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12-20-05
WRITTEN DECISION ~~ENTERED~~ NOT FOR PUBLICATION

FILED
DEC 19 2005
CLERK U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
BY DEPUTY

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CLERK, U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
BY DEPUTY

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re) CASE NO. 96-12037-H7
)
VERN D. BLANCHARD d/b/a) MEMORANDUM DECISION
AMERICAN MULTI-SYSTEMS,)
)
Debtor.)

Scott A. McMillan ("McMillan"), special counsel for the chapter 7 trustee, filed his application seeking approval of compensation pursuant to a court approved contingency agreement. Debtor Vern D. Blanchard objected.

At issue is whether McMillan's fees should be denied in their entirety because he failed to make all the necessary disclosures under Federal Rule Bankruptcy Procedure ("FRBP") 2014 and was not disinterested at the time he was employed. Also at issue is the reasonableness of his fee request.

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

1 I.

2 FACTS

3 On or about June 2, 1999, James L. Kennedy, the chapter 7
4 trustee, filed an adversary complaint (Adversary No. 99-90357) (the
5 "adversary") against the debtor and others seeking, inter alia to
6 avoid fraudulent transfers and alleging a conspiracy to effect
7 fraudulent transfers. On December 18, 2001, the trustee filed an
8 ex parte application to employ McMillan as special counsel to
9 litigate the adversary after prior counsel withdrew its
10 representation. The trustee's ex parte application stated that
11 McMillan was currently representing a creditor, Apex Wholesale,
12 Inc. ("Apex"), and that such representation did not appear to
13 present a potential or actual conflict. In connection with the
14 application, McMillan filed a declaration regarding his
15 disinterestedness and disclosed that he would continue representing
16 Apex, but made no other disclosures regarding his involvement with
17 Apex.

18 On December 20, 2001, an order was entered approving
19 McMillan's employment as special counsel. The order provided,
20 among other things, that McMillan's compensation was "subject to
21 further court approval after due notice and hearing, and subject to
22 the provisions of Bankruptcy Code sections 328 and 330...." [See
23 Order ¶ 3].

24 After many discovery disputes and several appeals, McMillan
25 obtained a default judgment against the debtor and other defendants
26 on February 3, 2005, in the amount of \$14,631,640. The judgment
27 was entered on March 8, 2005.

28 Thereafter, McMillan began locating assets and executing on

1 the judgment. As part of his collection efforts, he successfully
2 recovered almost one million shares of GameTech stock and real
3 estate, the total value of which exceeds the amount of claims in
4 this estate.

5 The trustee moved for an order determining the liquidation of
6 assets and petitioned the Court for instructions regarding the
7 same. In that motion, the trustee sought to obtain court approval
8 to liquidate only those assets which were necessary to pay the
9 claims in the estate because McMillan's collection efforts resulted
10 in a solvent estate. After the trustee noticed his motion,
11 McMillan objected on the grounds that the trustee had improperly
12 calculated his fees pursuant to his contingency agreement.
13 McMillan maintains that under his contingency agreement he is
14 entitled to 50% of the value of the recovered assets as his fee,
15 regardless of whether they are needed to pay the claims of this
16 estate. McMillan further contends that his contingency agreement
17 is subject to Bankruptcy Code section 328 and, therefore, the Court
18 does not have discretion to review his fees for reasonableness.
19 The trustee's motion was continued to November 17, 2005,¹ to allow
20 McMillan time to file his fee application.

21 The debtor objected to McMillan's fee application on several
22 grounds. He contends that McMillan breached his fiduciary duty
23 because he represented an interest adverse to the estate. Debtor
24 bases his argument on the fact that McMillan was/is an employee of
25 creditor Apex, was/is on the Board of Directors, and was/is an
26 owner or shareholder of Apex, all of which was not disclosed to

27

28 ¹ The Court granted the trustee's motion to liquidate only those assets
necessary to pay claims in this estate.

