NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. CC-06-1232-PaDMo
JOHN D. CASTELLUCCI,	Bk. No. SV 01-20176-KT
Debtor.	
LINDA CASTELLUCCI,	
Appellant,	
v.	**M E M O R A N D U M**[1]
JAMES ANDREW HINDS, JR., d/b/a/ THE LAW OFFICES OF JAMES ANDREW HINDS, JR.,	
Appellee.	

Argued and Submitted on March 22, 2007
at Pasadena, California

Filed - July 26, 2007

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Kathleen T. Thompson, Bankruptcy Judge, Presiding.

Before: PAPPAS, DUNN and MONTALI, Bankruptcy Judges

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

INTRODUCTION

The bankruptcy court approved some, but not all, of the attorney fees and costs sought by Appellee James Andrew Hinds, Jr. ("Hinds") arising from his representation of debtor John D. Castelluci during his chapter 11[2] case. Because the court found that Hinds had violated his obligations under the Bankruptcy Code and Rules to disclose the details of his legal relationships with others, and because Hinds received substantial payments during pendency of the chapter 11 case without prior notice to parties or approval by the bankruptcy court, the court declined to award Hinds the full amount of fees he requested, and also ordered him to disgorge to the chapter 7 trustee a portion of the unauthorized payments he received.

While Hinds did not appeal the bankruptcy court's ruling, Appellant Linda Castelluci, the debtor's spouse, did. She argues that the bankruptcy court erred when it struck her objection to Hinds' fee application because she lacked standing. She also contends the bankruptcy court should have denied Hinds any fees or expenses, and should have ordered him to disgorge all the payments he received.

We agree that Appellant had standing to object to Hinds' fee application. We REVERSE the bankruptcy court's order and REMAND this matter to the bankruptcy court with instructions that it consider Appellant's objection in further proceedings.

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[2] 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 1001-9036, as enacted and promulgated prior to the effective date (October 17, 2005) of most of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, April 20, 2005, 119 Stat. 23.

FACTS

Separate involuntary chapter 7 petitions were filed in the bankruptcy court against John D. Castellucci ("Debtor") and his wife, Linda Castellucci ("Appellant"), on October 29, 2001. They both engaged attorney Hinds to represent them in the bankruptcy cases pursuant to a fee agreement dated October 31, 2001 ("Fee Agreement"). The Fee Agreement, which both Debtor and Appellant signed, provided they would be jointly and severally responsible for all amounts due to Hinds for any services provided in either case. At the same time, Debtor, Appellant and Hinds signed a conflicts waiver, which provided, "At the present time none of us see any existing conflicts in the existing and potential representation of each of you, in these matters . . . ."

The involuntary petition filed against Appellant was dismissed by the bankruptcy court on February 4, 2002. But an order for relief was entered in Debtor's case on November 30, 2001. The case was converted to a chapter 11 case on Debtor's motion on the same day.

On January 2, 2002, an application seeking bankruptcy court approval for Hinds' law firm to be employed as counsel for Debtor as debtor-in-possession (the "Employment Application") was filed. The Employment Application was supported by the declaration of Paul R. Shankman, Of Counsel to Hinds' firm. The Employment Application disclosed that Hinds represented Appellant in her involuntary case. It also contains the following statement:

> At the present time there does not appear to be any conflict of interest in the proposed representation of the Debtor's wife in her involuntary bankruptcy case. Counsel acknowledges that should an actual conflict arise counsel will make a supplemental report to

> this Court and withdraw as counsel for Linda Castellucci in her case. Should a conflict be identified, counsel will [sic] a supplement and amendment to this Application will be filed and served seeking further instructions from this Court.

In addition, as later quoted by the bankruptcy court in its decision, the Employment Application recites:

> Paragraph 4 of the Employment Application states: "The Firm received no pre-petition retainer as part of this proposed engagement. During the so-called 'gap period,' the Debtor paid the Firm $7,500, all of which has been paid for services rendered prior to the adjudication of this case, including payment of the fee required upon conversion of this case to one under Chapter 11, Title 11 of the Code, and as part of the proposed engagement in the involuntary case filed against the Debtor's wife in her involuntary case (In re Linda Castellucci, Case No. SV-01-20177 AG). As of the date of this Application the Firm has filed a Rule 12(b)(1) Motion for Reconsideration of this ruling. Should the Linda Castellucci case proceed before this Court and should Mrs. Castellucci elect to retain the Firm as her counsel in her case, a supplement and amendment to this Application will be filed and served."
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> Paragraph 5 of the Employment Application states: "It is contemplated that the Debtor may not be able to compensate his counsel for work performed during the course of this case without the assistance of certain third parties such as his employer(s). Should payment from any third-party source be required the Debtor and proposed general counsel will notify the Office of the United States Trustee and this Court of the source and amount of said proposed payment."

Memorandum on Application for Fees and Expenses by Law Offices of James Andrew Hinds, Jr.(the "Fee Memorandum")at 5.

The Employment Application discloses that after the filing of the involuntary petition against Debtor, and before conversion of his case to a chapter 11 case, Hinds received a $7,500 payment toward his fees. The declaration accompanying the Employment

Application states that no fees were owed to Hinds on the date of conversion.

In addition, attached to the Employment Application is a copy of the Disclosure of Compensation of Attorney for Debtor which had been filed in Debtor's bankruptcy case by Hinds on December 27, 2001, presumably to comply with Rule 2016(b).[3] This disclosure represents that Hinds "will seek payment of compensation [for his post-petition services] upon duly noticed interim fee applications."

