(31)

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

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| In re | : | |
| | : | Bankruptcy No. 78-00922 |
| RANDY MAURICE KENNARD, | : | |
| | : | MEMORANDUM DECISION AND ORDER |
| LORETTA JOHNSON KENNARD, | : | |
| | : | |
| Bankrupts. | : | |

Appearances: William T. Thurman representing himself as trustee. B.L. Dart and John D. Parken representing themselves as creditors. Stephen H. Anderson representing himself as creditor.

ISSUES AND FACTUAL BACKGROUND

The trustee has objected to the secured classification of the claim held by Stephen Anderson and B.L. Dart (hereinafter called creditors). Proper classification turns on the validity of their attorneys lien under UTAH CODE ANN., Section 78-51-41 (1977).

Creditors represented the debtors in an action to recover possession of a restaurant in Park City, Utah. An amended complaint was filed in state court on June 14, 1978, followed by a motion for preliminary injunction and a three-day evidentiary hearing. The debtors prevailed. Findings of fact, conclusions of law, and a preliminary injunction were entered. A request for an interlocutory appeal to the Utah Supreme Court was denied.

As a result of these proceedings, the parties composed a tentative resolution of differences on August 25, 1978. It provided, among other things, for a $40,000 cash payment to debtors.

At this juncture, affairs took a turn for the worse. The resolution dissolved, debtors filed for bankruptcy on September 21, 1978, and an interim trustee, later confirmed,

was appointed. Settlement prospects, however, revived and a modified accord was reached. This was reported at the first meeting of creditors on October 10 and approved by the Court on October 12. It provided for an immediate cash payment of $18,000 and additional deferred payments of $8,000.

On January 11, 1979, the trustee petitioned the Court for payment of creditors who had acted as his counsel in negotiating and drafting the settlement. This document represents that:

> Trustee engaged the services of Dart & Stegall, Attorneys at Law to represent the trustee in connection with settlement negotiations with Third Parties at the commencement of these bankruptcy proceedings.
>
> As a result of said representation, the estate received a settlement with Third Parties from a pending lawsuit at the time the bankruptcy petitions were filed in the total sum which will be Twenty-Six Thousand Dollars ($26,000.00) after full payment is received by [sic] one of the parties.
>
> Trustee has received at the present time Eighteen Thousand Dollars ($18,000.00) cash as a result of the settlements and the efforts of the attorneys Dart & Stegall. (Emphasis supplied.)

The Court honored this request on September 11, 1979 and creditors were paid for work performed between the petition in bankruptcy and approval of the settlement. However, their claim for prepetition fees, filed on October 10, 1978, went unrecognized until the trustee objected, on March 20, 1980, to its treatment as a secured claim. A hearing on this objection was held April 15. Memoranda and affidavits with exhibits were filed by both sides to the controversy and the Court is prepared to rule. The claim is secured for the following reasons.

## THE BANKRUPTCY FRAMEWORK: SECTION 67b

Section 67b of the Bankruptcy Act, former 11 U.S.C. Section 107b, regulates the validity of certain liens against the trustee in bankruptcy cases commenced before October 1, 1979.

It provides:

> The provisions of section 60 of this Act to the contrary notwithstanding and except as otherwise provided in subdivision c of this section, statutory liens in favor of employees, contractors, mechanics, or any other class of persons... created or recognized by the laws of the United States or any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him.

In Utah, attorneys liens "created or recognized" by Section 78-51-41 are both "statutory" and "liens," as distinct from priorities, within the meaning of Section 67b. 4 Collier on Bankruptcy, ¶67.20(2) at 219-222 and 67.20(9) at 252-254 (14th ed. 1978); 4A Id., ¶70.87(2) at 1003-1005. A distinction, however, must be drawn between a common law retaining lien and the statutory charging lien found in Section 78-41-51; the former is not within the terms of Section 67b while the latter is. 4 Id., ¶67.20(2) at 215-216; Flake v. Frandsen, 578 P.2d 516, 517 (Utah 1978) (distinguishing between common law retaining lien and statutory charging lien); Midvale Motors, Inc. v. Saunders, 442 P.2d 938, 940 (Utah 1968) (same).

