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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re:	Bankruptcy Case No. 01-32123-TC
AT COMM CORPORATION, a Delaware corporation, aka @Comm Corporation, fka Xiox Corporation,	Chapter 11
Debtor.	

MEMORANDUM RE FIRST, SECOND AND FINAL, AND SUPPLEMENTAL FEE APPLICATIONS OF MURRAY & MURRAY AND WILSON, SONSINI, GOODRICH & ROSATI

A regularly scheduled hearing on final allowance of the first interim fee applications, the second and final fee applications, and the supplemental fee applications of Murray & Murray and Wilson, Sonsini, Goodrich and Rosati was held on July 14, 2003 at 9:30 a.m. Janice M. Murray appeared for Applicant Murray & Murray (M&M). Thomas C. Klein appeared for Applicant Wilson, Sonsini, Goodrich & Rosati (WSGR). Maureen McQuaid appeared for Debtor. Richard A. Rogan appeared for the Official Committee of Unsecured Creditors. Margaret H. McGee appeared for the United States Trustee.

INTRODUCTION

M&M filed its First Interim Fee Application on October 21, 2002, seeking $235,144[1] in fees and $11,558 in expenses incurred between August 14, 2001 and September 30, 2002. M&M seeks final approval of these fees and expenses, which were awarded on an interim basis in the amounts sought on November 18, 2002 after notice and an uncontested hearing. M&M also seeks final allowance of $66,234 in fees and $6,506 in expenses incurred between October 1, 2002 and March 20, 2003, as set forth in its Second and Final Fee Application filed on March 26, 2003. Finally, M&M seeks final allowance of $17,733 in fees and $565 in expenses, pursuant to its Supplement to the Second and Final Fee Application, filed on June 23, 2003, for fees and expenses incurred from March 21, 2003 through June 22, 2003 in defending objections to the final allowance of M&M's fees.

WSGR filed its First Interim Fee Application on October 21, 2002, seeking $130,123 in fees and $1,175 in expenses incurred between August 14, 2001 and August 31, 2002. WSGR seeks final approval of these fees and expenses, which were awarded on an interim basis in the amounts sought on November 18, 2002 after notice and an uncontested hearing. WSGR also seeks final allowance of $48,277 and $171 in expenses incurred between September 1, 2002 and December 31, 2002, as set forth in its Second and Final Fee Application filed on March 28, 2003. Finally, WSGR seeks final allowance of $40,259 in fees and $663 in expenses incurred between January 1, 2003 and June 19, 2003. Of

[1] The totals are rounded to the nearest dollar amount.

the amounts sought by WSGR in its Supplemental Fee Application, $28,975 is related to the fee dispute,[2] and $1,112 is related to the Second and Final and Supplemental Fee Applications.[3]

Debtor, the Unsecured Creditors Committee, and the United States Trustee filed objections to final allowance of the fees provisionally awarded and to the fees sought in the Second Fee Applications. Debtor and the Creditors Committee also filed objections to the Supplemental Fee Applications. These objections are discussed below.

BASIC FACTS OF CASE

Debtor was initially incorporated as a California corporation in 1982, became a publicly held company in February 1986, and was subsequently reincorporated in Delaware in April 1987. Debtor is in the business of developing and marketing telephone management systems, call accounting systems, and related customer maintenance and support.

During September and October 1997, Debtor raised $3,000,000 in a private placement of stock. Debtor raised over $9.5 million in September and October 1998 through the issuance of a Series A preferred, convertible stock. During 1999, Debtor raised approximately $7.5 million through the issuance of its Series B preferred, convertible stock to fund the development of a new product line. In a second closing in February 2000, Debtor sold an additional $12.9 million of its Series B preferred stock. In December 2000, Debtor sold $9 million of its Series C preferred,

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[2] This includes a voluntary $5,000 reduction.

[3] This also includes a voluntary $5,000 reduction.

convertible stock. As of the petition date, Debtor had approximately 374 shareholders, not including shareholders for whom shares were held in street accounts and whose names were not otherwise publicly available.

For its fiscal year ending December 31, 2000, Debtor had revenues of $5 million, and a net loss of $19.7 million. Debtor experienced a net loss of approximately $15 million for the first half of 2001. As of July 31, 2001, two weeks before Debtor filed bankruptcy, Debtor had assets of $2.3 million, liabilities of $7.3 million, and an accumulated deficit of approximately $51.4 million. Debtor's balance sheet as of October 31, 2002 lists assets of $1.1 million and liabilities of $7 million.

