UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
London Division

IN RE:	:	
	:	**Chapter 11**
MONTIE'S RESOURCES, LLC	:	**Case No. 11-61482**
	:	**Judge Joseph M. Scott**
Debtor.	:	
_____	:	
	:	
	:	
IN RE:	:	**Chapter 11**
	:	**Case No. 11-61483**
EMLYN COAL PROCESSING, LLC	:	**Judge Joseph M. Scott**
	:	
Debtor.	:	
_____	:	

ORDER DENYING APPLICATIONS TO EMPLOY

The Debtors, Montie's Resources, LLC ("Montie's") and Emlyn Coal Processing, LLC ("Emlyn") (collectively "Debtors") are before the Court on:

1. Montie's Application of Debtor for an Order Authorizing the Employment of Delcotto Law Group PLLC and Troutman and Napier, PLLC as Its General Co-Counsel Nunc Pro Tunc to the Petition Date ("Montie's Application") (Montie's Doc. 5&12); and

2. Emlyn's Application of Debtor for an Order Authorizing the Employment of Delcotto Law Group PLLC and Troutman and Napier, PLLC as Its General Co-Counsel Nunc Pro Tunc to the Petition Date ("Emlyns Application") (Emlyn Doc. 5); and

3. The Objection ("UST Objection") (Emlyn Doc. 61; Montie's Doc. 41) of the United States Trustee ("U.S. Trustee"); and

4. The Objection ("Kloeber Objection") (Emlyn Doc. 69; Montie's Doc. 44) of David N. Kloeber, Jr. ("Kloeber"); and

5. The Responses of Debtors to the Trustee Objection (Emlyn Docs. 77; Montie's Docs. 49), and the Kloeber Objection (Emlyn Docs. 99; Montie's Docs. 60).

Hearings were held on Montie's Application and Emlyns Application, collectively "Debtors' Applications" on November 29, 2011, and December 14, 2011. At the hearing on November 29, 2011, the Court ordered that: Debtors file a report with the Court (a) explaining how the duties of the two law firms are divided to avoid duplication of efforts and (b) clarifying the debts owed by the two Debtors to each other.

This Court has jurisdiction of this matter pursuant to 28 U.S.C. § 1334(b) and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

RELEVANT FACTS

1. On November 4, 2011, Debtors filed voluntary petitions for relief under chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code").

2. An Official Committee of Unsecured Creditors ("Emlyn Committee") has been appointed in Emlyn's case (Emlyn Doc. 98). The U.S. Trustee was unable to appoint a committee in Montie's case (Montie's Doc. 55).

3. The two chapter 11s have not been consolidated either substantively or administratively.

4. Bartolomea Montanari ("Montanari") is the managing member and owner of one hundred percent of the membership interests of Emlyn.

5. The Bart and Lisa Montanari Family Limited Partnership ("Family LP") is the member and owner of one hundred percent of the membership interests of Montie's. Montanari owns and controls the Family LP.

6. According to the Debtors' schedules, they share some common creditors (Emlyn Doc. 63; Montie's Doc. 42).

7. The largest secured creditor of each Debtor is Kloeber with both Debtors scheduling $12,292,382.23 in debt owed to Kloeber. However, at the hearing on December 14, 2011, counsel for Kloeber stated that the debt owed to Kloeber is not all joint debt. Some of the debt is owed by Montie's, some by Emlyn, and some is joint debt owed by both Debtors.

8. Montie's owns or leases approximately 116 million tons of coal reserves in Kentucky and Tennessee. Emlyn is in the business of processing and mining coal, including mining coal at the Corn Creek Mine owned by Montie's in Woodbine, Kentucky. Emlyn uses some of Montie's leased equipment to mine and process coal.

9. There are no formal agreements between Montie's and Emlyn regarding Emlyn mining Montie's coal or Emlyn's use of equipment leased by Montie's.

10. Montie's did not have any income during 2010 and has not had any income during 2011.

11. Since Montie's does not have any income, Emlyn pays Montie's bills, including lease payments.

12. Dean Langdon of DLG represented Debtors at the hearing on the Debtors' Applications and proffered that it is his belief that there is nothing on the books of either company supporting a claim between the two companies.

13. Emlyn's original Schedule B (Emlyn Doc. 63) reflected an accounts receivable that Montie's owed to Emlyn for an "unknown" amount for equipment payments and general overhead. However, on December 13, 2011, Emlyn amended its schedules (Emlyn Doc. 101) and deleted the accounts receivable from Montie's. As an explanation, Emlyn states that because of the initial confusion surrounding the Debtors' finances and records, the receivable was listed on Schedule B out of an abundance of caution. The item was removed based on Montanari's testimony at the 341 meeting that there is no documentation to support the existence of the receivable and no such receivable is listed on Emlyn's books.

14. At an evidentiary hearing held November 29, 2011, an exhibit of Emlyn's Balance Sheet as of October 31, 2010, was introduced and admitted into the record. The balance sheet reflects as a current asset of Emlyn, an amount "Due from Montie's" of $1,257,520.27. (Emlyn Doc. 80, Ex. K-1). Because Montie's had no income for 2010 or 2011, it is reasonable to assume

that this debt still exists or that it at least deserves an explanation as it is clearly in Emlyn's financial records.

