

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE
SOUTHERN DISTRICT OF GEORGIA
Savannah Division

IN RE:)	Chapter 7 Case
)	Number <u>86-40143</u>
ROSE MARINE, INC.)	
)	
Debtor)	
ROSE MARINE, INC.)	
)	
Plaintiff)	
)	
vs.)	Adversary Proceeding
)	Number <u>88-4038</u>
MARINE CONTRACTING CORPORATION,)	
EARL J. HADEN, JR.,)	
ROBERT H THOMPSON AND)	
JOHN BUDGE)	FILED	
)	at 2 O'clock & 59 min. P.M.
Defendants)	Date: 4-27-90

ORDER

Marine Contracting Corporation, Earl J. Haden, Jr., Robert H. Thompson and John Budge, defendants in this adversary proceeding, seek to disqualify Donald E. Austin as attorney for plaintiff. Based upon the evidence presented at the hearing on the motion, briefs submitted, and oral arguments of counsel, this court makes the following findings of fact and conclusions of law.

Rose Marine, Inc. filed for protection under Chapter 11 of Title 11, United States Code on February 5, 1990. The debtor acted as debtor-in-possession until order of this court dated

August 2, 1988, converting the Chapter 11 case to a case under Chapter 7. Subsequent to conversion, W. Jan Jankowski was appointed trustee. While a Chapter 11 proceeding, by order of the Honorable Herman W. Coolidge, Bankruptcy Judge, dated

August 27, 1986, Donald E. Austin was appointed as attorney for the debtor-in-possession over the objection of Delores Diamond whom Judge Coolidge found had no standing to object to Mr. Austin's appointment. At the time of his appointment, Mr. Austin was president of the debtor, a member of the board of directors of the debtor and a 90% shareholder in the debtor, but agreed to serve as the attorney for the debtor without compensation.¹ Mr. Austin, in his capacity as attorney for the debtor-in-possession, brought this adversary proceeding on January 6, 1988. The adversary proceeding alleges a cause of action based upon breach of contract and tort claims that arose prepetition. According to Mr. Austin, the actions of the defendants which gave rise to the complaint were not discovered, nor discoverable by the debtor, until after the Chapter 11 proceeding was commenced.

The defendants assert three grounds for the disqualification of Mr. Austin as counsel:

1. The Chapter 7 bankruptcy trustee is the proper party

to represent the interests of the debtor-plaintiff in this lawsuit and not Mr. Austin;

2. Mr. Austin is not a disinterested party and is therefore ineligible to act as attorney for the debtor, plaintiff; and

3. Mr. Austin is a material witness as to the facts of this lawsuit.

Regarding the contention of the defendants that the Chapter 7 trustee, Mr. Jankowski, is the appropriate party in interest to proceed with this adversary proceeding, the defendants are correct. Although the standing of the named plaintiff to bring this proceeding is at best tangentially connected to the issue

¹The order appointing Mr. Austin as attorney for the debtor provided "that Donald E. Austin shall serve as attorney for Rose Marine, Inc. without compensation so long as Rose Marine, Inc. shall remain in this court as a debtor under Chapter 11 of the Bankruptcy Code." In re: Rose Marine, Ch. 11 Case No. 86-40143, Slip op. at 2 (Bankr. S.D.Ga. August 27, 1986).

presented by the defendants' motion, determining the real party in interest as now raised by the defendants is appropriate. This adversary proceeding was commenced by Rose Marine, Inc. as debtor-in-possession while the underlying case was a Chapter 11 case. The debtor-in-possession is required to perform all of the functions and duties, with minor exceptions, of a trustee serving in a case under Chapter 11.² 11 U.S.C. §1107(a). The trustee and debtor-in-possession in a Chapter 11 proceeding succeed to all causes of action held by a debtor at the time the bankruptcy petition is

