UNPUBLISHED

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

In re	)	Bankruptcy Case No. 96C-24958
	)	
HAMMOND COMPUTER, INC., dba NETWORK CENTRE, a Utah corporation,	)	Chapter 11
	)	
Debtor.	)	**MEMORANDUM OPINION AND ORDER**

The second and final application for compensation and reimbursement of costs filed by Joel R. Dangerfield came on for hearing before the Honorable Glen E. Clark, Chief Judge, United States Bankruptcy Court, on July 8, 1997. The following appearances were made: Joel R. Dangerfield for Hammond Computer, Inc.; John P. Mullen and Kristina L. Jezairian for Novell, Inc.; Peter J. Kuhn for the United States Trustee; Duane H. Gillman, trustee; R. Mont McDowell for the trustee; David L. Miller for the Internal Revenue Service; Gerald H. Suniville for Alan E. Wright; and Mary Ellen Sloan for Salt Lake County.

FACTS

On July 26, 1996, Hammond Computer, Inc., dba Network Centre, a Utah corporation ("debtor"), commenced a voluntary Chapter 11 case in this Court. The debtor is represented by Joel R. Dangerfield ("Dangerfield") whose appointment as attorney for the debtor was approved by this Court on September 6, 1996.

The debtor was engaged in the business of sales, service and support of computer software products. Among other agreements, the debtor had an agreement with Novell, Inc. ("Novell") to act as an Authorized Original Equipment Manufacturer with a non-exclusive world-wide license to market Novell bundled products and services for internal use to end users and to authorized resellers. The debtor's gross sales for 1994 and 1995 were $20,962,391.00 and $18,633,524.00 respectively. Gross sales for January 1, 1996, through July 26, 1996, were $5,665,737.00. Alan E. Wright ("Wright") served as the president, treasurer and one of the debtor's two directors. The other director is Charles Groves. Wright is the sole shareholder of the stock of the debtor.

On November 7, 1996, Novell filed a motion for the appointment of a trustee. A hearing on the motion was held December 12 and 13, 1996, where the debtor, through Dangerfield, vigorously opposed the motion. In granting the motion for the appointment of a trustee, the Court found that in January 1996, Wright, as the individual in control of the debtor corporation, initiated the creation of Internet Centre, Inc. ("Internet Centre"), a related corporation controlled exclusively by Wright, to take over a portion of the debtor's business, that the debtor capitalized Internet Centre with a $30,000.00 transfer using a back-dated check of the debtor, that the debtor and Internet Centre shared employees, shared assets, shared bank accounts, and conducted business operations from the same business address, that pre-petition and post-petition funds had been commingled, and that confusion existed regarding the trade name of the debtor and Internet Centre. The Court also found that the debtor made payments on behalf of Wright to purchase stock of the debtor and for the purchase of Wright's personal residence. Although it was shown that Dangerfield represented the debtor on the petition date and had advised the debtor concerning the bankruptcy pre-petition, there was no

showing that Dangerfield advised or facilitated the debtor in any of the dealings or transactions that the Court found as the basis for the appointment of a trustee. Dangerfield does not dispute that he was aware of the pre-petition fraudulent transfers and preferences. The only evidence regarding Dangerfield's conduct prior to or during the pendency of the case is that Dangerfield carried out the instructions and directions of the debtor-in-possession.

On June 4, 1997, Dangerfield filed his second and final application for fees and costs with the Court seeking $12,120.00 in fees and $327.06 in reimbursement of costs as well as $7,584.92 as the balance of interim compensation pursuant to the first verified application. Novell objects to the application arguing that Dangerfield's services not only failed to benefit or aid the estate, but actually harmed the estate because Dangerfield: (1) resisted Novell's motion to appoint a trustee, a motion that was ultimately determined by the Court to be in the best interest of the estate; (2) failed to investigate or make any attempt to recover the debtor's pre- and post-petition transfers of funds and assets to Internet Centre; (3) failed to investigate or attempt to recover the $297,000.00 transferred by the debtor to pay off Wright's personal residence; (4) failed to investigate or attempt to recover the transfer of debtor's Novell inventory to Quest Corporation; and (5) failed to investigate numerous other uses of the debtor's funds by Wright.

Dangerfield responds that investigations into each of the allegations were underway and that a plan of reorganization was being developed that would repay unsecured creditors in full, and, if successful, the plan would negate the need to bring the avoiding actions discussed in Novell's fee objection. Dangerfield argues that the case was only a few months old at the time of the appointment of the trustee, that debtor and debtor's counsel were concentrating on time-sensitive matters, that the

limitation period to bring avoiding actions had not expired, and that the debtor simply had not had time to bring the avoiding actions. Dangerfield also argues that the best chance for debtor's business to successfully reorganize in Chapter 11 was for the debtor's management to remain in place because of management's experience and contacts within the industry, that this particular industry requires unique knowledge and experience that a Chapter 11 trustee would lack, and that opposing the appointment of the trustee was in the best interest of creditors and the estate.

