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UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF CALIFORNIA

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
FRESNO DIVISION

In re	Case No. 13-16155-B-7
Michael Weilert and Genevieve M. de Montremare,	DC No. MCW-1
Debtors.	

MEMORANDUM DECISION REGARDING MOTION TO DISQUALIFY

Marshall Whitney, Esq., of McCormick, Barstow, Sheppard, Wayte & Carruth LLP, appeared on behalf of Wild, Carter & Tipton.

Mandy L. Jeffcoach, Esq., of McCormick, Barstow, Sheppard, Wayte & Carruth LLP, appeared on behalf of Wild, Carter & Tipton.

Peter L. Fear, Esq., of the Law Offices of Peter L Fear, appeared on behalf of the chapter 7 trustee, James E. Salven.

Daniel B. Spitzer, Esq., of the Law Offices of Daniel B. Spitzer, appeared on behalf of special counsel to chapter 7 trustee, James E. Salven.

This disposition is not appropriate for publication however may be cited for whatever persuasive value it may have (*see* Fed. R.App. P. 32.1).

In this case, a creditor-law firm is being sued by the trustee for alleged legal malpractice in its representation of the debtors in pre-petition litigation. The creditor-law firm seeks to have the trustee's special counsel in that malpractice case (the creditor-law firm's adversary in the underlying litigation) disqualified because of inadequate disclosures and potential conflicts of interest. The necessary disclosures having now been made (albeit late) and the court not convinced that an actual conflict of interest with the estate currently exists, the motion to disqualify the trustee's special counsel (the "Motion") will be denied.

INTRODUCTION

Professionals retained by a bankruptcy estate are subject to disqualification and other sanctions if the court finds that, at any time before or during employment, the professional holds or represents an interest adverse to the estate or is not "disinterested." 11 U.S.C. § 327(a).[1] A narrow "safe harbor" spares a professional the "dooms day" sanction of disqualification based solely on the fact that the professional represents a creditor of the bankruptcy estate. § 327(b). However, if another creditor or the U.S. Trustee objects, the court must disapprove or disqualify the professional if there is an actual conflict of interest. § 327(c). Employment of special counsel is further treated in § 327(e). Where a trustee seeks to retain, "for a specified special purpose . . . an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed." This section has been analogized in case law to be applicable where such representation was of a creditor. In order to assess whether a professional should be, or continue to be, employed by the estate, the Federal Rules of Bankruptcy Procedure impose on the professional strict and continuing duties of complete candor, to the court and other interested parties, to disclose any "connections" the professional has with the debtor, creditors, any other party in interest and others under pain of disqualification and possibly fee disallowance or disgorgement. Rule 2014.

For the reasons set forth below, the court will deny the Motion.

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[1] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

FACTS

A. Pre-petition Events

Dr. Michael Weilert and Genevieve M. de Montremare formed the M&G Weilert Family Limited Partnership. Dr. Weilert and Ms. Montremare and the Family Limited Partnership shall collectively be referred to as "Debtors." The Debtors owned a 15 acre ranch in Parlier, California (the "Ranch"). In May 2008, Brian L. Gwartz and Cheryl A. Skigin, individually and as co-trustees of the Pendragon Trust (hereinafter "Pendragon"), purchased the Ranch from the Debtors. Pendragon purchased the Ranch for use by Brian Gwartz in boarding, training, and breeding Friesian horses, and the adequacy of the Ranch's facilities for these uses was important to Brian Gwartz' desire to train for equestrian competition. Pendragon's other prominent consideration was the international reputation of debtor Genevieve M. de Montremare and her dedication to the breeding and promotion of the Friesian breed before her alleged death in November 2007, who had been portrayed by Dr. Weilert as the heiress to her dynastic family's fortune. Soon after the sale, Pendragon claimed that Dr. Weilert misrepresented the derivation and condition of the Ranch.

When Pendragon confronted Dr. Weilert with his apparent misrepresentations, he refused to negotiate. Pendragon retained the Dowling, Aaron, Inc. ("DAI") law firm to obtain necessary permits to repair or construct certain buildings on the Ranch. Initially, Pendragon did not wish to litigate but eventually DAI filed and prosecuted a lawsuit on Pendragon's behalf against the Debtors (the "Ranch Litigation"). In April 2010, the law firm of Wild, Carter & Tipton ("WCT") became counsel for the Debtors. Mediation overtures by Pendragon were rebuffed by WCT on behalf of the Debtors. Frustrated by that fact and other alleged problems in DAI's representation of Pendragon, in April 2011 Pendragron replaced DAI with attorney Daniel B. Spitzer, Esq. (hereinafter "Attorney Spitzer" or "Spitzer"). Following discovery, numerous pleading motions and at least one motion for summary judgment in the Fresno County Superior Court (the "State Court"), the trial of the action between Pendragon and the Debtors began in September 2012.

After over 21 trial days, on October 25, 2012, the State Court jury found the Debtors liable on all counts, including those of intentional fraud and concealment. The punitive damage phase began four days later. The jury awarded a total judgment of $1,553,800. Of that sum, $850,000 was punitive damages. The State Court stayed enforcement of the Pendragon judgment pending resolution of post-trial motions. During that stay, the Debtors made several transfers of assets that were documented by their attorney, WCT. The post-trial motions filed by the Debtors were denied by the State Court. The Debtors filed an appeal of the judgment in December 2012 but did not seek a stay of enforcement or file an undertaking.

In late May 2013, Pendragon obtained a post-judgment charging order, turnover order, and assignment order from the State Court. The Debtors filed a petition for a writ in the California Court of Appeal challenging those orders and sought a stay of enforcement. The writ was summarily denied on June 7, 2013.