1 this Court. Thus, debtor alleges that McMillan is not
2 disinterested. Debtor also points out that subsequent to his
3 employment by the trustee, McMillan entered into a contingency
4 agreement with Apex whereby he would be paid by Apex in the event
5 of a recovery. Next, debtor contends that McMillan's fees should
6 be denied because he engaged in bad faith and egregious conduct.
7 Lastly, debtor contends that McMillan's fees should be denied
8 because there was no benefit to the estate and no new assets were
9 recovered.²

10 After considering the pleadings³ and oral argument regarding
11 McMillan's fees, the Court took the matter under submission.

12 II.

13 DISCUSSION

14 A. DEBTOR'S STANDING TO OBJECT TO MCMILLAN'S FEES

15 As an initial issue, it is undisputed that this estate is
16 solvent. As a result, the debtor has standing to challenge
17 McMillan's fee application. See Stoll v. Quintanar (In re Stoll),
18 252 B.R. 492, 495 at n.4 (B.A.P. 9th Cir. 2000).⁴

19 ///

20 ///

21 _____

22 ² The Court does not discuss debtor's arguments regarding whether the assets
23 collected by McMillan are property of this estate because the default judgment is
now a final order.

24 ³ The Court does not consider the brief filed by the debtor on November 21,
25 2005, because it was submitted without leave from this Court and after the hearing
26 on this matter. This Court's local rules do not authorize additional briefing
beyond what is delineated in BLR 9014. Accordingly, the Court grants McMillan's
27 motion to strike the debtor's supplemental pleading. Even if the Court did consider
the debtor's brief, it simply repeats arguments he has already made.

28 ⁴ Defendant CJB Family Trust also filed an objection to McMillan's fee
application. CJB Family Trust is not a creditor of this estate and, therefore, does
not have standing.

1 B. CONFLICT OF INTEREST - DUTY OF FULL DISCLOSURE

2 Section 327(a), which governs the trustee's employment of
3 professionals, provides:

4 (a) Except as otherwise provided in this
5 section, the trustee, with the court's
6 approval, may employ one or more attorneys ...
7 that do not hold or represent an interest
8 adverse to the estate, and that are
9 disinterested persons, to represent or assist
10 the trustee in carrying out the trustee's
11 duties under this title.

12 The disinterested requirement of section 327(a) is subject to
13 two limited exceptions. The first exception applies to a trustee
14 employing a professional that represents a creditor. Section
15 327(c) permits a trustee to employ as counsel non-disinterested
16 persons, if the only reason for the lack of disinterestedness is
17 the attorney's representation of a creditor. Section 327(c)
18 provides:

19 (c) In a case under chapter 7, 12, or 11 of
20 this title, a person is not disqualified for
21 employment under this section solely because of
22 such person's employment by or representation
23 of a creditor, unless there is objection by
24 another creditor or the United States trustee,
25 in which case the court shall disapprove such
26 employment if there is an actual conflict of
27 interest.

28 The other exception occurs in section 327(e) whenever a
trustee seeks to employ a debtor's former counsel for a specified
special purpose by providing that:

(e) The trustee, with the court's approval, may
employ, for a specified special purpose, other
than to represent the trustee in conducting the
case, an attorney that has represented the
debtor, if in the best interest of the estate,
and if such attorney does not represent or hold
any interest adverse to the debtor or to the
estate with respect to the matter on which such
attorney is to be employed.

1 McMillan, who is a creditor's attorney representing a trustee
2 as special counsel for a limited purpose, does not squarely fit
3 within either exception of the disinterestedness requirement under
4 section 327(a). While section 327(e) contemplates employing
5 counsel for a limited purpose, it makes reference only to a
6 debtor's former attorney and does not mention attorneys who
7 represent creditors. Similarly, even though section 327(c)
8 encompasses employing a creditor's attorney as counsel for the
9 trustee, it does not explicitly provide guidance for retaining such
10 an attorney as special counsel.

11 Courts have filled this gap by utilizing the standard found in
12 section 327(e), thereby permitting a creditor's law firm to
13 simultaneously serve as special counsel to the trustee if it does
14 not hold an adverse interest "with respect to the matter on which
15 such attorney is to be employed." Fondiller v. Robertson (In re
16 Fondiller), 15 B.R. 890, 892 (B.A.P. 9th Cir. 1983), appeal
17 dismissed, 707 F.2d 441 (9th Cir. 1983). The Ninth Circuit has
18 stated that "where the trustee seeks to appoint counsel only as
19 'special counsel' for a specific matter, there need only be no
20 conflict between the trustee and counsel's creditor client with
21 respect to the specific matter itself." Stoumbos v. Kilimnik, 988
22 F.2d 949, 964 (9th Cir. 1993) (citations omitted).

