UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

In re:	)	Case No. 04-24042
	)	
ARMBRUSTER ENERGY	)	Chapter 7
ENTERPRISES, LLC,	)	
Debtor.	)	Judge Arthur I. Harris

ORDER REGARDING APPLICATION FOR COMPENSATION
(DOCKET #230)

This case is currently before the Court on the application for compensation submitted by special counsel for the Chapter 7 trustee (Docket #230) and an objection filed by creditor EBY-Brown Co., LLC, on June 19, 2006. Special counsel seeks $139,413.68 in attorney fees and $1,465.78 in expenses for work on behalf of the Chapter 7 trustee in adversary proceeding 05-1224, pursuant to the Court's November 23, 2005, order (Docket #217) approving the employment of special counsel on a contingency fee basis. For the reasons that follow, the Court overrules EBY-Brown's initial objection but declines to rule on the application for compensation until additional information and/or briefing is provided by special counsel, the Chapter 7 trustee, and the U.S. Trustee consistent with this order.

EBY-Brown's Objection, Section 328, and Airspect

In its objection, Creditor EBY-Brown asserts that special counsel is not disinterested and continues to represent principals of the debtor in related matters.

Special counsel currently represents Jeff and Lee Armbruster, principals of the debtor, in state court litigation brought by EBY-Brown against the Armbrusters as guarantors of the debtor's obligations.

EBY-Brown also bases its objection on special counsel's allegedly substandard legal representation of the debtor when the Chapter 11 petition was filed. Specifically, EBY-Brown asserts that when counsel filed this case on behalf of the debtor on November 3, 2004, counsel intentionally or negligently failed to notify EBY-Brown of the bankruptcy filing for approximately 24 hours, even though counsel was aware that EBY-Brown had agents in place in Columbus, Ohio, ready to reclaim tobacco products and other merchandise from the debtor's 18 convenience stores, pursuant to an existing security agreement. Although the seizure of this merchandise from the debtor's stores had a negative effect on the debtor's business, it also reduced the debtor's indebtedness to EBY-Brown. EBY-Brown's postpetition seizure and continued failure to return this merchandise was the subject of adversary proceeding 05-1224, which was settled on the eve of trial for $350,000, with special counsel representing the plaintiff – Chapter 7 trustee Waldemar Wojcik.

Resolution of EBY-Brown's objection hinges in large part upon whether the Court's November 23, 2005, order pre-approved special counsel's contingency fee

arrangement under 11 U.S.C. § 328. Section 328 of the Bankruptcy Code provides in pertinent part:

> (a) The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

In *In re Airspect*, 385 F.3d 915 (6th Cir. 2004), the Sixth Circuit held that

> whether a court "pre-approves" a fee arrangement under § 328 should be judged by the totality of the circumstances, looking at both the application and the bankruptcy court's order. Factors in the determination may include whether the debtor's motion for appointment specifically requested fee pre-approval, whether the court's order assessed the reasonableness of the fee, and whether either the order or the motion expressly invoked § 328.

385 F.3d at 922.

In the present case, while neither the application nor the order specifically invoked section 328, both the application and the order detailed the 40 percent contingent fee arrangement, and the application explained why the trustee believed the 40 percent contingent fee arrangement was reasonable under the specific facts and circumstances giving rise to the trustee's need for representation in the two

adversary proceedings. Under the totality of the circumstances, the Court has little difficulty finding that it pre-approved the 40 percent contingent fee arrangement consistent with section 328 and the Sixth Circuit's decision in *Airspect*. Therefore, the Court will only allow compensation different from the compensation provided under the 40 percent contingent fee arrangement if such terms and conditions prove to have been improvident *in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions in November 2005.*

Most of the issues raised in EBY-Brown's objection involve matters that could have been anticipated and raised when the Chapter 7 trustee sought the appointment of special counsel in November 2005. Despite being served electronically with the application to employ special counsel, EBY-Brown raised no objection to the appointment of special counsel or to the 40 percent contingent fee arrangement detailed in the application. EBY-Brown was well aware of the delay in notifying EBY-Brown of the debtor's Chapter 11 petition long before November 2005. *See, e.g.*, EBY-Brown's Response to Debtor's Motion for Contempt dated May 18, 2005 (Docket #128). All the relevant facts about special counsel's prior representation of the debtor under Chapter 11 were known to EBY-Brown when the application to employ special counsel was filed.