15. Emlyn's Schedule B reflects a receivable noted as "Coal A/R as of 11/4/11" in the amount of $130,859.21. There is no indication of whether this receivable includes any of Montie's coal mined and sold by Emlyn to a third party.

16. Emlyn's Statement of Financial Affairs (Emlyn Doc. 75) reflects that during the ninety-day preference period, Emlyn paid Fountain Leasing, a creditor of Montie's, $20,078.50 for equipment leases.

17. Further in Montie's response (Montie's Doc. 61) to a motion for relief from stay filed by Fountain Leasing, Montie's has offered to incorporate the monthly lease payments owed by Montie's to Fountain Leasing into the cash collateral budget of its affiliate, Emlyn.

18. On November 28, 2011, Emlyn was added to Montie's creditor list (Montie's Doc. 46) and Montie's was added to Emlyn's creditor list (Emlyn Doc. 71).

DEBTORS' APPLICATIONS AND THE OBJECTIONS

Debtors propose to employ two Lexington, Kentucky, law firms, Delcotto Law Group PLLC ("DLG") and Troutman & Napier, PLLC ("T&N"), as co-counsel representing both Debtors. According to the Debtors, T&N was first consulted by Montanari, the designated representative for both Debtors, on September 27, 2011, for the purposes of having T&N review Debtors' financials and circumstances regarding potential bankruptcy. Initially, both Michael W. Troutman and Gregory A. Napier worked with Montanari. In October 2011, after considering the time frame in which the Debtors' bankruptcy petitions needed to be filed, the limited availability of Mr. Troutman during early November 2011, and the fact that Mr. Napier, as the sole attorney continuing to work on the matter, "would not be able to process the information and prepare all the needed schedules and first day motions," Messrs. Troutman, Napier and Montanari determined that the expertise and assistance of DLG was needed. (Response to Trustee Objection ¶ 4). At that time DLG was enlisted as co-counsel.

T&N received a total retainer of $50,000 with $3,500 being received on October 11, 2011, and the remaining $46,500 received on October 21, 2011. The entire $50,000 was received from Emlyn. After payment of prepetition services by both firms, $21,280.88 remains in escrow. The law firms request approval of a lien in their favor against the funds in escrow. DLG & T&N also seek a weekly "carve-out" of $5,000 in the cash collateral order to be held in T&N's escrow account pending further orders of the Court. The law firms are requesting a lien in the existing escrow and future "carve-out" payments that will be put into the escrow account.

The UST Objection is filed on the basis that the Debtors do not need two law firms to represent each Debtor. The U.S. Trustee specifically objects to the employment of T&N and asserts that T&N has no expertise necessary to assist DLG in representing Debtors and T&N's representation would result in increased legal fees and duplication of efforts between the law firms.

The Kloeber Objection raises the same objection as the U.S. Trustee and includes the following additional arguments against employment of DLG and T&N:

a. The same firm(s) cannot represent both of the Debtors because there are potential avoidance claims and preferential or fraudulent transfer claims between the two Debtors. There are also executory contracts between the two Debtors and intercompany claims between the two Debtors.

b. Debtors' use of $50,000 for the Retainer was not authorized by Kloeber and is in violation of a Forbearance Agreement entered into between Debtors and Kloeber. Kloeber does not consent to the use of his cash collateral for the Retainer proposed by the Debtors.

c. The Court should deny the request of DLG and T&N for a security interest in the escrow account. Granting the law firms a security interest in Kloeber's cash collateral requires that Debtors comply with 11 U.S.C. § 364(d) by showing that Debtors could not obtain counsel to represent them without a senior security interest in cash collateral and that Kloeber is adequately protected.

d. Montie's Application should be denied because Montie's does not have funds to pay legal fees.

e. It is a violation of Emlyn's fiduciary duties to Emlyn's creditors to pay Montie's expenses.

LAW AND ANALYSIS

In this district, the general rule is that an attorney is not necessarily prohibited from representing affiliate debtors and debtors should be free to select counsel of their choice. "However, this choice is tempered by ethical restraints placed upon attorneys by the Rules and Code which prohibit representation involving an interest materially adverse to the estate." *In re Fairvue Club Props. LLC*, No. 09-13807, 2010 WL 569561, at *3 (Bankr. M.D. Tenn. Feb. 12, 2010).

Pursuant to § 327 of the Bankruptcy Code:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not *hold or represent an interest adverse to the estate*, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.
>
> . . .
>
> (c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, *unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest*.

11 U.S.C. § 327(a), (c) (emphasis added).

> The Bankruptcy Code does not define the phrase "hold or represent an interest adverse to the estate." However, most Courts adopt the definition in *In re Roberts,* 46 B.R. 815 (Bankr. D. Utah 1985), *aff'd in relevant parts and rev'd and remanded in part on other grounds,* 75 B.R. 402 (D. Utah 1987). The Court in *In re Roberts* construed the phrase "hold an adverse interest" to mean:
>
> > for two or more entities (1) to possess ... an economic interest that would tend to lessen the value of the bankruptcy estate or that would create either 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.
>
> *Id*. at 826–827.

