

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
CUTTY'S, INC., : Case No. 89-1097-C H
Debtor. : Chapter 11
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**ORDER--HEARING ON APPLICATION FOR ALLOWANCE
OF COMPENSATION AND EXPENSES**

On September 17, 1990, a hearing was held on the application for allowance of compensation and expenses. The following attorneys appeared on behalf of their respective clients: John H. Neiman, John Stone and L. Jay Irwin III for Neiman, Neiman, Stone and Spellman ("Neiman Firm"); Terry L. Gibson as Assistant U.S. Trustee; and Roger Kuhle for Lease America. At the conclusion of said hearing, the Court took the matter under advisement and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A). The Court, upon review of the pleadings, arguments of counsel, evidence admitted and briefs submitted now enters its findings and conclusions pursuant to Fed.R.Bankr. 7052.

FINDINGS OF FACT

1. Debtor filed a voluntary Chapter 11 petition on May 17, 1989.

2. Debtor filed its application to employ the Neiman Firm with the filing of the petition. Attached to the application to employ the Neiman Firm was an affidavit from the law firm as required by Fed. R. Bankr. P. 2014. The affidavit, signed by attorney John H. Neiman, asserted that the Neiman Firm "has no connection with the above-named debtor, debtor's creditors, or any other party in interest herein, except as an attorney for debtor previously rendering legal services."

3. The Court approved the Debtor's employment of the Neiman Firm.

4. On June 5, 1989, the Debtor-in-Possession filed its Statement of Financial Affairs indicating that it had paid a retainer of \$10,000.00 to the Neiman Firm for its representation in this Chapter 11 proceeding.

5. An Attorney Fee Disclosure Statement was also filed by the Neiman Firm on June 5, 1989, as required by Fed. R. Bankr. P. 2016(b). This statement indicated that the Debtor-in-Possession agreed to pay a \$10,000.00 retainer to the law firm, but the retainer had not been paid as of that date.

6. The Statement of Financial Affairs and the schedules filed by Debtor-in-Possession on June 7, 1990, with subsequent amendment June 15, 1990, indicate that one of the creditors in this Chapter 7 case is an entity known as Guardian Credit Company ("Guardian"). Guardian holds all of the outstanding preferred stock of Debtor which it obtained in August of 1988

in a transaction with Debtor's former principal and controlling shareholder, Richard J. Cutler.

7. The Neiman Firm filed an Application for Interim Allowance for Attorney Fees and Expenses on August 14, 1989. The application sought the approval of fees and reimbursement of expenses totaling \$21,122.58 for services rendered during the period of May 23, 1989 through August 9, 1989. The application further stated that the Neiman firm held \$7,090.25, which represented the balance of a retainer paid by the Debtor-in-Possession, which could be applied to the \$21,122.58 sought by the Neiman firm. No objections to said application were filed and the Court entered an order approving the application on September 12, 1989.

8. The Neiman Firm filed a Second Application for Interim Allowance of Attorney Fees and Expenses, requesting the approval of additional fees and expenses totalling \$48,804.51 for services rendered from August 10, 1989 through April 6, 1990.

9. The U.S. Trustee filed its Objection to the Second Application for Interim Allowance for Attorney's Fees and Expenses. The U.S. Trustee objection principally objected to the payment of over \$12,000.00, which concerned fees and expenses incurred in the preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement, on the grounds that the Disclosure Statement and Amended Disclosure Statement were inadequate.

10. John H. Neiman filed a response to the U.S. Trustee's objection. Paragraph 2 of the response stated:

The firm of Neiman, Neiman, Stone and Spellman, P.C., received a \$10,000.00 retainer from Guardian Credit Corporation at the time it was employed. Prior to May 17, 1989, the firm and in particular John H. Neiman, performed services and incurred expenses in the amount of \$2,909.75, leaving a balance in the retainer of \$7,090.25. Approximately July 10, 1989, the law firm received an additional \$10,000.00 from Guardian Credit Corporation. On August 14, 1989, applicant filed an application for interim allowance requesting allowance through August 9, 1989, of \$18,252.25 in fees and \$2,870.33 in expenses, a total of \$21,122.58. After the order of Judge Hill was entered September 12, 1989, allowing said application, the balance in the retainer furnished by Guardian Credit Corporation of \$7,090.25 plus the additional \$10,000.00 retainer received from Guardian Credit Corporation being a total of \$17,090.25 was applied on the fees and expenses allowed by order of court dated September 12, 1989, leaving a balance outstanding on the fees allowed on that order of \$4,032.33.

11. U.S. Trustee filed an amended and substituted objection to the Second Application for Allowance of Compensation and Expenses on August 20, 1990. The U.S. Trustee reasserted its objection to the \$12,000.00 in fees and expenses concerning the preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement; the payment of Neiman Firm fees and expenses for Debtor by Guardian; and, the failure of the Neiman firm to disclose such payments.