23 It is undisputed that with respect to the fraudulent transfer
24 action against the debtor and other defendants, the interests of
25 Apex and the estate coincide: if money is recovered for the estate,
26 Apex would be entitled to its pro rata share. Therefore, there is
27 no conflict between the trustee and McMillan, Apex's counsel.

28 Nonetheless, the debtor argues that McMillan should be denied

1 his fees in their entirety because he did not make complete
2 disclosures regarding his relationship with Apex. Federal Rule
3 Bankruptcy Procedure 2014(a), which requires a verified statement
4 by the professional to be employed, implements section 327. Rule
5 2014(a) provides:

6 The application shall state the specific facts
7 showing the necessity for the employment, the
8 name of the person to be employed, the reasons
9 for the selection, the professional services to
10 be rendered, any proposed arrangement for
11 compensation, and, to the best of the
12 applicant's knowledge, all of the person's
13 connections with the debtor, creditors, any
14 other party in interest, their respective
15 attorneys and accountants, the United States
16 trustee, or any person employed in the office
17 of the United States trustee. The application
18 shall be accompanied by a verified statement of
19 the person to be employed setting forth the
20 person's connections with the debtor,
21 creditors, any other party in interest, their
22 respective attorneys and accountants, the
23 United States trustee, or any person employed
24 in the office of the United States trustee.

25 "This rule assists the court in ensuring that the attorney has
26 no conflicts of interest and is disinterested, as required by
27 [section] 327(a)." Neben & Starrett, Inc. v. Chartwell Fin. Corp.
28 (In re Park-Helena Corp.), 63 F.3d 877, 881 (9th Cir. 1995). "The
disclosure rules are applied literally, even if the results are
sometimes harsh. Negligent or inadvertent omissions 'do not
vitiate the failure to disclose.'" Id. McMillan's alleged failure
to make complete disclosures regarding his connections with Apex is
a ground for denial of compensation wholly apart from the act of
representing conflicting interests. See Film Ventures Int'l, Inc.
v. Asher (In re Film Ventures Int'l, Inc.), 75 B.R. 250, 252
(B.A.P. 9th Cir. 1987) (citation omitted). The court has
discretion whether to deny fees when there is a lack of disclosure.

1 Id. at 253.

2 Prior to McMillan's employment in the fraudulent transfer
3 adversary, the trustee noticed his intent to settle the adversary
4 with the debtor. Apex objected. In his declaration in support of
5 Apex's objection, McMillan states that "I am an officer of creditor
6 Apex Wholesale Inc...." He also declares that he conveyed his
7 willingness to take over the litigation efforts of the trustee's
8 prior special counsel. The debtor filed a reply brief supporting
9 the settlement with the trustee and argued that he had standing to
10 oppose McMillan's employment as special counsel. [See docket #63 in
11 Adversary No. 99-90357]. Debtor argued that McMillan was not
12 disinterested because Apex was a creditor and McMillan was on the
13 Board of Directors. According to debtor, because McMillan was on
14 the Board of Directors, he had a personal stake in estate matters.
15 Debtor argued that in essence, McMillan was the creditor (as
16 opposed to Apex). In response, McMillan maintained that his
17 ownership interest and control in Apex did not create a conflict
18 because he was acting only as special counsel for the trustee. He
19 reiterated that his interests were aligned with those of the estate
20 and other creditors.

21 The Court held several hearings regarding the trustee's motion
22 to compromise the fraudulent transfer adversary and gave the
23 parties additional time to brief several issues. At the November
24 20, 2001, hearing, the Court found that debtor did not have
25 standing to object to McMillan's employment as special counsel.
26 Nonetheless, all the parties and this Court were aware of
27 McMillan's relationship to Apex at that time due to the various
28 pleadings and declarations submitted by both McMillan and the

1 debtor.

2 Even if McMillan failed to make the disclosures alleged by the
3 debtor, those disclosures are irrelevant as to whether McMillan was
4 disinterested or whether he held an adverse interest to the estate
5 when he was being employed as special counsel. There need only be
6 no conflict between the trustee and counsel's creditor client with
7 respect to the specific matter. McMillan's role as a shareholder,
8 officer or employee of Apex would not change the fact that Apex's
9 interests paralleled that of the estate.

10 Moreover, notwithstanding the alleged inadequate disclosures,
11 this Court can exercise its discretion not to deny McMillan's fees
12 on this ground. Film Ventures Int'l, Inc., 75 B.R. at 253. The
13 debtor's position, besides being legally unsound, does not carry
14 much weight with the Court this late in the day. If the Court
15 disallowed McMillan's fees, his efforts to get 100% recovery for
16 the debtor's creditors, besides Apex, would result in a windfall to
17 the debtor since this is a solvent estate. Such a result would be
18 unfair given the circumstances of this case. The adversary has
19 been pending since 1999. There are numerous examples on the docket
20 that show debtor's failure to cooperate with the discovery process
21 which ultimately resulted in the Court granting the default
22 judgment against him. It is only through McMillan's diligence and
23 persistence that he obtained a judgment and collected assets that
24 will result in the debtor's creditors, including Apex, being paid
25 100%, plus interest, on their claims.

26 With respect to McMillan's subsequent contingency agreement
27 with Apex, McMillan has made clear that he is not getting paid for
28 his work in this matter by Apex. There will be no double recovery

1 for McMillan. The Court therefore cannot find that the agreement
2 with Apex creates a conflict.

3 The Court concludes that McMillan is disinterested and did
4 not, and does not, hold an adverse interest to the estate in his
5 special counsel role. Further, the Court finds his disclosures
6 were proper and adequate.

7 C. BAD FAITH AND EGREGIOUS CONDUCT

8 With respect to debtor's arguments regarding McMillan's bad
9 faith and egregious conduct, this Court made several evidentiary
10 rulings at the hearing which will not be repeated here. None of
11 the debtor's evidence offered in support of these arguments was
12 admissible.

13 D. REASONABLENESS OF FEES

14 McMillan contends that section 328 controls his employment
15 and, therefore, the Court may not change the agreement or delve
16 into the reasonableness of his fees. McMillan also argues that he
17 is entitled to 50% of the recovery under his contingency agreement
18 regardless of whether the liquidation of all the assets he
19 recovered will result in a surplus with some monies being returned
20 to the debtor.

21 First, as pointed out at the hearing on this matter, the
22 trustee's ex parte employment application is silent with respect to
23 section 328. The order authorizing the trustee's employment of
24 McMillan states that his compensation is "subject to court approval
25 after due notice and a hearing, and subject to the provisions of
26 Bankruptcy Code sections 328 and 330,...." Thus, the order while
27 purporting to base the fees on section 328, also provided the Court
28 discretion to review the reasonableness of the fees pursuant to

1 section 330. Because the order is ambiguous as to which Code
2 section applies, it is subject to review under section 330. See
3 The Circle K Corp. v. Houlihan, Lokey, Howard & Zukin, Inc. (In re
4 Circle K Corp.), 272 F.3d 1150 (9th Cir. 2001) opinion amended and
5 superseded on denial of rehearing by, 279 F.3d 669 (9th Cir. 2002)
6 (finding that unless a professional's retention application
7 unambiguously specifies that it seeks approval under section 328,
8 it is subject to review under section 330); see also In re Campos,
9 166 B.R. 914, 916-17 (N.D. Cal. 1994) (Where it is ambiguous
10 whether the parties intended to limit the bankruptcy court's
11 authority in awarding attorneys' fees, the bankruptcy court is
12 permitted to authorize a reasonable fee pursuant to 11 U.S.C.
13 section 330). Therefore, the Court can exercise its discretion and
14 review the reasonableness of McMillan's fees.