No formalities are required for the perfecting of such liens; this is accomplished by operation of law when a complaint is filed. E.g., Lundy v. Cappuccio, 181 P. 165, 167 (Utah 1919). In any event, no challenge to the perfection of this lien, for example, an attack under Sections 67c and 70c of the Bankruptcy Act, has been raised. The sole issue is whether the lien is valid and this is "ordinarily said to be determined by reference to the law of the state where the property is located." 4 Collier on Bankruptcy, ¶67.20(2) at 219 and 67.25(1) at 347-348 (14th ed. 1978).

## THE UTAH LAW OF ATTORNEYS LIENS

Both parties have focused on Section 78-51-41 which governs attorneys liens in Utah and controls the disposition

of this case. It provides:

> The compensation of an attorney and counselor for his services is governed by agreement express or implied, which is not restrained by law. From the commencement of an action, or the service of an answer containing a counterclaim, the attorney who appears for a party has a lien upon his client's cause of action or counterclaim, which attaches to a verdict, report, decision or judgment in his client's favor and to the proceeds thereof in whosoever hands they may come, and cannot be affected by any settlement between the parties before or after judgment.

On its face, Section 78-51-41 appears to validate the lien. The trustee, however, differs with this conclusion for three reasons.

First. Boiled to essentials, the trustee's first argument is that under Section 78-51-41 the lien must attach, if at all, to a "verdict, report, decision, or judgment" of a court in order to be valid. He derives this argument from the language of the statute and six cases, all of which involved a judgment and lien, from which he infers that the judgments preconditioned the liens. He further infers that litigation which is compromised cannot give rise to a lien. Finally, he concludes that there was no verdict, report, decision, or judgment to which any lien could attach in this case. In any event, the settlement was achieved by the trustee and to allow a lien under these circumstances would constitute an unjust enrichment of creditors.

The premise of this argument, that a judgment preconditions a lien, is faulty. The statute says that the filing of a complaint, not the obtaining of a judgment, creates the lien. Lundy v. Cappucio, supra, goes further by stating that the lien both arises and attaches at the commencement of a lawsuit. This result harmonizes all parts of the statute, since elsewhere it provides that settlement either before or after judgment cannot defeat the lien. This provision is anomolous if the lien cannot attach without a judgment. The lien, therefore, is not predicated on any judgment. And the reference to attachment does not signify

an event distinct in kind from origination of the lien. It merely confirms the merger of a lien already created with any judgment.

Nor do the cases cited by the trustee support his construction of the statute. None raises the question being considered. Moreover, other cases not mentioned in his memorandum endorse a more natural reading of Section 78-51-41, that liens can coexist with settlements. E.g., Jeffries v. Third Judicial Dist. Court of Salt Lake County, 63 P.2d 242, 244-245 (Utah 1936) ("'The language...is comprehensive, and creates a direct lien in favor of the attorney upon his client's cause of action, in whatever form it may assume, in the entire course of litigation, and entitles the attorney to follow the proceeds, without regard to any settlement before or after the judgment. It being a statutory lien, everyone must take notice of it, and any one settling with the client without the knowledge of the attorney does so at his own risk'"); Broadbent v. Denver & R.G. Ry. Co., 160 P. 1185, 1187 (Utah 1916) (Jury instruction that attorney had lien which could not be defeated by another's subsequent unilateral settlement with defendants, but which failed to note that lien arose at commencement of action, held harmless error since no dispute that action commenced prior to settlement). Cf. Kourbetis v. National Copper Bank of Salt Lake City, 264 P. 724, 726 (Utah 1928) (Appeal on claim for attorneys lien against settlement proceeds premature without trial and determination of this issue in lower court); In re Agee's Estate, 252 P. 891 (Utah 1927).

Assuming that the trustee's construction of the statute is correct, he misapprehends the facts to which it must be applied. He states categorically that "no verdict, report, decision, or judgment, had been produced...and nothing exists for an attorneys lien to attach to." Yet the preliminary injunction of the state court was entered

in July, 1980. The Utah Supreme Court denied defendants' request for an interlocutory appeal in August. A "report" of settlement was given at the first meeting of creditors on October 10. The Court approved the settlement on October 12. Finally, the settlement contemplates dismissal of the actions then pending in state court. While Utah Rule of Civil Procedure 41(a) does not require an order for stipulated dismissals, if custom was followed, such an order closed out the litigation. The settlement, therefore, was directly and indirectly the offspring of at least five verdicts, reports, decisions, or judgments.[1]

This view of the facts likewise undercuts the trustee's estimate of his role in effecting the settlement; pre-bankruptcy victories in state court, the tentative resolution on August 25, and creditors' efforts as counsel for the trustee (see his representations above) after bankruptcy, were the fulcrum for compromise. The lien was not a windfall. Compare Midvale Motors, Inc. v. Saunders, supra at 940.