12. Counsel for Debtor-in-Possession disclosed on August 30, 1990, that Cutty's did not have the required funds for an advance as required by counsel. Guardian agreed to loan funds

to Cutty's for the advance under an existing pre-petition loan agreement by and between Cutty's, Guardian, and United Federal Savings Bank of Iowa. Cutty's delivered the advance to counsel after Cutty's received the funds from Guardian.

13. The Second Amended Plan of Reorganization was confirmed on January 16, 1991. U.S. Trustee approved said order of confirmation as to form and content. Paragraph 13 of the Order Confirming Plan provides that Guardian will be infusing a total of approximately \$75,000.00 in additional capital to Debtor. This capital contribution will pay the administration expense of Debtor's attorneys. (Second Amended Plan of Reorganization With Amendments and Modifications ¶4.23).

DISCUSSION

I. Conflict of Interest and Disclosure

The initial issue is whether the Neiman Firm's connections with Guardian disqualify the Neiman firm from representation of the Debtor and provide cause for denial of compensation for services and reimbursement of expenses. 11

U.S.C. §327(a) provides:

- (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent any interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties

under Title 11.

11 U.S.C. §328(c) provides that the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under 11 U.S.C. §327 if, at any time during such professional person's employment under 11 U.S.C. §327, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

The U.S. Trustee does not specifically assert that the Neiman firm represents Guardian. However, the U.S. Trustee asserts that the payment of fees to the Neiman Firm for Debtor by Guardian, and the failure of the Neiman Firm to disclose such payments, results in the Neiman Firm appearing to hold an interest adverse to the bankruptcy estate and disqualifies the Neiman Firm from eligibility to represent the Debtor under the disinterested standard of 11 U.S.C. §327(a).

As U.S. Trustee asserts in its brief, the facts of the instant case are somewhat confused and clouded due to the lack of candor on the Neiman Firm's part to properly disclose the receipt and source of moneys that it has received for services rendered to the Debtor. However, the Second Amended Plan of Reorganization With Amendments and Modifications, and the order confirming Debtor's Second Amended Plan of Reorganization, clarify that Guardian is infusing additional capital into Debtor which will pay the administration expense

of Debtor's attorneys, the Neiman Firm. Because the payments from Guardian are a capital contribution to Debtor for payment of attorney fees, the Neiman Firm does not represent Guardian, the Neiman Firm meets the qualification standards of 11 U.S.C. §327(a), and the Court refuses to deny allowance of compensation and reimbursement of expenses pursuant to 11 U.S.C. § 328(c).

U.S. Trustee asserts that the Neiman Firm's failure to disclose the payment of Neiman Firm fees and expenses for Debtor by Guardian warrants denial of fees sought in the April 11, 1990 Application for Attorney Fees and Expenses and disgorgement of all fees previously received by the Neiman Firm. Fed.R.Bankr.P. 2014(a) provides:

- (a) An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to 11 U.S.C. §327 or 11 U.S.C. §1103 shall be made only on application of the trustee or committee, stating the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants. The application shall be accompanied by a verified statement to the person to be employed setting forth the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants.

In In re Rose Way, Inc., Double-D Leasing, Inc., Double-D, Inc., slip op. Nos. 89-1273, 89-1274, 89-1275 (Bankr. S.D. Iowa March 21, 1990), this Court stated its position, in conformance with In re Pierce, 809 F.2d 1356 (8th Cir. 1987), that a violation of the disclosure requirements of Fed. R. Bankr. P. 2014(a) constitutes a separate ground for denying attorney fees. In the instant case, because the payments from Guardian are a capital contribution to Debtor for payment of attorney fees, the Neiman Firm does not represent Guardian and the Neiman Firm meets the qualification standards of 11 U.S.C. § 327(a). Thus, although the Neiman Firm confused and clouded the facts due to its lack of straightforwardness and

directness, the Court finds that the Neiman Firm did not violate the disclosure requirements of Fed. R. Bankr. P. 2014.

Therefore, the Court refuses to deny fees sought in the April 11, 1990 Application for Attorney Fees and Expenses and disgorge all fees previously received by the Neiman Firm.

The Neiman Firm has also shown a lack of directness in disclosing two \$10,000.00 retainers received from Guardian.

11 U.S.C. §329(a) provides:

- (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.

Fed.R.Bankr.P. 2016(b) provides:

- (b) Every attorney for a debtor, whether or not the attorney applies for compensation, shall file with the court within 15 days after the order for relief or at any other time as the court may direct, a statement required by 11 U.S.C. §329 including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the

attorney's law firm shall not be required. A supplemental statement shall be filed within 15 days after any payment or agreement not previously disclosed.

The Court is disturbed by the conflicting statements contained in Debtor's Statement of Financial Affairs and Attorney Fee Disclosure Statement required by Fed. R. Bankr. P. 2016(b) concerning the initial \$10,000.00 retainer, and the Neiman Firm's failure to disclose the July 10, 1989 \$10,000.00 payment in a supplemental statement required by Fed. R. Bankr. P. 2016(b). Failure to meet these disclosure requirements is, of itself, sufficient justification to require the return of fees. See In re Land, 116 B.R. 798, 804 (D. Co. 1990); In re Kero-Sun, Inc., 58 B.R. 770, 777-81 (Bankr. D. Con. 1986). However, because the Neiman Firm did disclose the existence of the retainers, albeit indirectly, the Court refuses to deny fees to the Neiman Firm.