There is no reference to the terms of the Fee Agreement in the Employment Application or the accompanying declaration. Hinds later acknowledged that the Employment Application and declaration were deficient in that:

> The Employment Application disclosed that Hinds represented Appellant in her involuntary case, but Hinds failed therein to disclose: (1) that Appellant was a guarantor of the Debtor's fees and costs; (2) that Appellant asserted a secured claim against the residence in Malibu scheduled on the Debtor's Schedule D in the sum of $1.3 million [footnote omitted]; and (3) he did not attach a copy of the Engagement Letter to the Employment Application [footnote omitted].

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[3] Rule 2016(b) provides:

> **Disclosure of Compensation Paid or Promised to Attorney for Debtor.** Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 15 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any such sharing or agreement for the sharing of compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed.

Hinds' Response Br. at 4.

The bankruptcy court entered an order approving the Employment Application on January 8, 2002. That order specifies that "[c]ompensation shall be awarded [to Hinds] in accordance with §§ 328, 330 and 331 of the Bankruptcy Code."

During the course of Debtor's chapter 11 case, roughly on a monthly basis, Hinds filed declarations, again presumably as required by Rule 2016(b), disclosing his receipt of certain cash payments for his services in Debtor's bankruptcy case (the "2016(b) declarations"). Except for the amounts and dates of the payments, the twenty-five 2016(b) declarations submitted to the bankruptcy court are identical, and recite that:

> I, James Andrew Hinds, Jr., declare and state as follows:
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> * * *
>
> 2. On or about [date], the Debtor paid to the Law Offices of James Andrew Hinds, Jr. the total sum of [amount] for professional fees and costs incurred on a post-petition basis in this case. This payment is consistent with the Order approving employment of general reorganization counsel in this matter, the provisions of Chapter 11, Title 11, and is subject to final review and allowance by this Court in accordance with law.
>
> I declare under penalty of perjury, pursuant to the laws of the United States of America, that the foregoing is true and correct.
>
> Executed this [date] at Los Angeles, California.
>
> /signature/
> James Andrew Hinds, Jr.

The 2016(b) disclosures reveal that, all told, Hinds received

at least $289,099.71 in fee payments during the chapter 11 case.[4]

On May 19, 2003, Schaefer Oil Co., Inc. ("Schaefer Oil") filed a petition for relief under chapter 11. Case no. SV 03-14298 AG. Debtor was the president, as well as the sole member of the board of directors, of Schaefer Oil, and signed all documents on behalf of that company. On June 17, 2003, Schaefer Oil applied to the bankruptcy court to employ Hinds as its attorney. The Schaefer Oil employment application and accompanying declaration disclosed that Hinds was currently representing Debtor in his chapter 11 case. The bankruptcy court approved the employment application on September 4, 2003. Schaefer Oil's bankruptcy case was eventually dismissed on January 8, 2004.

In the meantime, at the request of Debtor's creditors, his chapter 11 case was converted to a chapter 7 case on February 5, 2004, and a chapter 7 trustee was appointed.

Hinds continued to represent Debtor until November 2004. At about that time, Hinds filed a complaint against Appellant in California Superior Court (the "Complaint"). In the Complaint, based upon the Fee Agreement, Hinds sought recovery from Appellant for fees for services in the approximate amount of $320,000. A significant portion of the fees which Hinds sought from Appellant arose from services he provided to Debtor as counsel in his bankruptcy case.[5]

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[4] None of the 2016(b) disclosures include copies of any payment instruments revealing the source of the payments.

[5] Appellant caused this action to be removed to the bankruptcy court on January 5, 2005. On November 14, 2006, the bankruptcy court stayed proceedings in that action pending the outcome of this appeal.

On November 8, 2005, the bankruptcy court approved a Settlement Agreement and Release executed by Debtor, Appellant, the chapter 7 trustee in Debtor's bankruptcy case, and Schaefer Oil. As part of the settlement, Appellant assigned to the chapter 7 estate her right to any disgorgement from Hinds that she might be entitled to receive, in exchange for a 25 percent interest in any net recovery obtained and actually collected from Hinds on account of disgorgement or other claims against Hinds.

Hinds had filed no applications for approval of any of his fees and expenses in Debtor's bankruptcy case. On December 16, 2005, the chapter 7 trustee filed a motion to fix a bar date for filing requests for payment of chapter 11 administrative claims. Apparently in response, on January 3, 2006, Hinds filed an "Application for Payment of: Final Fees and/or Expenses (11 U.S.C. § 330)" (the "Fee Application"). The Fee Application sought approval by the bankruptcy court of fees for Hinds' services in Debtor's bankruptcy case of $366,740.00, and reimbursement of expenses of $30,556.20, for a total of $397,296.20.

The Fee Application also sought court approval of several payments that had been made during the pendency of Debtor's chapter 11 case to Hinds totaling $296,599.71, presumably including those reflected in the 2016(b) disclosures as having been made "by Debtor." But, for the first time, Hinds disclosed in the Fee Application that the source of these payments was not just Debtor's post-petition income, but some payments had been made to Hinds by Schaefer Oil, and by Debtor's creditor Lou

Lubensky.[6] Hinds alleged in the Fee Application that, except for the $7,500 retainer and three previously undisclosed payments of $10,000, $2,000, and $3,000, all prior payments he received had been contemporaneously disclosed in the various 2016(b) disclosures. As a result of the payments, the Fee Application requested payment of net fees and costs from the bankruptcy estate to Hinds totaling $100,696.49 (i.e., $397,296.20 less $296,559.71).

