NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	)	BAP No. MT-05-1327-KMoB
	)	
MARSHALL ALWERDT and DEBRA ALWERDT,	)	Bk. No. 03-62701
	)	
Debtors.	)	
	)	
JOHN E. SEIDLITZ, JR,	)	
	)	
Appellant,	)	
	)	
v.	)	**MEMORANDUM**[*]
	)	
MARSHALL ALWERDT; DEBRA ALWERDT; GARY S. DESCHENES, Trustee; UNITED STATES TRUSTEE,	)	
	)	
Appellees.	)	

Argued and Submitted on February 24, 2006
at Pasadena, California

Filed - March 10, 2006

Appeal from the United States Bankruptcy Court
for the District of Montana

Honorable Ralph B. Kirscher, Chief Bankruptcy Judge, Presiding

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Before: KLEIN, MONTALI and BRANDT, Bankruptcy Judges.

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[*]This disposition is not appropriate for publication and may not be cited except when pertinent under the doctrine of law of the case or the rules of res judicata, including issue and claim preclusion. See 9th Cir. BAP Rule 8013-1.

This appeal exemplifies the adage that hard cases make bad law. The bankruptcy court denied the trustee's application for retroactive attorney's fees and costs on behalf of appellant attorney John Seidlitz, who had settled a state-court personal injury action that was property of the estate. Although the court was addressing a serious problem, the corrective measure was directed against the least culpable person in circumstances in which the bankruptcy trustee did not perform his duties, and that leaves us with a definite and firm conviction that the result was incorrect. Accordingly, we REVERSE.

FACTS

The facts are not in dispute. Debra and Marshall Alwerdt, represented by Scott M. Radford, filed a voluntary petition under chapter 7 on August 18, 2003. In Schedule B, the debtors listed a personal injury cause of action for a "slip and fall" at Taco John's and listed John E. Seidlitz as the attorney handling the action that was pending in state court at the time of filing. The debtors did not exempt the cause of action in Schedule C.

At the meeting of creditors on September 18, 2003, Ms. Alwerdt testified that Seidlitz was representing her in the personal injury action and that she retained him for the sole purpose of receiving compensation for medical costs.

Neither the debtors, nor the debtors' counsel, notified Seidlitz of the existence of the bankruptcy case. Moreover, trustee Gary Deschenes (who is a lawyer) did not contact Seidlitz after September 18, 2003, to inquire about the cause of action that he knew was property of the estate.

In July 2004, and still without knowledge of the bankruptcy case, Seidlitz settled the personal injury claim for $16,000. His attorney's fees of $4,787.60 and costs of $1,124.24 were deducted therefrom, as well as a medical lien in the amount of $425.

According to Seidlitz, he learned about the bankruptcy from his debtor client after the settlement funds were in his hands and promptly advised her that her bankruptcy counsel, Radford, needed to become involved. Thereafter, Seidlitz and Radford communicated. Seidlitz turned the funds over to Radford, who placed them in his trust account. Seidlitz, having been informed that Radford planned to assist the debtors in exempting the settlement funds, awaited further developments.

Radford informed the trustee about the settlement, and, on October 15, 2004, the trustee filed a motion for turnover of the debtors' entire share of the personal injury claim, which motion the court granted three days later.

Ten days after the turnover order, the debtors filed a motion to amend Schedules B and C, which motion was granted that same day.[1] Amended Schedule B listed a value of $16,000 for the personal injury claim and Amended Schedule C exempted said amount as future medical costs pursuant to Montana Code Ann. § 25-13-608(1)(f).

The trustee objected to the amended exemption because the debtors had not provided him with any information evidencing that the monies were designated for future medical costs.

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[1]In light of Federal Rule of Bankruptcy Procedure 1009(a), which permits a debtor to amend schedules "at any time before the case is closed," it is not clear why a motion was needed.

On November 12, 2004, the debtors filed a motion to reconsider the order granting the trustee's motion for turnover.

The court held a hearing on the debtor's motion for reconsideration and the trustee's objection to exemption on December 6, 2004. At this hearing, Ms. Alwerdt told the court that Seidlitz had been unaware of the bankruptcy. The court responded that lack of knowledge did not matter and expressed concern about the situation.[2] In a later discussion where

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[2]The court explained:

THE COURT: I think this case raises some problems. In my reading of this matter, the personal injury claim was scheduled in 2003, it was discussed at the 341 meeting. It was discussed as to who was representing the personal injury – or handling the personal injury case for the debtor. There's no exemption for the amount that was within the initial documents. I don't see where the trustee ever moved to have the attorney on the personal injury case as employment-approved.