ANALYSIS

Novell objects to Dangerfield's fees on two grounds. First, that Dangerfield's fees and costs associated with defending the motion for the appointment of a trustee were not beneficial to the estate under 11 U.S.C. § 330 and, second, that as a professional appointed to represent the debtor-in-possession, Dangerfield failed in his duty to the estate to see to it that certain avoiding actions were commenced against insiders of the debtor.

Defense of Motion for the Appointment of a Trustee

The first issue regarding defending the motion for the appointment of a trustee looks to an analysis of section 330 of the Bankruptcy Code. Section 330(a)(3) provides that:

> (3) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including--
>
> (A) the time spent on such services;
>
> (B) the rates charged for such services;
>
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

The language of § 330(a)(3)(C) focuses the determination of whether the services were beneficial at the point in time when the services were rendered and not at some later date with the benefit of hindsight. At the time that Dangerfield provided services to the debtor in defending the motion for the appointment of a trustee, Dangerfield had no way of knowing how the Court would rule. As the attorney for the debtor, Dangerfield had an ethical responsibility to represent the debtor using all of his legal knowledge, skill, thoroughness, and preparation reasonably necessary to defend Novell's motion. See, Utah Rules of Professional Conduct,[1] Rule 1.1. Counsel cannot expect to be compensated for services after it becomes clear that there is no reasonable prospect in prevailing or that counsel knew or should have known from the outset that the debtor would not prevail. In re Lederman Enterprises, Inc., 997 F.2d 1321 (10th Cir. 1993).

From the facts before the Court and the argument presented at the hearing on the motion for the appointment of a trustee, it is this Court's opinion that Dangerfield prepared and argued the debtor's defense to Novell's motion for the appointment of a trustee with a genuine belief that the debtor may prevail at the hearing.

Duty to the Estate

Regarding the issue of whether Dangerfield failed to carry out a duty owed to the estate by not investigating and bringing avoiding actions against insiders to set aside various preferences and fraudulent transfers, the Court must analyze the relative duties owed to the estate in a bankruptcy

[1]These rules were promulgated pursuant to the integration of the Utah State Bar by the Supreme Court on June 30, 1981, in In re Integration and Governance of the Utah State Bar, 632 P.2d 845 (1981), and Article VIII Section 4 of the Utah Constitution, amended effective July 1, 1985.

proceeding. The directors of a debtor-in-possession Chapter 11 corporation bear essentially the same fiduciary obligation to creditors and shareholders as would a trustee for a debtor-out-of-possession. Wolf v. Weinstein, 372 U.S. 633, 83 S. Ct. 969, 10 L. Ed. 33 (1963). Indeed, the willingness of courts to leave debtors in possession is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee. Commodity Futures Trading Com'n v. Weintraub, 471 U.S. 343, 105 S. Ct. 1986, 85 L. Ed. 372 (1986). When it is shown that the debtor-in-possession has breached its fiduciary duty to the estate, then cause exists for the appointment of a trustee and the bankruptcy court must order the appointment of a trustee. In re Oklahoma Refining Co., 838 F.3d 1135 (10th Cir. 1988). These cases look to the debtor-in-possession to live up to a fiduciary duty owed to the estate or face removal from its position as debtor-in-possession.

Ordinarily, the role of policing the activities of a debtor-in-possession is performed by individual creditors (such as Novell in this case), the creditors' committees, and the United States Trustee. Because the Bankruptcy Code empowers the Chapter 11 debtor to remain in possession of property of the estate, to operate the debtor business and to propose a plan of reorganization, it stands that debtor's counsel should not be financially penalized even if the honest business decisions or reorganizational efforts of the debtor-in-possession turn out to be a dismal failure. The entire concept of bankruptcy reorganization contemplates a certain degree of entrepreneurship, and concomitant risk, being taken by debtor's management in its efforts to successfully reorganize the debtor's business. However, when the conduct of the debtor becomes so egregious as to pass from bad judgment to illegal or fraudulent conduct, courts have held that debtor's counsel has a duty to