Oppositions to the Fee Application were filed by the chapter 7 trustee, in which the U.S. Trustee joined, by a creditor, Williams, and by Appellant. A hearing was conducted by the bankruptcy court on the Fee Application on January 31, 2006. Hinds appeared in person, and Appellant, the chapter 7 trustee, the U.S. Trustee, and creditors Williams and Capstone Capital were represented by counsel. The bankruptcy court heard comments and argument from the parties and took the issues under submission.

The bankruptcy court entered its decision on the issues on June 15, 2006 (the "Fee Memorandum"). The bankruptcy court approved fees for Hinds in the amount of $366,740, and costs in the amount of $30,566, essentially as Hinds had requested. However, because the bankruptcy court found that Hinds had engaged

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[6] The record is not clear regarding the nature of the relationship between Lubensky and Debtor. However, a fair reading would indicate that it was not a simple, arms-length debtor-creditor relationship. See Fee Memorandum at 8 n. 6 ("Lubensky did not proceed with his relief from stay motion, filed on January 11, 2002, or move forward with foreclosure while allowing the Debtors to stay in the home without payment on their obligations to Lubensky. . . . In addition, it appears that Lubensky guaranteed Hinds' fees in the Schaefer Oil case and personally funded a buy-out of a major creditor's interest in the Schaefer Oil case. Hinds describes Lubensky as the Debtor's 'business partner.'")

in what it described as "multiple, material breaches of a chapter 11 debtor's counsel's obligations under the Bankruptcy Code and Rules," the court reduced Hinds' fee award by 15 percent ($55,011), together with another $50,471.17 representing the attorney's fees incurred by the chapter 7 trustee in objecting to Hinds' Fee Application.[7] An additional $30,000 of Hinds' fees was ordered subordinated to the payment of all other claims in the case. Therefore, under the bankruptcy court's decision, the net amount of compensation Hinds could receive as a chapter 11 administrative claimant was $231,247.83.

In addition to reducing his fees, the bankruptcy court ruled that Hinds must disgorge $121,793.70 of the fee payments he had received to the trustee. The court indicated that it may consider further disgorgement if it became necessary to pay the claims of creditors with a higher priority than Hinds, or to equalize payment of claims of equal priority.[8]

The bankruptcy court explained the basis for its fee reduction and disgorgement order in these words:

> Hinds failed to make adequate disclosures in the Employment Application in violation of Rule 2014(a). Specifically, he failed to disclose that a specific third party, namely Linda Castellucci, was considered a co-obligor for

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[7] This amount was fixed later, after the trustee filed a statement documenting the extent of his attorney fees. Hinds does not challenge this amount on appeal.

[8] We cannot determine, based on the record, the actual financial impact of the bankruptcy court's decision on Hinds. If there are sufficient funds available for distribution to pay all chapter 7 and 11 administrative claims, Hinds could receive the full amount of fees and costs awarded to him by the bankruptcy court. If the funds in the bankruptcy estate are inadequate to pay chapter 11 administrative claims in full, Hinds would share pro-rata with other creditors holding claims of similar priority. See § 726(a), (b).

> payment of fees incurred in representation of the Debtor. Hinds failed to disclose that third party obligors and third party payors were creditors or alleged creditors of the estate. Thereafter, Hinds failed to accurately disclose the identity of persons tendering payments on his fees, totaling $121,793.70. Hinds violated Rule 2016(b) by failing to file required disclosures as to four payments totaling $17,000. Hinds failed to make timely application for approval of his fees. He received at least $128,543.70 in 2002, $142,000 in 2003, and $17,000 in 2004. No fee application was filed until January 2006. This substantial delay prejudiced the ability of creditors and the court to evaluate the services rendered and the reasonableness of fees. The court finds that the delay was unreasonable and that Hinds knew or should have known that the delay would impair or, if the case were dismissed, preclude review of Hinds' fees. Nothing in the record suggests that Hinds held the fees in his trust account until approved by the court.

Memorandum Decision at 16.

While sustaining the various objections to the Fee Application filed by the chapter 7 trustee, U.S. Trustee, and Williams, in its Fee Memorandum, the bankruptcy court struck the objection filed by Appellant because, in the court's opinion, she lacked standing to contest Hinds' fee request.

The bankruptcy court entered its Fee Memorandum as an order on June 16, 2006. Appellant filed a timely appeal.

JURISDICTION

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (B). We have jurisdiction pursuant to 28 U.S.C. § 158.

ISSUE

The sole issue we address is whether Appellant had standing to object to the Fee Application.

STANDARD OF REVIEW

Standing to object in the trial court is a jurisdictional question that we review de novo. Nat'l Org. for Women v. Scheidler, 510 U.S. 249, 253 (1994); Paine v. Dickey (In re Paine), 250 B.R. 99, 104 (9th Cir. BAP 2000). See also McClellan Fed. Credit Union v. Parker (In re Parker), 193 B.R. 525, 527 (9th Cir. BAP 1996) (holding that a similar standard applies in determining standing on appeal).

DISCUSSION

In an interesting variation on the usual scenario, Hinds, the professional whose fee request was reduced by the bankruptcy court, has not appealed,[9] and instead asks us to affirm the bankruptcy court's decision as a proper exercise of its discretion. He acknowledges that he violated the Bankruptcy Code and Rules in connection with his employment and service as counsel for the debtor-in-possession, and he concedes that the fee reduction and other measures employed by the bankruptcy court were calculated and appropriate responses to his conduct under the circumstances.