Debtor's Amended Disclosure Statement, filed on November 12, 2002, identifies the following claim amounts and priorities: administrative claims: $1,136,567; secured claims: $0; tax claims: $28,000; non-employee priority claims: $0; non-WARN Act employee claims: $19,366; settled WARN Act Claims ($15,000 priority, $25,000 administrative claim to counsel, and $120,000 general unsecured claim); and $5.7 million general unsecured claims according to Debtor's books and records or $7.7 million according to proofs of claim filed by non-shareholders.

Debtor's post-petition activities include: (1) obtaining extensions of time to assume or reject the leases of Debtor's two office facilities; (2) obtaining court approval to sell surplus property, to honor pre-petition employee benefits, and to honor pre-petition customer support agreements; (3) settling nearly $1.6 million in asserted WARN Act claims; and (4) negotiating a consensual plan with the Creditors Committee. The plan

negotiations concluded on or about May 9, 2002, nine months into the case.

Under the Amended Plan, Debtor paid $66,000 in cash to convenience claims ($3,000 or less). Existing equity was eliminated. New preferred, convertible stock was issued for the benefit of holders of general unsecured claims. Two million shares of Class A common stock were issued to management and employees. Four million shares of Class B common stock were issued for the benefit of holders of general unsecured claims. The Amended Plan, which was confirmed by order filed December 20, 2002, was designed to preserve Debtor's substantial net operating loss and ultimately to enhance the value of the new equity in the reorganized company.

LEGAL STANDARD

A fee applicant bears the burden of establishing the reasonableness of its fees. In re Crown Oil, Inc., 257 B.R. 531, 538 (Bankr. D. Mont. 2000). The Bankruptcy Court has an independent obligation to review all fee applications and to evaluate whether the amount of compensation sought is appropriate. 11 U.S.C. §§ 327-330; Crown Oil, 257 B.R. at 537-38. The Lodestar method of calculating fees is relevant to the court's inquiry, but not dispositive of whether the fees sought are reasonable. Unsecured Creditors' Comm. v. Puget Sound Plywood, Inc., 924 F.2d 955, 960 (9th Cir. 1991).

AMOUNTS SOUGHT BY CATEGORY FOR EACH APPLICANT

(First, Second and Supplemental Fee Applications combined)

	M&M	WSGR
Case Administration	$ 17,231	$ 25,838
Employment of Professionals	25,033	
Firm's fee Applications	17,130	18,182
Others' Fee Applications	11,837	
Fee Dispute	17,733	28,975
Motion to Withdraw	4,002	
Case Commencement	5,503	
Sch & Stmts, SEC Filings	13,368	
Monthly Operating Reports	10,084	
Asset Disposition	8,194	
Real Property/Landlords	5,996	
Executory Contracts	5,161	
Other	3,084	
Plan and Disclosure Statement	126,614	62,969
Claims	10,356	
WARN Act Claims & Settlement	32,967	8,362
Other Labor/Employment	4,817	1,672
SEC - No Action Letter		27,132
SEC - Other Filings/Matters		18,050
Certificate of Incorporation		18,279
Other Corporate Matters		9,198
Estimated Fees	1,245	1,350
TOTAL	$320,355	$220,007

OBJECTIONS

Not including the fees sought by M&M and WSGR in their supplemental applications, Debtor and the Creditors Committee seek a $98,911 reduction in fees sought by M&M (approx. 31%), and a $104,554 reduction in WSGR's fees (48%). The specific reductions sought by Debtor and the Committee are as follows:

Firm	Matter	Reduction sought
M&M	Motion to withdraw	$5,247
M&M	Employment of professionals	$10,000
M&M	Applications for compensation	$10,753
M&M	Claims trafficking analysis	$4,011
M&M	Mtn to honor customer contracts	$2,500
M&M	Monthly operating reports	$2,000
M&M	America II	$3,000
M&M	Employee benefits motion	$1,400
M&M	WARN Act	$13,000
M&M	Lease motions	$2,000
M&M	Plan and disclosure statement	$45,000
	Total, non UST-objections to M&M fees	**$98,911**
WSGR	WARN Act	$7,000
WSGR	Applications for compensation	$12,655
WSGR	Plan and disclosure statement	$50,000
WSGR	SEC matters	$21,173
WSGR	Certification of incorporation	$13,726
	Total, non-UST objections to WSGR fees	**$104,554**

In addition to these amounts, Debtor and the Committee object to the entirety of the fees and expenses sought by M&M in its Supplemental Fee Application ($17,733 fees, $565 expenses) as well as to all fees sought by WSGR in its Supplemental Fee Application ($40,259 fees, $663 expenses).

