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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

NORTHERN BUILDING SUPPLY,

No. 97-12487

Debtor(s).

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Memorandum on Objections to Compensation of Counsel for Debtor

This case was filed in 1997 as a Chapter 11. It was converted to Chapter 7 that same year when debtor Northern Building Supply was not able to confirm a plan of reorganization.

While the case was in Chapter 11, Philip M. Arnot was appointed counsel for the debtor. He has filed a fee application seeking \$8,397.00 in fees and \$133.21 in expenses for services rendered while the case was in Chapter 11, less a \$4,000.00 retainer. The U.S. Trustee has objected and seeks recovery of all fees paid to Arnot in the case. The U.S. Trustee has raised a number of grounds for objection which the court finds are either not supported by the record or not grounds for objection as a matter of law.

A. Pre-conversion Conduct

The debtor is a general partnership. The U.S. Trustee has alleged that Arnot is not entitled to compensation because his services benefitted the individual partners and were not in the best interests of the bankruptcy estate and because Arnot engaged in a conspiracy to conceal prepetition transfers to insiders. While both of these allegations are very serious, and would merit forfeiture of fees if the court found them to be true, the record does not come close to substantiating these allegations or even justifying further hearings.

The U.S. Trustee has pointed to no specific time entries for services which were for the benefit

1 of the individual partners rather than the estate. A review by the court finds no such entries. The mere
2 fact that the partners would have benefitted from confirmation of a plan does not mean that Arnot was
3 working against the interests of the bankruptcy estate. Arnot's fees were modest and directly related to
4 preservation of the estate and reorganization.

5 While undisclosed transfers may have come to light, the U.S. Trustee has produced no evidence
6 that Arnot knew about the transfers and intentionally omitted them from the schedules. His declaration
7 that the schedules revealed the information he was given is un-rebutted. Debtor's counsel is not
8 responsible for mis-statements in schedules absent evidence that he knew about them, and is not expected
9 to be a policeman of the debtor's conduct. *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 458
10 (D.Utah 1998). *In re Dieringer*, 132 B.R. 34, 36 (Bankr.N.D.Cal.1991).

11 12 B. Post-conversion Conduct

13 The remainder of the U.S. Trustee's objections relate to Arnot's post-conversion conduct. His
14 fee application does not seek compensation for post-conversion services. However, the U.S. Trustee
15 argues that his conduct was unethical and warrants a forfeiture of fees. There are no factual disputes
16 about Arnot's post-conversion activities; Arnot's conduct is clear but the legal ramifications are
17 disputed.

18 After conversion to Chapter 7, the case trustee, Linda Scheutte, filed suit against the general
19 partners to recover enough funds to pay all creditors. Arnot appeared as attorney for the partners and
20 filed an answer on their behalf. Then, also acting on behalf of the partners, Arnot contacted the creditors
21 directly and negotiated the compromise of the claims in return for payment by the partners. Then, acting
22 as attorney for the debtor, Arnot filed objections to the claims on the grounds that the claim had been
23 "satisfied by third parties." By this method, most of the claims were eliminated and the partners were
24 able to settle the trustee's suit against them by paying the costs of administration.

25 Both the U.S. Trustee and Arnot appear to have staked out erroneous legal positions. The court
26 will address them in turn before trying to make sense of the case.

1 Arnot argues that after conversion to Chapter 7 his role as attorney for the debtor terminated and
2 he solely represented the partners, as he was free to do. However both the file and the law belie this
3 position. The file is full of pleadings Arnot filed after conversion on behalf of the debtor, including
4 numerous objections to claims. Moreover, an attorney for a Chapter 11 debtor continues to be the
5 debtor's counsel after conversion to Chapter 7, and may even be eligible for fees from the estate for
6 services which benefitted the estate. *In re Smith*, 305 F.3d 1078 (9th Cir. 2002). Arnot's argument that
7 after conversion he represented only the partners is disingenuous and not supported by the law; he was
8 clearly engaged in dual representation.

9 On the other hand, the position of the U.S. Trustee that the debtor and Arnot continued to have a
10 fiduciary duty to the estate after conversion is equally flawed. Once the case is converted,
11 representation of the estate is solely in the hands of the Chapter 7 trustee. *In re Eisen*, 31 F.3d 1447,
12 1451 n. 2 (9th Cir.1994). A Chapter 7 debtor is not a debtor in possession; its attorney owes no duty to
13 the estate and may represent the debtor in disputes against the estate.

14 The court finds equally flawed the U.S. Trustee's arguments that there is anything inherently
15 wrong with partners buying up claims from creditors at a discount. There is no disclosure requirement
16 in Chapter 7, as there is in Chapter 11. Claims in bankruptcy are freely transferrable, and the court has
17 no business paternally scrutinizing transfers to make sure that the transferors have made the best possible
18 deal. Rule 3001(e) of the Federal Rules of Bankruptcy Procedure was amended in 1991 to limit the
19 terms of transfers of claims and undo those prior cases which authorized courts to monitor the manner in
20 which claims are transferred. *In re Olson*, 120 F.3d 98, 101 (8th Cir. 1997). There is no reason for the
21 court to look for some excuse to second-guess the judgment of the claimholders in this case, who were
22 almost all business trade creditors and many of them were represented by attorneys.¹

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25 ¹If Arnot or anyone else made misrepresentations to induce the creditors to compromise their
26 claims, they are of course liable for garden variety fraud under state law. The U.S. Trustee has no
standing to litigate those claims on behalf of the creditors, and this court has no jurisdiction over such
claims. See *In re Hunter*, 66 F.3d 1002, 1005-06 (9th Cir.1995).

1 The only unanswered question is whether Arnot violated any ethical rules by his dual
2 representation of the debtor and its partners after conversion. The court is hard-pressed to see why it
3 needs to address this issue. From a legal standpoint, everyone in this case is happy with the exception of
4 the U.S. Trustee. The creditors have all received the payment they agreed to accept. The partners have
5 avoided personal bankruptcy. The trustee has been paid in full. Nobody except the U.S. Trustee has
6 objected to Arnot's fees, which are modest and will not reduce the payments to the creditors or the
7 trustee. The only beneficiaries of disallowance would be the partners themselves, who are apparently
8 happy with Arnot's services. Deciding the propriety of the dual representation is pointless. The court
9 will accordingly abstain from dealing with it, without prejudice to the rights of any party.

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11 C. Conclusion

12 The objections of the U.S. Trustee will be overruled, without prejudice to any other party.
13 Arnot's fees and expenses will be allowed as filed. Arnot shall submit an appropriate form of order.

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18 Dated: February 13, 2003

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20 Alan Jaroslovsky
21 U.S. Bankruptcy Judge
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