Appellant, on the other hand, insists that the bankruptcy court erred in deciding she lacked standing to object to Hinds' fee application. She also urges us to reverse the bankruptcy

[9] Hinds also filed no cross-appeal in response to Appellant's appeal.

court's order because it did not disallow Hinds' request for compensation and expenses in any amount, and because it did not require him to fully disgorge all the payments he received.

We agree with Appellant that she had standing to object to Hinds' application in the bankruptcy court. As a result, a reversal of the bankruptcy court's decision and a remand is required.[10]

Standing to object to a fee application in the bankruptcy court has both a constitutional and prudential dimension.

Constitutional standing requires that a party:

> must demonstrate that "(1) it has suffered an 'injury in fact' that is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical; (2) the injury in fairly traceable to the challenged conduct of the [other party]; and (3) that it be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.

City of Sausalito v. O'Neill, 386 F.3d 1186, 1197 (9th Cir. 2004) (quoting Friends of Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc., 528 U.S. 167, 180-181 (2000)).

Appellant meets the constitutional threshold for standing to object to the Fee Application in the bankruptcy court. She holds a particularized, concrete, judicially cognizable interest in the outcome of the dispute over the Fee Application, in that she may

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[10] Under these circumstances, we decline Appellant's invitation to review the substance of the bankruptcy court's fee award and disgorgement order for an abuse of discretion. It is true that the chapter 7 trustee, joined by the United States Trustee, objected to the Fee Application, as did creditor Williams, and those objections are substantially similar to the objections asserted by Appellant. Nevertheless, Appellant's objection goes further than the others by asking that Hinds' employment be deemed void ab initio, and of course, she has a direct stake in the outcome. Thus we decline to act as a trial court and deal with the merits of her objections before they have been considered by the bankruptcy court.

be liable under the Fee Agreement for any amounts awarded to Hinds that are not paid to him by the bankruptcy estate. There is also causal connection between the bankruptcy court's approval of the Fee Application and Appellant's potential liability to Hinds. And it was certainly within the power of the bankruptcy court to redress Appellant's alleged injury by denying Hinds' request. Assuming Appellant's objection was sustained, the bankruptcy court could have denied Hinds' right to recover any fees or expenses incurred in Debtor's case. §§ 327(c); 330(a).

Appellant also has a potential property interest in any funds ordered disgorged by Hinds. Pursuant to the Settlement Agreement and Release she executed with the chapter 7 trustee in Debtor's bankruptcy case, which was approved by the bankruptcy court, Appellant is entitled to receive 25 percent of any net recovery obtained and actually collected from Hinds on account of disgorgement or other affirmative claims against Hinds.

Based upon these interests, clearly, then, Appellant satisfies the constitutional standard for standing to object to the Fee Application.

Appellant also enjoys prudential standing under the Bankruptcy Code to object to Hinds' fees. In doing so, Appellant must be asserting her own rights, not those of other parties, and her interest must fall within the zone of interests protected by the Bankruptcy Code. Dunmore v. United States, 358 F.3d 1107, 1112 (9th Cir. 2004). While the Code does not specify which parties may object to an estate professional's application for approval of compensation and expenses, under § 330(a) and Rule 2002(a)(6), among others, "parties in interest" are entitled to

receive notice of the filing of, and the hearing concerning, such application. Presumably, the same parties in interest entitled to notice of the filing and hearing on a fee application would, in response to the notice, have some right to be heard.[11] We have held that a party holding a "pecuniary interest" in property of the estate is a party in interest. Hasso v. Mozsgai (In re La Sierra Fin. Servs.), 290 B.R. 718, 728 (9th Cir. BAP 2002). Therefore, under these facts, we conclude that Appellant had standing to challenge Hinds' application for fees.

CONCLUSION

We REVERSE the bankruptcy court's decision striking and refusing to consider Appellant's objection to the Fee Application because she lacked standing. Because Appellant has argued that Hinds should receive no fees from the bankruptcy estate, and should be ordered to disgorge all payments he received, we REMAND this matter to the bankruptcy court for further proceedings to consider the merits of Appellant's objection.

PAPPAS, Bankruptcy Judge, concurring:

The Panel resolves this appeal by holding that Appellant had standing to object to Hinds' fee application. I concur with the

[11] The Code grants parties in interest a broad right to be heard in chapter 11 cases. See § 1109(b) (providing that, in a chapter 11 case, a party in interest "may raise and may appear and be heard on any issue in a case . . . .") While Hinds' fees and costs were considered only after Debtor's bankruptcy case was converted to a chapter 7 case, the services in question, and Hinds' conduct under examination, all occurred while the case was in chapter 11. In this context, we see little reason to question Appellant's statutory right to be heard in the chapter 7 case.

Panel's decision concerning this narrow issue, and that a remand to the bankruptcy court is therefore required.

As noted above, the Panel does not address the merits of Appellant's multiple arguments urging that, based upon his conduct in this case, Hinds should receive no fees and expenses from the bankruptcy estate, and that he should be ordered to disgorge all payments he did receive. While I am confident that, upon remand, the bankruptcy court will give serious consideration to her arguments, I write separately to acknowledge the legal significance of Appellant's contentions, and to highlight the many facts in the record which support Appellant's concerns.[12]

I.

To put what follows in context, and before turning to the facts, a brief review of the applicable provisions of the Code, Rules and case law is in order.

The bankruptcy court may, but need not, award compensation to bankruptcy estate professionals under § 330(a). The relevant provisions specify that:

> (a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103 –
>
> (A) reasonable compensation for actual, necessary services rendered by the trustee, an examiner, professional person or attorney and by any paraprofessional person employed by any such person; and

[12] I thank my colleagues for their willingness to include an expanded recitation of the facts in the Panel's decision to facilitate some of the observations offered in this concurrence.