Debtor and the Creditors Committee object to the fees sought by Applicants on the grounds that (1) they are excessive in light

of Applicants' pre-petition familiarity with Debtor[4] and the overall simplicity of the case; (2) there was unnecessary duplication of services between M&M and WSGR; (3) the firms billed for overhead and spent excessive time on their fee applications; (4) M&M filed an unnecessary motion to withdraw as counsel; and (5) M&M improperly demanded monthly fee payments without a court order authorizing such payments.

The United States Trustee (UST) joins in the objections that the fees are excessive in light of the case's complexity. The UST objects to 50% of the $62,969 in fees sought by WSGR in connection with the plan and disclosure statement, on the grounds that much of the services provided exceeded the limited scope of WSGR's approved engagement as corporate counsel. The UST objects to all fees sought by M&M in connection with SEC filings, which the UST contends duplicated the efforts of WSGR. The UST objects to $26,872 in fees charged by WSGR in connection with its fee application, and $33,975 in fees related to the fee dispute. The UST objects to WSGR's $25,839 fees incurred in connection with non-plan related bankruptcy administration. The UST also objects to the fees sought by M&M and WSGR in connection with the WARN Act claims, arguing that the two firms performed duplicate work. Finally, the UST asks the court to sanction M&M in the amount of 10% of its total fees for requiring Debtor to pay M&M's invoices on a monthly basis without a court order approving such payments.

[4] Debtor asserts that, prior to its bankruptcy filing, M&M and WSGR each billed Debtor is excess of $40,000.

DETERMINATION OF REASONABLE AND NECESSARY FEES

A. WARN ACT CLAIMS

The overall thrust of the objections is that the fees sought are excessive because this was essentially an uncontested case. I will begin the fee-review process by addressing the one matter in the case in which a dispute arose, the WARN Act claims asserted by former employees.

M&M and WSGR together seek over $41,000 in fees related to litigation of $1.5 million in claims asserted under the Worker Adjustment and Retraining Notification Act, 29 U.S.C. §§ 2101, et seq. (WARN Act). M&M seeks approximately $33,000[5] in fees in connection with defense of the WARN Act claims. Of this amount, $4,367 is for research, $15,276 is for preparing a claim objection, $12,913 is for settlement of the claim objection, and $501 is for miscellaneous work. WSGR seeks approximately $8,373 for research regarding the WARN Act and for advice provided M&M by WSGR's employment department.

The United States Trustee contends that certain of the fees sought by M&M are for research that duplicates work performed by WSGR. Debtor and the Creditors Committee argue that M&M's fees should be reduced by $13,000 and WSGR's by $7,000 because the extensive post-petition research was unnecessary in light of analysis paid for Debtor pre-bankruptcy.[6] Debtor and the Creditors Committee also argue that M&M failed to consider the

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[5] Debtor calculates the number as $33,901; M&M calculates the number is $32,967; the court calculates the number as $33,057.

[6] Debtor does not specify the amount paid pre-petition for this analysis. Welling Decl. In Support Of Reorganized Debtor's Objections, 13-14: ¶ 55).

limited risk posed by the WARN Act claims, and to limit its legal work accordingly.

After review of Applicants' time records, the relevant pleadings, and the record of the relevant court proceedings, I determine that the work performed by Applicants in responding to the WARN Act claims does not warrant the approximately $41,000 sought for that work. First, I note that only one-third of the amount sought is for work other than research and preparation of a formal objection to claim. The matter was settled without any contested hearings, and Applicants seek approximately $13,000 for the settlement negotiations. Second, the amount sought for research and the written objection to claim is unreasonable. My review of the claim objection reveals that the issues raised are not complex, and that the background information included in the papers was incorporated wholesale from prior pleadings. The likely source of inefficiency is duplication of effort——both firms seek a significant amount for research. Finally, my sense that the amount sought for objecting to the WARN Act claims is unreasonable is supported by the fact that the settlement allocates $25,000 to compensate claimants' counsel for prosecuting the same claims.

M&M is allowed fees for the WARN Act claims in the amount of $22,000. WSGR is allowed fees for the WARN Act claims in the amount of $5,600.