I see a settlement occurring in July during the pendency of this Chapter 7 case without any information to the court, without any request for approval of the settlement before this Court to determine if it was fair and reasonable and beneficial to the estate. I see monies distributed, a closing occurring, a settlement statement occurring, an attorney getting paid fees who has not been approved. I see costs being paid.

About the only thing I see that correctly happened is that the monies left over from the settlement [were] actually deposited in the trust with Mr. Radford. But at this point, I don't have a settlement. There's no settlement here. It's not been approved by this Court. And there's been a request for turnover.

I direct that the monies that Mr. Radford holds in his trust account be paid to the trustee until further order of this Court. I also advise Mr. Radford and the trustee to advise the personal injury attorney that he better consider how he's going to pay to the trustee to be held for subsequent order fees that he has taken in settlement of this case. Somebody had better inform, whoever, the company that there is no binding settlement by this Court. I don't know if there's an insurance carrier.

Tr. of Oral Ruling, at p. 19-20.

Radford told the court that Seidlitz did not know of the bankruptcy until July of that year, the court reiterated that the lack of knowledge was not controlling.

Ultimately, the court denied the motion for reconsideration and continued the trustee's objection to exemption until all monies were transmitted to the trustee. The court directed the debtors to turnover to the trustee all monies arising from the personal injury action, and advised the parties that no approved settlement of the personal injury claim or award of attorney's fees to Seidlitz existed because the Court had not approved any settlement or award.

On April 1, 2005, the trustee filed a motion "for approval of settlement" regarding the debtors' personal injury settlement in the amount of $16,000. Attached as Exhibit A was a letter addressed to John Seidlitz from defense counsel explaining that Continental Western Insurance agreed to settle the matter for $16,000.

On the same day, the trustee filed a motion for "approval of stipulation" that reflected a compromise among the trustee, the debtors, Radford, and Seidlitz. The stipulation and agreement were attached as Exhibit A and included the following terms: (1) the trustee shall accept the sum of $6,000 as payment in full for the outstanding equity in the personal injury settlement; (2) debtors shall receive the sum of $3,663.16 from the settlement money and an additional $1,000 paid from attorney Scott Radford (who had filed a pending motion to withdraw "to be taken care of simultaneously" with the compromise) and $1,000 paid from attorney John Seidlitz; (3) and attorney John Seidlitz holds $425

to be paid to Dr. Stoebe for a medical lien. These numbers add up to $12,088.16, not $16,000.

The compromise agreement does not reference any payment to Seidlitz. A letter, however, from Seidlitz to the trustee indicates that the settlement included his fee. Specifically, the letter states: "we have a settlement agreement which provides $6,000 of the settlement is paid to the trustee, $3,663.16 paid to Deb, in addition to $1,000 paid to Deb from Scott Radford, $1,000 paid to Deb from John E. Seidlitz, Jr., $425.00 in lien paid to Stoebe, and my fee (less $1,000) is approved." Inferentially, Seidlitz's net fee was $3,911.84 (= $16,000 - $12,088.16).

On April 6, 2005, the trustee filed an application to employ Seidlitz as special counsel for the estate to recover and administer property of the estate. The application proposed to pay Seidlitz a contingency fee of the amount recovered as reasonable compensation for the actual and necessary services provided by him on behalf of the bankruptcy estate.

The next day the court entered an order authorizing Seidlitz's employment but did not authorize a contingency fee.

On April 14, 2005, the court entered orders approving the settlement of the personal injury action and of the compromise.

On June 3, 2005, the trustee filed a first and final application for payment of Seidlitz's attorney's fees in the sum of $4,787.60 and $1,124.14 in costs as reasonable compensation for the services provided.

The court held a hearing on the application for attorney's fees on June 30, 2005, which the trustee, the debtors, and

Seidlitz attended. At the outset of the hearing, the court expressed its concern that Seidlitz's employment was not requested on a timely basis as a consequence of oversight and negligence on the part of counsel. The court noted that the dereliction was not necessarily that of Seidlitz, but of the others involved. In other words, Radford and the debtors deserved to be chastised for not informing Seidlitz of the bankruptcy and Deschenes was derelict in his duty as trustee.

Although the court empathized with Seidlitz, it explained:

> [T]here's a protocol when these people are in bankruptcy and there are claims and people are p[u]rsuing claims that there has to be employment. And the case law is really specific on this. Even if I wanted to stretch it back as some nunc pro tunc, in reading the requirements for that, I can't meet them. The facts aren't there. I just find this to be a really unfortunate situation. But as much as I hate to do it, I don't see how I can award these fees. It's very troubling to me.

Tr., p. 7, lines 5-13.