> (B) reimbursement for actual, necessary expenses.
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> (2) The court may, on its own motion or on motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

As noted in § 330(a)(1), the right to compensation and reimbursement of expenses is limited to those "employed under section 327 or 1103[13] . . . ." Section 327(a), in turn, requires that, to be employed by the bankruptcy estate, professionals "not hold or represent an interest adverse to the estate" and are "disinterested persons."[14] Finally, § 327(c) requires that estate professionals remain free of adverse interests throughout the term of that employment.[15]

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[13] Section 1103 governs employment of professionals by committees in chapter 11 cases, and is therefore not implicated in this appeal. Hinds' employment was approved by the bankruptcy court under authority of § 327.

[14] The text of § 327(a) provides that:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, or other professional persons, 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. . . .

[15] Section 327(c) provides, in pertinent part that:

> [T]he court may deny allowance of compensation for services or reimbursement of expenses of a professional person employed under section 327 . . . if, at any time, during such professional person's employment . . . such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

Assuming a professional is eligible under § 327(a), the debtor-in-possession's employment of that professional must be approved by the bankruptcy court. Rule 2014(a) dictates that bankruptcy court approval be obtained via an application, supported by a verified statement of the person to be employed. The Rule also specifies the requisite information for inclusion in that application and verified statement:

> The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, 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. The application shall be accompanied by a verified statement of the person to be employed, setting forth 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.

Rule 2014(a) (emphasis added).

The Ninth Circuit has instructed that full disclosure is an essential prerequisite for both employment and compensation of estate professionals:

> The bankruptcy court must ensure that attorneys who represent the debtor do so in the best interests of the bankruptcy estate. The court must ensure, for example, that the attorneys do not have interests adverse to those of the estate, that the attorneys only charge for services that benefit the estate, and that they charge only reasonable fees. To facilitate the court's policing responsibilities, the Bankruptcy Code and Federal Rules of Bankruptcy Procedure impose several disclosure requirements on attorneys who seek to represent a debtor and who seek to recover fees. The disclosure rules

> impose upon attorneys an independent responsibility. Thus, failure to comply with the disclosure rules is a sanctionable violation.

Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d 877, 880 (9th Cir. 1995).

We echoed the Circuit's concern in Mehdipour v. Marcus & Millichap (In re Mehdipour), 202 B.R. 474 (9th Cir. BAP 1996): "Professionals must disclose all connections with the debtor, creditors and parties in interest, no matter how irrelevant or trivial those connections may seem. The disclosure rules are not discretionary." Id. at 881.

Some circuits take such a demanding view of the disclosure requirements that, absent strict compliance with the Code and Rules, compensation will be denied to professionals who fail to adequately disclose relevant facts. See In re Big Rivers Elec. Corp., 355 F.3d 415 (6th Cir. 2004)(failure to disclose third-party fee agreement resulted in loss of all fees); Matter of Prudhomme, 43 F.3d 1000, 1003 (5th Cir. 1995)(all fees denied to an attorney who exhibits a willful disregard of his fiduciary obligations to fully disclose the nature and circumstances of his fee arrangement); Electro-wire Products v. Sirote & Permit, P.C. (In re Prince), 40 F.3d 356 (11th Cir. 1994)(denial of fees for failure to disclose multiple conflicts); Turner v. Davis, Gillenwater & Lynch (In re Inv. Bankers), 4 F.3d 1556, 1565 (10th Cir. 1993) (compensation issues must be fully disclosed or attorney risks losing all fees).

II.

Set against this landscape of legal requirements, in my opinion, Appellant persuasively argues that Hinds' was guilty of serious violations of the disclosure requirements of the Code and Rules in connection with his application to the bankruptcy court for approval of his employment as attorney for Debtor in the chapter 11 case. Indeed, Appellant contends that the bankruptcy court's approval of Hinds' employment as counsel for Debtor as debtor-in-possession should be declared void ab initio because Hinds failed to disclose that he held or represented an interest adverse to the bankruptcy estate at the time he filed the Employment Application. This argument deserves consideration by the bankruptcy court upon remand.

The adverse interest referenced by Appellant derives from two circumstances. First, under the Fee Agreement, Appellant was allegedly obligated to pay all of Hinds' fees and costs, including those incurred in representing Debtor. Second, Appellant, whom Hinds was simultaneously representing in another bankruptcy case, was at that same time a creditor in Debtor's bankruptcy case, holding a deed of trust on Debtor's home.[16] According to Appellant, because Hinds was burdened with these disqualifying conflicts of interests, neither of which were adequately disclosed to the bankruptcy court in Hinds' Employment Application, Hinds

[16] It is true the bankruptcy court eventually concluded that the debt allegedly owed by Debtor to Appellant arose from a sham transaction. However, the court did not reach this conclusion until much later in Debtor's bankruptcy case, long after approving Hinds' employment. The salient consideration here is that Appellant's status as an alleged creditor was not timely disclosed by Hinds. Further, the record before us does not indicate whether Hinds represented Appellant in her capacity as a secured creditor in Debtor's case.

was ineligible to represent Debtor as debtor-in-possession.

There is support in our cases for the proposition that if a professional holds or represents an adverse interest, or is not disinterested, the bankruptcy court's order authorizing employment of that professional is ineffective:

> Section 327(a) prohibits the employment of professionals who hold or represent an interest adverse to the estate and who are not disinterested. The bankruptcy court does not have authority to allow the employment of a professional in violation of § 327 and the employment is void ab initio.