B. PREPARATION OF FEE APPLICATIONS

I turn next to the second category that can be separated easily from the general work regarding case administration and

confirmation of a plan——the preparation of the first and second fee applications at issue here.[7]

M&M seeks $12,938 for fees incurred in preparing its First Interim Fee Application, which is 5.5% of the amount sought in that application. M&M seeks $4,192 in fees for preparing the Second Fee Application, which is 6.3% of the amount sought in that application. In its Supplemental Fee Application, M&M seeks $17,733, all of which relates to defense of its fee applications against the various objections filed.

WSGR seeks $10,460 for fees incurred in preparing its First Interim Fee Application, which is 8% of the fees sought. WSGR seeks $3,716 in fees for preparing the Second Fee Application, which is 7.7% of the fees sought.[8] In its Supplemental Fee Application, WSGR seeks $29,531 for responding to objections and for preparing the Supplemental Fee Application.

I determine that the amounts sought by both firms for preparing fee applications are excessive. This is a case in which both firms have allowed themselves to bill too many hours for the preparation of routine matters. This pattern extends to their fee applications. Except where the amount sought is very small, it should be possible for a firm to prepare a fee application for

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[7] I address separately in Section D the fees sought for defending the fee applications, because the allowance of those fees depends upon how successful applicants are in that defense.

[8] WSGR's Second Fee Application seeks only $3,160 in fees related to the Second Fee Application. WSGR's Supplemental Fee Application, however, seeks an additional $556 in fees related to the Second Fee Application, which is half of the $1,112 in fees sought in the Supplemental Fee Application related to preparation of the Second Fee Application and the Supplemental Fee Application.

five percent of the amount sought. For an application in an amount of $100,000, for instance, such an approach would permit the firm to use a paralegal for 10 hours at $150 per hour and an attorney for 10 hours at $350 per hour. It is my experience that the more efficient firms in this district generally seek less than five percent of the amount sought for preparation of large fee applications. Accordingly, the amount sought for preparation of fee applications by both M&M and WSGR will be reduced to five percent of the amount sought. I note that because this decision orders other reductions in the fees sought by both firms, the amount allowed herein for preparation of fee applications substantially exceeds five percent of the fees allowed.

M&M is allowed fees for preparation of its fee applications in the amount of $15,971. WSGR is allowed fees for preparation of its fee applications in the amount of $9,585.

C. CASE ADMINISTRATION AND CHAPTER 11 PLAN

Having addressed the fees allowable for disputed matters and for preparing fee applications, and having reserved for discussion in Section D fees allowable for responding to the objections to the fee applications, I now turn to the central question——what fees should be allowed for confirming the chapter 11 plan and other case administration.

The salient fact in this fee dispute is that together M&M and WSGR seek total fees of $428,033 for confirming an uncontested chapter 11 plan.[9] There was not a single contested hearing

[9] Stated differently, for work other than the WARN Act claims, fee applications, and defending fee applications, M&M seeks fees of $263,115 and WSGR seeks fees of $164,918.

regarding case administration or plan confirmation. While the plan did require negotiations with the Creditors Committee, those negotiations were not costly. Together the two firms seek $45,000 for these negotiations. Although WSGR was appointed to act as special corporate counsel, virtually all of its fees are for work related to the bankruptcy case, as opposed to work related to the company's operations.

Not only was the case not contested, it was also not particularly complex. There were no significant sales of assets or significant events regarding case administration, other than confirmation of the plan. The plan itself was not unduly complex. It was a stock-for-debt plan, designed to preserve Debtor's large net operating losses. The main plan-design questions were the amount of stock to be designated for employee incentives and how to preserve the net operating loss. It is some indication of the complexity of the case that special tax counsel seeks total fees of only $16,110, and counsel for the Creditors Committee seeks fees totaling only $65,522. Without doubt, the duties of a debtor's counsel are more extensive than those of committee counsel, especially in the case of a public company, but the ratio of debtor's counsel fees to committee counsel fees is usually much lower than the five-to-one ratio present here.

The Creditors Committee, the United States Trustee, and Debtor object to specific amounts sought by Applicants in various billing categories. I find several of these objections to be persuasive. After review of the time records, the filed papers, and the proceedings in this case, and after consideration of the amount and nature of the work involved, I find that the fees

sought by M&M under the following billing categories exceed the amount reasonable and necessary for such work.

