

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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April 13, 2000

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Counsel for Debtors
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Chapter 12 Trustee
Post Office Box 8285
Rapid City, South Dakota 57709

Subject: *In re Bert and Rosalie J. Outka,*
Chapter 12; Bankr. No. 97-50491

Dear Counsel and Trustee:

The matter before the Court is the amended fee application filed February 2, 2000 by Attorney Hurley, counsel for Debtors. This is a core proceeding under 28 U.S.C. § 157(b). This letter decision and accompanying order shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Attorney Hurley's fees must be reduced to reflect time spent preparing Debtors' original plan.

SUMMARY. The material facts are set forth in the Court's order dated March 1, 2000, which requested a response from Attorney Hurley. As set forth in Attorney Hurley's response filed March 29, 2000, the one correction to the Order is that Attorney Hurley did disclose that the \$3,500 retainer his office received was from Leo Outka, the brother of Debtor Bert Outka, not from Debtors.

Debtors' statement of financial affairs and Attorney Hurley's March 29, 2000 supplement indicate that Attorney Hurley's work for Debtors began in July 1997. His pre-filing services for Debtors included overseeing the sales of 1,200 acres of realty and some personalty and settling the claims of Dakota Plains Federal Credit Union and First National Bank. According to Debtors' statement of financial affairs, the Credit Union, First National Bank, and Meade County were all paid in full a few days before Debtors filed their Chapter 12 petition. However, all three creditors were still included on Debtors' schedules and their claim "treatment" was recited in Debtors' plan. In fact, under Debtors' original plan, the Trustee was going to be paid a commission of the County's

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taxes, which apparently had already been paid. Most notable, Debtors' initial plan failed to comply with 11 U.S.C. § 1225(a)(4). The Trustee objected to the first plan. After confirmation of their first plan was denied, Debtors filed motions for after-the-fact approval of their pre-petition sales and they agreed at confirmation to pay \$12,000, plus trustee's commission, to the unsecured creditors, in addition to disposable income. The provision to pay the Trustee a commission on the real estate taxes was deleted from Debtors' confirmed plan.

The substantial pre-filing work by Attorney Hurley for Debtors was not set forth in Attorney Hurley's § 329(a) and Rule 2016(b) disclosure statement. Also, Debtors' application to employ Attorney Hurley and Attorney Hurley's affidavit as a professional to be employed under Rule 2014(a) did not disclose the substantial pre-filing work performed for Debtors nor that Attorney Hurley's firm was apparently still owed \$1,200.61 for these pre-filing services, as indicated in Attorney Hurley's original fee application. Moreover, the employment application indicated the \$3,500 retainer paid by Leo Outka included an "advance" on attorneys' fees, not that the entire retainer would be or had been applied against Debtors' pre-filing balance. In other words, Attorney Hurley's compensation arrangement was not fully disclosed as required by § 329(a) and F.Rs.Bankr.P. 2014(a) and 2016(b).

Attorney Hurley was apparently paid \$3,500 for his pre-filing work and the Chapter 12 filing fee. He has requested another \$3,426.30 for his post-filing work. The post-filing work included a motion to approve the pre-petition real estate and personal property sales, preparation of a plan, and negotiation and preparation of a Plan as Confirmed.

With all the facts now on the table, the Court must address two issues before it can approve Attorney Hurley's fee application.¹ First, what sanction, if any, is appropriate where Attorney Hurley's compensation arrangement with Debtors and Leo Outka for pre-filing services was not fully disclosed under § 329(a) and Rule 2016(b) and where Attorney Hurley's substantial pre-filing work for Debtors was not adequately disclosed in either

¹ In this case, the pre-petition retainer was not paid by Debtors and was not excessively large. Further, no party in interest has sought a review of these fees under § 329(b). Accordingly, the Court will not inquire further into the reasonableness of Attorney Hurley's fees for pre-petition services paid from the pre-petition retainer.

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Debtors' application to employ him or his statement of disinterestedness under Rule 2014(a)? Second, are the fees of \$3,426.30 to be paid to Attorney Hurley for his post-petition services in this case reasonable?

