11 and BFCA looked to the bank group to pay its bills, Hill at 91, ll.9-25 and, became evident with Primrose's and Schonberg's conversation with the bank group in which they undertook to control Mr. Maloof, the sole shareholder, sole director, and CEO for the bank group's benefit, Schlachet Interview at 142, l.1-154.2. That shift was altogether complete when Primrose complied with Denise Burns' (bank group counsel) direction, purportedly the word of the newly installed Director, Charles Sweet, to hold back any papers of the Debtors from anyone, Primrose Interview at 82, l.8-83, l.12, after BFCA had resigned the representation of the Debtors but before it had resumed its role on June 7, 2002. As a result of its shift in loyalties to the bank group, BFCA had become loyal to only party, the bank group, whose adverse interests mattered. Its conduct took a going concern, whose primary value arose from its continuing as a going concern, Schwartz Interview at 154, ll.8-20, valued at \$120-150MM, Schlachet Interview at 31, l.4-32, l.10, and reduced it to \$31MM, its sales price to Eagle Rock.

13.) The compromised loyalties of BFCA are the very hazards against which both the statute and the cases interpreting it are so vigilant to guard, cf. *In re: Fretter's, Inc.*, *supra*, *In re: Roberts, supra*, *Buckley, supra*. That the same parties so easily changed

loyalties in this long-running conflict is nothing short of uncanny: John Rudd, who appeared as the Chief Restructuring Officer for Level Propane in March, 2002 and upon which BFCA relied for the weekly payment of its spiraling fees, only to appear as the bank group's watchdog, with a waiver of conflict-of-interest, post-petition, BFCA appeared as the nominal counsel for Level Propane, ran up bills of over \$550,000 in a few months' time, only to resign on a pretext, refuse to disgorge work-product that it acknowledges under oath was Level Propane's for the asking, and resurfaced as counsel for the Debtor in an involuntary Chapter 7, Marwil Interview at 36, 1.16-37, 1.1, after which alternatives are rebuffed by the Director installed by the bank group, Salvagni Interview at 54, ll. 15-21, in renunciation of the promise set forth in the Conversion Agreement that he had previously appeared to honor, Examiner's Exhibit Vol. A, Tab 162A, Salvagni Interview at 51, ll.1-15. It is altogether clear that BFCA took its marching orders from the Debtors' largest creditor rather than its sole director from at least March, 2002. The court that disqualified counsel in *Fretter's, Inc., supra*, observed:

“ . . . [C]ourts struggle with trying to anticipate whether a set of facts known in the abstract at the outset of a case amounts to an adverse interest, In the case at hand, however, the Court has the benefit of hindsight in making that determination. Looking at the events that transpired, it is clear that the mortgages were adverse interests,” 219 B.R. at 778

Here, as in *Fretter's Inc.*, the economic interest of BFCA have emerged as adverse to the Debtors. It was the Debtors' purpose that Level Propane be sold and that other going concerns be left in the WHM Emprises group. It was the Debtors' purpose that a take-over by the bank group be avoided, Schlachet Interview at 117, 1.5- 118, 1.6, Forbearance Agreement, Hill Interview at 106, 1.24-107, 1.1. It was the purpose of the bank group to control the Debtors, particularly Level Propane, by whatever means required, whether

through a CRO or by means of a bankruptcy, Salvagni Interview at 29, ll.13-21. A professional could be in the middle of no sharper a struggle for control as BFCA.

14.) All the more troubling is that those who represented the Debtors knew of their compromised loyalties as they denied them. The ferocity with which the bank group acted with the acquiescence of BFCA was recognized by Primrose, Interview at 91, l.21-92, l.11. The duty owed to the Debtors to represent them with respect to a claimed insolvency was recognized by Schonberg's insistence that BFCA never acted as insolvency counsel, Schonberg Interview at 60, ll.19-22, 88, ll.21-25, 89, l.2, despite the hundreds of hours billed by Schonberg himself denominated "Ch.11," Docket No. 1620, Examiner's Exhibits Vol A, Tab 166B, Motion Exhibit "B (2)." That BFCA was utterly compromised in the loyalty owed to its client was recognized by Schwartz's spontaneous protest that "My hands are clean, you know," when questioned regarding the firm's relationship to bank group counsel, Schwartz Interview at 100, ll.9-10. The only difference between this case and the cases in which counsel has been disqualified in the past is that the conflict here was covert, in contrast to *Buckley*, and the monetary scale of wrong much greater than *Fretter's, Inc.*

15.) In conclusion, the already existing record demonstrates that BFCA was never qualified to represent the Debtors in this case, *In re: Georgetown of Kettering, supra, In re: Federated Department Stores, supra, In re: Lew H. Thompson, supra, In the Matter of: Roger J. Au & Son, Inc., supra, In re: Fretter, Inc., supra, In re: Greystone Holdings, L.L.C, supra, Buckley v. TransAmerican, Inc. (In re: Southern Kitchens, Inc.), supra, In re: Roberts, supra.* Compromised as it was by its hopeless entanglement in the pre-petition struggle for corporate control between the bank group and the sole shareholder,

sole director and CEO of the present Debtors, BFCA could never meet the stringent standard for professional disinterestedness set by these decisions, and, especially with the benefit of clear hindsight, *In re: Fretter's, Inc.*, *supra*, must be disqualified.

-2-

**DEBTORS' COUNSEL, THUS DISQUALIFIED FOR APPOINTMENT UNDER
11 U.S.C. Sec. 327, MUST RETURN ANY FEES AWARDED TO IT AS
APPOINTED COUNSEL**

16.) In each of the cases cited above in which counsel was disqualified for want of disinterestedness, disqualified counsel were required to return for fees awarded for work performed during the pendency of its appointment. Where fees had been awarded, they were disallowed, see e.g. *Thompson, supra*, at 318, *Buckley, supra*, at , *Fretter's, Inc.*, *supra*, at 541. It is a byword that "Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation, *In re: Georgetown of Kittering, supra* at 541 and that: "Failure to disclose facts giving rise to a conflict of interest is grounds for denial of compensation, *Roger J. Au & Son, supra*, at 242.

17.) In this case, the facts demonstrating BFCA's conflict of interest and entanglement in the struggle for corporate control described above, are both abundant as undisclosed. The depth of BFCA's entanglement with the Debtors' leading adversary, the bank group, as well as BFCA's failure to disclose its entanglements and its further failure to disclose that it was compensated for much of its pre-petition representation of the Debtors on the authority, through John Rudd, of the Debtors' leading adversary is sufficient basis to deny all compensation. Indeed, the holding of *In re: Georgetown of*

Kettering, supra, compels the denial of compensation. In as much as these fees have already been paid, the fees must be returned to the estate.

CONCLUSION

18.) For the reasons above-stated BFCA must be disqualified as appointed Counsel for the Debtors-in-Possession. As a result of their entanglements with parties with adverse interests to the Debtors and their concomitant conflict of interest, BFCA was never possessed of the requisite disinterestedness for appointment under 11 U.S.C. Sec.327. Further, their failure to disclose those entanglements and concomitant conflict of interest is sufficient ground to deny payment of compensation. In as much as substantial fees have been paid to BFCA, as disqualified counsel they are obligated to return them.

WHEREFORE, for the reasons above-stated, your Movant prays that his Motion to Disqualify Debtors' Counsel be granted and that this Court grant such other relief as is appropriate in the premises and within its sound discretion.

Respectfully Submitted,

/s/David C. Eisler
David C. Eisler, Counsel for the Movant
Ohio Reg. No. 0020362
P.O. B. 1721
Medina, OH 44258
(216) 513-6369; (216) 214-2106
inqs@AOL.com

SERVICE

I hereby certify that on this 14th day of November, 2006, the foregoing was filed electronically. Notice of this filing will be sent to all parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

/s/David C. Eisler
David C. Eisler, Counsel for the Movant