(1) $9,527 sought for routine, unopposed motions to honor pre-petition employee-benefit and customer-support agreements;

(2) $7,833 sought for a routine, unopposed motion to assume a pre-petition contract for the sale of certain assets of the estate;

(3) more than $10,000 sought for supervising the preparation of, and for review of, monthly operating reports. (Debtor had a separate financial advisor——KPMG);

(4) $5,140 sought for routine, unopposed motions to extend the time to assume or reject real property leases;

(5) $4,000 for formally withdrawing from the case after Debtor had discharged M&M as counsel;

(6) $4,300 for research on claims trafficking that duplicated work performed by special tax counsel; and

(7) $10,000 for work related to Debtor's employment of other professionals.

After similar review, I find that the fees sought by WSGR for the following work exceed the reasonable and necessary amount.

(1) Approximately $20,000 sought for drafting a new certificate of incorporation and bylaws; and

(2) Approximately $28,000 sought for an unsuccessful request for a no-action letter from the SEC.

This is a case, however, in which it is not sufficient to examine only the amount each firm seeks for each of the many different billing categories in its fee application. As noted

above, the amounts sought under several billing categories are excessive. The amounts sought for other billing categories have also been challenged, but this court might resolve its doubts in favor of Applicants, if the total amounts sought were not so clearly excessive. From my experience in reviewing fee applications in other chapter 11 cases in this district, cases involving confirmation of an uncontested plan, even one involving a public company, generally entail fees much less than those sought here. It is plausible that this case involved an unexpected wrinkle or two that reasonably required an attorney to spend more time than one would expect, but that did not manifest itself in a paper filed with the court. It is not plausible that this happened wholesale. It appears more likely that the large fees sought are the product of a more general failure of discipline——failure to take care that work performed was truly necessary and was performed in a cost-effective way, and failure of the two firms to divide work in a manner that avoided duplication of effort. The total amount sought in this case undermines the credibility that the court ordinarily accords the time records of counsel as representing work that is both necessary and efficiently performed.

Neither of the two firms bears primary responsibility for the excessive fees, such that one firm should bear a disproportionate part of the necessary adjustment in fees. As noted above, I have determined that each firm seeks excessive fees in more than one billing category. Each firm was heavily involved in the main activity in the case——drafting and confirming the chapter 11 plan. Each firm seeks very substantial fees. This is not a case in

which one firm was clearly in charge of organizing the work and can be held primarily responsible for ensuring that the all work was necessary and was performed without duplication of effort.

Upon consideration of the fee applications of M&M and WSGR, the objections thereto filed by the parties in interest, and all the considerations set forth above, I determine that M&M should be allowed fees in the amount of $160,000, and that WSGR should be allowed fees in the amount of $119,000, for all work other than the WARN Act claims and the preparation and defense of their fee applications.

D. DEFENSE OF FEE APPLICATIONS

I determine that neither firm should be allowed additional fees for responding to the objections to their final fee applications. Those objections have been largely sustained. The court has disallowed a significant portion of the fees sought in almost every category in which an objection was raised. Not including the reduction for defense of fee application discussed herein, the reductions ordered are substantial: $158,559 for M&M;[10] $54,838 for WSGR.[11] The reductions are larger than the reductions requested against M&M and represent more than half of the reductions sought against WSGR. The objecting parties have

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[10] The reduction of $158,559 is calculated as follows: the total amount sought other than for responding to the objection to fees (i.e., $320,355 minus $17,733) less the amount allowed for work other than responding to the objections to fees (i.e., $144,023).

[11] The reduction of $54,838 is calculated as follows: the total amount sought other than for responding to the objection to fees (i.e., $220,007 minus $28,975) less the amount allowed for work other than responding to the objections to fees (i.e., $136,194).

established clearly that both M&M and WSGR failed to use sound billing discretion in submitting and defending their final fee applications. I exercise my discretion not to award fees for the largely unsuccessful defense of those applications. Boldt v. Crake (In re Riverside-Linden Investment Co.), 945 F.2d 320, 323 (9th Cir. 1991).

E. EQUITIES OF LATE OBJECTION TO FEES

Neither Debtor, the Committee, nor the United States Trustee objected to the first interim fee application of either M&M or WSGR. The two firms contend that the court should not allow these parties to "lie in wait" and assert their objections only after the plan has been confirmed. This argument is unpersuasive.

First, as noted above, the court has an independent obligation to review fees, even when no party objects. 11 U.S.C. §§ 327-330; In re Crown Oil, Inc., 257 B.R. 531, 537-38 (Bankr. D. Mont. 2000). Second, in determining the appropriate fees, I have taken account of the fact that a plan was confirmed, that the case was successful, and that the work of both firms was fully competent. Third, I am not convinced the late objections are unfair. The basis of the objections, that the fees are just too high for an uncontested case, became fully apparent only as the fees continued to accrue at a high rate during the second application period, well after Debtor and the Creditors Committee had agreed upon the terms of the plan. Finally, the objections based on M&M's unauthorized receipt of advances should be considered carefully by the court whenever raised, because they concern the integrity of counsel.

F. UNAUTHORIZED ADVANCES TO M&M

Debtor, the Creditors Committee, and the United States Trustee object to allowance of the fees requested by M&M on the basis that M&M improperly received monthly advances on its fees without prior court approval. M&M does not contest receiving monthly advances to be held in trust by the firm pending formal allowance of its fees, but contends that nothing in this practice was inappropriate, because the firm adequately disclosed the arrangement to the court.

M&M demanded and received monthly advances from Debtor under the following provision of its August 15, 2001 engagement letter (the Engagement Letter).

> In the event that the Chapter 11 Advance Retainer is exhausted after the commencement of the bankruptcy case, we shall have the right to move the Bankruptcy Court for an order approving an interim compensation procedure allowing At Comm to pay attorneys' fees and costs on a monthly basis, and if such interim compensation procedure is approved by the Court, such fees and costs shall be so paid. In the event that we do not so move the Court or the Court does not approve such an interim compensation procedure, we shall have the right to apply to the United States Bankruptcy Court for additional fees and costs pursuant to the provisions of the Bankruptcy Code, which authorizes applications for such interim compensation to be submitted once every one hundred and twenty (120) days, or more frequently if authorized by the Court. Prior to the submission of any such applications, we shall invoice At Comm on a monthly basis, and At Comm shall immediately remit the balance due to us to be held in trust pending Court approval of such fees and costs.

In its Disclosure of Compensation Pursuant to 11 U.S.C. §§ 329(b) and Federal Rule of Bankruptcy Procedure 2016(b)(the Rule 2016 Disclosure), M&M disclosed receiving a pre-petition retainer in the amount of $58,632. The Rule 2016 Disclosure also contains a provision regarding monthly payment of fees.

> The Debtor has also agreed that Murray & Murray shall have the right to move the Bankruptcy Court for an order approving an interim compensation procedure allowing the Debtor to pay attorneys' fees and costs on a monthly basis if and when the Retainer is exhausted, and if such an interim compensation procedure is approved by the Court, such fees and costs shall be so paid. In the event that Murray & Murray does not so move the Court or the Court does not approve such an interim compensation procedure, Murray & Murray shall have the right to apply to the Court for additional fees and costs pursuant to the provisions of the Bankruptcy Code, which authorizes applications for such interim compensation to be submitted once every one hundred twenty (120) days, or more frequently if authorized by the Court. Prior to the submission of such applications, Murray & Murray shall invoice the Debtor on a monthly basis, and the Debtor shall immediately remit the balance due to Murray & Murray to be held in trust pending Court approval of such fees and costs. Payment shall be immediately forthcoming upon approval of such fees and costs. The Debtor has also granted Murray & Murray a continuing security interest in the Retainer and any other sums paid to Murray & Murray to secure the full payment of Murray & Murray's attorneys' fees and costs incurred in the Chapter 11 case.

These monthly advance provisions were not set forth, however, in the firm's Application of Debtor for Order Authorizing Employment of Counsel (the Application for Employment), or in the order granting that application. In its Application for Employment, M&M requests that it "be employed under a general retainer on an hourly basis with compensation for services and reimbursement of expenses to be paid by the Debtor pursuant to 11 U.S.C. §§ 330, 331, 503, and 507." The prayer in the Application asks the court to enter an order authorizing the employment of M&M "on the terms and conditions hereinabove set forth." The terms of employment described in the Engagement Letter or the Rule 2016 Disclosure are not incorporated by reference into the Application. The order authorizing employment of M&M, which was drafted by M&M, provides only that Debtor is

authorized to employ the firm "upon the terms and conditions set forth in the aforementioned application."

Nor were creditors afforded prior notice of the monthly advance provisions. The Application for Employment and the Rule 2016 Disclosure were served only upon the United States Trustee. The Engagement Letter was apparently not filed with the court nor served on anyone.

M&M contends that it was not required to seek court approval of the monthly advance provisions, only to disclose them.