Second. The trustee makes a second assault on the lien by contending that it applies between attorney and client inter se but not against third parties such as the trustee. The statutory lien, however, ignores personalities. It attaches in rem to the cause of action and any proceeds therefrom. Cf. Utah C.V. Federal Credit Union v. Jenkins, 528 P.2d 1187, 1188 (Utah 1974); Petrie v. General Contracting Company, 413 P.2d 600, 601-602 (Utah 1966); In re Agee's Estate, supra. Moreover, it follows those proceeds "in

[1] The trustee maintains, in effect, that verdicts, reports, decisions, or judgments mean verdicts and so forth of a court. This may be implied from the nature of verdicts and judgments and, taken together, all four terms share this feature. On the other hand, the statute does not expressly so provide, and this implication leads to redundancy since "decisions" is at once broad enough to swallow verdicts and judgments and free from their more technical connotations. "Report", by the same token, does not necessarily have judicial overtones. It is compatible with insurance investigations, a corporate boardroom, an assembly of creditors, or administrative proceedings, all of which might bear fruit in connection with the resolution of a claim to which an attorneys lien may attach. The fact that the statute permits such attachment before or after judgment, regardless of any settlement, supports a broader, ajudicial reading of these terms.

whosoever hands they may come." E.g. In re Agee's Estate, supra at 895-897 (Lien enforceable against funds in decedent's estate despite objection of administrator that action must be brought against him in personal capacity); Lundy v. Cappucio, supra at 167 (Lien follows proceeds of judgment into hands of creditors who have garnished such judgment). This result is underscored by Section 67b which insulates the lien from challenge by the trustee. Indeed, if the rule were as contended, the lien would be unenforceable unless and until the res was conveyed from third parties, such as defendants and the trustee, to the client. Such a rule does violence to the concept of liens as interests in property and not as rights of action against any person. Such a rule is also counterproductive in that property must be reached circuitously and at the expense of attorney-client relationships. But see Midvale Motors, Inc. v. Saunders, supra at 941.[2]

Third. The trustee maintains that it would be "inequitable" to allow the lien to stand because it will deplete funds remaining in the estate, leaving little or nothing for unsecured creditors. The trustee does not contend that the lien is unfair per se. This would be impossible since he has stipulated that creditors' fees were reasonable. Rather he contends that the lien is unfair because it consumes a disproportionate share of the estate.

[2] The Court is aware of a statement in Midvale that "the better rule in the absence of special circumstances requiring a contrary holding to prevent injustice, is to require counsel to bring a separate action against his client to determine the amount of his fee and to foreclose his charging lien if any he has." This language, however, is gratuitous because (1) the attorney, through improper withdrawal, had forfeited his lien, and (2) his labors did not bear fruit to which any lien could attach. The dictum was probably prompted by the fact that counsel, after notice of withdrawal to his client, appeared ex parte, and not only obtained permission to withdraw, but also had his fee set and a lien imposed. The dictum may be read as disapproving this conduct. Not only do other Utah cases show a divergence from the Midvale rule, but also elsewhere the Utah Court has tolerated similar behavior as "justified in aid of the lien." Hampton v. Hampton, 39 P.2d 703, 706-707 (Utah 1935).

It is not uncommon, however, for the claims of secured creditors to erode an estate, leaving nothing for unsecured creditors in bankruptcy. The law will not displace secured creditors under these circumstances unless there has been a preference or other voidable transaction. Here the law, under Section 67b, specifically protects attorneys liens. The trustee cites no cases, presents no controlling reasons, and offers no evidence for a departure from the law. The invocation of "equity' will not fill this vacuum.

The objection to claim is disallowed. The debt is secured to the extent stipulated in court and as clarified in the affidavits of creditors. The relative priority of this claim is not properly raised before the Court and no ruling is made on that issue.

DATED this 24 day of October, 1980.

Ralph R. Mabey
United States Bankruptcy Judge