Mehdipour, 202 B.R. at 478. Our Court of Appeals has also spoken out strongly against professionals who do not disclose the details of fee agreements containing provisions giving rise to possible adverse interests. In Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis), 113 F.3d 1040, 1045 (9th Cir. 1997), the court of appeals quoted the Sixth Circuit's decision in In re Downs, 103 F.3d 472, 479 (6th Cir. 1996), with approval:

> The bankruptcy court should deny all compensation to an attorney who exhibits a willful disregard of his fiduciary obligations to fully disclose the nature and circumstances of his fee arrangement under § 329 and Rule 2016. The authority to do so is inherent, and in the face of such infractions should be wielded forcefully.

For additional support, Appellant cites In re Maximus Computers, Inc., 278 B.R. 189, 194 (9th Cir. BAP 2002), where counsel's simultaneous representation of a creditor and debtor, together with the creditor's payment of debtor's fees, resulted in an order reversing counsel's authorization for employment by an estate.

To be precise, Hinds did disclose that he was representing Appellant in her bankruptcy case. And the bankruptcy court found

that "[this] dual representation was adequately disclosed and transparent at the time both to the court and to [objecting] creditors Capstone Capital LLC and Williams." Fee Memorandum at 9.

Even so, the bankruptcy court found that Hinds' disclosure was not adequate. For several reasons, I agree. For example, it is undisputed that, in connection with the Employment Application, Hinds did not disclose the existence and terms of the Fee Agreement signed by Debtor and Appellant, a clear violation of Rule 2014(a)'s mandate that such application "state the specific facts showing . . . any proposed arrangement for compensation" and "all of the [professional's] connections with the debtor, creditors, [or] any other party in interest. . . ."[17] Equally offensive, Hinds also did not disclose Appellant's status as an alleged secured creditor in Debtor's case in the Fee Application.

Hinds' simultaneous representation of Debtor and Appellant under a Fee Agreement requiring both clients to pay all of Hinds' fees, when coupled with Appellant's status as an alleged secured creditor of Debtor's bankruptcy estate, may (or may not) have

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[17] As one bankruptcy law scholar has observed:

> Third party payments are a special problem [in bankruptcy cases] because they shade into a conventional, noncompensation conflict, the representation of other parties in interest. The reason is that a third-party payor is virtually certain to be a party in interest. . . . Because [third party guarantees] do raise serious conventional conflict problems, they should be subject to special scrutiny and less-dangerous alternatives [to financing professional fees] should be explored.

J. LAWRENCE WESTBROOK, Fees and Inherent Conflicts of Interest, 1 AM. BANKR. L. REV. 287, 301 (Winter 1993).

rendered Hinds ineligible for employment as counsel for Debtor as debtor-in-possession under § 327(a).[18] But regardless of whether the bankruptcy court might have decided, under these facts, that Hinds could represent Debtor in the chapter 11 case, the attorney's admitted failure to disclose in the Employment Application the details of his Fee Agreement with Appellant and her status as a secured creditor of Debtor was a significant violation of Rule 2014(a).[19] Had these important facts been properly disclosed, and had the bankruptcy court deemed Appellant's or Hinds' interests adverse to the estate, under § 327(a) and Mehdipour, the bankruptcy court was powerless to approve Hinds' employment as counsel for the debtor-in-possession.

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[18] I acknowledge that the mere representation of a creditor by a proposed estate professional does not disqualify him or her from employment by the bankruptcy estate. If the dual representation is adequately disclosed and unless a creditor or the U.S. Trustee objects, to disqualify the professional, the bankruptcy court must find that the representation amounts to an actual conflict of interest. See § 327(c). Here, however, when Debtor's bankruptcy case was commenced, Appellant purportedly held a deed of trust on Debtor's home to secure her claim, a lien which was subsequently voided by the bankruptcy court. It is doubtful, then, that Hinds could simultaneously represent Debtor and Appellant, under these circumstances.

[19] It is not enough that the necessary facts about the professional's relationship with the third party appear somewhere in the bankruptcy court's files. One court has so concluded. In re Hathaway Ranch P'ship, 116 B.R. 208, 213 (Bankr. C.D. Cal. 1990) ("The disclosure must be made in the application for order approving employment. It is not sufficient that the information might be mined from petitions, schedules, § 341 meeting testimony, or other sources.") See also In re Lotus Props., L.P., 200 B.R. 388, 393 (Bankr. C.D. Cal 1996) (concluding that the Code requires that the factual/legal relationship between a third-party payor-insider, the debtor, their attorneys, and their contractual arrangement concerning fees be fully disclosed at the outset of the proposed professional's representation, and that the professional demonstrate the absence of facts that would otherwise render the professional not disinterested, in actual conflict or facing an impermissible potential for a conflict.)

As it turned out, Hinds' employment was approved by the bankruptcy court, and he provided services to Debtor under authority of that order. While Appellant argues that Hinds can receive no compensation as a matter of law under these circumstances, our cases suggest otherwise. If full disclosure is made, even at a later stage in the proceedings, the bankruptcy court has discretion to determine whether to disallow all, part, or none of the fees and expenses of a properly employed professional. Movitz v. Baker (In re Triple Star Welding, Inc.), 324 B.R. 778, 789 (9th Cir. BAP 2005)(citing Lewis, 113 F.3d at 1045-46). In Triple Star Welding, the Panel considered the two conflicting principles implicated in deciding whether compensation may be awarded when the underlying employment should not have been authorized. On the one hand, proper court approval of counsel's employment is a prerequisite for compensation under the Bankruptcy Code and Rules, and the bankruptcy court cannot simply disregard those rules and instead award compensation under quantum meruit or other state law theories. Id. at 790 n.14, citing Law Offices of Ivan W. Halperin v. Occidental Fin. Group (In re Occidental Fin. Group), 40 F.3d 1059, 1062-63 (9th Cir. 1994); and DeRonde v. Shirley (In re Shirley), 134 B.R. 940, 944-45 (9th Cir. BAP 1992).