There was testimony from several of the parties at the hearing. The trustee defended Seidlitz, stressing that there was no wrongdoing by Seidlitz and that the case would have not settled except for his efforts. Seidlitz explained that he did not know about the bankruptcy until after the settlement, and, after he became aware of it, the parties came together and compromised. The debtor, Ms. Alwerdt, testified to the same effect. When the court asked Ms. Alwerdt if she ever told Seidlitz that she had filed bankruptcy, she responded, "I never did. I didn't realize that it was going to be a problem; because in the beginning, nothing was mentioned to us about it."

On July 15, 2005, the court entered a memorandum decision denying the trustee's application for attorney's fees and costs

on behalf of Seidlitz. The court framed the issue as whether the trustee's application for retroactive approval of Seidlitz's fees and costs satisfied settled requirements for retroactive compensation.

The memorandum decision cited Ninth Circuit and BAP precedent, Atkins v. Wain (In re Atkins), 69 F.3d 970, 973 (9th Cir. 1995), and McCutchen v. Official Committee of Unsecured Creditors (In re Weibel), 176 B.R. 209, 211 (9th Cir. BAP 1994), and explained that the general rule is that Seidlitz could not earn compensation for the personal injury representation until after the filing of his employment application. As to the exception to the general rule, it pointed out that to justify a request for retroactive fees, counsel must show both a satisfactory explanation for the failure to receive prior judicial approval and that he or she has benefitted the bankruptcy estate in some significant way. The court cited Atkins, 69 F.3d at 974, 976; Okamoto v. THC Financial Corp., 837 F.2d 389, 392 (9th Cir. 1988)("THC Financial"); Larson v. United States Trustee, 174 B.R. 797, 802 (9th Cir. BAP 1994); and In re Sirefeco, 144 B.R. 495, 496 (Bankr. D. Mont. 1992).

The court was satisfied that Seidlitz's services benefitted the estate, but held that there was no satisfactory explanation given for the failure to receive prior judicial approval of Seidlitz's employment. As to Seidlitz's contention that he was not familiar with bankruptcy law and was not advised of the debtor's bankruptcy case, the court, citing Stallcop v. Kaiser Foundation Hospitals, 820 F.2d 1044, 1050 (9th Cir. 1987), believed that the debtors were charged with constructive

knowledge of the law's requirements, including the need to obtain court approval of Seidlitz's employment.

The court highlighted the fact that trustee Deschenes and the debtor's attorney Radford were both experienced bankruptcy practitioners, but that neither provided any explanation as to why, despite discussing the personal injury claim at the meeting of creditors, no employment application for Seidlitz was filed for more than a year.

On July 15, 2005, the court entered an order denying the trustee's application for attorney fees and costs for Seidlitz "for failure to satisfactorily explain the failure to receive prior court approval of Seidlitz's employment as required for retroactive approval under the holdings of In re Atkins, 69 F.3d 970, 973-74, 976 (9th Cir. 1995), and THC Financial, 837 F.2d 389, 392 (9th Cir. 1988)."

The court took no measures against Radford or Deschenes.

This timely appeal ensued.

JURISDICTION

The bankruptcy court had jurisdiction via 28 U.S.C. § 1334. We have jurisdiction under 28 U.S.C. § 158(a)(1).

ISSUE

Whether the bankruptcy court erred in denying retroactive attorney's fees and costs.

STANDARD OF REVIEW

We view a bankruptcy court's decision regarding an award of fees for a abuse of discretion. Monument Auto Detail, Inc. v.

Gore Brothers (In re Monument Auto Detail, Inc.), 226 B.R. 219, 224 (9th Cir. BAP 1998). An abuse of discretion may be based on an incorrect legal standard, or a clearly erroneous view of the facts, or a ruling that leaves the reviewing court with a definite and firm conviction that there has been a clear error of judgment. SEC v. Coldicutt, 258 F.3d 939, 941 (9th Cir. 2001); Ho v. Dowell (In re Ho), 274 B.R. 867, 871 (9th Cir. BAP 2002).

DISCUSSION

Although the bankruptcy court applied a correct legal standard, had an accurate view of the facts, and was addressing a serious dereliction of duty, we nevertheless have the firm and definite conviction that Seidlitz, although unquestionably responsible for knowing that he had to be employed, should not be punished for the dereliction of Deschenes and Radford.

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Bankruptcy Code § 330 authorizes reasonable compensation to a professional person employed under § 327. 11 U.S.C. §§ 330 & 327; Andrew v. Coopersmith (In re Downtown Inv. Club III), 89 B.R. 59, 63 (9th Cir. BAP 1988)("Downtown"). Both § 327[3] and

[3]Section 327, provides in pertinent part:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, 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.

