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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
FRESNO DIVISION

In re) Case No. 07-11185-B-11
Running Horse, L.L.C.,)
Debtor.)
_____)

**MEMORANDUM DECISION REGARDING DEBTOR'S
APPLICATION TO EMPLOY SPECIAL COUNSEL**

Riley C. Walter, Esq., of Walter Law Group, appeared on behalf of debtor, Running Horse, L.L.C. (the "Debtor").

Jeffrey J. Lodge, Esq., appeared on behalf of Sara L. Kistler, Acting United States Trustee.

Patricia Bone O'Neill, Esq., of Pascuzzi, O'Neill & Moore, appeared on behalf of proposed special counsel for the Debtor.

Before the court is the Debtor's Application to Employ Special Counsel (the "Application"). The Debtor seeks to employ the law firm of Pascuzzi, O'Neill & Moore ("Pascuzzi") to serve as its "special counsel" pursuant to 11 U.S.C. § 327(e). The United States Trustee ("UST") objects on the grounds that Pascuzzi already represents parties with adverse interests and is not eligible to represent the Debtor. For the reasons set forth below, the Application will be denied.

This memorandum decision contains the court's findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52(a), made applicable to this contested matter by Federal Rule of Bankruptcy Procedure 7052. The bankruptcy court

1 has jurisdiction over this matter under 28 U.S.C. § 1334 and 11 U.S.C. § 327¹ and
2 General Orders 182 and 330 of the U.S. District Court for the Eastern District of
3 California. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

4 **Background and Findings of Fact.**

5 The Debtor is a limited liability company. It either owns or asserts some control
6 over approximately 435 acres of partially developed land in southwest Fresno (the
7 “Property”), which it hopes to transform into an 18-hole golf course and residential
8 community. The Debtor’s schedules state that the value of the Property stands
9 somewhere between \$20 million and \$40 million. The Property consists of 38 separate
10 parcels of land. Each parcel is subject to multiple liens and interests recorded in various
11 orders and combinations, including tax liens, co-ownership interests, trust deeds,
12 mechanic’s liens, and writs of attachment. The exact amount of these liens is unknown,
13 and probably cannot be determined without one or more adversary proceedings, but the
14 schedules strongly suggest that the secured debts against the Property greatly exceed the
15 value of the Property. The Debtor contends that virtually all of the liens and interests are
16 disputed.

17 In 2006, the Debtor ran out of money and development of the Property ceased after
18 partial completion of the golf course. None of the homes have been built. Numerous
19 lawsuits have been filed against the Debtor and others in the state court seeking, *inter*
20 *alia*, to enforce mechanic’s liens and other claims against the Property. In March 2007,²
21 ownership of the Debtor was acquired by Hole-in-One Management and Development,
22 LLC (“Hole-in-One”), an entity controlled by Richard Evans (“Evans”), a creditor of the
23

24 ¹Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy
25 Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-
26 9036, as enacted and promulgated *after* October 17, 2005, the effective date of The Bankruptcy
27 Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat.
28 23.

²Unless otherwise indicated, all dates are 2007.

1 Debtor. Pascuzzi was the attorney for Evans and Hole-in-One and negotiated the change
2 of ownership on their behalf. After that transaction, Pascuzzi began providing legal
3 services for the Debtor as well.³ Under Evans' control, the Debtor filed a voluntary
4 chapter 11 petition on April 27 to stop, *inter alia*, nonjudicial foreclosure actions by two
5 of the largest secured creditors. Since the filing, the Debtor has been actively seeking
6 new financing or buyers for the Property who will complete the development project.⁴

7 On May 1, the Debtor filed an application to employ Riley C. Walter, Esq., and his
8 law firm, Walter Law Group ("WLG") to serve as its general counsel pursuant to
9 § 327(a). There were no objections and WLG's employment was approved. The
10 application to employ WLG defines the scope of legal services which WLG will perform
11 as general counsel for the bankruptcy estate to include:

12 *Take all necessary action to protect and preserve the estate,*
13 *including, if required by the facts and circumstances, the*
14 *prosecution of actions and adversary or other proceedings on*
15 *the estate's behalf; the defense of any actions and adversary*
16 *or other proceedings against the estate; negotiations*
17 *concerning all disputes and litigation in which the estate is*
18 *involved, and, where appropriate, the filing and prosecution of*
19 *objections to claims filed against the estate;*

20 . . .

21 *Develop, negotiate and promulgate a plan* (Emphasis added.)

