UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

MATCO ELECTRONICS GROUP, INC.	CASE NO. 02-60835
	Chapter 11
Debtor	Jointly Administered

IN RE:

U.S. ASSEMBLIES NEW ENGLAND, INC.	CASE NO. 02-60836
Debtor	

IN RE:

U.S. ASSEMBLIES IN FLORIDA, INC.	CASE NO. 02-60837
Debtor	

IN RE:

U.S. ASSEMBLIES RALEIGH, INC.	CASE NO. 02-60838
Debtor	

IN RE:

MATCO TECHNOLOGIES	CASE NO. 02-60839
Debtor	

IN RE:

U.S. ASSEMBLIES SAN DIEGO, INC.	CASE NO. 02-60840
Debtor	

IN RE:

CAROLINA ASSEMBLIES, INC.	CASE NO. 02-60841
Debtor	

IN RE:

U.S. ASSEMBLIES HALLSTEAD, INC. CASE NO. 02-60842

Debtor

IN RE:

U.S. ASSEMBLIES IN GEORGIA, INC. CASE NO. 02-60843

Debtor

IN RE:

U.S. ASSEMBLIES ENDICOTT, INC. CASE NO. 02-60844

Debtor

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,

CONCLUSIONS OF LAW AND ORDER

By way of background, on February 13, 2002, some of the creditors ("Petitioning Creditors") of the above-referenced debtors' filed involuntary petitions pursuant to chapter 11 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"). On March 8, 2002, the Court signed an Order granting the motion of the Petitioning Creditors for joint administration of the cases. On March 15, 2002, the Court granted the Order for Relief, effective March 11, 2002. The Committee was appointed by the U.S. Trustee on or about March 27, 2002.[1] Dennis Losik, a senior credit executive with Avnet, Inc. ("Avnet"), was allegedly named to the Committee and serves as its co-chair.

On April 2, 2002, the Court signed an order approving the employment of the law firm of Berkman Henoch Peterson & Peddy, P.C. as counsel for the Committee. By Order dated December 16, 2002, Nixon Peabody LLP ("Nixon") was substituted as counsel to the Committee, retroactive to October 25, 2002.

On January 27, 2005, American Manufacturing Services, Inc. ("AMS") filed a complaint in the New York State Supreme Court, Broome County ("State Court Action).[2] The Committee, as well as its individual members, are listed as defendants in the State Court Action. Neither Douglas Spelfogel, Esq. ("Spelfogel"), nor the Nixon firm, of which Spelfogel is a member, are

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[1] The Committee is comprised of the following unsecured creditors: Arrow Electronics, Inc., Avnet, Inc., Future Electronics, Heiland Electronics, Inc., Jaco Electronics, Inc., Mentec, LLC, PartMiner, Inc., Pioneer Standard-Electronics, Inc., Tyco Electronics Corporation and Ben Khoushnood, in an *ex officio* capacity. Some of the Committee members were also among the "Petitioning Creditors."

[2] According to the files of the U.S. District Court, N.D.N.Y., on February 25, 2005, Avnet, a defendant in the State Court Action, filed a Notice of Removal with respect to that action (3:05-cv-00252-TJM-DEP). A similar Notice of Removal was filed on March 2, 2005, by some of the other defendants, including the Committee (3:05-cv-00276-TJM-DEP).

named as defendants. However, among the allegations in AMS's complaint is the statement that

> [u]pon information and belief, one or more members of the Committee began to approach AMS's customers and urge them not to do business with AMS. Upon information and belief, the Committee members undertook such actions pursuant to the strategy the Committee and its counsel had formulated to put enormous economic pressure upon AMS in order to induce it to pay an immediate cash settlement to the unsecured creditors.

See ¶ 61 of the Complaint, attached as Exhibit "A" to Avnet's Sur-Reply, filed March 25, 2005.

On March 1, 2005, Avnet filed a motion[3] in this Court seeking to have Spelfogel and Nixon removed as counsel for the Committee on the basis that there is a "perception, if not the reality, of a conflict of interest" with Spelfogel's and Nixon's continued representation of the Committee. *See* ¶ 9 of Avnet's Motion. Spelfogel/Nixon, on behalf of the Committee, filed opposition to Avnet's motion on March 22, 2005. The Court heard oral argument on March 29, 2005, at its regular motion term at Utica, New York.[4] At a status conference in the case that same date, the Court indicated it would make every effort to have a decision for the parties by April 26, 2005, the adjourned date for Avnet's motion.

