

UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

In Re

GREYSTONE ON PAYETTE,
LLC,

Debtor.

**Bankruptcy Case
No. 08-01062-JDP**

MEMORANDUM OF DECISION

Howard R. Foley, FOLEY FREEMAN, Meridian, Idaho, former Debtor's counsel.

Richard Crawforth, Boise, Idaho, Chapter 7 Trustee.

Introduction

Attorney Howard Foley ("Counsel") has applied to the Court for allowance of compensation for professional services rendered as counsel¹ for Debtor Greystone on Payette, LLC. Docket No. 145. The application was the subject of a hearing held on February 3, 2009, at which Counsel

¹ This case began as a chapter 11 case; it was later converted to a chapter 7 case, as explained below.

and the chapter 7² trustee, Richard Crawforth, appeared and offered argument. At the conclusion of the hearing, the Court took the issues under advisement. This memorandum constitutes the Court's findings and conclusions,³ and disposes of the issues.

Facts

On June 5, 2008, Counsel filed what he has described as "emergency" chapter 11 petitions on behalf of two entities, Greystone on Payette, LLC and Greystone Village, LLC,⁴ in order to stave off foreclosure sales scheduled to occur the following day. Along with the petition in this case, Debtor filed an application to employ Counsel to serve as its bankruptcy attorney. Docket No. 6. The application represented that Counsel did not represent any other entity involved in this case, and that

² Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 - 1532, and all rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001 - 9037.

³ *See* Fed. R. Bankr. P. 7052, 9014.

⁴ The Greystone Village, LLC case was assigned Case No. 08-1065-TLM.

he was “disinterested” as that term is defined in § 101(14).⁵ Docket No. 6, ¶ 5. The application further averred that Counsel did not represent or hold any interest adverse to the interests of the bankruptcy estate with respect to the matters on which he proposed to be employed. *Id.* This application was accompanied by Counsel’s affidavit which contained similar representations about Counsel’s qualifications to serve as attorney for Debtor. Docket No. 7.

The § 341(a) meeting of creditors was initially scheduled for July 14, 2008, but was continued to July 23, 2008. Counsel represents that it was at

⁵ That section provides:

The term “disinterested person” means a person that—
(A) is not a creditor, an equity security holder, or an insider;
(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
(C) does not have an interest materially adverse to the interest of the 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[.]

11 U.S.C. § 101(14).

the continued meeting when he first learned that, prior to the petitions being filed, Debtor had extended a \$1,000,000 loan to the other chapter 11 debtor, Greystone Village, LLC, to cover construction costs at Greystone Village, and that this loan remained unpaid.

On July 30, 2008, the U.S. Trustee objected to Debtor's application to employ Counsel. Docket No. 29. Shortly thereafter, on August 5, 2008, Debtor submitted its application to employ D. Blair Clark as counsel for Debtor, Docket No. 30, along with a stipulation between Counsel and Mr. Clark agreeing to his substitution as Debtor's attorney. Docket No. 31. No objections were filed to Mr. Clark's application, and his employment was approved by the Court on September 16, 2008. Docket No. 57. As it turned out, Debtor was unable to propose a confirmable plan, and on October 16, 2008, the Court granted Debtor's request to convert the case to chapter 7. Docket No. 101.

Counsel thereafter submitted his application seeking approval of compensation for services he rendered to Debtor from June 6, 2008 to August 11, 2008. Crawford objected to the application on the grounds

that because Counsel's employment was never approved by the Court, Counsel is not entitled to a priority administrative claim. Docket No. 150.

Discussion

Subject to court approval, the Code allows a chapter 11 debtor to employ professional persons, such as an attorney, "that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title." 11 U.S.C. § 327(a). In this case, Counsel asks the Court to, in effect, exercise discretion to overlook the lack of adverse interest and disinterestedness requirements imposed by the Code on potential estate professionals. The Court is unable to accommodate Counsel's request.

Only a professional whose employment has been approved by the Court under § 327 or § 1103⁶ is authorized to recover compensation or expenses from the bankruptcy estate under § 330(a)(1). *Atkins v. Wain*,

⁶ Section 1103 refers to professionals employed to represent committees in chapter 11 cases, and is therefore inapplicable in this setting.

Samuel & Co. (In re Atkins), 69 F.3d 970, 973 (9th Cir. 1995); *DeRonde v. Shirley (In re Shirley)*, 134 B.R. 940, 943-44 (9th Cir. B.A.P. 1992) (“[c]ourt approval of the employment of counsel for a debtor in possession is *sine qua non* to counsel getting paid. Failure to receive court approval for the employment of a professional in accordance with § 327 and Rule 2014 precludes the payment of fees.”). Here, Counsel concedes his application to serve as Debtor’s counsel was never approved by the Court. He argues, however, that the Court may, even now, approve his employment *nunc pro tunc*, and as a result, his fee application.