15 McMillan's argument that he is entitled to fees totaling 50%
16 of the total value of the assets recovered is unreasonable for
17 several reasons. Section 704(1) of the Code specifies that two of
18 the Chapter 7 trustee's primary duties are to liquidate assets of
19 the estate and to close the estate as expeditiously as is
20 compatible with the best interests of parties in interest. This
21 Court has previously found that the trustee's duty to expeditiously
22 close the estate is his "main" duty. In re Riverside-Linden Inv.
23 Co., 85 B.R. 107, 111 (Bankr. S.D. Cal. 1988) aff'd 925 F.2d 320
24 (9th Cir. 1991). According to the trustee, the liquidation of the
25 GameTech stock will be sufficient to pay all claims and
26 administrative expenses. In fact, in a competitive bidding process
27 in this Court on November 17, 2005, the trustee sold the stock to
28 three purchasers, some for over the initial bid. Therefore, it is

1 likely that there may be a surplus estate. The debtor's
2 entitlement to surplus property or equity is not a claim under
3 section 101(5). Thus, any further liquidation of assets recovered
4 by McMillan will be beyond the trustee's duties.

5 Further, the Court must evaluate the reasonableness of
6 McMillan's fees under the standards set forth in section 330(a)(3).
7 Under section 330(a)(3)(C) the Court should examine whether
8 McMillan's services were necessary to the administration of, or
9 beneficial at the time at which the service was rendered toward the
10 completion of, a case under this title. Those assets recovered
11 whose value exceeds that of the claims in this case aren't
12 necessary to the administration of the estate.

13 McMillan was employed by the trustee who represents the
14 interests of the estate. An attorney for the trustee is not
15 working to recover assets simply to pay his own fees. Implicit in
16 the contingency agreement between the trustee and McMillan is that
17 he is entitled to fees only for that property which is being
18 liquidated for the benefit of the creditors of this estate.

19 The Court finds that a reasonable fee for McMillan would equal
20 50% of the proceeds necessary to pay creditor claims, with
21 interest, exclusive of McMillan's own fees. Further, the amount of
22 \$11,000 which was previously awarded in favor of a third party and
23 against this estate because of McMillan's actions regarding the
24 improper filing of a lis pendens should be deducted. The Court
25 leaves it up to the trustee to calculate the exact dollar amount.

26 The Court finds that debtor's arguments regarding no benefit
27 to the estate are without merit. McMillan was successful in his
28 efforts in the fraudulent transfer adversary by receiving a

1 judgment and collecting assets which are sufficient to pay 100%,
2 plus interest, of the claims in this estate. This outcome is the
3 direct result of McMillan's efforts.

4 III.

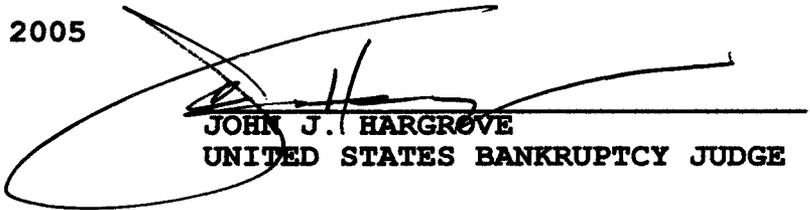
5 CONCLUSION

6 For the reasons noted above, the Court finds that McMillan did
7 not, and does not, hold an adverse interest to this estate and has
8 at all times throughout this adversary proceeding remained
9 disinterested. The Court also finds that McMillan made the
10 appropriate disclosures under FRBP 2014(a).

11 The Court finds that McMillan's fees are subject to a
12 reasonableness review because the order authorizing his employment
13 is ambiguous as to whether section 328 or section 330 applies.
14 After reviewing the fees, the Court finds that McMillan is entitled
15 to receive 50% of the proceeds necessary to pay creditor claims
16 plus interest and administrative expenses exclusive of his own
17 fees, minus \$11,000.

18 This Memorandum Decision constitutes findings of fact and
19 conclusions of law pursuant to Federal Rule of Bankruptcy Procedure
20 7052. Counsel for the trustee is directed to file with this Court
21 an order in conformance with this Memorandum Decision within ten
22 (10) days from the date of entry hereof.

23
24 Dated: December 19, 2005

25 
26 JOHN J. HARGROVE
27 UNITED STATES BANKRUPTCY JUDGE
28