Avnet contends that the conflict stems from the possibility that Nixon/Spelfogel may have to "point the finger" at the Committee in defense of the allegations mentioned above. Avnet

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[3] Avnet indicates that it is bringing the motion "in its own right, as a creditor and interested party. Avnet is not seeking to act on behalf of the Committee . . . ." *See* ¶ 17 of Avnet's Motion.

[4] At the hearing, Spelfogel asserted that Avnet's counsel had sent a letter asking that Nixon indemnify Avnet or defend it in the State Court Action; otherwise, it intended to file the motion now before this Court. The letter allegedly was sent to all members of the Committee, including Avnet's representative, and on February 23, 2005, a vote was taken via telephone to continue representation by Nixon. The Committee also allegedly established a three member subcommittee to monitor the litigation. That subcommittee reviewed the opposition papers prepared by Spelfogel and with the exception of Avnet, the Committee approved their submission to the Court.

argues that there is an actual conflict because what is compromised is Nixon's ability to exercise independent judgment on behalf of the Committee under those circumstances. As pointed out by Avnet's counsel at the hearing held on March 29, 2005 before this Court, "in theory, every action taken on behalf of the Committee in the State Court Action is going to be subsumed in every major issue in the main case. The reality is that there can be no resolution of the main adversary proceeding, the State Court Action or any other big issues in the case as part of a global resolution." Thus, it is Avnet's position that "[t]he Committee is entitled to independent and objective advice and counsel with respect to the ongoing administration of the Debtor's estate, the ongoing adversary proceedings and other contested matters pending in this Court, and the State Court Action." *Id.* at ¶ 15. In addition, Avnet asks that the Court "direct the parties to suspend the mediation process for the adversary proceedings pending in this Court until such time as the Court has approved the appointment of substitute counsel for the Committee." *Id.* at ¶ 16.

DISCUSSION

As an initial matter, the Court notes that Nixon, on behalf of the Committee, asserts that Avnet lacks standing to seek the relief requested because Avnet is not Nixon's client. However, as pointed out by Avnet, "[a] motion seeking the disqualification of an attorney representing conflicting interests by an unaffected party is an appropriate means by which to bring the alleged conflict to the attention of the court." *Vegetable Kingdom, Inc. v. Katzen,* 653 F.Supp. 917, 923 (N.D.N.Y. 1987). The court in *Vegetable Kingdom* noted that case law supports the proposition that an attorney has an obligation to challenge a lawyer's representation of a client in the event

that he/she is aware of facts that may justify disqualification based on a conflict of interest. *Id.* at n.4; *see also SMI Indus. Canada Ltd. v. Caelter Indus., Inc.*, 586 F.Supp. 808, 815 (N.D.N.Y. 1984).

Nixon, on behalf of the Committee, also makes the argument that the Court should deny the relief requested given that the allegations involving the Committee members and Committee's counsel and the "so-called conflict" have been known for approximately two years.

On April 22, 2002, the Committee commenced an adversary proceeding against, among others, the Debtors, BSB Bank & Trust Company, and AMS. Relevant to the matter herein, AMS filed its answer and three counterclaims against the Committee on August 16, 2002, alleging that "'the Committee decided to destroy AMS for improper purposes, and that the Committee was engaged in a game of economic blackmail against the AMS investors.'" *The Official Committee of Unsecured Creditors of The Matco Electronics Groups, Inc. v. Matco Electronics Group, Inc.*, Case No. 02-60835-02-60844, Adv. No. 02-80095, slip op. at 6 (Bankr. N.D.N.Y. April 4, 2003).