One issue that perhaps could not have been anticipated in November 2005

was special counsel's later representation of the Jeff and Lee Armbruster in the state court litigation involving the Armbrusters' personal guarantees of the debtor's indebtedness to EBY-Brown. While EBY-Brown asserts that this dual representation presented a conflict that required disqualification of counsel, the Court disagrees. Under section 328(c), the focus is on whether such professional person 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 Court sees no conflict in special counsel seeking damages from EBY-Brown on behalf of the debtor's estate and in representing the Armbrusters on their personal guarantees of the debtor's indebtedness to EBY-Brown. Although EBY-Brown sought to characterize the adversary proceeding as including alleged negligence or intentional misconduct by counsel for the debtor, the Court rejected that characterization. The Chapter 7 trustee remains free to pursue such claims, but the adversary proceeding against EBY-Brown has always been about EBY-Brown's alleged violation of the automatic stay *after* it received notice of the bankruptcy filing, in particular, EBY-Brown's alleged failure to return the merchandise after receiving notice of the bankruptcy filing.

Accordingly, the Court overrules EBY-Brown's initial objection to special counsel's application for compensation.

Prior Payments to Counsel Without a Fee Application Being Filed or Approved by the Court

In response to EBY-Brown's written objection and questions from the Court, counsel disclosed the receipt of postpetition payments during the pendency of the case under Chapter 11 (Docket #242). On July 10, 2006, counsel filed an application for approval of legal fees (Docket #245), which seeks approval of $159,757.75 in fees and reimbursement of $6,267.41 in expenses. In the application, counsel admits receiving a monthly "stipend" of $10,000 during the pendency of the case under Chapter 11, a total of $90,000. The application seeks approval of the fees and expenses and an order authorizing the Chapter 7 trustee to pay the balance of fees and expenses outstanding. No application for compensation was filed during pendency of the case under Chapter 11, nor were any interim fees approved. As explained below, these payments to counsel without a fee application being filed or approved by the Court raise serious questions about whether counsel has complied with the requirements of the Bankruptcy Code and, if not, what the appropriate consequences should be.

This case was initially filed under Chapter 11 on November 3, 2004. On November 17, 2004, the debtor filed an application to employ the law firm of Lasko & Lind Co., L.P.A. as attorneys for the debtor-in-possession in this case as

well as for the debtor-in-possession of the related case of Pinzone Armbruster, Inc., Case No. 04-24014. The application disclosed the payment of a total retainer of $10,000 for the two cases (Docket #17 at ¶12). The application further acknowledged counsel's obligation to apply to the Court for allowance of compensation.

> During the course of these cases, the Firm will apply to the Court for allowance of compensation for professional services rendered and reimbursement of expenses incurred in these Chapter 11 cases in accordance with the applicable provisions of the Bankruptcy Code, the Bankruptcy Rules, the Local Rules of the United States Bankruptcy Court for the Southern [*sic*] District of Ohio, the United States Trustee Fee Guidelines, and any Orders entered in these cases governing professional compensation and reimbursement for services rendered and charges and disbursements incurred. Such applications will constitute a request for interim payment against the firm's reasonable fees to be determined at the conclusion of the cases.

Id. at ¶13. On January 26, 2005, the Court approved the debtor's application to retain counsel effective *nunc pro tunc* as of November 3, 2004 (Docket #56). The order further provided that "Awards of compensation and expenses shall be sought pursuant to Sections 330 and 331 of the Bankruptcy Code, the Bankruptcy Rules, the Local Rules and the rules and orders of this Court." *Id.* at ¶3. Nothing in the application, the supporting affidavit, or the Court's order mentions a monthly "stipend" to be paid to counsel.

During the pendency of the Chapter 11 case, counsel for the debtor-in-

possession expended considerable efforts on behalf of the debtor. These efforts included: (1) an evidentiary hearing on a motion for relief from stay by Equilon Enterprises, LLC (dba Shell Oil Products), which lasted several days in March 2005, (2) preparation for an evidentiary hearing involving an alleged violation of the automatic stay by creditor EBY-Brown, (3) the filing of a lawsuit in state court against Fifth Third Bank, which was subsequently removed to federal court and designated as adversary proceeding 05-1420, and (4) preparation of a proposed plan of reorganization and disclosure statement. Although the case was ultimately converted to a proceeding under Chapter 7 on August 24, 2005 (Docket #193), counsel for the debtor incurred attorney fees and expenses in excess of $166,000 during the pendency of the case under Chapter 11. Docket #242 at Exhibit 5; Docket #245.

Counsel for the debtor never filed an interim application for compensation for services performed during the pendency of the case under Chapter 11, nor has counsel filed a supplemental disclosure under Bankruptcy Rule 2016(b). On July 10, 2006, counsel filed an application for approval of legal fees (Docket #245), in which counsel admits receiving nine monthly payments of $10,000 each during the pendency of the case under Chapter 11. Docket #242 at Exhibit 6; Docket #245. It is unclear whether these payments were ever disclosed

to the Office of the United States Trustee or to the Chapter 7 trustee at any time up to and including when the same counsel sought to be employed as special counsel for the Chapter 7 trustee in November 2005. The monthly DIP reports do include check registers noting payments to "Lasko and Lind," but on Form 1 the same reports more prominently indicate that "No professional fees (attorney, accountant, etc.) have been paid without specific court authorization." *See, e.g.*, Docket #242 at 1 of 44 and 26 of 44.

These payments to counsel without a fee application being filed or approved by the Court raise serious questions about whether counsel has complied with the requirements of the Bankruptcy Code and, if not, what the appropriate consequences should be. *See, e.g.*, *In re Kisseberth*, 272 F.3d 714, 721 (6th Cir. 2001) ("Disgorgement may be proper even though the failure to disclose resulted . . . from negligence or inadvertence."); *In re Downs*, 103 F.3d 472 (6th Cir. 1996) (bankruptcy court abused discretion in allowing attorney to retain some fees, as attorney's failure to disclose fee arrangement warranted full disgorgement and denial of fees).

Accordingly, the Court will defer ruling on special counsel's application for fees (Docket #230) until –

1. The United States Trustee files a statement indicating whether his

office was aware of the $90,000 paid to counsel during the pendency of the case under Chapter 11 any time up to and including when counsel sought to be employed as special counsel for the Chapter 7 trustee in November 2005; and

2. The Chapter 7 trustee files a statement indicating whether he was aware of the $90,000 paid to counsel during the pendency of the case under Chapter 11 any time up to and including when counsel sought to be employed as his special counsel in November 2005.

In addition, the Court invites special counsel, the Chapter 7 trustee, the United States Trustee, and any other parties in interest to file any briefs or motions they believe to be appropriate. For example, these parties may wish to suggest their preference among the following options, or suggest other options of their own:

- reduce or subordinate the award of fees for work during the pendency of the case under Chapter 11, but award special counsel the contingency fee requested after deducting for time spent pursuing the same claims against EBY-Brown while the case was pending under Chapter 11

- require disgorgement of the $90,000 already paid, but award special counsel the full contingency fee requested

- require disgorgement of the $90,000 already paid, but award special counsel fees only for the actual time reasonably spent since November 2005 pursuing claims against EBY-Brown, with a cap equal to forty percent of the $350,000 recovered on behalf of the Chapter 7 trustee.

This matter will then be the subject of further proceedings.

IT IS SO ORDERED.

/s/ Arthur I. Harris 7/13/06
Arthur I. Harris
United States Bankruptcy Judge