On the other hand, the Ninth Circuit has occasionally approved retroactive authorization of a professional's employment, or authorized payment for part of the time the professional worked for the estate. Id., citing Atkins v. Wain, Samuel & Co. (In re Atkins), 69 F.3d 970, 973-76 (9th Cir. 1995)(employment and fees may be retroactively authorized in exceptional circumstances). Our own decision in Mehdipour, cited by Appellant to support

denying all fees here, does not rule out allowing retroactive employment and fees during the period of employment when there was no conflict:

> Any professional who the court determines to hold or represent an interest adverse to the estate or who is not disinterested is not an officer of the estate during the time of conflict and must be denied compensation for services performed during the conflict pursuant to § 330.

Mehdipour, 202 B.R. at 478 (emphasis added). We have also recognized that the bankruptcy court had discretion to award compensation for services performed in reliance on an order authorizing employment, before that order was reversed on appeal. First Interstate Bank of Nev. v. CIC Inv. Corp. (In re CIC Inv. Corp.), 192 B.R. 549, 553-54 (9th Cir. BAP 1996).[20]

Based upon these cases decided in this Circuit, I think it is likely that a professional who does not fully disclose required information at the time of applying for approval of his employment, such as the existence of a fee agreement requiring another to pay his fees, or his representation of a client with a potential interest adverse to the estate, may not be employed under § 327(a), and any order authorizing that employment is ineffective. Even so, the case law allows the bankruptcy court a certain degree of discretion to approve payment of fees for services provided during the time of the professional's representation when there was no conflict, and after full disclosure has occurred.

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[20] In CIC Inv. Corp., however, the professional had disclosed its conflicts at the outset and the lack of disinterestedness was not immediately clear. Triple Star Welding, 324 B.R. at 790 (citing CIC Inv. Corp., 192 B.R. at 54-56).

In this instance, though, it would seem Hinds' deserves little lenience from the bankruptcy court. It is clear that Hinds held or represented adverse interests from the outset of his employment, and did not disclose either the terms of the Fee Agreement requiring Appellant to pay his fees, or that she was a creditor, in connection with seeking court approval of his employment. It is also significant in this case that Hinds never effectively rectified his lack of candor concerning his potentially adverse interests during the chapter 11 case.

Under these facts, Appellant's contention that the bankruptcy court should have denied him any fees or expenses raises a legitimate issue.

III.

Distinct from Hinds' disclosure shortcomings in obtaining approval of his employment, Appellant also focuses our attention on Hinds' many violations of the disclosure and procedural requirements regarding the payments made to him as Debtor's attorney.

Hinds admits he violated the Code and Rules in failing to properly disclose the true details of many of the post-petition payments he received during the chapter 11 case, and by accepting payments for fees without proper application, notice to parties, and prior bankruptcy court approval. To demonstrate the extent of the problem, this tabulation of Hinds' various and sundry Code and Rule transgressions is offered:

- Hinds' Employment Application represented that Hinds would notify the U.S. Trustee and the bankruptcy court if payments from any third parties would be required, and the source and amounts of those payments. He did no such thing. Instead, Hinds acknowledges he received almost $300,000 in payments

without prior application, notice to parties, or bankruptcy court approval.

- Hinds' 2016(b) disclosures filed with the bankruptcy court purportedly to disclose the details of payments made to him identified some of these payments. But they all indicated that the source of the payments was "the Debtor." In fact, many of the payments came from third parties Schaefer Oil (another chapter 11 debtor) and creditor Lubensky.

- Hinds admits that he failed to file any disclosures as to four post-petition payments totaling $17,000, a clear violation of Rule 2016(b). Some of the payments to Hinds were never disclosed, and only brought to light via Appellant's objections to his Fee Application.

- The bankruptcy court found that "Nothing in the record suggests that Hinds held payments in a trust account until approved by the court." In other words, Hinds had access to the funds as he received them.

- While he received payments of $128,543.70 in 2002, $142,000 in 2003 and $17,000 in 2004, Hinds never sought court approval for, and he was never authorized to receive, any interim fee payments. No fee application was filed until January 2006, and then only after the chapter 7 trustee caused a deadline to be set for asserting administrative claims. Hinds' delays in seeking fee approvals from the bankruptcy court therefore ranged from two to four years. The bankruptcy court found that this delay was unreasonable, and that Hinds knew or should have known that the delay would impair, or if the case were dismissed, preclude review of fees.

- The bankruptcy court concluded that "Hinds has disregarded procedures and statutory requirements of the Bankruptcy Code. Hinds is the creator of all of the problems relating to the payments, lack of adequate disclosure, and unreasonable delay."

Estate professionals may not be paid compensation or expenses absent prior approval by the bankruptcy court obtained after notice and a hearing. § 330(a); Rule 2016(a); Knudsen Corp., 84 B.R. 668, 671 (9th Cir. BAP 1988).[21] Section 329(a) and Rule

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[21] In Knudsen, the Panel approved an arrangement for periodic payments to professionals without prior bankruptcy court approval, provided that system afforded parties an adequate opportunity to obtain subsequent review of the reasonableness of the compensation and payments. However, the Panel made clear that an essential element to any such payments was prior approval by the bankruptcy (continued...)