B. The Bankruptcy Filings and Early Bankruptcy Litigation

After the writ was denied, the Debtors filed a chapter 11 bankruptcy case on behalf M&G Weilert Family Limited Partnership and the case was assigned to Judge Lee.[2] Attorney Spitzer, Pendragon's counsel, appeared before Judge Lee in the related adversary proceeding to oppose a motion for a temporary restraining order and order to show cause regarding preliminary injunction. Attorney Spitzer submitted a declaration in that litigation detailing, *inter alia*, his role as counsel for Pendragon in the Ranch Litigation. In July 2013, Attorney Spitzer filed a motion to dismiss or convert the Debtors' chapter 11 case. The record on that motion included a declaration in support of the motion detailing facts about Attorney Spitzer's role as trial counsel in the Ranch Litigation.[3] Subsequently, the M&G Weilert Family Limited Partnership chapter 11 case

[2] U.S. Bankruptcy Court, Eastern District of California, No. 13-14036.

[3] See Adversary Proceeding No. 13-01066 (Doc. 20 and 29).

was dismissed. Thereafter, the Debtors filed two chapter 7 cases which were assigned to Judge Lee and substantively consolidated.[4] James Salven was appointed chapter 7 trustee (the "Trustee"), and he retained Peter Fear, Esq., as his general counsel ("General Counsel").

C. Appointment of Attorney Spitzer and Motion to Disqualify

Sometime in August 2014, the Trustee was made aware of a potential malpractice action by the Debtors' bankruptcy estate (the "Bankruptcy Estate") against the Debtors' former counsel, WCT.[5] After a search of nearly six months, the only attorney the Trustee could find willing to undertake the representation on a financially feasible basis was Attorney Spitzer.[6] The Trustee signed a retainer agreement on June 9, 2015 (the "Agreement"). The Agreement, which was filed with the employment application, is nine pages long and outlines the terms for payment of fees on a strictly contingency basis with the exception of costs which must be approved by the court before payment. The Agreement contains disclosures, including Attorney Spitzer's representation of Pendragon: 1) in the underlying Ranch Litigation against the Debtors; 2) in the previous chapter 11 case; 3) in adversary proceedings against the Debtors objecting to their discharge; and 4) determining dischargeability of debt. The Agreement also discussed the potential conflict of interest involving Attorney Spitzer's prior representation of Pendragon and the fact that Attorney Spitzer could be a potential witness in the Bankruptcy Estate's malpractice litigation against WCT (the "WCT Malpractice Action").

On June 11, 2015, both the Trustee's application for an order authorizing employment of attorney as special counsel (Doc. 393), and the declaration of Spitzer in

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[4] The lead case is case number 13-16155-B-7, *In re Michael Weilert, M.D. and Genevieve M. de Montremare*.

[5] See (Doc. 393).

[6] Declaration of Peter Fear (Doc. 503).

support of the application (Doc. 396), were filed with the court (the "Application"). The declaration disclosed Spitzer's representation of Pendragon in the Ranch Litigation and the various bankruptcy proceedings involving these Debtors and their affiliates. The Application was noticed for hearing to all creditors, including Debtors' counsel, WCT and affiliated attorneys (Doc. 394).[7] No one appeared in opposition to the Application. The hearing was continued to July 23, 2015, for submission of additional information requested by the court. In response, six days before that hearing, the Trustee filed the supplemental declaration of Attorney Spitzer. On July 23, 2015, the court issued its civil minutes (Doc. 430), which stated as follows:

> "This matter was fully noticed in compliance with the Local Rules and there is no opposition. Accordingly, the respondent(s) default was entered and the motion was granted without oral argument for cause shown. The moving party shall submit a proposed order."

The order appointing Attorney Spitzer as special counsel was entered on July 24, 2015 (Doc. 431). Noticeably absent from the disclosures or the Agreement was a clear and unambiguous statement that Attorney Spitzer was representing Pendragon in a then-potential legal malpractice claim against its former counsel, DAI, relating to DAI's alleged errors and omissions prior to Pendragon's retention of Attorney Spitzer in the Ranch Litigation.

In September 2015, Attorney Spitzer, on behalf of the Bankruptcy Estate, filed a complaint in the State Court commencing the legal malpractice action against Debtors' counsel in the Ranch Litigation, WCT, and some of its affiliated attorneys (the "WCT Malpractice Action").[8] One month later, Attorney Spitzer undertook formal representation of Pendragon and filed a legal malpractice action in the State Court against Pendragon's former counsel, DAI, and some of its affiliated attorneys. It is

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[7] Interestingly, affiliated attorneys with DAI also received notice of this application.

[8] The parties have advised the court that a trial date is scheduled for the WCT action in March 2017.

worth noting that Attorney Spitzer had negotiated a tolling Agreement with DAI much earlier on February 15, 2012.[9] Attorney Spitzer did not augment his previous disclosures to the bankruptcy court by revealing his representation of Pendragon at or around the time he filed the DAI Malpractice Action in State Court.

In July 2016, Debtors' former counsel, WCT, filed a motion in the State Court to disqualify Attorney Spitzer as counsel in the WCT Malpractice Action. The hearing was continued to September 13, 2016. That motion was denied on the grounds that exclusive jurisdiction over employment of professionals in bankruptcy cases rests with the bankruptcy court. Concurrently, Attorney Spitzer filed, with the bankruptcy court, a Second Supplemental Declaration Regarding Trustee's Application for Order Authorizing Employment of Attorney as Special Counsel (Doc. No. 458). The second supplemental declaration reiterates Attorney Spitzer's role as trial counsel in the Ranch Litigation and states that, as of October 25, 2015, Attorney Spitzer undertook the representation of Pendragon in the DAI Malpractice Action. Attorney Spitzer claims that he had previously informed the Trustee and his General Counsel of the pendency of the DAI Malpractice Action and neither one has expressed any objection or reservation. This supplemental disclosure, along with the State Court's denial of WCT's motion to disqualify Attorney Spitzer, were the catalysts for this Motion.[10]

JURISDICTION

This court has subject matter jurisdiction pursuant to 28 U.S.C. § 1334(b) in that this a civil proceeding arising under Title 11 of the United States Code. The district

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[9] Attorney Spitzer claims that "no decision" was made to pursue DAI in a formal litigation until early October of 2015 when negotiations broke down.

[10] At oral argument, counsel for WCT raised numerous evidentiary objections to the evidence submitted by Attorney Spitzer. The court ruled on these objections at oral argument.

court referred this matter to this court pursuant to 28 U.S.C. § 157(a). The bankruptcy court's authority to hear and determine cases under Title 11 in all core proceedings is derived from 28 U.S.C. § 157(b)(1). This is a "core" proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

ISSUES

This court is being asked, one, to determine whether the Trustee's special counsel, who has been employed to represent the Bankruptcy Estate in a malpractice suit against the Debtors' prior counsel in connection with their representation of Debtors in pre-petition civil litigation, has an actual conflict of interest with the estate based upon:

a. Special counsel's prior representation of a creditor in that pre-petition civil action against the Debtors where the judgment has become final;

b. Special counsel's representation of the same creditor in a malpractice suit against that creditor's prior counsel in that same pre-petition civil action.

Second, the court is being asked to decide whether Trustee's special counsel should be disqualified because of inadequate disclosure of his connections where those defects have now been remedied.

ANALYSIS

I. Adequacy of Disclosures

A. Requirements for Appointment

A chapter 7 Trustee is obligated to "collect and reduce to money the property of the estate for which such Trustee serves." § 704(a)(1). Subsection (a) of § 327 authorizes the Trustee, "with the court's approval," [t]o "employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons to represent or assist Trustee in carrying out the Trustee's duty under this title." Section 101(14)(A) defines a "disinterested person" to include a person who "is not a creditor, an equity security holder, or an insider." A person who is not disinterested as that term is defined in § 101(14) is disqualified from acting as a professional for the estate. *In re Capitol Metals Co., Inc.*, 228 B.R. 724, 726-27 (9th Cir.

BAP 1998).

Section 327 generally "imposes the 'disinterested' requirement on all general and special counsel employed under that section . . . ." *In re Maximus Computers, Inc.*, 278 B.R. 189, 196 (9th Cir. BAP 2002). The applicant bears the burden of proving the "standards for appointment have been met." *In re Capitol Metals*, 228 B.R. at 727. Section 327(a) has been interpreted "to mean the attorney must not represent an adverse interest relating to the services which are to be performed by that attorney." *In re Fondiller*, 15 B.R. 890, 892 (9th Cir. BAP 1981).

In this case, Attorney Spitzer has been appointed as special counsel to represent the Trustee against the Debtors' former counsel in the WCT Malpractice Action. Attorney Spitzer must be, both, disinterested, and, not hold or represent an interest "adverse to the estate." First, Attorney Spitzer is disinterested according to the "disinterested person" definition,. He is not, himself, a creditor, an equity security holder, or an insider of any of the debtor entities. He has not been, and was not within two years before the filing date, a director, officer, or employee of the debtor. He does not have an interest materially adverse to the interest of the estate or to any class of creditors, or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in the debtor, or "for any other reason." No party has brought to the court's attention any allegation that Attorney Spitzer himself has an interest materially adverse to the Bankruptcy Estate other than the previously approved Agreement for his services to the Trustee as special counsel. Attorney Spitzer's prior relationship with the Debtors was as an advocate adverse to the Debtors in the pre-petition Ranch Litigation. No party has, however, brought to the court's attention any issue regarding a personal interest that Attorney Spitzer has that is adverse to the Bankruptcy Estate or to the Debtors.

Second, Attorney Spitzer does not possess an "adverse interest" to the Bankruptcy Estate. A generally accepted definition of "adverse interest" is, (1) the possession or assertion of an economic interest that would tend to lessen the value of the Bankruptcy

Estate; or (2) possession or assertion of an economic interest that would create either an actual or potential dispute in which the Bankruptcy Estate is the rival claimant; or (3) possession of a predisposition under circumstances that create a bias against the Bankruptcy Estate. *Dye v. Brown (In re AFI Holding, Inc.)*, 355 B.R. 139, 148-49 (9th Cir. BAP 2006). Other than his contingency fee contract represented by the Agreement, Attorney Spitzer does not possess or assert an economic interest tending to lessen the value of the Bankruptcy Estate. WCT claims that, because Pendragon has the DAI Malpractice Action, currently pending in State Court, against its former counsel, Pendragon and the Bankruptcy Estate may be rival claimants to the same damages. For reasons indicated below, such a situation appears at this time to be unlikely and does not rise to an "adverse interest" that would disqualify Attorney Spitzer. Finally, there is no evidence that Attorney Spitzer possesses a predisposition creating a bias against the estate.

B. Sufficiency of Disclosures

To enable a bankruptcy court to evaluate an attorney's potential employment, Rule 2014(a) requires that an application for employment of an attorney under section 327 shall be accompanied by a verified statement of the person to be employed setting forth "all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." This disclosure requirement is applied "strictly." *In re Park-Helena Corp.*, 63 F.3d 877, 881 (9th Cir. 1995). Pursuant to the disclosure rules, the attorney has the duty to disclose all relevant information to the court and may not exercise any discretion to withhold information. See*, Park-Helena*, 63 F.3d at 882; *In re Thomas*, 476 B.R. 579, 586 (N.D.Cal. 2012). "The purpose of such disclosure is to permit the bankruptcy court and parties in interest to determine whether the connection disqualifies the applicant from the employment sought, or whether further inquiry should be made before deciding whether to approve the employment. This decision should not be left to counsel, whose judgment may be

clouded by the benefits of the potential employment." *In re Lee*, 94 B.R. 172, 176 (Bankr.C.D. Cal., 1988). The duty to disclose extends to "all facts that may be pertinent to a court's determination of whether an attorney is disinterested or holds an adverse interest to the estate" regardless of whether the attorney thinks the information is sufficient to render him adversely interested. *Park-Helena*, 63 F.3d at 882. "Negligent or inadvertent omissions do not vitiate the failure to disclose," and such a failure "may result in a denial of all requested fees." *Id.* at 881-82.

In this case, the challenges to the sufficiency of disclosure relate to three specific events. First, the original disclosure dated June 9, 2015, accompanying the Trustee's application to employ Attorney Spitzer (Doc. No. 396). Second, the supplemental declaration of Attorney Spitzer dated July16, 2015 (Doc. No. 428), in which Attorney Spitzer responded to Judge Lee's requests for additional information. The third is the second supplemental disclosure by Attorney Spitzer dated August 17, 2016, (Doc. No. 458) which prompted this disqualification litigation. The court will discuss each in turn.

1. Initial and First Supplemental Disclosures

WCT, Debtors' counsel in the Ranch Litigation in State Court and the defendant in the WCT Malpractice Action filed by the Trustee, contends that Spitzer's initial disclosures were completely inadequate. Specifically, WCT argues that the initial disclosures did not state clearly that Attorney Spitzer was trial counsel in the Ranch Litigation. In addition, WCT contends that the initial disclosure was misleading in not revealing Attorney Spitzer's ongoing representation of Pendragon in the DAI Malpractice Action against Pendragon's former counsel in the Ranch Litigation.[11] Additionally, WCT contends that Attorney Spitzer improperly described the then-pending DAI Malpractice Action, in which he represented Pendragon, as "a collection

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[11] DAI was predecessor counsel to Attorney Spitzer in the Ranch Litigation.

action."[12]

The initial disclosures were served on all creditors, including WCT.[13] There was no objection. The initial disclosures revealed that Attorney Spitzer represented Pendragon who was the largest creditor in the Debtors' bankruptcy case. The initial filings included the Agreement which contained a conflict waiver for Spitzer's representation of Pendragon in the Ranch Litigation against the Debtors. Attorney Spitzer also disclosed, to the Trustee and the Trustee's general counsel, the potential conflicts including Spitzer's potential role as a witness in the WCT Malpractice Action and that the Trustee had determined (along with the Trustee's General Counsel) that there were no actual conflicts. In response to Judge Lee's inquiry, Spitzer submitted a supplemental declaration on July 16, 2015, which outlined the claims against WCT including alleged negligent estate planning services and negligent handling of the Ranch Litigation and that Attorney Spitzer, on behalf of the Bankruptcy Estate, would seek disgorgement of $500,000 of WCT's fees paid to it by the Debtors.

The initial (and supplemental) disclosures were inadequate in Attorney Spitzer's failure to mention his ongoing representation of Pendragon in the DAI Malpractice Action against Pendragon's predecessor counsel. It was not until WCT filed the motion to disqualify Spitzer in the State Court (which the State Court did not decide on the merits) that additional disclosures were filed in this case and Spitzer's representation of Pendragon in the DAI Malpractice Action was manifest.

Attorney Spitzer did reveal his representation of Pendragon in specific matters and the disclosure encompassed his representation of Pendragon in the Ranch Litigation which, logically would include his success in that matter. Presumably, Judge Lee was

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[12] WCT also contends the disclosure was not adequate in noting that Attorney Spitzer could be a "witness" in the malpractice action against WCT. The "witness conflict" will be discussed in detail below. The disclosure will be discussed here.

[13] See (Doc. No. 394).

aware of those facts since Spitzer represented Pendragon in a motion to dismiss the earlier chapter 11 case filed by the Weilert Family Limited Partnership.[14]

However, no party in interest objected at the time the initial disclosures were filed. Other than the DAI Malpractice Action, all facts were presented to the court including recommendations of the Trustee and his General Counsel.

2. Later Disclosure of the DAI Malpractice Litigation Connection

Counsel is obligated to make full and candid disclosure regardless of how irrelevant or trivial those connections may seem. See, *In re Mehdipour*, 202 B.R. 474, 480 (9th Cir. 1996). Failure to comply with disclosure requirements may result in employment being denied or revoked, or other sanctions imposed "even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or any Bankruptcy Rule." *Park-Helena*, 63 F.3d at 880. The duty of disclosure is ongoing. *In re West Delta Oil Co., Inc.*, 432 F.3d 347, 355 (5th Cir. 2005). The penalty for nondisclosure is within the bankruptcy court's discretion and can range from nothing, as in *First Interstate Bank of Nevada , N.A. v. CIC Inv. Corp. (In re CIC Inv. Corp.)* 175 B.R. 52, 54 (9th Cir. BAP 1994), to disallowance of all fees. *Park-Helena*, 63 F.3d at 882.

Here, there is a clear failure by Attorney Spitzer to seasonably disclose his ongoing representation of Pendragon, against its former counsel, in the DAI Malpractice Action. This litigation is related to the Bankruptcy Estate's claim, against Debtors' former counsel, in the WCT Malpractice Action. The second supplemental declaration of Attorney Spitzer (Doc. 458) was not filed until late in these proceedings. In the second supplemental declaration, Attorney Spitzer states he undertook the representation in October of 2015. He also states that he had previously informed the Trustee.[15]

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[14] See case number 13-14036, (Doc. No. 29).

[15] Second Supplemental Declaration of Attorney Spitzer, (5:22-24).

Attorney Spitzer also states he "believes" that the representation of Pendragon against DAI has "no relevance" to the WCT Malpractice Action and that, in "his opinion," it does not pose a conflict and that "allegations against [DAI] do not contradict the allegations in the action against WCT."[16]

First, it is not up to the professional to decide which connections should be disclosed. Second, negligent or inadvertent disclosures are not excused under *Park-Helena*. Third, Attorney Spitzer's position, that failure to promptly disclose the DAI Malpractice Action connection was somehow inadvertent, strains credulity. Attorney Spitzer admitted that, after being appointed as the estate's special counsel for litigation against WCT, Attorney Spitzer negotiated four separate tolling agreements with DAI. This court simply does not believe that inadvertence explains the failure to disclose Attorney Spitzer's continuing engagement in litigation that is closely related to the Bankruptcy Estate's malpractice claim against WCT. Rather, it appears to be either hubris or a mistake of law, neither of which is a defense for failing to make timely disclosures.

A court has considerable discretion, once the true facts are known, on how to address the lack of disclosure. *In re Film Adventures International*, 75 B.R. 250, 253 (9th Cir. BAP 1987); *In re Lewis*, 113 F.3d 1040, 1045-6 (9th Cir., 1997). The bankruptcy court has discretion to excuse the failure to disclose. *CIC Inv. Corp.*, 175 B.R. at 54. If the bankruptcy court finds there is no need for remedial measures, it appropriately can excuse the failure in the exercise of this discretion. *Id.* citing *In re Film Adventures International*, 75 B.R. at 253.

Here, the court will excuse Attorney Spitzer's failure to disclose. First, Spitzer's late disclosure has served the purpose of the disclosure requirements in this case. WCT has now filed two motions to disqualify, one in the State Court and one in this court. There has been vigorous argument over Attorney Spitzer's continuing service as special

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[16] *Id.* at 6:4-9.

counsel. Second, according to the original documents filed in support of Attorney Spitzer's appointment, it was extremely difficult to locate counsel willing to accept the WCT Malpractice Action on a contingency basis. A trial date is imminent and the Bankruptcy Estate's position would be prejudiced by the disqualification of Attorney Spitzer, for failure to disclose, when the purpose of the disclosure requirements has now been served.[17]

The court is confident that the able counsel on this Motion have presented all of the facts to the court upon which it may assess the motion to disqualify on the grounds of inadequate disclosure. While Attorney Spitzer's initial disclosure of connections was wholly inadequate, the subsequent disclosure and attendant litigation on this motion resolves any prejudice. Given the potential harm to the estate, the facts militate in favor of this court excusing the disclosure at this time.

II. Alleged Conflicts of Interest.

A. General Standards

Under § 327(c), a person is not disqualified for employment solely because of such person's employment by or representation of a creditor unless there is an objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest. There need only be no conflict between the Trustee and counsel's creditor client with respect to the specific matter itself when a special counsel is appointed for a specific matter. *Stoumbos v. Kilimnik*, 988 F.2d 949, 964 (9th Cir., 1993). "Thus, where the interest of the special counsel and the interest of the estate are identical with respect to the matter for which special counsel is

[17] To be sure, as argued by WCT, trial dates can be continued and schedules changed to accommodate new counsel. The prejudice suffered by the estate would be substantial. Successor counsel, even if willing, would not have the familiarity with the case that Attorney Spitzer does. Also, it is speculative that the Superior Court would accommodate a plaintiff who has to change counsel so late in the process.

retained, there is no conflict and the representation can stand." *In re AroChem Corp.*, 176 F.3d 610, 622 (2nd Cir., 1999). Where attorneys are employed by both the Trustee and a creditor, there is no actual conflict of interest warranting disqualification unless (i) the interest of the trustee and the creditor are in fact directly conflicting or (ii) the creditor is actually afforded a preference that is denied other creditors. *Johnson v. Richter, Miller & Finn. (In re Johnson)*, 312 B.R. 810, 822 (DC E.D.Va, 2004). An attorney's representation of a creditor does not *per se* deprive that attorney of "disinterested" status, but rather becomes a potential disqualifier for employment to represent the Trustee on the conceptually distinct theory of actual conflict of interest. *In re Kobra Properties*, 406 B.R. 396, 403 (Bankr.E.D.Cal., 2009). The actual conflict of interest occurs between jointly represented clients "whenever their common lawyer's representation of the one is rendered less effective by reason of his representation of the other." *Blecher & Collins v. Northwestern Airlines, Inc.*, 858 F.Supp. 1442 (C.D. California, 1994). In determining the existence of a conflict of interest, the bankruptcy court does not ignore rules of professional conduct governing attorneys. State rules of professional responsibility do apply as long as they do not conflict with the bankruptcy code or the bankruptcy rules. *AFI Holding*, 355 B.R. at 153 n.15.

WCT contends that Attorney Spitzer has a conflict of interest in representing the estate for essentially three reasons. First, that Spitzer's representation of Pendragon in the Ranch Litigation against the Debtors, and of the Trustee against Debtors' former counsel in the WCT Malpractice Action, results in a conflict because Attorney Spitzer may need to utilize confidential information received from his client (Pendragon) in pursuing the action against WCT.[18] Second, that Spitzer may be called as a witness in the WCT Malpractice Action. Third, that Attorney Spitzer's concurrent representation of Pendragon against their former counsel in the DAI Malpractice Action results in

[18] As noted below, the "holder" of that privileged information, Pendragon, is not prosecuting the Motion.

"factual" conflicts. These "factual conflicts" arguably stem from inconsistent positions Spitzer will theoretically advocate in the WCT and DAI Malpractice Actions. These claims are discussed below.

B. Alleged Conflict in Current Representation of the Bankruptcy Estate and Former Representation of Pendragon in the Ranch Litigation Against the Debtors

The interests of Pendragon and the estate are not in direct conflict as a result of Attorney Spitzer's successful representation of Pendragon in the pre-petition Ranch Litigation against the Debtors. As a result of that litigation, Pendragon became a creditor in this bankruptcy case.[19] The interests of Pendragon and the Trustee are aligned in that, the more the Trustee can recover, the larger distribution Pendragon will receive from the assets of the Bankruptcy Estate.

Second, WCT most likely waived any objection to Attorney Spitzer's appointment by failing to object at the time of Attorney Spitzer's Application. WCT received notice of the Application and no objection was filed.

Third, any conflict arising as a result of Attorney Spitzer's representation of Pendragon in the Ranch Litigation was waived by the Trustee through his General Counsel and the Application was noticed to all creditors before Attorney Spitzer was appointed. California Rule of Professional Conduct 3-310(c) provides in part:

> "A member shall not, without the informed written consent of each client:
> (1) Accept representation of more than one client in a matter in which the interest of the clients potentially conflict; or
>
> (2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or
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> (3) Represent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter."

Bankruptcy cases have applied these Rules. See, *In re Jaeger*, 213 B.R. 578, 583

[19] WCT is also a creditor in this bankruptcy case.

(Bankr.C.D. Cal. 1997); *In re Lee*, 94 B.R. at 177-78.

While the policy of section 327(a) requires a professional to give undivided loyalty to the client, this requirement may be waived in appropriate cases if the parties in interest so desire. *In re Wheatfield Business Park LLC*, 286 B.R. 412, 423 (Bankr.C.D.Cal., 2002). Here, the Trustee has the benefit of General Counsel. When the Trustee discovered the potential claim against WCT, he sought representation for several months without success. When the Trustee decided to retain Attorney Spitzer, the Trustee and his General Counsel reviewed the Agreement. No creditor (including WCT) objected to the Application. According to the evidence, the Trustee was made aware of the potential conflict issues and the Trustee and his General Counsel determined there were none that would justify the disqualification of Attorney Spitzer.

Fourth, no present actual conflict from Spitzer's sequential representations has been described by WCT. WCT cites *People ex rel. Dept. of Corp. v. SpeeDee Oil Change Systems, Inc.*, 20 Cal. 4th 1135, 86 Cal. Rptr.2d 816 (1999). This case is not controlling because there, the same law firm represented (albeit fleetingly) both the plaintiff and the defendant in the same litigation which resulted in a *per se* disqualification. In fact, the California Supreme Court stated that on a disqualification motion, a court must balance such varied interests, as the party's right to chosen counsel, the interest in representing a client, the burden placed on the client to find new counsel, and the possibility that tactical abuse underlies the disqualification motion. *Id.* at 1145. This is not a situation where Attorney Spitzer is representing both the plaintiff (the estate) and the defendant (WCT) in the same action which was the situation in *SpeeDee Oil*. At oral argument, WCT's counsel emphasized that it is possible the State Court will consolidate the malpractice case against WCT and the case against DAI for trial. That, of course, is speculative at this moment and is not a present disqualifying conflict. Even if the malpractice cases are consolidated, no *per se* conflict would result as discussed in this Memorandum.

WCT also cites *State Farm Mutual Automobile Insurance Company v. Federal*

Insurance Company, 72 Cal. App.4th 1422; 86 Cal.Rptr.2nd 20 (1999) arguing Attorney Spitzer's intimate involvement with the Ranch Litigation against the debtor disqualifies him here. The *State Farm* case is not persuasive. There, a law firm represented two insurance companies. In one matter, the law firm represented insurance company A who had a coverage dispute with insurance company B. Simultaneously, the law firm represented at least one of insurance company B's insureds in defense of a matter. Because of the concurrent adverse representation of both insurance companies, the California Court of Appeal reversed a trial court ruling denying the motion to disqualify. Here, Attorney Spitzer's representation of Pendragon in the prior law suit against the debtor is not concurrent adverse representation to the Bankruptcy Estate. At no time during the course of the Ranch Litigation against these Debtors did Spitzer represent the estate and, as indicated above, the interest of Pendragon and the estate are aligned in the attempting to maximize recovery for creditors. For these independent reasons, there is no present actual conflict.

C. The Alleged "Witness" Conflict

WCT claims that Attorney Spitzer will need to testify in the WCT Malpractice Action concerning WCT's alleged negligence in representing the Debtors in the Ranch Litigation. However, the declarations filed in support of the Motion outlined no scenario where Attorney Spitzer would be called as a witness. Rather, WCT posits the argument that it is "likely" Attorney Spitzer will be called as a witness.

Because the advocate-witness rule lends itself to "potential for abuse," motions to disqualify under this rule should be subjected to particularly strict judicial scrutiny. *Optyl Eyewear Fashion International Corp. v. Style Companies Limited*, 760 F.2d. 1045, 1050 (9th Cir., 1985). To be justified, a motion to disqualify must be based on present concerns and not concerns which are merely anticipatory and speculative. *In re Coordinated Pre-trial Proceedings, etc.*, 658 F.2d 1355, 1361 (9th Cir. 1981). "A necessary witness is not the same thing as the 'best' witness. If the evidence that would

be offered by having an opposing attorney testify can be elicited through other means, then the attorney is not a necessary witness. In addition, of course, if the testimony is not relevant or is only marginally relevant, it certainly is not necessary." *Harter v. University of Indianapolis*, 5 F.Supp.2d 657, 665 (S.D. Indiana, 1998). California Rule of Professional Conduct 5-210 provides as follows:

> A member shall not act as an advocate before a jury which will hear testimony from the member unless:
>
> (a) the testimony relates to an uncontested matter; or
>
> (b) the testimony relates to the nature and value of legal services rendered in the case; or
>
> (c) the member has the informed, written consent of the client . . . .

Assuming that the malpractice litigation against WCT will involve a jury trial, a clear exception to the advocate witness rule is the informed, written consent of the client. Here, the Agreement reveals Spitzer's potential role as a witness, even though, that likelihood seems very remote. Both the Trustee and his general counsel reviewed that remote possibility and determined that the estate would not be harmed by the retention of Attorney Spitzer.

Second, again, WCT did not oppose the appointment of Attorney Spitzer and received notice of his uncontested appointment.

Third, it is self evident that the Trustee will likely not call attorney Spitizer as a witness. That leaves the possibility that WCT will call Attorney Spitzer as a witness. However, there is nothing in the declaration supporting the Motion suggesting that Attorney Spitzer would offer evidence that would be other than cumulative.

WCT relies on *Kennedy v. Aldridge*, 201 Cal.App 4th 1197, 1201; 135 Cal.Rptr. 3d 545 (2011), to support its position. That case is inapposite. The Court of Appeal in *Kennedy* noted that there was a "near certain prospect" that the disqualified counsel would have to testify in the litigation at issue. *Id.* at 1200. The evidence in *Kennedy* was that the attorney had deep family entanglements involving that attorney's adversary. Those entanglements were such that the attorney was in a position to acquire confidential

information from that attorney's opponent. In this case, there is no risk that Attorney Spitzer acquired confidential information from WCT. WCT was Attorney Spitzer's adversary in the underlying case.

In short, WCT has provided no factual basis for the court to conclude that Attorney Spitzer will be a witness in the malpractice case against WCT. Putting aside that issue, the affirmative waiver by the Trustee and the waiver by WCT in failing to object to the appointment of Attorney Spitzer all militate in favor of finding no conflict of interest due to the "advocate-witness" rule in this case.

D. Alleged "Factual" Conflicts of Interest in Prosecuting DAI Malpractice Action

WCT vigorously argues that various factual positions that Attorney Spitzer must necessarily take in the WCT Malpractice Action will conflict with his loyalty to Pendragon in prosecuting its action against Pendragon's former counsel, DAI. These conflicting loyalties will harm the Bankruptcy Estate, according to WCT, and necessitate disqualification of Attorney Spitzer. Among the evidence submitted in the Trustee's opposition to this Motion was the third amended complaint filed in the Fresno County Superior Court in the DAI Malpractice Action (*Gwartz, et al. v. Dowling, Aaron et al.).*[20]

According to the allegations of the third amended complaint, DAI represented Pendragon between July 2008 and April 2011 when DAI withdrew. Attorney Spitzer was Pendragon's successor counsel. Pendragon alleges DAI was retained for advice concerning permitting and the repair of buildings on the Ranch. Pendragon allegedly did not wish to litigate and retained DAI to represent Pendragon's interest in land use and construction issues. Pendragon alleges that its trustee, Gwartz, has suffered emotional distress as a result of delays that were allegedly caused by DAI's negligence. Pendragon alleges that DAI inflated its attorney's fees and did not properly pursue mediation of the

[20] Fresno County Superior Court case number 15-CECG03230.

dispute before the Ranch Litigation began to spiral. Attorney Spitzer took the case from DAI and prosecuted the Ranch Litigation against the Debtors to a successful conclusion resulting in a jury verdict of $1,553,800 against the Debtors. Of that judgment, $850,000 was for punitive damages.

WCT argues that the estate's litigation position is that WCT's attorney's fees paid by Debtors should be disgorged to the estate because various alleged WCT errors exacerbated the damages awarded against the Debtors. Accordingly, Attorney Spitzer will have to argue a position contrary to the one previously urged by Pendragon in the Ranch Litigation. WCT also argues that to prevail in the WCT malpractice action, Attorney Spitzer will have to argue compensatory damages should have been less than what was awarded Pendragon by the jury but for the alleged malpractice of WCT thereby refuting the argument that WCT made on behalf of the Debtors at the trial. In the DAI malpractice action, Pendragon alleges they were damaged because they were told by DAI that the Debtors did not want to mediate the case when in reality DAI received an early demand for mediation. However in the action against WCT, Trustee alleges that WCT refused to mediate thereby subjecting the Debtors to proliferating attorney's fees. In addition, in the DAI malpractice action, it is claimed that DAI improperly included a breach of contract claim drawing excessive pleading motions thereby escalating Pendragon's attorney's fees. In contrast, the estate will need to take the position that the numerous pleading challenges were imprudent and increased the Debtors' attorney fees.

The Trustee and Attorney Spitzer dispute these arguments. They argue that there is no inconsistency between the position to be taken in the WCT Malpractice Litigation on behalf of the estate or in the DAI Malpractice Litigation on behalf of Pendragon. The estate may argue certain tactical errors by WCT including reliance on Dr. Weilert's credibility, contributed to the adverse verdict. According to Attorney Spitzer, there were grounds for challenging the punitive damage award on appeal which could have led to reversal. One of those challenges would be that the punitive damage award resulted from the passion and prejudice of the jury. Attorney Spitzer and the Trustee also argue

that there is no conflict with respect to the matter for which Attorney Spitzer is employed for the estate because Spitzer is no longer representing Pendragon in any litigation against these Debtors.

The conflicts alleged to exist by WCT are speculative. So are the responsive arguments by the Trustee and Attorney Spitzer. On a disqualification motion, this court is not asked to speculate about trial strategy or evidence theories in litigation that is to be tried. Rather, under *Stoumbos*, there need only be no conflict between the Trustee and counsel's creditor client with respect to this specific matter itself. *Stoumbos*, 988 F.2d at 964 citing *Fondiller*, 15 B.R. at 892, *appeal dismissed*, 707 F.2d 441 (9th Cir. 1983); *see also Altenberg v. Schiffer (In re Sally Shops, Inc.)*, 50 B.R. 264, 266 (Bankr.E.D.Pa. 1985) (following *Fondiller*).

While not clear in the Ninth Circuit, even those courts which analyze counsel appointments as either involving "potential" conflicts of interest or "actual" conflicts of interest and determine based on that dichotomy whether counsel is disqualified, would likely find against disqualification in this case. See, *In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 867 (Bankr.N.D.Ill 1992)[potential conflict of the law firm representing creditor bank precluded firm's representation of the debtor in possession because the firm was not disinterested due to a close relationship with, and financial dependence on creditor bank]; *In re Empire State Conglomerates, Inc.*, 564 B.R. 306, 315 (Bankr.S.D.N.Y., 2016) quoting *In re Diva Jewelry Design, Inc.*, 367 B.R. 463, 472 (Bankr.S.D. N.Y. 2007)[an actual conflict of interest under [11 U.S.C. § 327(c)] is "an active competition between two interests, in which one interest can only be served at the expense of the other."]. See also, *Lennear v. Diamond Pet Food Processors of California, LLC*, 147 F.Supp.3d 1037, 1050-52 (E.D. California, 2015)[counsel for debtor in pending civil rights action does not have an adverse interest warranting disqualification when he is representing the Trustee in the same action]. The "potential" conflicts of interest raised by WCT in the Motion may not become conflicts at all. Based upon the evidence before this court, the potential for these conflicts to arise

seems remote.

Independently, the court cannot ignore that Pendragon itself is silent in these proceedings and is not pursuing the disqualification of Attorney Spitzer. Indeed, one of the trustees of the trust, also an attorney, submitted a declaration supporting the continued employment of Attorney Spitzer.[21] The Trustee's General Counsel has also weighed in, stating under oath that, after his examination of the complaint against DAI, he sees no possible conflict of interest between Pendragon and the Trustee with regard to the allegations of that complaint.[22]

Turning specifically to the alleged factual conflict resulting from Attorney Spitzer having to take incongruent positions on the damages recovered by Pendragon in the Ranch Litigation, there is no requirement that the compensatory damage component be challenged in the WCT malpractice action. Eight hundred fifty thousand dollars ($850,000) of the verdict in the Ranch Litigation was for punitive damages. The Trustee's position asserting alleged negligence by WCT in not appropriately seeking review of that award is not inconsistent with the position in the Ranch Litigation, that compensatory damages should have been awarded, or, for that matter, some punitive damages either. Further, even if there was a logical inconsistency, that "conflict" was waived early in the case.[23]

Alleged inconsistent positions that may be argued in the DAI Malpractice Action is also not an actual conflict for purposes of Section 327(c). The allegations in the

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[21] (Doc. No. 502.)

[22] (Doc. No. 503.)

[23] At oral argument, WCT's counsel argued damages caused by counsel's alleged negligence is a pre-requisite to the estate's recovery. To be sure, some loss must stem from negligence. But, counsel's reference at oral argument to *Marshak v. Ballesteros*, 72 Cal.App.4th 1514, 1518; 86 Cal.Rptr.2d 1 (1999) is misplaced. *Marshak*, a "settle and sue" case, held damages cannot be speculative and summary judgment was appropriate. Here, damages are "real" in that a verdict and judgment has been entered. Nothing in *Marshak* suggests a single theory of damages must be pursued in all legal malpractice cases.

amended complaint against DAI relate to actions taken long before Attorney Spitzer took the underlying matter to trial. Thus, the claims are temporally remote. Two of the potential factual paradoxes emphasized by WCT in the Motion, improper pleading leading to numerous demurrers, and alleged mishandling of a mediation demand, are speculative "conflicts" if at all. There is no opposing or supporting evidence in the Motion that the numerous demurrers WCT filed and prosecuted as well as other challenges to the pleading were negligent or that this will be the estate's position in the malpractice case. The mediation issue is contrived. WCT claims there is an actual conflict because, on the one hand, in the WCT action Attorney Spitzer will need to argue that WCT's refusal to mediate caused the Debtors' damage and, on the other hand, that DAI's mishandling of the mediation demand caused Pendragon damage. Nothing would prevent either side from agreeing to mediate at any moment in the Ranch Litigation which seems to negate any factual conflict between the two actions. Further, the apparent focus of the WCT malpractice action relates to a failure to mediate long after DAI's alleged errors.[24]

CONCLUSION

The disclosures made by Attorney Spitzer and the Trustee, with the exception of the ongoing representation of Pendragon in the DAI matter, are adequate. For the reasons indicated, the court exercises its discretion and excuses that failure to disclose with a stern warning to counsel. No actual conflict of interest sufficient to warrant disqualification under Section 327(c) has been established by WCT. Thus, for now, Attorney Spitzer remains qualified to act a special counsel for the estate in the WCT

[24] The court is aware that some courts find a presumption of sorts that a potential conflict will ripen into an actual conflict and are therefore disqualifying: *In re BH&P, Inc.*, 949F.2d 1300 (3rd Cir. 1991); *In re Stamford Color Photo, Inc.*, 98 B.R. 135, 137-38 (Bankr.D.Conn. 1989); *Matter of Codesco, Inc.* 18 B.R. 997, 999 (Bankr.S.D. N.Y., 1982). However, this court has not been directed by the parties and has not found any example of such a presumption arising under controlling Ninth Circuit law.

matter. The court notes, however, that failures to disclose may result in the disallowance of all fees or the removal of counsel. *In re Helena-Park Corp.*, 63 F.3d at 882. Should subsequent events result in this court having to review the qualifications of special counsel in this matter again, the court reminds counsel and the Trustee of the panoply of remedies the court can impose. See *Park-Helena*.

The motion to disqualify will be DENIED. A separate order shall issue.

Dated: December 8, 2016

/s/ René Lastreto II
René Lastreto II
United States Bankruptcy Judge