The Court notes that it accepts John H. Neiman's assertion in the May 29, 1990 response to U.S. Trustee's objection that the \$2,909.75 in services and expenses were incurred pre-petition. Prior court approval under 11 U.S.C. § 327(a) is not necessary as to pre-petition services. Kressel v. Kotz, 34 B.R. 388 (D. Minn. 1983), aff'd in Kotz v. Westphal, 746 F.2d 1329 (8th Cir. 1984). However, as indicated by 11 U.S.C. § 329 and Fed. R. Bankr. P. 2017, the compensation drawn for such pre-petition services and costs is subject to court scrutiny and must be reasonable. Matter of

Independent Sales Corp., 73 B.R. 772, 779 (Bankr. S.D. Iowa 1987); Kressel v. Kotz, 34 B.R. at 392. See also In re Rose Way, Inc., Double-D, Inc. Double-D Leasing, Inc., slip op Nos. 89-1273, 89-1274, 89-1275 at p. 10 (Bankr. S.D. Iowa March 21, 1990). Thus, the Neiman Firm should have disclosed the pre-petition payment of \$2,909.75 in fees and expenses in the June 5, 1989 Attorney Fee Disclosure Statement also.

II. Fees and Expenses Incurred in the Preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement

Fed. R. Bankr. P. 2016 requires an applicant seeking interim or final compensation for services from the estate, or reimbursement of necessary expenses, to provide a detailed statement of services rendered, time expended, expenses incurred, and the amounts requested. The adequacy of a fee application in this district is governed by those guidelines set forth in Matter of Pothoven, 84 B.R. 579 (Bankr. S.D. Iowa 1988).

An attorney can only be compensated for services which are actual and necessary professional services for the trustee based on "the nature, the extent, and the value..." of the services; "the time spent on" the services; and "the cost of comparable services" in a case other than bankruptcy. The awarded compensation must be "reasonable." 11 U.S.C. §330(a)(2). The court may also award "reimbursement for actual, necessary expenses." 11 U.S.C. §330(a)(2).

Benefit to the estate, while not the sole criterion, is a relevant factor in determining reasonable compensation. Matter of Urban American Development Co., 564 F.2d 808, 810 (8th Cir. 1977); In re Tamarack Trail Co., 25 B.R. 259 (Bankr. S.D. Ohio 1982); In re Rosen, 25 B.R. 81 (Bankr. D.S.C. 1982); In re Zweig, 35 B.R. 37 (Bankr. N.D. Ga. 1983); In re Jordan, 54 B.R. 864 (Bankr. D.R.I. 1985). Attorney compensation should be reasonable and based upon the time, the complexity of the matter, the extent and value of such services, and the compensation to be expected for comparable nonbankruptcy services. In re McCombs, 751 F.2d 286, 287 (8th Cir. 1984).

Courts have disallowed or reduced fees requested by an attorney where the attorney services were of reduced or no benefit to the estate. See, e.g., In re Tamarack Trail Co., 25 B.R. 259 (Bankr. S.D. Ohio 1982) (Disallowed a portion of the fees requested by the debtor's attorney on the grounds that the services rendered in connection with the plan, which was ultimately rejected by the creditors, was of reduced benefit to the estate); In re Zweig, 35 B.R. 37 (Bankr. N.D. Ga. 1983) (Allowed compensation to debtor's attorney only for those services which benefitted the estate and not for those which were personal to the debtor in his individual capacity); In re Nelson, 96 B.R. 868 (Bankr. C.D. Ill. 1989) (Compensation reduced where much of attorney's time and labor was not required in that debtors had stubbornly fought for reorganization even though from the very beginning debtors had

been advised against reorganization in favor of liquidation and even though creditor at one point had proposed partial liquidation which would have permitted debtors to continue farming on reduced scale).

In the instant case, the U.S. Trustee objects to the payment of over \$12,000.00 in fees and expenses incurred in the preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement, on the grounds that the Disclosure Statement and Amended Disclosure Statement were inadequate. On May 29, 1990, the Court approved Debtor's Second Amended Disclosure Statement. On January 16, 1991, the Court entered an order confirming Debtor's Second Amended Plan of Reorganization. Due to the approval of Debtor's Second Amended Disclosure Statement and Confirmation of Debtor's Second Amended Plan of Reorganization, the Court is satisfied that fees and expenses incurred in the preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement benefitted the estate. The U.S. Trustee's objection to the \$12,000.00 in fees and expenses incurred in the preparation of the Debtor's Disclosure Statement and Amended Disclosure Statement is denied.

ORDER

IT IS ACCORDINGLY ORDERED that the Second Application for Allowance of Compensation and Expenses is approved.

IT IS FURTHER ORDERED that the U.S. Trustee's Amended and

Substituted Objection to the Second Application for Allowance
of Compensation and Expenses is denied.

Dated this 29th day of March, 1991.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE