

1 WRITTEN DECISION - NOT FOR PUBLICATION

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CLERK, U.S. BANKRUPTCY COURT  
SOUTHERN DISTRICT OF CALIFORNIA  
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8 UNITED STATES BANKRUPTCY COURT  
9 SOUTHERN DISTRICT OF CALIFORNIA

10 In re: ) CASE NO. 05-13794-H11  
11 )  
12 JAMES CECIL HARLAN III ) MEMORANDUM DECISION  
13 and JOANN LYNN HARLAN, )  
14 Debtors. )

15 The United States Trustee ("UST") moved for disgorgement of  
16 fees and costs paid to T. Edward Malpass ("Malpass") for  
17 representation of James Cecil Harlan III and Joann Lynn Harlan  
18 ("debtors") and requested an accounting.

19 At the July 18, 2006, hearing, the Court heard oral  
20 argument, authorized additional briefing,<sup>1</sup> and took the matter  
21 under submission unless grounds were shown that an evidentiary  
22 hearing was needed.

23 At issue is whether this Court should order Malpass to  
24 disgorge all fees and costs that he has received to date, and  
25 deny his fees in total.

26  
27 <sup>1</sup> The Court gave Malpass until August 18, 2006, to file final  
28 declaration and final points and authorities. [see docket #143]. Instead,  
Malpass filed the pleadings with the Court on the September 27, 2006. The  
Court has discretion to consider late filed pleadings and will do so in this  
case. Agate Holdings, Inc. v. Ceresota Mill Ltd. P'ship (In re Ceresota Mill  
Ltd. P'ship), 211 B.R. 315, 318 (B.A.P. 8th Cir. 1997) ("[W]hile a trial court  
may have the discretion to consider a late-filed document where no party  
objects, a party filing an untimely document without an accompanying 9006(b)  
motion does so at its peril.")

1 This Court has jurisdiction to determine this matter  
2 pursuant to 28 U.S.C. §§ 1334 and 157(b)(1) and General Order  
3 No. 312-D of the United States District Court for the Southern  
4 District of California. This is a core proceeding pursuant to  
5 28 U.S.C. § 157(b)(2)(A).

6 I.

7 FACTS

8 Debtors filed their voluntary Chapter 11 petition on  
9 October 14, 2005.

10 A. THE SCHEDULES AND STATEMENT OF AFFAIRS

11 The debtors' Schedule F shows that Ian and Anita Waddell  
12 (the "Waddells") are creditors of this estate. The nature of the  
13 Waddells' claim is described as "[a]ny claims from various LLC  
14 matters, co-debtor claims, co-ownership" and is set forth as  
15 "contingent, unliquidated and disputed." On Schedule H, debtors  
16 listed Ian Waddell as a co-debtor with regard to "La Quinta  
17 Mortgage."

18 The Statement of Financial Affairs ("SFA") shows at  
19 Question No. 9, that Malpass received \$5,000 from debtors on  
20 September 15, 2005. In addition, SFA question no. 9 shows that  
21 the debtors made another payment to Malpass of \$20,843 on  
22 October 10, 2005, just four days before the case was filed.

23 B. MALPASS' ATTEMPTS TO GET EMPLOYED

24 Malpass represents the Wadells in their Chapter 11  
25 bankruptcy case that was filed in the Central District. When the  
26 UST discovered that Malpass represented the Wadells, the UST  
27 "requested that Malpass address the issue in his employment  
28 application and include supporting case law. This issue was

1 initially addressed at the first § 341(a) Meeting of Creditors  
2 held on November 15, 2005." [See docket #97 at 3:18-25]. The  
3 UST also requested that Malpass file a noticed motion for his  
4 employment pursuant to the United States Trustee's Guideline No.  
5 3 and the case of In re Mahoney, Trocki & Assoc., Inc., 54 B.R.  
6 823, 826 (Bankr. S. D. Cal. 1985), since he failed to obtain  
7 employment within thirty days of the filing.

8 On December 20, 2005, almost two months after the filing,  
9 Malpass filed a Notice of Intended Action re: Authorizing Debtors  
10 to Employ the Law Offices of T. Edward Malpass (the "NOIA").  
11 Malpass failed to file either an application or a declaration  
12 with the NOIA. On January 17, 2006, the UST filed an objection  
13 to the NOIA and a hearing was set for March 7, 2006. The UST  
14 expressed concern about Mr. Harlan's testimony at the 341a held  
15 on January 10, 2006, that he paid Malpass \$10,000 from non-estate  
16 assets since the case was filed. [See docket #23 at 2:21-23].  
17 The UST argued that Malpass "has shown a disregard of the  
18 Bankruptcy Code by his failure to obtain employment at the outset  
19 and by his acceptance of \$10,000 on a postpetition basis from the  
20 Harlans without court authorization of his employment and/or  
21 payment." [Id. 3:8-12].

22 On February 21, 2006, Malpass filed a Motion for Employment  
23 of Counsel.<sup>2</sup> The UST opposed the Motion for Employment of  
24 Counsel on several grounds. The UST argued that Malpass had a  
25 conflict of interest that would prohibit his employment. In  
26 addition, the UST argued that even if no conflict existed, this

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27  
28 <sup>2</sup> Malpass also filed an Ex Parte Motion to Set Expedited Hearing and Restrict Notice of Debtor's Motion for Approval of Employment of Counsel (the "ex parte motion"). On February 21, 2006, the Court denied the ex parte motion.

1 Court should not approve any employment on a nunc pro tunc basis  
2 due to Malpass' delay in submitting the motion for employment.

3 U.S. Bank also objected to Malpass' employment. U.S. Bank  
4 noted that Mr. Harlan and Mr. Waddell were guarantors of a  
5 \$4,150,000 secured loan made by Morgan Guaranty Trust Co. of  
6 New York (the predecessor in interest to U.S. Bank) to Market  
7 Square Housing LLC, a Wisconsin LLC, which was not in bankruptcy.  
8 U.S. Bank argued that to the extent its claim was undersecured,  
9 then debtors and the Waddells would have serious issues between  
10 them concerning suretyship and indemnity. U.S. Bank also pointed  
11 out that the creditors and assets for each Chapter 11 were not  
12 the same.

13 On April 7, 2006, the Court continued the hearing regarding  
14 Malpass' employment to May 12, 2006, and directed Malpass to file  
15 a fee application by April 21, 2006. Malpass failed to file his  
16 fee application by that date.

17 C. THE COURT'S OSC AND UST'S MOTION TO DISMISS OR CONVERT

18 On February 6, 2006, this Court issued an Order to Show  
19 Cause Why Case Should Not have a Chapter 11 Trustee Appointed, Be  
20 Dismissed or Converted to a Chapter 7 Proceeding (the "OSC"). On  
21 March 8, 2006, the UST filed a Motion to Dismiss or Convert the  
22 case to Chapter 7. On April 11, 2006, the Court entered an order  
23 directing the appointment of a Chapter 11 trustee. Richard M.  
24 Kipperman was subsequently appointed Chapter 11 trustee (the  
25 "Chapter 11 trustee").

26 Subsequent to the appointment of the Chapter 11 trustee,  
27 Malpass filed a declaration on May 9, 2006, voluntarily  
28 withdrawing the noticed motion regarding his employment "because

1 it was superceded by the appointment of the trustee." [See  
2 docket #80 at 2:11-20].

3 D. POST-PETITION PAYMENTS TO MALPASS

4 The January and March 2006 Operating Reports show \$10,000  
5 payments were made to Malpass from the "personal portion" of the  
6 DIP account. Malpass never filed supplemental 2016(b) statements  
7 for these payments.<sup>3</sup>

8 II.

9 DISCUSSION

10 It is undisputed that Malpass never obtained Court  
11 authorization for his employment even though he acted as the  
12 attorney for the debtors in their capacity as Chapter 11 debtors  
13 in possession from October 14, 2005 until April 11, 2006, when  
14 the Chapter 11 trustee was appointed. It is also undisputed that  
15 Malpass has voluntarily withdrawn his application for employment  
16 contending it is now moot since the Chapter 11 trustee was  
17 appointed. Nonetheless, Malpass seeks to retain fees paid to him  
18 both pre and postpetition since he has been paid by Mr. Harlan's  
19 postpetition income.<sup>4</sup>

20 Malpass argues that neither § 327 nor Federal Rule  
21 Bankruptcy Procedure ("FRBP") 2014 requires court approval for an  
22 attorney to appear and represent debtors in a Chapter 11 case.  
23 [See docket #109 at 1:21-22]. According to Malpass, "attorneys  
24 can perform services and receive payment without the debtor  
25 having obtained an employment authorization under § 327, which

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27 <sup>3</sup> Malpass has been paid \$80,843 from Mr. Harlan. [See docket #100 at  
28 3:15-16].

<sup>4</sup> On February 22, 2006, the UST's Office entered into a stipulation with  
the debtors acknowledging, among other things, that Mr. Harlan's postpetition  
earnings were to be treated as personal services income.

1 may occur between the filing of the case and entry of an  
2 employment authorization order, and in other instances, including  
3 where the employment authorization process is not completed when  
4 a Chapter 11 trustee is appointed in the case, as occurred here."  
5 [Id. 1:27-28; 2:1-2]. Thus, Malpass argues that "lack of an  
6 employment order is not a per se bar to representation or receipt  
7 and retention of payments made by a debtor from non-estate  
8 property." [Id. 2:2-3]. Malpass further argues that §§ 327 and  
9 330 govern employment and payment of professionals paid from the  
10 estate, but "[t]hey are not properly applied to review of  
11 payments made from non-estate property." [Id. 5:19-21].  
12 Malpass maintains that the case of In re Boh! Ristorante, Inc.,  
13 99 B.R. 971 (B.A.P. 9th Cir. 1989) does not stand for the  
14 proposition that employment is required under § 327 when fees are  
15 received from non-estate funds. [See generally docket #150 -  
16 Supplemental Memorandum of Points and Authorities of T. Edward  
17 Malpass In Opposition to United States Trustee's Motion for  
18 Disgorgement of Attorney Fees and Costs filed on September 27,  
19 2006].

20 A. NECESSITY OF EMPLOYMENT

21 Section 327(a) provides that "[t]he trustee...with the  
22 court's approval, may employ one or more attorneys...that do not  
23 hold or present an interest adverse to the estate, and that are  
24 disinterested persons...." Section 327(a) is made applicable to  
25 debtors, as debtors in possession, through §§ 1101(1) and  
26 1107(a).

27 The procedure for obtaining employment is set forth in FRBP  
28 2014(a). Section 327(a) and FRBP 2014 are designed to make

1 certain that an attorney does not have interests adverse to those  
2 of the estate. "The bankruptcy court must ensure that attorneys  
3 who represent the debtor do so in the best interests of the  
4 bankruptcy estate." In re Park-Helena Corp., 63 F.3d 877, 880  
5 (9th Cir. 1995) (finding that Rule 2014(a) "assists the court in  
6 ensuring that the attorney has no conflicts of interest and is  
7 disinterested, as required by 11 U.S.C. § 327(a).").

8 It is well-settled that employment of a professional for a  
9 debtor in possession is a prerequisite to the payment of fees.  
10 Atkins v. Wain, Samuel & Co. (In re Atkins), 69 F.3d 970, 973  
11 (9th Cir. 1995) ("[P]rofessionals who perform services for a  
12 debtor in possession cannot recover fees for services rendered to  
13 the estate unless those services have been previously authorized  
14 by a court order.") (citations omitted); Okamoto v. THC Finc.  
15 Corp. (In re THC Fin. Corp.), 837 F.3d 389, 391-92 (9th Cir.  
16 1988); DeRonde v. Shirley (In re Shirley), 134 B.R. 940, 943-44  
17 (B.A.P. 9th Cir. 1992); McCutchen, Doyle, Brown & Enersen v.  
18 Official Comm. of Unsecured Creditors (In re Weibel, Inc.), 176  
19 B.R. 209 (B.A.P. 9th Cir. 1994). The obligation to obtain court  
20 approval for employment as the attorney for a debtor in  
21 possession remains even though the attorney may receive payment  
22 from non-estate funds. In re Boh! Ristorante, Inc., 99 B.R. 971,  
23 972-73 (B.A.P. 9th Cir. 1989).

24 Malpass argues that the case of Boh! Ristorante confirms  
25 that "§ 327 employment authorization is not required with regard  
26 to representation and payments which are not made from the  
27 bankruptcy estate under section 330." [See docket #109 at 2:22-  
28 27]. The Court has studied Boh! Ristorante at length and cannot

1 find any language that stands for the proposition that an  
2 attorney who receives payment from non-estate funds may  
3 circumvent the requirements of § 327(a). The BAP addressed two  
4 limited issues on appeal in Boh! Ristorante: "1-- whether an  
5 attorney who receives compensation from a third-party, must  
6 obtain authorization for employment under § 327; and 2-- whether  
7 the bankruptcy court abused its discretion in denying all fees to  
8 the appellant." Id. at 972. Thus, the issue of employment under  
9 § 327 when an attorney will receive payment from non-estate funds  
10 was squarely before the appellate court. The Panel ultimately  
11 decided that employment was necessary even when the attorney  
12 received payment from non-estate funds. Nonetheless, the Panel  
13 decided even though the attorney's *nunc pro tunc* employment  
14 request was denied by the bankruptcy court, the "harsh penalty"  
15 of denying all fees "was not justified under these *limited*  
16 *circumstances.*" Id. at 972-73 (emphasis added).

17 In affirming the bankruptcy court's finding that § 327(a)  
18 was applicable to an attorney who receives compensation from a  
19 third party, the Bankruptcy Appellate Panel noted:

20 In support of the bankruptcy court's  
21 application of section 327(a), Bankruptcy  
22 Rule 2014(a) requires that the application  
23 set forth 'any proposed arrangement for  
24 compensation.' Additionally, an important  
25 purpose of an application for employment  
26 pursuant to section 327 is to make certain  
27 that the person sought to be employed does  
28 not hold an interest adverse to the estate.

25 Id. at 972-973.

26 Numerous other courts have also held that the "requirements  
27 of § 327(a) are not conditioned on the attorney's seeking  
28 compensation from the estate under § 330(a)." In re Peterson,

1 163 B.R. 665, 669 (Bankr. D. Conn. 1994).

2 While employment under § 327(a) is a  
3 condition precedent to compensation from the  
4 estate under § 330(a), the requirements of §  
5 327(a) are not conditioned on the attorney's  
6 seeking compensation from the estate under §  
7 330(a). In re Hargis, 148 B.R. 19, 22 (Bankr.  
8 N.D. Tex.1991); In re Rheuban, 121 B.R. 368,  
9 385 (Bankr. C.D. Cal.1990); Land v. First  
10 Nat'l Bank in Alamosa (In re Land), 116 B.R.  
11 798, 805 (D. Colo. 1990) (approval must be  
12 obtained under § 327(a) even where fees are  
13 paid by a third party and not by the estate),  
14 aff'd, 943 F.2d 1265 (10th Cir.1991); In re  
15 Martin, 102 B.R. 653, 658 (Bankr. W. D. Tenn.  
16 1989) ("[T]he mere fact that a professional  
17 receives a retainer cannot be utilized by the  
18 professional as a circumvention of the  
19 Bankruptcy Code's requirement of an approval  
20 of employment...."); In re Boh! Ristorante,  
21 Inc., 99 B.R. 971, 973 (9th Cir. BAP 1989).

22 The Peterson court explained the rationale for the employment  
23 requirement in situations where payment is received from non-  
24 estate funds:

25 A contrary rule would permit attorneys for  
26 the trustee or debtor in possession to avoid  
27 the strictures of § 327(a) and Rule 2014(a)  
28 by demanding a large prepetition retainer and  
never applying to the court for compensation  
post-petition.

29 Id.; 3 Collier on Bankruptcy ¶ 327.03, at 327-16 (15th ed. rev.  
30 2006) ("Prior approval also gives the court an opportunity to  
31 review any conflicts, the professional's competency and the  
32 necessity for the services to be performed."); see also Taylor v.  
33 CSX Transp., Inc. (In re CSX Transp., Inc., 2005 WL 1705636 at  
34 \*4 n.2 (M.D. Ala. 2005) (noting that "Section 327(a) requires  
35 prior approval of the employment of an attorney representing the  
36 debtor even if payment of attorneys fees is not sought as an  
37 administrative expense, but is sought from a third party.")

1 citing In re Land, 116 B.R. 798, 805 (D. Co. 1990, *aff'd* 943 F.2d  
2 1265 (10th Cir. 1991) and In re Boh! Ristorante, Inc., 99 B.R.  
3 971, 972-73 (B.A.P. 9th Cir. 1989); In re W.T. Mayfield Sons  
4 Trucking Co., Inc., 225 B.R. 818, 823 (Bankr. N.D. Ga. 1998)  
5 ("That the attorney may be looking to a third party for payment  
6 is irrelevant to the obligation to obtain court approval.");  
7 Ferrara & Hantman v. Alvarez (In re Engel), 124 F.3d 567, 571  
8 (3rd Cir. 1997) (noting that "any debtor-in-possession must  
9 receive court approval in order to employ an attorney....  
10 Otherwise he is not permitted or authorized to retain counsel.  
11 This is true regardless of the source of compensation for the  
12 attorney so engaged."); 3 Collier on Bankruptcy ¶ 327.03, at 327-  
13 15-327-16 (15th ed. rev. 2006) ("Approval is required even if  
14 the professional is not be compensated from estate funds").

15 The Court concludes therefore that Malpass was required to  
16 seek and obtain an order from this Court authorizing his  
17 employment prior to receiving fees, regardless of their source,  
18 for services rendered to the estate. "Since professionals are  
19 charged with knowledge of the law, there is no unjust hardship in  
20 requiring them to observe the requirements of section 327." In  
21 re McKinney Ranch Assoc., 62 B.R. 249, 252 (Bankr. C.D. Cal.  
22 1986) (citation omitted).

23 An attorney's failure to obtain court authorization for  
24 employment is a sufficient basis for the denial of fees. Atkins,  
25 69 F.3d at 973 ("[P]rofessionals who perform services for a  
26 debtor in possession cannot recover fees for services rendered to  
27 the estate unless those services have been previously authorized  
28 by a court order.") (citations omitted). Because Malpass has

1 voluntarily withdrawn his employment application, this Court  
2 cannot authorize his employment at this late date. See Shapiro  
3 Buchman LLP v. Gore Brothers (In re Monument Auto Detail, Inc.),  
4 226 B.R. 219, 224 (B.A.P. 9th Cir. 1998) (law firm sought to  
5 retain legal fees even though it voluntarily withdrew its  
6 employment application).

7 To the extent Malpass relies on Boh! Ristorante for the  
8 proposition that disgorgement or denial of fees is too harsh a  
9 penalty on an attorney who is receiving payment from non-estate  
10 funds and who has not been employed, the Court finds the reliance  
11 misplaced. Even though the attorney in Boh! Ristorante had not  
12 been employed, the BAP found that the harsh penalty of the  
13 complete denial of fees was "not justified" under the "limited  
14 circumstances." Boh! Ristorante, 99 B.R. at 973. The Panel's  
15 holding was therefore quite narrow. See In re Famous  
16 Restaurants, Inc., 205 B.R. 922, 934 (Bankr. D. Az. 1996) ("[T]he  
17 effect of [Boh! Ristorante] has also been limited."). The Court  
18 can find none of the "limited circumstances" that were present in  
19 Boh! Ristorante applicable to this case, especially in light of  
20 the fact that Malpass is an experienced bankruptcy attorney who  
21 failed to file his motion for employment in a timely manner, and  
22 who also failed to make the appropriate disclosures under FRBP  
23 2016(b) as discussed below.

24 The Court concludes that Malpass' failure to obtain  
25 employment is grounds to order disgorgement. As discussed below,  
26 even if Malpass had not voluntarily withdrawn his motion for  
27 employment, he could not have been employed in any event.

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1           1.     NUNC PRO TUNC

2           The Court cannot find any exceptional circumstances that  
3 would warrant *nunc pro tunc* approval.     Atkins, 69 F.3d at 973.

4           Given that employment is a prerequisite to the receipt of  
5 fees in the Ninth Circuit, it behooves an attorney for a debtor  
6 in possession to seek approval of employment as early as possible  
7 in a bankruptcy case. "While there is no explicit requirement  
8 under section 327(a) or Rule 2014, courts routinely require that  
9 an application for employment be filed with the court prior to  
10 performance of services by the professional sought to be  
11 employed." 3 Collier on Bankruptcy ¶ 327.01[1], at 327-6 (15th  
12 ed. rev. 2006) (emphasis in original). In this district, an  
13 application for employment should be submitted within thirty-days  
14 of the petition date, otherwise an attorney will need to seek  
15 employment with a retroactive effect. See In re Mahoney, Trocki &  
16 Associates, Inc., 54 B.R. 823, 826 (Bankr. S. D. Cal. 1985); see  
17 also United States Trustee Guidelines, Guideline No. 3(B)  
18 (stating that when a professional is seeking employment with a  
19 retroactive effect more than thirty days after the commencement  
20 of services, the application shall be noticed to all creditors).<sup>5</sup>  
21 Other courts also "recognize that circumstances may require a  
22 professional to render services before obtaining court approval"  
23 and, therefore, permit the thirty-day grace period. 3 Collier on

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26           <sup>5</sup> The guidelines are available on the United States Trustee's website  
27 and are available upon request. Guideline No. 3(B) clearly states that "If an  
28 application to employ a professional by the debtor-in-possession ... is made  
more than thirty (30) days after the date of commencement of postpetition  
services by that professional, an explanation of the delay in form of an  
affidavit must accompany the Application." The guideline also states that the  
application seeking an order for *nunc pro tunc* approval must be "noticed to  
all creditors...."

1 Bankruptcy ¶ 327.03[3], at 327-26 n.55 (15th ed. rev. 2006).

2 Malpass failed to file an employment application within the  
3 thirty-day period. [See Transcript dated July 18, 2006  
4 (hereinafter Transcript) 6:14-25; 7:1-25]. The UST informed  
5 Malpass that he because he missed the thirty-day deadline, had a  
6 potential conflict of interest, and was requesting nunc pro tunc  
7 employment, he would have to do a noticed motion for his  
8 employment. [Transcript at 7:19-25]. Nonetheless, Malpass  
9 failed to file a noticed motion, instead filing the NOIA on  
10 December 20, 2005, when this case was over two months old.  
11 Further, Malpass failed to file an application or declaration in  
12 support of the NOIA. It was not until four months after the  
13 filing of the petition that Malpass finally filed a motion to be  
14 employed.

15 Nunc pro tunc approval of employment is limited to  
16 exceptional circumstances where an applicant can show both a  
17 satisfactory explanation for the failure to receive prior  
18 judicial approval and that he or she has benefitted the  
19 bankruptcy estate in some significant manner. Atkins, 69 F.3d  
20 at 973. The Court notes that Malpass has sufficient experience  
21 to know of the Bankruptcy Code's application requirements for his  
22 employment, as well as the existence of the United States Trustee  
23 Guidelines.<sup>6</sup>

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26  
27 <sup>6</sup> Malpass declared that he was admitted to practice law in 1977 and has  
28 concentrated his practice in bankruptcy law since he completed his clerkship  
with the Honorable David H. Patton, Bankruptcy Judge, in the Eastern District  
of Michigan in 1979. Malpass also declared that he is "board certified" in  
business bankruptcy law by the American Bankruptcy Board of Certification and  
am a member of its Board of Directors. Malpass is also certified as a  
specialist in bankruptcy law by the California.

1           A.     SATISFACTORY EXPLANATION

2           Malpass fails to provide a satisfactory explanation for  
3 the almost two-month delay in seeking employment despite his  
4 experience. His only explanation for the delay is that the UST  
5 initially requested that debtors file an application for  
6 employment and subsequently requested that debtors file a noticed  
7 motion. Further, Malpass failed to file his application or a  
8 declaration with the NOIA and it wasn't until the UST objected to  
9 the NOIA that he finally filed a noticed motion. In addition,  
10 the fact that Malpass is a sole practitioner or that the work  
11 load required after the filing required all his attention, are  
12 likewise unsatisfactory excuses for his delay. Malpass seems to  
13 blame the UST for not informing of the deadline to file his  
14 application under Mahoney, Trocki, but it is not the UST's duty  
15 to inform attorneys of the law. [See Decl. of T. Edward Malpass  
16 in Support of Supplemental Memorandum 2:7-10]. In short, Malpass  
17 has failed to provide any satisfactory explanation for his  
18 failure to file an employment application within the initial  
19 thirty-day period.

20           B.     BENEFIT TO THE ESTATE

21           In addition, the Court cannot find that Malpass'  
22 efforts benefitted the estate in any significant manner. If  
23 anything, his repeated delay in getting employed was an important  
24 factor this Court considered when issuing the OSC re the  
25 appointment of a Chapter 11 trustee. Now, the Chapter 11 trustee  
26 has hired counsel and debtors have been forced to hire new  
27 counsel thereby causing more delay and administrative fees to  
28 increase, all to the detriment of the creditors of this estate.

1 C. OTHER FACTORS: CONFLICT OF INTEREST

2 Besides the lack of a satisfactory explanation for the  
3 delay in seeking employment and lack of benefit to the estate,  
4 Malpass must have been qualified for employment pursuant to § 327  
5 during the period for which services were provided. The Court  
6 finds that Malpass was not qualified for employment since he had  
7 a conflict of interest.

8 Section 327(a) authorizes employment of professionals who 1)  
9 do not hold an interest adverse to the estate and 2) are  
10 disinterested persons. In re Wheatfield Business Parks LLC, 286  
11 B.R. 412, 418 (Bankr. C. D. Cal. 2002). "This standard is high:  
12 'If there is any doubt as to the existence of a conflict, that  
13 doubt should be resolved in favor of disqualification.'" Wheatfield,  
14 286 B.R. at 418 (citation omitted). "Where a  
15 bankruptcy debtor is a creditor of a related debtor, it is  
16 presumptively improper for the same attorney (or law firm) to be  
17 general counsel for the related debtors." Id. (citations  
18 omitted). The burden of proof was on Malpass to establish that  
19 he was both disinterested and did not represent an interest  
20 adverse to the estate. See Interwest Bus. Equip., Inc. v. United  
21 States Trustee (In re Interwest Bus. Equip., Inc.), 23 F.3d 311,  
22 318 (10th Cir. 1994).

23 While § 327(c) cautions that the mere representation of a  
24 creditor in a case is not *per se* disqualifying, in this case both  
25 the UST and U.S. Bank objected to Malpass' employment on the  
26 grounds that he had an actual conflict by virtue of his  
27 representation of the Waddells who were listed as creditors of  
28 this estate. The UST argues that the conflict is actual because

1 the Waddells are unliquidated disputed creditors. Also, the  
2 debtors and the Waddells are jointly liable for the same debts,  
3 yet they have different assets. According to the UST, it would  
4 be in the interest of the debtors to have these debts paid by the  
5 Waddells and conversely it would be in the interests of the  
6 Waddells to hold the debtors responsible for these debtors. The  
7 UST also contends that even if there is no actual conflict, the  
8 Court should disapprove Malpass' employment since the conflict is  
9 sufficiently important and there is a strong likelihood that it  
10 will ripen into an actual conflict. Finally, the UST notes that  
11 representation of a potential conflict requires the written  
12 consent of all the creditors in this case as per the directive  
13 set forth in Wheatfield, 285 B.R. at 424.

14 In response to the UST's objections, Malpass argues that the  
15 conflict is "only potential" and that the "mere existence of  
16 joint liability" is not disqualifying. Malpass maintains that  
17 "[t]here is no explanation for why the potential conflict in this  
18 case is significantly different from the conflicts present in  
19 other cases where employment has been authorized" but he fails to  
20 cite any of those cases. Malpass also argues that the notice  
21 provided by the motion to employment is sufficient evidence of  
22 consent of other creditors since none have objected.

23 The Court notes that the alleged conflict of interest is now  
24 actual since the Chapter 11 trustee has abandoned the real  
25 property secured by a lien that was guaranteed by both the  
26 Waddells and Harlans. The real property has since been  
27 foreclosed upon and has resulted in a significant deficiency for  
28 which both the Waddells and the Harlans are liable. Even so,

1 going back to the petition date, the Wheatfield court held that  
2 where a "bankruptcy debtor is a creditor of a related debtor, it  
3 is *presumptively improper* for the same attorney (or law firm) to  
4 be general counsel for the related debtors." Wheatfield, 286 B.R.  
5 at 418 (citations omitted) (emphasis added). The Waddells were  
6 listed on the debtors' schedules as a creditor and, as the UST  
7 pointed out, the interests of the Harlans' and the Waddells' were  
8 not parallel, but conflicting (it would be in the interest of the  
9 debtors to have these debts paid by the Waddells and conversely  
10 it would be in the interests of the Waddells to hold the debtors  
11 responsible for these debtors). Further, both a major secured  
12 creditor and the UST objected to Malpass' employment based on the  
13 conflict. The Court finds therefore that Malpass has not  
14 overcome the presumption that it would be improper for him to  
15 represent the debtors in this case. Finally, consent of all the  
16 creditors, and not just the clients, is necessary under  
17 Wheatfield, which was not obtained.

18 In sum, the Court finds that Malpass is not eligible for  
19 *nunc pro tunc* employment because he has failed to provide a  
20 satisfactory explanation for the delay, has failed to articulate  
21 or demonstrate any benefit to the estate, and has a conflict of  
22 interest that makes him disqualified for employment even if his  
23 application had been timely filed.

24 Because Malpass cannot under any circumstances be employed,  
25 the fees he received must be disgorged and his fees denied in  
26 total.

27 **B. MALPASS FAILED TO MEET THE DISCLOSURE REQUIREMENTS**

28 Besides failing to comply with § 327, Malpass has also

1 failed to comply with FRBP 2016 for multiple payments made by the  
2 Harlans during his representation. Federal Rule Bankruptcy  
3 Procedure 2016(b) provides:

4 Every attorney for a debtor, whether or not  
5 the attorney applies for compensation, shall  
6 file and transmit to the United States  
7 trustee within 15 days after the order for  
8 relief, or at another time as the court may  
9 direct, the statement required by section 327  
10 of the Code....

11 The UST points out that Mr. Harlan made five postpetition  
12 payments to Malpass in the amount of \$10,000 each for a total of  
13 \$50,000 in postpetition payments. These payments were not  
14 disclosed in separate 2016(b) statements.

15 Malpass argues that his 2016(b) statement was completed in  
16 the required form and filed at the time the petition was filed.  
17 Postpetition payments were also disclosed in "reports filed in  
18 the case" and disclosures were made to the U.S. Trustee's  
19 representatives and to the Court on the record at status  
20 hearings. [See docket #109 at 13: 11-28].

21 Even if Malpass relies on § 329 for his fees, he still had a  
22 duty to disclose any and all payments he received from Mr.  
23 Harlan. Those disclosures cannot be buried in reports or  
24 pleadings relating to different matters. Rather, payment and  
25 each agreement must be separately disclosed. "A supplemental  
26 statement shall be filed and transmitted to the United States  
27 trustee within fifteen days after payment or agreement not  
28 previously disclosed." FRBP 2016(b). "A bankruptcy court must  
be certain that an attorney who has filed a Rule 2016(b)  
statement will supplement that statement if further compensation  
is received." Law Offices of Nicholas A. Franke v. Tiffany (In

1 re Lewis), 113 F.3d 1040, 1045 (9th Cir. 1997). According to  
2 Malpass' May 9, 2006, declaration, he is an experienced  
3 bankruptcy attorney. Malpass has failed to offer any explanation  
4 as to why he failed to comply. "An attorney's failure to obey  
5 the disclosure and reporting requirements of the Bankruptcy Code  
6 and Rules gives the bankruptcy court the discretion to order  
7 disgorgement of attorney's fees." Id. at 1045. The bankruptcy  
8 court "has broad and inherent authority to deny any and all  
9 compensation when an attorney fails to meet the requirements of  
10 these provisions." Id. "[D]isgorgement for nondisclosure is  
11 appropriate "irrespective of the payment's source." Id. at 1046  
12 (citation omitted).

13 The Court finds that Malpass' failures to disclose are  
14 additional grounds for disgorgement.<sup>7</sup>

15 C. EVIDENTIARY HEARING

16 Malpass has argued that if the Court takes "further action  
17 on the issues raised" in the UST's motion, he would like an  
18 evidentiary hearing. He also contends that certain issues turn  
19

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20  
21 <sup>7</sup> The UST also argues that Malpass' initial 2016(b) statement shows he  
22 received \$20,839 from the debtors. The 2016(b) statement also showed that  
23 \$839.00 was used as a filing fee. The UST points out that contrary to  
24 Malpass' disclosure regarding prepetition fees, Mr. Harlan paid a total of  
25 \$30,843 prior to the filing of this bankruptcy case. There is a difference of  
26 approximately \$5,000 in what was paid and what was disclosed to the Court.  
27 The UST argues that this money received by Malpass prior to the filing date is  
28 clearly property of the estate to the extent that it is not offset by services  
rendered to the estate. Because the time sheets show \$5,703.75 in services  
rendered to the Harlans and Waddells, the UST argues that at least \$27,148.13  
was held by Malpass when the case was filed for which services were not  
provided. According to the UST, at minimum, this amount should be turned over  
to the Chapter 11 trustee. The Court finds it unnecessary to differentiate  
whether certain funds are or are not property of the estate since the Court is  
finding that all fees received should be disgorged and is denying all  
compensation. The Court also notes that apparently the debtor has entered into  
an agreement with the Chapter 11 trustee that any funds disgorged would be  
used pursuant to the terms of the Chapter 11 plan. [See docket #143].

1 on facts which should be the subject of an evidentiary  
2 presentation.

3 The Court has throughly reviewed the record and the  
4 pleadings in this matter. Several hearings were held regarding  
5 Malpass' employment and the UST's motion, and the issues relating  
6 to both have been fully briefed. Malpass has not proffered any  
7 facts which demonstrate why an evidentiary hearing would be  
8 necessary and the Court cannot find any.

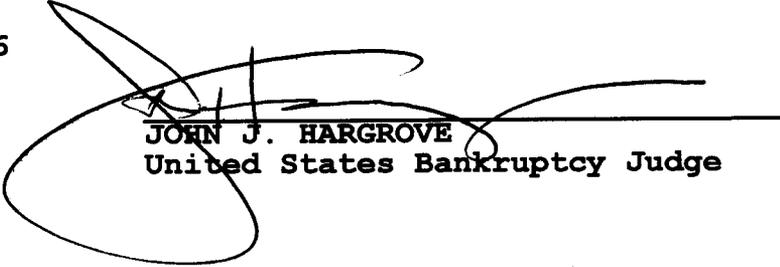
9 III.

10 CONCLUSION

11 For the reasons stated above, the Court grants the UST's  
12 motion to disgorge. No further payment of fees is authorized.  
13 The disgorged funds should be turned over to the Chapter 11  
14 trustee.

15 This Memorandum Decision constitutes findings of fact and  
16 conclusions of law pursuant to Federal Rule of Bankruptcy  
17 Procedure 7052. The UST is directed to file with this Court an  
18 order in conformance with this Memorandum Decision within ten  
19 (10) days from the date of entry hereof.

20  
21 Dated: October 4, 2006

22   
23 JOHN J. HARGROVE  
24 United States Bankruptcy Judge  
25  
26  
27

28 S:\Harlan Disgorgement.wpd