> An interest adverse to the estate pursuant to section 327(a) is the same as an actual conflict of interest pursuant to section 327(c). . . .
>
> In determining whether a professional has or represents an "adverse interest," one court observed: "[I]f it is plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that other representation, then they have a conflict and an interest adverse to the estate." *In re The Leslie Fay Cos.,* 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994). An actual conflict exists if there is an active competition between two interests, in which one interest can only be served at the expense of the other. As a general principle, professional persons employed by the trustee should be free of any conflicting interest which might, in the view of the trustee or the bankruptcy court, affect the performance of their services or which might impair the high degree of impartiality and detached judgment expected of them during the administration of a case.

In re Midway Motor Sales, Inc., 355 B.R. 26, 33 (Bankr. N.D. Ohio 2006) (some quotations and citations omitted).

A debtor in possession is a statutory fiduciary of its own estate. 11 U.S.C. §§ 1106, 1107(a).

> It is the duty of counsel for the debtor in possession to survey the landscape in search of property of the estate, defenses to claims, preferential transfers, fraudulent conveyances and other causes of action that may yield a recovery to the estate. The jaundiced eye and scowling mien that counsel for the debtor is required to cast upon everyone in sight will likely not fall upon the party with whom he has a potential conflict.

Interwest Bus. Equip., Inc. v. U.S. Trustee (In re Interwest Bus. Equip., Inc.), 23 F.3d 311, 316 (quotations and citation omitted).

Applying the definitions and concepts quoted above to the specific facts of this case, Emlyn's balance sheet, contrary to the testimony of Montanari at the 341 meeting and contrary to the proffer made by Mr. Langdon at the hearing on December 14, 2011, reflects that there is a significant debt owed to Emlyn by Montie's in Emlyn's records. This is an issue that must be addressed by counsel for the Debtors in which there is an "active competition between two interests [Montie's & Emlyn], in which one interest can only be served at the expense of the other." Counsel for Emlyn cannot merely turn a blind eye to this debt. Emlyn is a fiduciary of its

bankruptcy estate and must act in the best interests of its unsecured creditors. Such actions do not include dismissing this debt owed to Emlyn by its affiliate, Montie's.

Further, Emlyn has a potential preference claim against Fountain Leasing that needs to be investigated on behalf of Emlyn to the detriment of Montie's. Because there are no formal written agreements between Emlyn and Montie's, Emlyn had no duty to pay Montie's lease payments to Fountain Leasing even if Emlyn is using the equipment. Certainly Emlyn's Committee will not, and cannot, turn a blind eye to this potential recovery for the benefit of Emlyn's estate. This is another situation where Emlyn's unsecured creditors may benefit at the expense of Montie's and its unsecured creditors.

Finally, Montie's must have counsel that is strictly loyal to it because it does not have a creditor's committee looking out for its unsecured creditors. Montie's is the fiduciary in charge of looking out for the best interest of its own unsecured creditors. Specifically, Emlyn has been benefitting at Montie's expense by mining coal on Montie's property at the Corn Creek Mine apparently without remitting any royalties or other payments to Montie's. Emlyn has a significant account receivable related to coal. Without books and records maintained between the two companies, it is unclear whether a portion of Emlyn's coal receivable relates to coal that Emlyn sold that was mined from the Corn Creek Mine. Montie's is obligated to discontinue this relationship which is very lucrative to Emlyn's creditors and detrimental to Montie's.

Mr. Langdon asserts that there is such a synergy between the two companies that there cannot be any adverse interests between the two without destroying both entities. While that was the relationship of the Debtors outside of bankruptcy, it cannot be permitted in bankruptcy, particularly where the unsecured creditors of one debtor are not the same as the other debtor and where Emlyn, under questionable circumstances, has all the income to the detriment of Montie's.

The Court has no alternative but to find that in seeking to represent both Debtors, both DLG and T&N will represent an interest adverse to the estates, disqualifying DLG and T&N from

representing the Debtors under § 327(a) and that both DLG and T&N have an actual conflict of interest disqualifying them from representing the Debtors under § 327(c).

The Court's decision makes resolution of the Trustee Objection and the other bases for the Kloeber Objection moot.

CONCLUSION

Having reviewed the record and the pleadings and having considered the arguments of counsel,

IT IS, HEREBY, ORDERED that Emlyns Application and Montie's Application are **DENIED** in their entirety.

By our decision today, we do not change the general rule in this district that simultaneous representation of related estates in bankruptcy is not per se prohibited. Instead, each application must be evaluated on its own merits.

Copies to:
Dean A. Langdon, Esq.
Gregory A. Napier, Esq.
Patricia K. Burgess, Esq. (For service on interested parties)
Rachelle C. Dodson , Esq.

~~~~~~

The affixing of this Court's electronic seal below is proof this document has been signed by the Judge and electronically entered by the Clerk in the official record of this case.

Signed By:
Joseph M. Scott, Jr.
Bankruptcy Judge
Dated: Thursday, January 05, 2012 (jms)
~~~~~~