DISCUSSION: INADEQUATE DISCLOSURE. Section 329(a) has broad application. *In re McDonald Brothers Construction, Inc.*, 114 B.R. 989, 995 (Bankr. N.D. Ill. 1990). It requires a debtor's attorney to disclose compensation he has received or expects to receive regardless of the source of payment and regardless of whether he intends to seek compensation from the bankruptcy estate. *Id.*; *In re Land*, 138 B.R. 66, 69-70 (D. Neb. 1992), *aff'd*, 994 F.2d 843 (8th Cir. 1993). Congress' rationale for this disclosure is clear.

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.

H.R.Rep.No.595, 95th Cong., 1st Sess. 329 (1977); S.Rep.No.989, 95th Cong., 2d Sess. 39 (1978), U.S.Code Cong. & Admin.News 1978, pp. 5787,5825, 6285 (cited in *McDonald Brothers Construction*, 114 B.R. at 995, and *Land*, 138 B.R. at 69).

An attorney's and the debtor's required disclosures under Rule 2014(a) when an employment application is filed are similarly important. The Rule specifically requires any proposed arrangement for compensation to be disclosed. It also requires all the attorney's connections with the debtors to be disclosed.

Here, both the employment application and Attorney Hurley's disclosure of compensation and his affidavit of disinterestedness were silent regarding what services had been already performed by Attorney Hurley for Debtors and the pleadings were unclear regarding what services had been or would be paid by Leo Outka and what services Debtors would pay through their bankruptcy estate. Thus, an inadequate disclosure was made under § 329(a) and Rules 2014(a) and 2016(b).

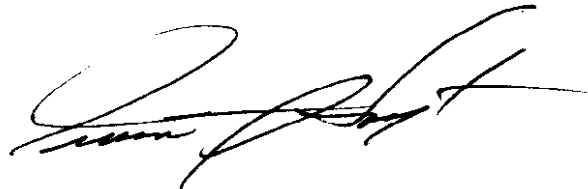
The Court cannot find where its previous employment and fee-related decisions involving Attorney Hurley directly addressed these particular disclosure requirements under § 329(a) and Rules 2014(a) and 2016(b). Accordingly, this letter decision will be considered the warning shot across the bow and no sanction will be imposed. If an inadequate disclosure is made in future cases, however, employment may be terminated or an appropriate deduction in fees will be made.

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REASONABLENESS OF FEES SOUGHT. Not all of Attorney Hurley's requested compensation for post-petition services is reasonable. The first plan prepared by Attorney Hurley could not be confirmed because it ignored the best interest of creditors test under § 1225(a)(4). Section 1225(a)(4) does not require a triggering objection to insure its implementation; it is mandatory for any Chapter 12 plan. Compare 11 U.S.C. § 1225(b). Further, the Court cannot assume the debtor has complied with the provision even if no objection is filed. F.R.Bankr.P. 3015(f) (court may presume plan complies with § 1225(a)(3) if no objection is filed). An attorney of Mr. Hurley's experience and one charging \$125 per hour should not file a plan that contains such an error. Accordingly, compensation for time spent preparing the first plan and related services and costs will not be allowed. This includes: 1 hour on December 31, 1997; 4 hours on January 5, 1998, 1 hour on January 23, 1998; .20 hours on February 2, 1998; and 3 hours on February 11, 1998 for a total of 9.20 hours or \$1,150.² Costs related to Debtors' original plan that will be deducted include postage of \$12.71 on January 5, 1998. The Court is unable to identify the copying charge for the original plan. Attorney Hurley must identify and deduct that amount also when he prepares his fee order.

Attorney Hurley shall prepare an order consistent with this letter decision.

Sincerely,



Irvin N. Hoyt
Bankruptcy Judge

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.

APR 13 2000

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota

By 

INH:sh

CC: case file (docket original; copies to **NOTICE OF ENTRY** (rest))

Under F.R.Bankr.P. 9022(a)
Entered

APR 13 2000

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

² Sales tax on allowed services also must be adjusted accordingly.

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Total notices mailed: 6

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