filed. Miller v. Shallowford Community Hospital, 767 F.2d 1556 (11th Cir. 1985); Anaconda-Ericsson, Inc. v. Hesson (In re: Teltronic Services), 762 F.2d 185 (2nd Cir. 1985); Transload and Transport v. American Marine Underwriters, 94 B.R. 416 (E.D. La. 1988); 4 Collier on Bankruptcy ¶541.10[5] (L. King 15th ed. 1985). The debtor-in-possession with the powers of a trustee is the appropriate party in interest to proceed with a cause of action which arose prepetition. However, when a case is converted to a liquidation under Chapter 7 of Title 11, the trustee becomes the real party in interest. In re: Crouthamel Potato Chip Co., 52 B.R. 960 (E.D. Pa. 1985), rev'd on other grounds, 786 F.2d 141 (3rd Cir. 1986). The trustee is the "legal representative of the bankruptcy estate with the capacity to sue and be sued". 11 U.S.C. 323. The Chapter 7 trustee remains the party in interest to pursue the prepetition cause of action unless the property interest of the estate is abandoned by the trustee pursuant to 11 U.S.C. §554. Upon conversion of the underlying Chapter 11 proceeding to a case under Chapter 7, the trustee becomes the real party in interest in not only the Chapter 7 case, but also in all related adversary proceedings. By motion to disqualify plaintiff's counsel, the

²The exceptions to the trustees duties and responsibilities to be performed by a debtor-in-possession are those trustee duties set forth in 11 U.S.C. §1106(a) (2), (3), (4).

defendants have raised the issue of the real party in interest. Bankruptcy Rule 7025, which makes Federal Rule of Civil Procedure 25 applicable to adversary proceedings in bankruptcy, requires the substitution of the trustee for the debtor-in-possession as

plaintiff.³ However, substitution of the trustee as plaintiff in this adversary proceeding is only appropriate in the event that the trustee undertakes the prosecution of the proceeding.

The responsibility of the trustee to collect assets and to effectuate the policy of equity of distribution does not per se compel litigation by the trustee at every instance where a potentiality for recovery exists. To the contrary, a trustee has a substantial degree of discretion to sue or not to sue. In re: v. Savino Oil & Heating Co., 91 B.R. 655 (Bankr. E.D. N.Y. 1988). The Bankruptcy Code, Title 11 United States Code, creates the position of trustee to collect the assets of a debtor's estate in a Chapter 7 liquidation, and a forum, this court, to resolve competing claims in interest against those assets. The trustee has the responsibility of collecting the property of the estate and should the trustee fail to perform his duties and responsibilities, then pursuant to 11 U.S.C. §324(a), any party in interest may move for removal of the trustee, and the court may remove a trustee for cause. Great deference must be given to the trustee's exercise of

³Federal Rules of Civil Procedure 25(c) provides:

Transfer of Interest. In case of any transfer of interest, the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party.

. . .

judgment when, after weighing the potential expense to the estate in pursuing litigation against the probability of recovery, the trustee determines that litigation is not in the best interests of the estate. The mere fact that a Chapter 11 debtor-in-possession commenced an adversary proceeding to liquidate and collect a prepetition cause of action and a subsequent Chapter 7 trustee refuses to prosecute that cause of action is alone insufficient to establish a basis for removal. A party seeking removal carries the burden of proving that the refusal by the trustee was without justification. Should the trustee after examination decline to undertake the pending cause of action, the trustee, pursuant to 11 U.S.C. 554, should seek to abandon the cause of action.

The connection of this contention of the defendants motion to disqualify plaintiff's counsel is that when the trustee as the real party in interest is substituted for the debtor in this proceeding, the trustee must select counsel. As the trustee is the real party in interest, the attorney for the debtor is not representing the trustee, and therefore, not representing the real party in interest in this proceeding. Having determined that the trustee is the real party in interest, it is incumbent upon the trustee, if the trustee decides to pursue this adversary proceeding, to select counsel to prosecute the cause of action. The availability of Mr. Austin to act as counsel, should the trustee so decide, is contingent upon the outcome of the remaining issue for consideration.

The second contention of the defendants is that Mr. Austin is not a disinterested party and is, therefore, ineligible to act as attorney for the plaintiff. The issue of disinterestedness as it pertains to Mr. Austin's participation as counsel for the debtor-in-possession in the underlying case during its status as a Chapter 11 proceeding was resolved by Judge Coolidge in favor of Mr. Austin's participation as the attorney. Judge Coolidge having approved that participation, this court will not disturb those findings.

The contention for disqualification is that Mr. Austin is a material witness to the facts of this lawsuit. The defendants do not assert that Mr. Austin's testimony is necessary for their defense. To the contrary, the defendants assert that Mr. Austin's testimony is material to the plaintiff's case. As there has been no assertion by the defendants that Mr. Austin's testimony is necessary for their defense, the decision of whether or not Mr. Austin is to testify rests with the plaintiff. The American Bar Association Model Rules of Professional Conduct deal with the problem of a lawyer acting as an advocate and witness in a proceeding. Model Rule 3.7 provides:

(a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness except where:

- (1) the testimony relates to an uncontested issue;
- (2) the testimony relates to the nature and

value of legal services rendered in the case:

(3) disqualification of the lawyer would work substantial hardship on the client.

(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.

Model Rules of Professional Conduct Rule 3.7 (1983).

If, after undertaking employment in contemplation of or pending litigation, a lawyer learns that, or it is obvious that, he ought to be called as a witness on behalf of his client, he should withdraw from the conduct of the trial, except that he may continue the representation and may testify in the circumstances enumerated in Rule 3.7. See ABA Comm. On Ethics and Professional Responsibility, Informal Op. 89-1529 (1989). A lawyer should avoid becoming a witness and an advocate in the same case as the two roles can be and usually are inconsistent with one another. Model Rules of Professional Conduct Rule 3.7 comment (1983). A lawyer should be permitted to testify only where the attorney's testimony is uncontested, relates to the extent and value of legal services rendered in an action, or where it is clearly unfair to the client to force the attorneys withdrawal. Id. The standards of

the American Bar Association Model Rules of Professional Conduct apply to members of the bar of the United States District Court for the Southern District of Georgia. S.D.Ga. R.IV, R.5(d). The American Bar Association Model Rules of Professional Conduct also apply to

attorneys in bankruptcy proceedings. In re: Cropper Co., 35 B.R. 625, 631 (M. D. Ga. 1983). The plaintiff failed to set forth any basis under the ABA standards to permit Mr. Austin to continue as counsel for the plaintiff and to appear as a witness for the plaintiff in this proceeding.

It is therefore ORDERED that W. Jan Jankowski, the Chapter 7 trustee for the estate of Rose Marine, Inc. in the underlying Chapter 7 Bankruptcy Case No. 86-40143, investigate the cause of action asserted by the debtor in this adversary proceeding. In the event that the trustee determines that the property interest of the estate in the cause of action asserted is burdensome to the estate or that it is of inconsequential value and benefit to the estate, then on or before May 17, 1990, the trustee shall pursuant to Bankruptcy Rule 6007 give notice to all parties in interest of his intention to abandon the cause of action to the debtor. Unless a party in interest files a written objection with the court and serves the objection on the trustee within fifteen (15) days following the mailing of the trustee's notice of intention to abandon the cause of action, the interest of the estate in the cause of action is abandoned and an order will issue dismissing the adversary proceeding without prejudice. In the event that the trustee determines that it is in the best interests of the estate to pursue the cause of action, the trustee shall apply, on or before May 17, 1990, to be substituted as the appropriate party/plaintiff

in this adversary proceeding. Upon such application, this court will enter an order authorizing and directing the substitution of W. Jan Jankowski, Chapter 7 trustee for the estate of Rose Marine, Inc., as the party plaintiff. In the event that the

Chapter 7 trustee determines that the prosecution of this cause of action is in the best interests of the estate, the trustee shall move for the appointment of counsel for special purpose pursuant to 11 U.S.C. §327(e) to represent the trustee in this adversary proceeding. In the event that the trustee moves to retain Mr. Austin as the attorney, Mr. Austin will be barred from testifying as a witness in the trial of the adversary proceeding.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia
this 27th day of April, 1990.