2016(b) require a debtor's attorney to file a statement with the bankruptcy court concerning any payments of compensation to the attorney. That Rule also requires that a supplemental statement be filed within 15 days after any payment not previously disclosed. Violation of any of these provisions can justify the denial of all compensation and expenses to the professional. Lewis, 113 F.3d at 1045; Hale v. U.S. Trustee (In re Basham), 208 B.R. 926, 931 (9th Cir. BAP 1997), aff'd 152 F.3d 924 (9th Cir. 1997).

Hinds makes no real attempt to excuse his disregard of the Code and Rules in accepting these payments. To me, Appellant's argument rings true that an ample basis exists to deny Hinds any compensation.

IV.

In obtaining court approval of his employment, Hinds failed to adequately disclose his fee arrangement with Appellant and that she was a creditor, both potentially constituting adverse interests to Debtor's bankruptcy estate. In addition to these Code and Rule compliance defects, Hinds also received, without prior court approval, over $280,000 in payments of fees during Debtor's chapter 11 case, in many instances from third parties, without adequately disclosing the existence or source of such payments.[22]

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[21](...continued)
court of the arrangement itself. 84 B.R. at 673. There was no such prior approval for payments to Hinds in this case.

[22] Hinds also significantly delayed in applying for approval of his fees and expenses. In this regard, the bankruptcy court aptly characterized Hinds' mode of operation:

(continued...)

While Hinds' reprehensible ambivalence for his duties under the Code and Rules as an estate professional is clear from this record, the bankruptcy court approved his fee and expense request totaling nearly $400,000, and decided that a reduction of 15 per cent to account for what it described as his "multiple, material breaches of counsel's obligations," and by the amount incurred by the trustee in objecting to his fee application, was sufficient to redress Hinds' conduct. The bankruptcy court also ordered Hinds to disgorge to the trustee approximately $120,000 of the post-bankruptcy payments he had received.[23]

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[22](...continued)

> The procedure used by Hinds to realize payment of his attorneys' fees for his services as the Debtor's general bankruptcy counsel appears to boil down to the following: (1) get hired by the Debtor; (2) secure sources of payment [of fees] from third parties; (3) get employed by the Bankruptcy Court; (4) obtain payment of fees from the Debtor or a third party; (5) file [in many instances, an erroneous and misleading] Rule 2016(b) statement when payments are received; (6) file a fee application only when (and presumably, if) the Trustee sends notice setting a deadline for filing administrative claims.

Fee Memorandum at 13. The court also observed that "Hinds is the creator of all of the problems relating to [this payment scheme], lack of disclosure, and unreasonable delay." Id. at 16.

[23] There is no doubt that a bankruptcy court may, under § 329(a), scrutinize payments made to a chapter 11 debtor's counsel by third parties, and order return of any amounts found to be excessive. Hinds has not argued to the contrary. See In re BOH! Restaurante, Inc., 99 B.R. 971, 973 (9th Cir. BAP 1989):

> Payments to a debtor's attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor's attorney, and should be subject to careful scrutiny.

Id. quoting S. Rep. No. 95-989, 95th Cong. 2d Sess. 39 (1978). In (continued...)

No analysis or extended discussion was provided by the bankruptcy court as to why, under these egregious circumstances, Hinds should be allowed any fees or expenses. This seems odd since, as noted above, Hinds' disclosure deficiencies were such that, at least arguably, his employment as attorney for debtor-in-possession was tainted from the outset, a condition never, ever remedied by Hinds. And this is not a case where a bankruptcy professional inadvertently forgot to properly disclose an isolated or insignificant post-petition payment of fees. Hinds received, and had access to, multiple unauthorized post-petition payments totaling over $280,000.

I am sensitive to the discretion accorded the presiding judge in assessing the proper amount of professional fees to be awarded in a bankruptcy case.[24] Still, bankruptcy courts must be mindful of the Ninth Circuit's instruction that "[t]he bankruptcy court should deny all compensation to an attorney who exhibits a willful disregard of his fiduciary obligations" and that "in the face of such infractions [this power] should be wielded forcefully."

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[23](...continued)
BOH! Restaurante, Inc., the Panel concluded, based on this legislative history, that fees paid to the debtor's counsel may be reviewed by the bankruptcy court "regardless of their source." Id.; accord Henderson v. Kisseberth (In re Kisseberth), 273 F.3d 714, 718 (6th Cir. 2001) ("Any payment made to an attorney for representing a debtor in connection with a bankruptcy proceeding is reviewable by the bankruptcy court notwithstanding the source of payment.") (quoting In re Walters, 868 F.2d 665, 668 (4th Cir. 1989)).

[24] For example, the Panel should be especially deferential to the judgment of a presiding bankruptcy judge who is familiar with, and has developed special insights involving, a bankruptcy case over time. In this case, though, the bankruptcy judge who decided the Hinds fee issue did not assume responsibility for this bankruptcy case until 2005, when the former presiding judge retired.

Lewis, 113 F.3d at 1045.

Hinds's conduct is as model for how not to discharge the disclosure, procedural and other obligations of a bankruptcy estate professional. Instead of being candid and comprehensive, his disclosures omitted multiple material facts which deprived the parties and bankruptcy court of its opportunity to consider his fitness to represent a chapter 11 debtor-in-possession. And Hinds' disregard for the requirements of the Bankruptcy Code and Rules governing prior approval for payments of compensation can only be viewed as willful, especially when he had assured parties and the bankruptcy court that he would observe proper procedures in connection with obtaining approval of his compensation.

On remand, the bankruptcy court will have an opportunity to further consider Appellant's arguments.