On August 18, 2003, the Committee filed its Third Amended Complaint. In its Answer to that complaint, AMS asserted five counterclaims alleging (1) breach of contract; (2) breach of covenant of good faith and fair dealing; (3) unfair competition; (4) tortious interference with contract, and (5) tortious interference with prospective contractual relations. *See The Official Committee of Unsecured Creditors of The Matco Electronics Groups, Inc. v. Matco Electronics Group, Inc.*, Case No. 02-60835-02-60844, Adv. No. 02-80095, slip op. at 6 (Bankr. N.D.N.Y. Jan. 30, 2004). On September 23, 2003, the Committee filed a motion seeking dismissal of the counterclaims on the basis that the Court lacks subject matter jurisdiction over them. *Id.* at 8. In the counterclaims of AMS, there were allegations concerning not only the Committee but also

its individual members. By Order dated January 30, 2004, the Court granted the Committee's motion and dismissed the counterclaims asserted in the adversary proceeding in this Court, without prejudice to their pursuit in another forum . . . ." *Id.* at 17-18. According to Avnet, it was unaware of the counterclaims asserted against the Committee until after they were dismissed by this Court. *See* Avnet's Supplemental Memorandum of Law, filed April 21, 2005.

It is the Committee's position that the "[c]ourts have made clear that a delay of as little as a few months is grounds to deny a motion to disqualify counsel, let alone years, as in this case." *See* Committee's Opposition at 4. However, as recently noted by the Honorable Adlai S. Hardin, Jr., U.S. Bankruptcy Judge for the Southern District of New York, the Second Circuit has held that "'[s]ince . . . disqualification is in the public interest, the court cannot act contrary to that interest by permitting a party's delay in moving for disqualification to justify the continuance of a breach of the Code of Professional Responsibility.'"[5] *In re I Successor Corp.*, 321 B.R.640, 662 (Bankr. S.D.N.Y. 2005) (citations omitted). In his discussion, Judge Hardin cited to cases in which the courts had addressed delays in filing a motion to disqualify, which ranged from five months to three years. *Id.* In those cases, the courts considered the prejudice to the parties and whether the motion had been brought as a dilatory tactic and whether there was a reasonable explanation for the delay. *Id.* Judge Hardin concluded that any delay in filing a motion to disqualify counsel is not an automatic basis for its denial. *Id.* Rather, any delay is but one factor to be considered. *Id.* The court recognized, however, that "[b]ecause motions to disqualify

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[5] The Second Circuit has recognized the American Bar Association's Code of Professional Responsibility as providing appropriate guidelines for professional conduct of members of the bar. *See Salvagno*, 2003 WL 21939629 at *6; *Sumitoma*, 2001 WL 145747 at *2; *I Successor Corp.,* 2005 WL 627561 at *4 (citations omitted).

attorneys can be tactically motivated, cause delay and additional expense, and disrupt attorney-client relationships, the movant must meet a high standard of proof to disqualify . . . ." *Id.* at 647 (citations omitted); *see also A.V. By Versace, Inc. v. Gianni Versace, S.p.A.*, 160 F.Supp.2d 657, 663 (S.D.N.Y. 2001) (indicating that the proponent of disqualification must show more than "mere speculation."). This standard requires that Avnet establish more than simply the appearance of impropriety, it must demonstrate a genuine conflict of interest. *Id.*; *In re Hampton Hotel Investors, L.P.*, 289 B.R. 563, 583 (Bankr. S.D.N.Y. 2003).

Whether to grant a motion to disqualify is a matter of the Court's discretion. *See U.S. v. Salvagno,* Case No. 5:02-CR-51, 2003 WL 21939629, at *5 (N.D.N.Y. March 4, 2003); *Sumitomo Corp. v. J.P. Morgan & Co., Inc.*, Case Nos. 99 Civ. 8780 and 99 Civ. 4004, 2000 WL 145747 at *3 (S.D.N.Y. Feb. 8, 2000). As pointed out by the court in *Vegetable Kingdom,*