22 The Debtor now seeks through the Application to employ Pascuzzi to serve as its
23 "special counsel" pursuant to § 327(e). Pascuzzi specializes in real estate and business
24 law. Pascuzzi's principal, Harry S. Pascuzzi, Esq., has practiced real estate law for 20
25 years, has a real estate license, and has worked in the title and escrow industry. Pascuzzi
26 states in support of the Application:

27 _____
28 ³The Debtor's schedules list Pascuzzi as a general unsecured creditor "for notice only."
Neither the schedules nor the Application disclose the value of the pre-petition services which
Pascuzzi performed for the Debtor. Nor do they disclose who has agreed to pay Pascuzzi to
represent the Debtor, and how much, if any, Pascuzzi has been paid for those services.

⁴The Debtor recently entered into a nonbinding letter of intent to sell the Property to an
entity controlled by Donald Trump. It is not clear from the record whether those negotiations are
ongoing.

1 *Knowledge of all of these aspects of law and real estate are*
2 *necessary to understand the Running Horse project, to*
3 *organize the appropriate documents, and to present the asset*
4 *to potential bidders and investors in an succinct and organized*
5 *manner which can be readily digested and acted upon.*
6 *(Emphasis added.)*

7 The Application defines the scope of Pascuzzi’s employment vaguely as “represent
8 the Debtors [sic] on real estate and business transaction matters.” On June 14, the UST
9 wrote a letter to Pascuzzi requesting, *inter alia*, more detail regarding the scope of
10 services it intended to provide for the Debtor. Pascuzzi responded to the UST’s inquiry
11 and described, again vaguely, the scope of its potential employment as “limited to
12 providing real estate background and support to [WLG] and the debtor-in-possession
13 Running Horse, LLC”

14 The record reflects that Pascuzzi has already been intimately and actively involved
15 at the center of this case. Harry S. Pascuzzi disclosed in his declaration, “I have been
16 providing the necessary information to Mr. Walter to aid him in his representation of [the
17 Debtor].” Mr. Pascuzzi projects that he personally will devote 4-8 hours each day for the
18 next two months working on the Debtor’s case. Pascuzzi describes its activities in this
19 case as follows:

20 To date, the majority of Mr. Pascuzzi’s time has been spent
21 seeking potential bidders and investors for the project,
22 including telephone conversations, e-mails, and personal
23 meetings with legitimately interested parties. He has spent
24 time negotiating with potential bidders and investors,
25 including the [Donald] Trump Organization. As a result of
26 the publicity and tenacity of the negotiations with the Trump
27 Organization, other investors and bidders have come to the
28 negotiating table thereby ultimately increasing the sale price
 of the project for the benefit of the creditors.

24 **Analysis and Conclusions of Law.**

25 Pursuant to § 1107(a), the debtor-in-possession of a chapter 11 bankruptcy estate
26 has virtually the same rights and responsibilities as a trustee, including the authority to
27 employ professionals at the expense of the bankruptcy estate. Section 327(a) authorizes a
28 debtor-in-possession to employ as general counsel an attorney who is a “disinterested

1 person” and does not hold or represent an interest adverse to the bankruptcy estate.⁵
2 Section 327(e) creates a limited exception to the “disinterested” test under § 327(a). It
3 authorizes a debtor-in-possession to employ as “special counsel” an attorney who may
4 otherwise not be “disinterested” and eligible for employment under § 327(a):

5 The trustee, with the court’s approval, may employ, for a
6 *specified special purpose, other than to represent the trustee*
7 *in conducting the case, an attorney that has represented the*
8 *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. (Emphasis added.)

9 The debtor has the burden of proof to show that the proposed employment is
10 proper. *See In re Big Mac Marine*, 326 B.R. 150, 154 (B.A.P. 8th Cir. 2005). There is no
11 dispute here that Pascuzzi is not eligible for employment under § 327(a). The record
12 clearly establishes that Pascuzzi is not “disinterested” by virtue of its prior and concurrent
13 representation of the Debtor, Hole-in-One, various secured creditors, and parties with
14 interests adverse to the Debtor and the bankruptcy estate.⁶

15 The language of § 327(e) sets up a three-prong test for the employment of special
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17 ⁵The term “disinterested person” is defined in § 101(14) in pertinent part as a person
18 who;

19 is not a creditor, an equity security holder, or an insider;

20 . . .

21 does not have an interest materially adverse to the interest of the
22 estate or of 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.

23 ⁶Harry S. Pascuzzi’s declaration filed in support of the Application states that Pascuzzi
24 represented Evans and his company, Hole-in-One in acquiring ownership of the Debtor, and
25 continues to represent Hole-in-One. Pascuzzi also represents six homeowners for whom it has
26 filed complaints in the state court against the Debtor in connection with their purchase of homes
27 in the Debtor’s development project and has already obtained a \$1.4 million writ of attachment
28 on their behalf. Pascuzzi also represents another of Evans’ companies, Elon Golf Construction,
Inc., and a creditor, Emmett’s Excavation, Inc., for which it has filed mechanic’s liens against
the Property totaling more than \$9 million. Pascuzzi has filed complaints in the state court to
perfect and enforce those liens.

1 counsel. First, the employment may only be authorized for a “specified special purpose”
2 other than “conducting the case.” The “special purpose” must be unrelated to the debtor’s
3 reorganization and must be “explicitly defined or described in the application seeking
4 approval of the attorney’s employment.” 3 *Collier on Bankruptcy* (15th Ed. Rev.)
5 ¶ 327.04[9][d] (2006).

6 The second and third prongs of the “special counsel” test are dependent upon the
7 first. Once the purpose for special counsel’s employment is adequately and specifically
8 defined, then the debtor must show that the proposed attorney or law firm “does not
9 represent or hold any interest adverse to the debtor or to the estate” with respect to the
10 specified purpose of the proposed employment. The Debtor must also show that the
11 employment of special counsel for a specified purpose is in the “best interest of the
12 estate.”

13 Here, the UST argues that Pascuzzi has and does still represent numerous parties
14 with interests adverse to the Debtor and that Pascuzzi is therefore ineligible for
15 employment under § 327(e). See footnote 6, *supra*. Although the UST’s argument
16 appears to be well supported by the record, this court does not need to decide whether
17 Pascuzzi passes or fails the “adverse interest” test. For the reasons summarized below,
18 the court is not persuaded that the Debtor seeks to employ Pascuzzi for a “specified
19 special purpose,” which is sufficiently disconnected from the Debtor’s general duty of
20 conducting the case. § 327(e); See *In re Neuman*, 138 B.R. 683, 686 (S.D.N.Y. 1992).

21 The Debtor has already employed WLG, an experienced bankruptcy firm, to serve
22 as its general counsel in virtually all aspects of the Debtor’s reorganization, including
23 formulation of a chapter 11 plan. At the very core of this bankruptcy case is the Debtor’s
24 ability to sell its assets or obtain financing to complete the golf course/residential
25 development. Intertwined in that process are numerous disputes regarding the liens and
26 interests attached to the 38 parcels of land that comprise the Property. The Debtor must
27 successfully resolve those disputes, by negotiation or otherwise, and put itself in a
28 position, structurally and financially, to reorganize in chapter 11. Pascuzzi acknowledges

1 in support of the Application that its expertise in real estate and business law is
2 “necessary to understand the Running Horse project” and that WLG needs Pascuzzi’s
3 “real estate background and support.”

4 This court can find nothing “specific” or “special” about the intended scope of
5 Pascuzzi’s employment. Neither can the court find that Pascuzzi’s services giving
6 “support to WLG,” as described in the Application and supporting documents, are
7 substantially unrelated to the Debtor’s reorganization effort. Any attorney retained to
8 advise and assist the debtor’s general counsel is necessarily involved in “conducting the
9 case” and therefore must be “disinterested.” *See In re Neuman*, 138 B.R. at 686 (the
10 employment of the debtor’s former law firm, a pre-petition creditor, with an expertise in
11 Medicare law, to advise and assist the trustee with regard to the allowability of the U.S.
12 Government’s Medicare overpayment claims, was too closely related to “conducting the
13 case”).

14 When an attorney is not a “disinterested person,” but purports to act under the
15 exception of § 327(e), approval by the court must be explicit; it cannot take the form of
16 silent acquiescence. 3 *Collier on Bankruptcy* (15th Ed. Rev.), ¶ 327.04[9][d] (2006).
17 When the “adverse interest” specter looms like a dark cloud over a professional’s
18 employment under § 327(e), the court must closely scrutinize the proposed “special
19 purpose” for that employment before it can properly consider the “adverse interest” and
20 “best interest of the estate” tests. The court may look at the totality of the circumstances
21 to determine whether the scope of work will, or has been, properly limited to a “special
22 purpose” within the meaning of § 327(e). Those circumstances include the actual
23 services performed by counsel before and after commencement of the case. *Id.* A
24 professional whose services may be vital to the debtor’s reorganization effort, but who is
25 not “disinterested” and eligible for employment under § 327(a), cannot circumvent that
26 requirement by trying to characterize the employment as “special counsel” under
27 § 327(e). *In re Tidewater Memorial Hospital, Inc.*, 110 B.R. 221, 228 (Bankr. E.D. Va.
28 1989).

1 Here, the scope of Pascuzzi’s proposed employment appears to be “far too
2 expansive an assignment to be appropriate for an appointment under § 327(e).” See
3 *Century Indemnity Company v. Congoleum Corporation (In re Congoleum Corp.)*, 426
4 F.3d 675, 692 (3rd Cir. 2005). The “special purpose” for which Pascuzzi would be
5 employed in this case, assisting WLG in matters requiring an expertise in real estate and
6 business transaction law, more properly falls under the ambit of § 327(a), which allows
7 for the employment of professionals to assist generally in the administration of the estate.
8 *Id.* That subsection, however, prohibits the employment of professionals who are not
9 “disinterested.”

10 Pascuzzi attempts to mitigate the obvious “conflict of interest” issues by arguing
11 that the interests of its multiple clients are aligned with the Debtor’s interest in
12 maximizing the value of the Property. Based on its legal expertise and prior involvement
13 in the case, Pascuzzi contends that its employment would be in the “best interest” of the
14 bankruptcy estate. § 327(e). It states in reply to the UST’s objection that “[i]t would be
15 extremely detrimental to the negotiations and sale of Running Horse if Mr. [Harry]
16 Pascuzzi is not appointed special counsel and [is] removed at this vital stage of
17 negotiations.”⁷ The court has no doubt about Pascuzzi’s experience and ability to assist
18 this Debtor on the matters described. Neither does the court have any reason to doubt that
19 Pascuzzi has been working diligently to maximize the value of the Property for the
20 potential benefit of the Debtor and all the other clients which Pascuzzi represents.
21 However, the “best interest of the estate” test does not, standing alone, justify the
22

23 ⁷Pascuzzi’s reply misstates the UST’s objection. The court has not been asked to
24 disqualify or “remove” Pascuzzi from working in connection with the case. The court has only
25 been asked to rule on Pascuzzi’s eligibility for employment as a professional under § 327(e).
26 The court takes no position here as to Pascuzzi’s ability to continue working with WLG in its
27 capacity as counsel for Evans and Hole-in-One. That, of course, would require that Pascuzzi do
28 what is required to comply with the California Rules of Professional Conduct. The Debtor’s
general counsel, WLG, has the primary responsibility to assure that the Debtor is protected from
conflicts of interest. If there is cause to bar Pascuzzi from any involvement in the case, for
conflict of interest reasons or otherwise, that issue will have to be addressed at another time.

1 employment of “special counsel.” All three elements of § 327(e), the “special purpose,”
2 “best interests of the estate,” and “adverse interest” tests, must be satisfied. Ironically, the
3 same factors which appear to make Pascuzzi’s employment so important at this time also
4 tend to establish that its employment will be too closely related to “conducting the case.”

5 Pascuzzi offers that it will not be involved in the general bankruptcy
6 administration, that all “administrative matters” will be performed solely by WLG. At
7 oral argument, Debtor’s counsel assured the court that Pascuzzi will limit its services
8 solely to contract negotiations with prospective purchasers or financiers. The Debtor’s
9 effort to draw an artificial distinction between “general bankruptcy administration” and
10 “contract negotiations” that will profoundly affect the reorganization effort and
11 disposition of assets does not pass statutory muster. Pascuzzi may not represent the
12 Debtor in “conducting the case.” The term “conducting the case” is not defined in the
13 Bankruptcy Code. However, the term has been recognized to include matters related to
14 formulation of a chapter 11 plan, and/or liquidation of the debtor’s assets. *In re Neuman*,
15 138 B.R. at 685, citing 2 *Collier on Bankruptcy* (15th Ed. & 1991 Supp.) ¶ 327.03[6].

16 Finally, in an effort to salvage the Application, Debtor’s counsel represented that
17 Pascuzzi would agree to withdraw from representing any other parties affected by this
18 bankruptcy case. However, the offer to withdraw from adverse representation does not
19 resolve the predicate need for a “special purpose.” Further, Pascuzzi’s withdrawal from
20 adverse representation does not expunge the existing conflict of interest issues. Pascuzzi
21 cannot spontaneously withdraw from representing all of its other clients. Even so, the
22 absence of “disinterestedness” cannot be cured with a waiver of those conflicts. The
23 chapter 11 debtor-in-possession has a fiduciary duty to its creditors that constrains its
24 ability to waive conflicts of interest. *In re B.E.S. Concrete Products, Inc.*, 93 B.R. 228,
25 235 (Bankr. E.D. Cal. 1988).

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