> Finally, the Debtor objects to Murray & Murray's fee applications on the grounds that Murray & Murray insisted that its monthly invoices be paid and held in trust. This arrangement is a condition of Murray & Murray's engagement letter, a copy of which is attached hereto as Exhibit "E" and incorporated herein by reference. Murray & Murray disclosed this condition in its DISCLOSURE OF COMPENSATION PURSUANT TO 11 U.S.C. § 329(a) AND FEDERAL RULE OF BANKRUPTCY PROCEDURE 2016(b) ("Disclosure of Compensation") filed on September 4, 2001, a copy of which is attached hereto as Exhibit "F" and incorporated herein by reference. Murray & Murray believes that this is an issue of disclosure as opposed to a matter for Court approval.

Response of Murray & Murray to [Objections to Fees] at 20.

The arrangement described above, under which M&M, after the petition date, received additional security for payment of its fees without prior court approval, constitutes a substantial breach of the procedures for payment of attorneys fees set forth in the Bankruptcy Code and Rules.

The monthly advances to M&M constitute a post-petition transfer of property of the Debtor. Because the advances were to be held in trust until M&M's fees were formally allowed, the payments did not afford M&M unrestricted use of the funds. In substance, the advances constitute an additional retainer paid

post-petition. Franke v. Tiffany, 113 F.3d 1040, 1044-45 (9th Cir. 1997). M&M's Rule 2016 Disclosure expressly states that M&M is to have a security interest in these post-petition advances to secure full payment of its fees. The Code defines, and innumerable decisions recognize, that the Debtor's giving of a security interest is a transfer of property of the Debtor. 11 U.S.C. § 101 (54); e.g., Saghi v. Walsh (In re Gurs), 34 B.R. 755, 756 (9th Cir. B.A.P. 1983); Fitzgerald v. First Security Bank of Idaho (In re Walker), 161 B.R. 484, 487 n.3 (Bankr. D. Idaho 1993).

A debtor may transfer property to its attorney post-petition only after notice to creditors and upon order of the court. Section 363(b) permits a debtor to transfer property out of the ordinary course of business only upon notice to creditors and opportunity for a hearing. The payment of a retainer to bankruptcy counsel is not a transfer in the ordinary course of business. Because creditors did not receive prior notice and opportunity for a hearing, the monthly advances to M&M violate section 363(b).

Moreover, the Bankruptcy Code imposes additional limitations upon post-petition transfers to a debtor's attorney. All terms of employment must be expressly approved by the court under section 328(a). The payment of a post-petition retainer is likewise allowed only upon express approval of the court, and may not be effected upon creditors' mere failure to object after notice of the proposed transfer. E.g., In re Pannebaker Custom Cabinet Corp., 198 B.R. 453, 464 (Bankr. M.D. Pa. 1996) ("post-petition retainer is merely a form of post-petition disbursement, and the

terms ‘disbursement,’ ‘payment’ and ‘compensation’ as utilized in the relevant authorities quite obviously relate to the transfer from the debtor-in-possession to counsel in the first instance.”).

The procedure for obtaining a post-petition retainer is similar to the procedure set forth in In re Knudsen Corp., 84 B.R. 668 (9th Cir. B.A.P. 1988), for obtaining an order for interim payment pending a formal fee application. Under Knudsen, a bankruptcy court may authorize such procedure only if “[t]he fee retainer procedure is, itself, the subject of a noticed hearing prior to any payment thereunder.“ Id. at 673.

The payment of a post-petition retainer to be held in trust differs from a Knudsen arrangement, under which the attorney is permitted to use the funds received, subject to possible disgorgement. Thus, in evaluating a post-petition retainer, the court need not give the same consideration to whether the attorney is financially able to pay any disgorgement ordered. But because payment of a retainer involves the transfer of a security interest, an attorney seeking a post-petition retainer is not relieved of the Knudsen requirement that creditors receive prior notice. Moreover, because of the potential for overreaching by the attorney, and because under section 328(a) all terms of employment are to be approved by the court, payment of a post-petition retainer should be permitted only on express approval by the court.

M&M’s argument that its receipt of the monthly advances was proper because they were referred to in M&M’s Rule 2016 Disclosure is not persuasive. First, nothing in Rule 2016(b) excuses an attorney from obtaining express court approval of the material

terms of employment under section 328(a), or from satisfying the requirements of sections 363(b), 328, 329, and 330 before receiving a post-petition transfer of property from the estate. Second, M&M did not fully comply with Rule 2016(b). That rule required M&M to file a supplemental disclosure statement within 15 days after receipt of each post-petition payment in respect of fees. This requirement applies to a payment received as a post-petition retainer. Franke v. Tiffany, 113 F.3d at 1044.