Bankruptcy courts possess the equitable power to approve retroactively compensation for valuable, but unauthorized, services of a professional. However, the Court’s power is limited to situations where “exceptional circumstances” exist. *Sherman v. Harbin (In re Harbin)*, 486 F.3d 510, 522 (9th Cir. 2007) (citing *In re Atkins*, 69 F.3d at 974); *see also Okamoto v. THC Fin. Corp. (In re THC Fin. Corp.)*, 837 F.2d 389, 392 (9th Cir. 1988). The Ninth Circuit explained:

To establish the presence of exceptional

circumstances, professionals seeking retroactive approval must satisfy two requirements: they must (1) satisfactorily explain their failure to receive prior judicial approval; and (2) demonstrate that their services benefitted the bankrupt estate in a significant manner.

In re Atkins, 69 F.3d at 974 (citing *Halperin v. Occidental Fin. Group, Inc. (In re Occidental Fin. Group, Inc)*, 40 F.3d 1059, 1062 (9th Cir. 1994), *In re THC Fin. Corp.*, 837 F.2d at 392). In addition to these requirements, a professional seeking retroactive authorization must also satisfy the criteria for employment pursuant to § 327. *In re Harbin*, 486 F.3d at 522-23; *In re Atkins*, 69 F.3d at 976.

Here, Counsel is disqualified from employment under § 327 because he also represents Greystone Village, LLC, a party with an interest adverse to the estate. However, Counsel alleges he had no knowledge of the loan from Debtor to Greystone Village, LLC at the time he filed Debtor's petition. Thus, he argues that, at least as far as he knew, he was qualified to represent Debtor at the time this case was commenced and the application to employ him was submitted. He contends that it was solely

the result of “subsequent events”⁷ that he became disqualified to serve as Debtor’s attorney, and that under these circumstances, he should not be precluded from obtaining compensation for the services he rendered during the initial stages of this case.

Unfortunately, Counsel’s lack of knowledge of his conflict of interest is not determinative in weighing his eligibility to serve as Debtor’s chapter 11 attorney. The Court has repeatedly held that a professional’s representation of a debtor’s creditor, an equity holder, or another interested party, constitutes representation of an adverse interest within the prohibition of § 327(a). *See, e.g., In re Larson*, 04.1 I.B.C.R. 20 (Bankr. D. Idaho 2004); *In re Thompson*, 2000 WL 33716961 (Bankr. D. Idaho Mar. 1, 2000); *In re MDR, Inc.*, 1999 WL 33486707 (Bankr. D. Idaho Aug. 3, 1999); *In re Dugger*, 99.1 I.B.C.R. 30 (Bankr. D. Idaho 1999); *In re Leypoldt*, 95 I.B.C.R. 220 (Bankr D. Idaho 1995); *In re Bliss Valley Foods, Inc.*, 88 I.B.C.R. 281

⁷ At the hearing, in response to the Court’s inquiry, Counsel conceded that the loan was made prior to the filing of the petition, and that it was only his discovery of its existence that occurred subsequent to the commencement of the case.

(Bankr. D. Idaho 1988). That any adverse interest exists is sufficient for disqualification of counsel to serve under § 327(a), and the Court need not weigh, measure or evaluate the degree of the conflict. *In re Larson*, 04.1 I.B.C.R. at 23; *In re Dugger*, 99.1 I.B.C.R. at 32.

Prior to bankruptcy, Debtor loaned a substantial sum to Greystone Village, LLC, a debt that remained unpaid on the bankruptcy filing date. Counsel was representing both Debtor and Greystone Village, LLC, when he applied to be employed as Debtor's counsel.⁸ In other words, when Debtor filed for bankruptcy relief and Counsel applied to be its bankruptcy attorney, Counsel was representing "an interest adverse to [Debtor's] estate" and therefore not eligible to serve as an estate professional under § 327(a). Since he could not be employed, the Court cannot approve any compensation for Counsel's post-petition legal

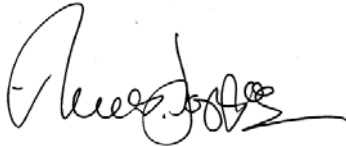
⁸ Counsel's representation of Debtor's related entity is something which, when it became known, should have been disclosed by Counsel in connection with his continuing quest to become Debtor's chapter 11 attorney. *See* Rule 2014(a) (requiring an applicant for employment to disclose, in a verified statement, any "connections with the debtor, creditors, [and] any other party in interest[.]"). Counsel's affidavit in support of his employment has never been corrected to disclose Counsel's connection with Greystone Village, LLC.

services, nor reimbursement for any costs he incurred. *In re Atkins*, 69 F.3d at 973; *In re Larson*, 04.1 I.B.C.R. at 24-25. Although this may appear to be a harsh result, strict enforcement of the ethical rules to which estate professionals are subject under the Code is required in order to protect the integrity of the bankruptcy system. *In re Bliss Valley Foods*, 88 I.B.C.R. at 287.

Conclusion

For these reasons, Counsel's application for allowance of compensation will be denied. A separate order will be entered.⁹

Dated: March 11, 2009



Honorable Jim D. Pappas
United States Bankruptcy Judge

⁹ Chief Judge Myers is presiding over the chapter 11 bankruptcy case of Greystone Village, LLC. Therefore, this Court expresses no opinion concerning Counsel's eligibility to be employed, or to recover compensation and expenses, as counsel for the debtor-in-possession in that case.