> [m]otions to disqualify opposing counsel should be approached with "cautious scrutiny." *Laker Airways Ltd. v. Pan American World Airways*, 103 F.R.D. 22, 28 (D.D.C.1984). Even when courts have had misgivings about the conduct of an attorney, the cases reveal considerable reluctance to resort to the severe remedy of disqualifying a party's chosen counsel from representing that party. *See, e.g., Richmond Hilton Associates v. City of Richmond*, 690 F.2d 1086, 1089 (4th Cir.1982); *Board of Education v. Nyquist*, 590 F.2d 1241, 1246 (2d Cir. 1979). This reluctance results from concerns over the "immediate adverse effect" disqualification has on the client separated from his lawyer, *id.*, the desire "to preserve, to the greatest extent possible, ... the individual's right to be represented by counsel of his or her choice," *Hull v. Celanese Corp.*, 513 F.2d 568, 569 (2d Cir.1975), and the awareness that disqualification motions are being made, with increasing frequency, with purely strategic purposes in mind. *Smith v. Whatcott*, 757 F.2d 1098, 1099-1100 (10th Cir.1985); *Nyquist*, 590 F.2d at 1246; *International Electronics Corp. v. Flanzer*, 527 F.2d 1288, 1289 (2d Cir.1975). Moreover, the Second Circuit has noted that what constitutes "ethical behavior" on the part of practicing attorneys is often the subject of vigorous debate, *see Armstrong v. McAlpin*, 625 F.2d 433, 443-44 (2d Cir.1980) *(en banc), vacated on other grounds*, 449 U.S. 1106, 101 S.Ct. 911, 66 L.Ed.2d 835 (1981), and consequently has expressed a strong preference for allowing the " 'comprehensive disciplinary machinery' of the state and federal bar" to remedy alleged ethical violations occurring during the course of ongoing litigation. *Id.* at 446 (quoting

> *Nyquist,* 590 F.2d at 1246); *see also Nyquist*, 590 F.2d at 1248 (Mansfield, J., concurring) ("Only where the attorney's unprofessional conduct may affect the outcome of the case is there any necessity to nip it in the bud. Otherwise conventional disciplinary machinery should be used and, if this is inadequate, the organized bar must assume the burden of making it effective as a deterrent.").
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> In assessing disqualification motions, courts in this circuit must adopt "a restrained approach that focuses primarily on preserving the integrity of the trial process." *Armstrong*, 625 F.2d at 444. Given the serious consequences that result when a litigant's attorney of choice is prevented from representing him, courts must be particularly wary of a mechanical or didactic application of the Code of Professional Responsibility and must "prevent literalism from possibly overcoming substantial justice to the parties." *J.P. Foley & Co., Inc. v. Vanderbilt*, 523 F.2d 1357, 1360 (2d Cir.1975) (Gurfein, J., concurring); *see also North American Foreign Trading Corp. v. Zale Corp.*, 83 F.R.D. 293, 295 (S.D.N.Y.1979).

Vegetable Kingdom, 653 F.Supp. at 921-922.

In the matter before the Court, it is important to note that Avnet is not simply requesting that Spelfogel/Nixon be disqualified in its representation of the Committee in the State Court Action, it is requesting that Spelfogel/Nixon be disqualified in its representation of the Committee in the Debtors' cases as well. Furthermore, it is not the Committee that is requesting the relief; rather, it is a single member of the Committee, with whom no other member of the Committee has joined. In fact, Nixon's opposition to the Avnet's motion is made on behalf of the Committee as a whole.

Spelfogel/Nixon has represented the Committee for over two years in what the Court considers a very complex and "hotly contested case" involving a number of related debtor entities. To disqualify Spelfogel/Nixon from its representation of the Committee in the case, as well as in the State Court Action and other adversary proceedings pending in this Court would be highly prejudicial to the Committee as it would require the Committee to seek other counsel and get them "up to speed." Disqualification would also result in substantial cost to the estate

in this regard.

Avnet has not demonstrated any actual conflict with respect to Spelfogel/Nixon's representation of the Committee in the case at this time. Its suggestion that there may be the perception, if not the reality, of a conflict of interest is simply not a sufficient basis to deny the Committee its choice of legal representation at this stage of the case, particularly where neither Spelfogel nor Nixon have been named as defendants in the State Court Action. Spelfogel directs the Court's attention to that fact that the allegations made in the complaint against the Committee which reference activities allegedly taken on the advice of counsel by the individual members is "upon information and belief." In addition, Spelfogel alleges that Avnet, in responding to the complaint filed in the State Court Action, actually took the position that the allegations against it were not actionable.

At the hearing on March 29, 2005, Avnet's counsel indicated that Avnet was contemplating filing a third party action against Nixon. In its Supplemental Memorandum of Law, filed on April 21, 2005, it states that "Avnet will be filing a third party complaint against Nixon Peabody in the event that the litigation is not dismissed."[6] Avnet, however, has not suggested that the Committee intends to file a third party complaint against Nixon in the State Court Action.

Canon 5 of the Code of Professional Responsibility requires attorneys to "exercise independent professional judgment on behalf of a client." N.Y. Jud. L., App., Canon 5 (McKinney 2003 & Supp. 2005. ("N.Y. Code"). A lawyer is not to continue employment "if the

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[6] In this regard, Avnet states that once responsive pleadings are required in the State Court Action, it "will likely move to dismiss the complaint."

exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected . . . if it would be likely to involve the lawyer in representing differing interests . . . ." *See* N.Y. Code at DR 5-105(B). In this regard, "courts in this Circuit have held that a lawyer owes a duty of undivided loyalty to his client that precludes him from doing anything adverse to a client's interests." *Sumitomo*, 2000WL 145747 at *3 (citations omitted). In this case, it is the Committee that is the client, not Avnet. Critical to any determination by the Court is the question of whether continued representation of the Committee by Nixon will undermine the Court's confidence in the vigor of its representation." *See id.* at *4.

Avnet also contends that it is likely that Spelfogel will be called as a witness in the State Court Action concerning the allegations that Nixon and the Committee formulated a strategy to put economic pressure on AMS in order to encourage an immediate cash settlement. N.Y. Code D.R. 5-102(b) provides that if a lawyer "'learns or it is obvious that the lawyer . . . may be called as a witness on a significant issue other than on behalf of the client, the lawyer may continue the representation until it is apparent that the testimony is or may be prejudicial to the client,' at which point the lawyer must withdraw." *Versace,*160 F.Supp.2d at 664. The standard for disqualification in this regard requires that the testimony be both necessary and "substantially likely" to be prejudicial to the client. *Id.* It is premature to consider whether Spelfogel might be called as a witness in the State Court Action and whether his testimony would be both necessary and likely to be prejudicial to the Committee. *See In re Allied Artists Pictures Corp.*, 17 B.R. 288, 291 (Bankr. S.D.N.Y. 1982) (indicating that a court cannot disqualify counsel on a "mere possibility.")

According to Spelfogel, a vote was taken of the Committee members on whether to

continue Nixon's representation in February 2005. With the exception of Avnet, all members consented to Nixon's continued representation.[7] Avnet points out that consent to Nixon's representation by its client does not cure the conflict which Avnet believes exists. *See In re Thompson*, Case No. 00-00013, 2000 WL 33716961, at * 4 (Bankr. D. Id. March 1, 2000).

The Court has examined the circumstances that exist at this stage in the case. The Court concludes that Avnet has failed to establish an actual conflict. Spelfogel/Nixon are not named as defendants in the State Court action. There are no definitive allegations against them which would cause the Court to conclude that they have a conflict of interest that would impair their representation of the Committee. Accordingly, the Court will deny Avnet's motion. The Court's refusal to disqualify Committee's counsel at this time does not prevent a request at a later time if subsequent events warrant the Court's further consideration. In addition, there is "'the comprehensive disciplinary machinery of the state and federal bar' to remedy alleged ethical violations occurring during the course of ongoing litigation." *Vegetable Kingdom*, 653 F.Supp. at 921-22 (citation omitted). Finally, any attorney's fees sought in connection with Spelfogel/Nixon's representation of the Committee are, of course, subject to notice and a hearing and ultimate approval of this Court while the case in ongoing. The Court notes that Code § 1103(b) expressly provides that an attorney employed by a committee may not "represent any other entity having an adverse interest in connection with the case." 11 U.S.C. § 1103(b). Furthermore, Code § 328(c) allows a court to deny compensation "at any time during such professional person's employment . . . such professional person is not a disinterested person, or

[7] Allegedly, following the vote a three member subcommittee was established to review papers in the State Court Action and to present their recommendations to the full Committee.

represents or holds an interest adverse to the interest of the estate . . . ." 11 U.S.C. § 328.

IT IS SO ORDERED.

Dated at Utica, New York

this 27th day of April 2005

/s/
STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge