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**UNITED STATES BANKRUPTCY COURT EASTERN
DISTRICT OF CALIFORNIA**

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

In re
Hummer Transportation, Inc.,

Debtor.

Case No. 11-60663
DCN: RHT-2
RHT-3

MEMORANDUM DECISION

1 Kimberly and Jesse Harty, represented by attorney Kenneth Allen,
2 brought a personal injury action against Hummer Transportation, Inc.,
3 which resulted in a \$5 million judgment. When Hummer could not
4 satisfy the judgment, the Hartys filed an involuntary Chapter 7
5 against it. The trustee wants to hire Allen to pursue additional
6 litigation against Hummer's insurance carrier and former lawyers. If
7 Allen succeeds, the estate, including the Hartys, will benefit.
8 Should the court approve the application?

9 **FACTS**

10 Kimberly Spoa-Harty was seriously injured in a traffic collision
11 involving her car and a tractor-trailer rig operated by the debtor,
12 Hummer Transportation, Inc. ("Hummer"), and owned by 1039012 Ontario,
13 Inc. ("Ontario, Inc."). Hummer was insured by National Continental
14 Insurance Company ("National"). Kimberly Spoa-Harty and her husband,
15 Jesse Harty, brought a state court action against Hummer in Porter
16 County, Indiana. The Hartys were represented by Kenneth J. Allen, and
17 Hummer was represented by Hume, Smith, Geddes, Green & Simmons, LLP
18 ("Hume Smith"). A jury returned a verdict for Kimberly Spoa-Harty of
19 \$4,270,000 for her damages and for Jesse Harty of \$950,000 for his
20 loss of consortium. National paid the Hartys its policy limits of
21 approximately \$842,000. The remainder of the judgment remains
22 unsatisfied.

23 The Hartys filed an involuntary petition against Hummer in the
24 Eastern District of California. Robert Hawkins was appointed as the
25 Chapter 7 trustee. Hummer's only assets are a cause of action against
26 National for failure to settle the Hartys' claims within policy limits
27 and a cause of action against Hume Smith for professional negligence
28 arising from Hume Smith's defense of Hummer in the Harty litigation.

1 The Hartys filed timely claims of approximately \$4,210,704 and
2 \$936,807. More than a year after the claims bar date and just before
3 the hearing on this matter, National filed a proof of claim for
4 approximately \$1.095 million. In its claim against Hummer, National
5 asserts purported reimbursement rights arising from National's payment
6 to the Hartys and from National's "uncovered attorney's fees and
7 costs" incurred for Hummer's defense in the action brought by the
8 Hartys. A small fraction of National's claim is for unpaid insurance
9 premiums.

10 After the order for relief, Hawkins filed an application to
11 appoint Allen as special counsel for the limited purpose of pursuing
12 causes of action against National and Hume Smith. The application was
13 supported by Allen's declaration, which stated, "No member of my
14 office has performed any services for the trustee or any creditor or
15 party in interest prior to the date of this [d]eclaration." Allen
16 Decl. Supp. Appl. Employ Special Counsel ¶ 4, July 13, 2013, ECF No.
17 77. That representation is untrue.

18 Unaware of Allen's representation of the Hartys, the court issued
19 an order approving Allen's employment. Later, Hawkins requested an
20 amendment to the order to correct payment terms that had been
21 inadvertently misstated in the original order. The amended order
22 corrected the payment terms but erroneously referred to the venue of
23 the action for which Allen's employment was sought.

24 Having had an order approving his employment, Allen filed an
25 action for Hawkins in Marion County, Indiana, against National and
26 Hume Smith. *Hawkins v. Nat'l Cont'l Ins. Co.*, No. 49C01-1211-CT-
27 044678 (Ind. Super. Ct. filed Nov. 19, 2012). This action remains
28 pending.

The Hartys filed a similar involuntary bankruptcy against Ontario, Inc. in Canada. The trustee of the Ontario, Inc. estate has joined as a plaintiff in Hawkins's action against National and Hume Smith.

Hume Smith, joined by National, and Hawkins now bring cross motions concerning Allen's employment as special counsel. Hume Smith moves under Federal Rule of Civil Procedure 60(b) to vacate the order employing Allen. Fed. R. Civ. P. 60(b), *incorporated by* Fed. R. Bankr. P. 9024. Hume Smith points to four obstacles to Allen's employment: (1) non-disclosure of Allen's long-standing attorney-client relationship with the Hartys; (2) Allen's status as a creditor of Hummer based on the contingency fee agreement with the Hartys; (3) Allen's status as a witness in the action against National and Hume Smith; and (4) the existence of an actual conflict of interest between Allen's representation of the Hartys and his representation of Hawkins.

By a supplemental application, Hawkins seeks to employ Allen as special counsel based on additional disclosures about Allen's connection with the Hartys. Hawkins admits the failure to disclose this connection previously but argues that the true facts now disclosed do not disqualify Allen.

JURISDICTION

This court has jurisdiction. See 28 U.S.C. § 1334; 11 U.S.C. § 327; General Order No. 182 of the U.S. District Court for the Eastern District of California. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(A).

1 DISCUSSION

2 I. Standards Governing Employment under § 327(a) and (c)

3 A Chapter 7 trustee has a statutory obligation to "collect and
4 reduce to money the property of the estate for which such trustee
5 serves." 11 U.S.C. § 704(a)(1). The trustee may employ counsel to
6 assist in these efforts. See *id.* § 327(a).

7 Section 327 governs the employment of attorneys by the Chapter 7
8 trustee. "The applicant bears the burden of proving that the
9 standards for appointment have been met." *Official Comm. of Unsecured*
10 *Creditors v. ABC Capital Mkts. Grp. (In re Capitol Metals Co., Inc.)*,
11 228 B.R. 724, 727 (B.A.P. 9th Cir. 1998) (citing *Credit Alliance Corp.*
12 *v. Boies (In re Crook)*, 79 B.R. 475, 478 (B.A.P. 9th Cir. 1987)).

13 Employment may be for a general or limited, specific purpose.
14 See 11 U.S.C. § 327(a),(c),(e); *Bank Brussels Lambert v. Coan (In re*
15 *AroChem Corp.)*, 176 F.3d 610, 622 (2d Cir. 1999) (distinguishing
16 between employment of general counsel and special counsel for purposes
17 of conflicts and eligibility analysis); *Fondiller v. Robertson (In re*
18 *Fondiller)*, 15 B.R. 890, 892 (B.A.P. 9th Cir. 1983) (same), *appeal*
19 *dismissed*, 707 F.2d 441 (9th Cir. 1983).

20 A creditor's attorney may be employed by the trustee provided the
21 attorney is "disinterested," "do[es] not hold or represent an interest
22 adverse to the estate," and, if an objection is made, does not have an
23 "actual conflict of interest." 11 U.S.C. § 327(a),(c). When applied
24 to employment of a creditor's attorney by the trustee as special
25 counsel for a specific matter, the conflicts and eligibility analysis
26 under § 327 is limited to the specific matter for which the attorney
27 is to be employed. See *Stoumbos v. Kilimnik*, 988 F.2d 949, 964 (9th
28 Cir. 1993); *Coan*, 176 F.3d at 622-29; *Fondiller*, 15 B.R. at 892.

1 Section 327 is implemented by Federal Rule of Bankruptcy
2 Procedure 2014(a), which requires an applicant to disclose all
3 connections with the debtor, creditors, parties in interest, and their
4 respective attorneys and accountants. The disclosure must be full,
5 candid, and complete. *Tevis v. Wilke, Fleury, Hoffelt, Gould &*
6 *Birney, LLP (In re Tevis)*, 347 B.R. 679, 693-94 (B.A.P. 9th Cir.
7 2006). The duty to disclose continues throughout the representation,
8 and incomplete disclosure may result in the denial of fees. *Neben &*
9 *Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.)*, 63
10 F.3d 877, 880-82 (9th Cir. 1995); *cf.* 11 U.S.C. § 328(c).

11 **II. Allen's Employment as Special Counsel**

12 **A. Disinterestedness**

13 An attorney must be a disinterested person to be employed as
14 special counsel by the trustee. 11 U.S.C. § 327(a). "Disinterested
15 person" is a defined term. *Id.* § 101(14). Creditors are not
16 disinterested persons. *Id.* § 101(14)(A). "Yet, § 327(c) makes clear
17 that an attorney's representation of a creditor does not per se
18 deprive that attorney of 'disinterested' status, but rather becomes a
19 potential disqualifier for employment" if an "actual conflict of
20 interest" exists. *See In re Kobra Props.*, 406 B.R. 396, 403 (Bankr.
21 E.D. Cal. 2009) (citing § 327(c)) (distinguishing between a creditor
22 and creditor's counsel).

23 Allen is not a creditor. He has filed no proof of claim, nor
24 could he do so. He does not "ha[ve] a claim against the debtor that
25 arose at the time of or before the order for relief." 11 U.S.C.
26 § 101(10)(A) (defining "creditor"); *see also id.* § 101(15) (defining
27 "entity"), (41) (defining "person"). The term "claim" generally means
28 a "right to payment." *See id.* § 101(5).

1 Ordinarily, the phrase "right to payment" under § 101(5) means an
2 enforceable obligation under applicable state law. *See Travelers Cas.*
3 *& Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450-51 (2007); *In re*
4 *Nat'l Gypsum Co.*, 139 B.R. 397, 405 (N.D. Tex. 1992). Because Indiana
5 is where the underlying action arose, Indiana law governs.

6 Hume Smith and National have provided no applicable law giving
7 rise to a right to payment that Allen could enforce against Hummer.
8 Indiana law recognizes no such right arising from Allen's contingency
9 fee agreement with the Hartys in their underlying personal injury
10 action against Hummer. *See State Farm Mut. Auto. Ins. Co. v. Ken Nunn*
11 *Law Office*, 977 N.E.2d 971, 980-81 (Ind. Ct. App. 2012) (denying
12 attorney recovery against tort defendant's insurer under quantum
13 meruit theory); *Wilson v. Sisters of St. Francis Health Servs. Inc.*,
14 952 N.E.2d 793 (Ind. Ct. App. 2011) (finding that a third party to a
15 contingency fee agreement between an attorney and a client did not
16 have an obligation to the attorney).

17 The only persons having an obligation to Allen under his
18 contingency fee agreement would be the other parties to that
19 agreement, his clients. Thus, under applicable nonbankruptcy law,
20 Allen has no claim enforceable against Hummer and is disinterested.

21 **B. No adverse interest**

22 Section 327(a) also requires that prospective counsel not hold or
23 represent an interest adverse to the estate. To *hold* an interest
24 adverse to the estate means "(1) to possess or assert any economic
25 interest that would tend to lessen the value of the bankrupt estate or
26 that would create either an actual or potential dispute in which the
27 estate is a rival claimant; or (2) to possess a predisposition under
28 circumstances that render such a bias against the estate." *Tevis*, 347

1 B.R. at 688.

2 "To represent an adverse interest means to serve as an attorney
3 for an entity holding such an adverse interest." *Id.* But in the
4 context of special counsel employed for a limited purpose, "the
5 attorney must not represent an adverse interest relating to the
6 services which are to be performed by that attorney." *Fondiller*, 15
7 B.R. at 892.

8 The key lies in the phrase "adverse interest." Here, the
9 interests of the Hartys and the estate in Hawkins's action are
10 aligned, not opposed. *Stoumbos*, 988 F.2d at 964 (recognizing the
11 alignment of the interests of the estate and a prepetition creditor
12 who filed an involuntary petition against the debtor because the
13 estate's recovery would increase the creditor's pro rata recovery).
14 Both the Hartys and the estate stand to benefit from any recovery in
15 Hawkins's action against National and Hume Smith. Because Allen's
16 role is limited to this specific matter, his representation of the
17 Hartys is not a disqualifying interest.

18 **C. No actual conflict of interest**

19 If a creditor or the U.S. Trustee objects, § 327(c) mandates that
20 the court disapprove the trustee's employment of a creditor's attorney
21 if an actual conflict of interest exists. But "where the trustee
22 seeks to appoint counsel only as 'special counsel' for a specific
23 matter, there need only be no conflict between the trustee and
24 counsel's creditor client with respect to the specific matter itself."
25 *Stoumbos*, 988 F.2d at 964.

26 "[A] conflict of interest is actual and warrants disqualification
27 under § 327(c) if there is active competition between two interests,
28 in which one interest can only be served at the expense of the other."

1 *Johnson v. Richter, Miller & Finn (In re Johnson)*, 312 B.R. 810, 822
2 (E.D. Va. 2004) (internal quotation marks omitted). "[T]here is no
3 'actual conflict of interest' warranting disqualification unless
4 (i) the interests of the trustee and the creditor are in fact directly
5 conflicting or (ii) the creditor is actually afforded a preference
6 that is denied to other creditors." *Id.* (footnote omitted), *quoted in*
7 *Byrd v. Johnson*, 467 B.R. 832, 848-49 (D. Md. 2012).

8 The court does not find active competition between both interests
9 represented by Allen. The Hartys have no direct cause of action under
10 Indiana law against either National or Hume Smith. *See Brady v.*
11 *Allstate Indem. Co.*, 788 N.E.2d 916, 920 (Ind. Ct. App. 2003) ("[The]
12 duty of good faith does not apply to an insurer's dealings with a
13 claimant in a third party claim." (citing *Menefee v. Schurr*, 751
14 N.E.2d 757, 760 (Ind. Ct. App. 2001))); *Keybank Nat'l Ass'n. v.*
15 *Shipley*, 846 N.E.2d 290, 297 (Ind. Ct. App. 2006) (finding attorney's
16 duty extends only to those in privity of contract with the attorney).
17 Furthermore, as unsecured creditors of estate, the Hartys benefit from
18 any recovery for the estate in Hawkins's action against National and
19 Hume Smith.

20 Allen's representation of the estate in this specific matter,
21 moreover, does not presently conflict with or limit his continued
22 representation of the Hartys. Hawkins's action is not adverse to the
23 Hartys' interest in recovery on their judgments. Thus, the interests
24 of the Hartys and the estate are aligned.

25 National has filed a proof of claim, but Allen's representation
26 in Hawkins's action does not afford a preference to the Hartys that is
27 denied to National as the only other unsecured creditor having filed a
28 claim. Any recovery in such action would be shared pro rata by both

1 the Hartys and National to the extent the estate had sufficient funds
2 to pay unsecured creditors. Although recovery against National and
3 Hume Smith would be detrimental to National, such detriment does not
4 result in what amounts to a preference in favor of the Hartys.

5 Hume Smith's arguments to the contrary are not persuasive.
6 Initially, Hume Smith argues that it or National might create a
7 conflict by offering a settlement, in exchange for withdrawing their
8 claims against the estate. This argument does not have merit. The
9 statute requires an actual, not a potential, conflict for
10 disqualification. Further, such a problem is systemic to § 327(c),
11 applying to every instance where a creditor's attorney is employed by
12 the Chapter 7 trustee, as another creditor could always seek to create
13 a conflict by purchasing the claim of the creditor client represented
14 by the trustee's attorney. In any case, an actual conflict of
15 interest is characterized by a current competition of interests.
16 Events that may occur in the future are not relevant.

17 National and Hume Smith also argue that Allen might be a witness
18 in Hawkins's action against them because of Allen's involvement in the
19 Hartys' communications of positions and settlement terms to Hume Smith
20 and National that were not accepted. There has been no showing that
21 Allen's testimony will be *necessary* in the action against National or
22 Hume Smith. See Ind. Rules of Prof'l Conduct 3.7(a) ("[A] lawyer
23 shall not act as advocate at a trial in which the lawyer is likely to
24 be a *necessary* witness" (emphasis added)). No showing has
25 been made that such evidence can be offered only through Allen's
26 testimony rather than through documentary evidence or testimony of the
27 Hartys or other members of Allen's firm. See Ind. Rules of Prof'l
28 Conduct 3.7(b) (permitting lawyer to act as advocate in a trial in

1 which another lawyer in the lawyer's firm is likely to be a witness
2 unless precluded from doing so by Rules 1.7 and 1.9).

3 And even if Allen may be called as a witness, the Indiana Rules
4 of Professional Conduct do not prohibit a lawyer from being called in
5 all instances. A lawyer may act as an advocate at trial for which he
6 is likely to be a witness if "the testimony relates to an uncontested
7 issue" or if "disqualification of the lawyer would work substantial
8 hardship on the client." Ind. Rules of Prof'l Conduct 3.7(a)(1), (3).
9 Allen may be called to testify on such mundane matters as
10 authenticating letters to Hume Smith containing settlement terms and
11 positions, or he may not need to be called at all.

12 Accordingly, all of the eligibility requirements of § 327(a) have
13 been met. No actual conflict of interest exists under § 327(c).

14 **III. Incomplete Disclosure under Rule 2014(a)**

15 Rule 2014(a) requires a full, fair, and complete disclosure of
16 connections to the debtor, creditors, and other parties in interest.
17 After an initial failure of disclosure but once the true facts are
18 known, the court "has considerable discretion . . . to allow all, part
19 or none of the fees." *In re Thomas*, 476 B.R. 579, 587 (N.D. Cal.
20 2012).

21 The court declines Hume Smith's invitation to revoke the
22 employment order or to dock Allen's fees on the basis of Allen's
23 failure to disclose his connections. First, the court believes the
24 error was unintentional. Second, the court notes that it was Hawkins
25 that first brought the matter to the court's attention. Third,
26 Allen's representation of the Hartys was not being concealed as the
27 representation was evident from the Hartys' judgment, which was
28 attached to the Hartys' proofs of claim filed July 12, 2012, before

1 the trustee's original application to employ Allen. Fourth, the court
2 finds that the failure did not alter the outcome. Finally, the court
3 concludes that the interests of the estate are best served by Allen's
4 continued participation.

5 **CONCLUSION**

6 For the reasons discussed, the supplemental application to employ
7 Allen as special counsel will be approved nunc pro tunc to July 23,
8 2012, and the motion to vacate the order previously approving his
9 employment will be denied. The order approving this employment will
10 provide the proper venue and court in which Hawkins's action is
11 pending. Hawkins will lodge orders consistent with this decision.

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13 Dated: September 12, 2013

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Fredrick E. Clement
15 United States Bankruptcy Judge
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