The Ninth Circuit permits the imposition of severe sanctions upon an attorney who obtains any payment in respect of his or her fees in violation of the procedures prescribed in the Bankruptcy Code and Rules. In Franke v. Tiffany, the court upheld an order denying all fees to counsel who obtained a post-petition retainer without prior court approval, and who failed to file a supplemental disclosure statement upon the receipt of each installment of that retainer. With respect to the range of sanctions the bankruptcy court may apply, the court stated:

> Although we did not explicitly so recognize in In re Park-Helena, the bankruptcy court's authority to deny completely these attorney's fees was grounded in the inherent authority over the debtor's attorney's compensation. The Bankruptcy Code contains a number of provisions (e.g., §§ 327, 329, 330, 331) designed to protect the debtor from the debtor's attorney (citation omitted). As a result, several courts have recognized that the bankruptcy court has broad and inherent authority to deny any and all compensation when an attorney fails to meet the requirements of these provisions (citations omitted). . .
>
> We agree with these courts . . . .

Franke v. Tiffany, 113 F.3d at 1044.

In the present case, two factors weigh in favor of a very strong sanction, short of disallowance of all fees.

First, M&M is a very experienced bankruptcy firm, and its failure to obtain prior court approval of the post-petition retainer was not a mere mistake. M&M is a bankruptcy boutique, not a general purpose law firm. It holds itself out as one of the premier bankruptcy firms in Silicon Valley. It stated in its Application for Employment that "the attorneys of Murray & Murray are skilled counsel in bankruptcy proceedings and have special knowledge which will enable them to perform services of particular value to the Debtor." M&M can perhaps argue in good faith that it is unclear whether **all** the Knudsen safeguards apply to the receipt of a post-petition retainer.[12] However, in light of the clear command of section 328(a) that material terms of employment be approved by the court, in light of the clear command of section 363(b) that any transfer of property of the estate out of the ordinary course of business be effected only after notice to creditors and an opportunity for a hearing, and in light of the clear command of Rule 2016(b) that each payment in respect of fees be separately disclosed, M&M cannot reasonably argue that it acted in good faith in obtaining monthly payment of additional security in the way that it did.

Second, the monthly payment of fees has the natural effect of lessening the likelihood that a debtor will challenge the formal allowance of fees claimed by debtor's attorney. Fees already paid are easier to accept. This effect is a matter of serious concern that must be weighed carefully whenever counsel requests a Knudsen

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[12] As noted above, when considering a retainer, the court may not need to consider the firm's financial ability to comply with any disgorgement order.

order. This effect is a matter of particular concern regarding the conduct of M&M in this case. As discussed above, M&M has not exercised sound billing judgment in this case. The combined effect of the improper insistence upon monthly advances, the natural effect of such payments on the fee review process, and M&M's overbilling, is to leave this court with a strong sense that M&M has overreached against its client.

Three factors counsel against the denial of all fees, notwithstanding M&M's flagrant violation of the proper procedure for obtaining a post-petition retainer. First, M&M obtained no advantage versus other creditors. The estate had sufficient funds to pay all administrative claim in full. Second, M&M might have received similar protection via a Knudsen order, had such relief been properly and frankly sought. Third, the partial disgorgement described below constitutes a very substantial sanction against M&M.

Upon due consideration of all relevant factors, the court determines that the fees sought by M&M should be reduced by $72,012, one-third of fees and expenses otherwise allowed under this decision, as a sanction for its improper receipt of a post-petition retainer.

CONCLUSION

M&M is allowed final fees and expenses as follows:

WARN Act Claims	$ 22,000
Preparation of Fee Applications	15,971
Defense of Fee Applications	0
Plan and all other Categories	160,000
Expenses	18,064
Less Sanction re Unauthorized Advances	(72,012)
Net Amount Allowed	$144,023

M&M shall immediately return to Debtor all funds received from Debtor in excess of the net fees and expenses allowed above.

WSGR is allowed final fees and expenses as follows:

WARN Act Claims	$ 5,600
Preparation of Fee Applications	9,585
Defense of Fee Applications	0
Plan and all Other Categories	119,000
Expenses	2,009
Total	$136,194

Debtor shall immediately pay to WSGR the difference between the fees and expenses allowed above and the amount WSGR has previously been paid.

Dated: September 19, 2003

/s/_____
Thomas E. Carlson
United States Bankruptcy Judge