take corrective measures or face the possibility of losing fees. In re Smitty's Truck Stop, Inc., 210 B.R. 844 (10th Cir. BAP 1997) (The failure to investigate and disclose conflicting claims to funds paid to an attorney as a retainer requires disgorgement of the retainer and denial of fees); In re Wild Horse Enterprises, Inc., 136 B.R. 830 (Bankr. C.D. Cal. 1991) (Debtor's attorney is a fiduciary to the estate and has a duty to remind the debtor of duties under the Code); FDIC v. O'Melveny & Meyers, 969 F.2d 744 (9th Cir. 1992) (Attorney has duty to avoid public harm when he discovers his client is engaging in fraud), rev'd on other grounds, 512 U.S. 79, 114 S. Ct. 2048, 120 L. Ed. 2d 67 (1994); In re Harp, 166 B.R. 740 (Bankr. N.D. Ala. 1993) (Lawyers representing debtors-in-possession are charged with special responsibilities of insuring that when the interest of the estate conflicts with the interest of the individual who signs their checks, that the interest of the estate prevails). Drawing the line between a debtor who routinely makes honest, but incredibly bad business decisions and a debtor who engages in illegal or fraudulent conduct may be very difficult.[2] Guidance for attorneys in this dilemma is provided in part by the Utah Rules of Professional Conduct ("U.R.P.C.") which define the limits of representation and the responsibilities of attorneys to their clients in general. Rule 1.2 of the U.R.P.C. requires an attorney to abide by the client's decision so long as the attorney knows that the conduct is not criminal or fraudulent. Here, while the debtor may have engaged in conduct that was fraudulent or even criminal in the past, nothing in the record shows that the debtor was engaged in fraudulent or criminal behavior during the course of representation by Dangerfield,

[2]There is no requirement under the Code that the debtor-in-possession or its management be disinterested. See, e.g, In re Best Western Heritage Inn Partnership, 79 B.R. 736 (Bankr. E.D. Tenn. 1987).

or that Dangerfield knew or should have known of any fraudulent or criminal conduct on the part of the debtor during the term of his representation of the debtor.

In addition to the requirements defined by the U.R.P.C., the attorney for a debtor-in-possession in Chapter 11 bankruptcy owes a fiduciary duty to the bankruptcy estate. In re Smitty's Truck Stop Inc., 210 B.R. 844 (10th Cir. BAP 1997). As a part of that fiduciary duty, the attorney must take corrective action when it becomes obvious that the best interests of the estate are not being protected by the individual controlling the debtor corporation.[3] This includes seeing to it that avoiding actions to set aside insider preferences and fraudulent transfers are timely filed if the filing of the avoiding action may benefit the estate. If it becomes obvious to counsel that the individual controlling the debtor will not permit the attorney to take actions that are in the best interests of the estate,[4] then counsel must resign[5] or accept the fact that the attorney's services will not be compensable from the estate. Here, at the time Novell filed its motion for the appointment of a

[3]This includes reminding the individual of his fiduciary duty owed to the bankruptcy estate, and exercising independent professional judgment in behalf of the bankruptcy estate and rendering candid advice. U.R.P.C. 1.2 and 2.1.

[4]U.R.P.C. 3.3 provides among other things that a lawyer shall not knowingly fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client. In a bankruptcy context the failure to commence an avoiding action to set aside a fraudulent transfer in favor of an insider may be considered assisting a fraudulent act and may be considered part of a continuing concealment in a criminal context.

[5]U.R.P.C. 1.16 provides in part that a lawyer may withdraw from representing a client if the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent or the client insists upon pursuing an objective that the lawyer considers repugnant or imprudent.

trustee, the debtor still had at least twenty months to commence the avoiding actions.[6] The Court is satisfied with Dangerfield's response that in the press of representing the debtor, prioritizing more time-sensitive matters could reasonably justify putting off the immediate commencement of the avoiding actions. The Court can only speculate about what action Dangerfield may have taken to remedy actions the principal and related entities may have taken pre-representation by him. However, there is no evidence that he allowed anything to happen which would have precluded him from taking effective action in the performance of his fiduciary duties to the estate.

Based upon the above and after thoroughly reviewing Dangerfield's itemized fee application and considering the nature, extent, and the value of the services, the Court finds the time spent on services and rates charged for the services to be reasonable and that the services were necessary to the administration of the estate and were beneficial at the time at which the services were rendered. Therefore, it is hereby

ORDERED that the fees in the amount of $7,584.92 as the balance from applicant's first application and $12,120.00 in fees from the second and final application are awarded; and it is hereby

ORDERED that reimbursement of expenses in the amount of $327.06 is awarded.

DATED this 3rd day of October, 1997.

BY THE COURT:

[6] 11 U.S.C. § 546(a)(1)(A).

/S/
GLEN E. CLARK, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT

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CERTIFICATE OF MAILING

I hereby certify that I mailed a copy of the foregoing Memorandum Opinion and Order to the following this 3rd day of October, 1997.

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