11 U.S.C. § 327.

Rule 2014 explicitly require attorneys to seek the approval of the court before they commence employment by the estate. Downtown, 89 B.R. at 63, citing, In re Kroeger Prop. & Dev., Inc., 57 B.R. 821 (9th Cir. BAP 1987).

Although the Bankruptcy Code does not authorize retroactive employment, In re Emco Enter., Inc., 94 B.R. 184, 187-88 (Bankr. E.D. Cal. 1988), retroactive compensation is permissible.

The bankruptcy courts in this circuit possess the equitable power to permit retroactive compensation of a professional's valuable but unauthorized services. Downtown, 89 B.R. at 63. Such retroactive compensation should be limited to situations in which "exceptional circumstances" exist. Atkins, 69 F.3d at 973, citing, Halperin v. Occidental Fin. Group, Inc. (In re Occidental Fin. Group, Inc.), 40 F.3d 1059, 1062 (9th Cir. 1995)("Occidental"); THC Financial, 837 F.2d at 392.

To establish the presence of exceptional circumstances, professionals who seek approval must satisfy two requirements: they must (1) satisfactorily explain their failure to receive prior judicial approval; and (2) demonstrate their services benefitted the bankruptcy estate in a significant manner. Atkins, 69 F.3d at 974, construing Occidental, 40 F.3d at 1062 (finding retroactive approval inappropriate where these two conditions were not met) and THC Financial, 837 F.2d at 392 (affirming denial of retroactive approval where these two conditions were not satisfied).

The burden of proof is on the applicant and the ultimate decision is within the discretion of the court. Neben & Starret, Inc. v. Chartwell Fin. Corp., (In re Park-Helena Corp.), 63 F.3d

877, 881 (9th Cir. 1995); In re B.E.S. Concrete Prods., Inc., 93 B.R. 228, 231 (Bankr. E.D. Cal. 1988)("B.E.S. Concrete").

Seidlitz misconstrues the standard to be derived from Atkins and focuses upon the nine-factor test from In re Twinton Properties Parnership, 27 B.R. 817, 819-20 (Bankr. M.D. Tenn. 1983), that has never been adopted in this circuit and that has never achieved more status than that of a list of examples that might be of interest to the trier of fact. Atkins, 69 F.3d at 974-76. As the Ninth Circuit said in Atkins:

> We conclude that the two requirements of THC Financial must be met in order for a professional to establish "exceptional circumstances." Moreover, the professional must have satisfied the criteria for employment pursuant to 11 U.S.C. § 327, other than the usual requirement of pre-employment approval. The other factors set forth in Twinton Properties may be, but need not be, considered by the court in exercising its discretion.

Id.

In this instance, the trier of fact, citing Atkins, elected to decide the matter without considering the other factors set forth in Twinton Properties. This was not error.

As indicated above, although the bankruptcy court applied the correct legal standard and had an accurate view of the facts, we are persuaded (to the level of having a "firm and definite conviction") that Seidlitz should not be punished for the dereliction of Deschenes. To be sure, the responsibility to assure proper employment ultimately fell on Seidlitz. But he could not have fulfilled those responsibilities until he knew, or should be charged with knowing, of the existence of the bankruptcy. When he did learn of the bankruptcy, he attempted to do the "right" thing and defer to the bankruptcy professionals.

The bankruptcy trustee, in particular, was plainly derelict in his duties. He knew about the lawsuit no later than September 18, 2003, yet did nothing until October 2004. Moreover, although it is Seidlitz's responsibility to assure that he has authority to conduct a lawsuit in any court on behalf of the real party in interest (i.e., the trustee), it was the trustee who was required to make the motion to have Seidlitz represent him.

The court recognized that the case presented a serious problem. We agree that there was a serious problem. The remedy, however, would be better directed against the trustee through his trustee fees and (if applicable) any fees for representing himself as counsel and against the debtors' bankruptcy counsel through 11 U.S.C. § 329, than against the least culpable person.[4]

CONCLUSION

The trial court applied correct legal standards. There was no clearly erroneous assessment of facts. Yet we have the firm and definite conviction that there was clear error of judgment. Hence, the trial court abused its discretion. We REVERSE.

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[4]At oral argument, we asked Seidlitz where his requested fees would go were we to affirm, and what would then become of the compromise among him, the debtor, Radford and the trustee. He informed us that he understood that the fees would go to the debtor, not the trustee; he could only speculate on the fate of the compromise.

If the answer regarding the fees is accurate, there could be the anomalous result that the debtor would recover fees she agreed to pay Seidlitz. Further, affirming the court's denial of Seidlitz's fees would have no effect on the bankruptcy estate since the trustee bargained for, and received with court approval, $6,000. Finally, the possibility that the court-approved compromise could become unwound means this dispute may be far from over. These possibilities further support our decision to reverse.