

attorney disqualification  
attorney disclosures  
disinterested  
adverse interest  
11 U.S.C. § 327(a)  
11 U.S.C. § 329(a)  
Fed. R. Bankr. P. 2014  
Fed. R. Bankr. P. 2016

In re Farrington, Case No. 07-32420-elp7

12/11/2007 ELP

Unpublished

On this motion of the UST to disqualify counsel for the chapter 11 debtor and to require counsel to disgorge retainers it had received, the court concluded that counsel was not disqualified to serve as counsel for the debtor in possession, but that counsel had violated the disclosure rules in various ways and had received an unauthorized postpetition retainer. Counsel was required to disgorge the postpetition retainer and \$10,000 of the prepetition retainer.

The court held that counsel was required to but failed to disclose that its retainer, part of which was received prepetition and part of which was received postpetition, was paid directly to counsel by a creditor of debtor, who had loaned the money for the retainer to debtor. Counsel also failed to disclose the receipt of the postpetition portion of the retainer or that the portion of the retainer received prepetition was not the entire retainer debtor had agreed to pay. Counsel was also required to but failed to disclose that the creditor who loaned debtor the funds for the retainer had once been a client of the attorney handling this bankruptcy case. The court concluded that counsel did not violate the disclosure rules intentionally to mislead the court or interested parties.

The court held that counsel was not disqualified from employment by the debtor in possession by its representation 15 years earlier of the creditor in the creditor's own bankruptcy case, or by the fact that it received payment of the retainer directly from the creditor rather than from the debtor. Receipt of the postpetition retainer, which was an unauthorized loan from the creditor to debtor, did not cause counsel to hold an interest adverse to the estate or prevent the law firm from being disinterested. Counsel did not solicit the postpetition payment, and held the funds received postpetition in its trust account.

By the time the court ruled on this motion, the case had converted to chapter 7. Counsel was required to turn the postpetition retainer over to the chapter 7 trustee. Counsel was also required to disgorge and was sanctioned \$10,000 of the prepetition retainer for violations of the disclosure rules.

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8 **NOT FOR PUBLICATION**

9 UNITED STATES BANKRUPTCY COURT  
10 FOR THE DISTRICT OF OREGON

11 In Re: ) Bankruptcy Case  
12 DEREK S. FARRINGTON, ) No. 07-32420-elp7  
13 Debtor. ) MEMORANDUM OPINION  
14 \_\_\_\_\_ )

15 Muhlheim Boyd LLP ("MB") is counsel for debtor Derek Farrington  
16 ("debtor") who filed a chapter 11<sup>1</sup> bankruptcy case that was later  
17 converted to chapter 7. The court approved MB's employment by the debtor  
18 in possession. Following the first meeting of creditors, at which  
19 counsel for the United States Trustee ("UST") explored information  
20 concerning debtor's payment of counsel and counsel's relationship with a  
21 creditor of debtor, the UST moved to disqualify MB as counsel for debtor  
22 and to require MB to disgorge the retainers it has been paid for its work  
23 in connection with this case. The UST took the position that MB is not  
24 \_\_\_\_\_

25 <sup>1</sup> Unless otherwise indicated, all chapter, section and rule  
26 references are to the Bankruptcy Code, 11 U.S.C. § 101 et seq., and to  
the Federal Rules of Bankruptcy Procedure.

1 qualified to serve as a professional in the case because it received a  
2 postpetition retainer without court approval, it either holds or  
3 represents an interest adverse to the estate or is not disinterested, and  
4 it violated the disclosure rules for professionals.

5 For the reasons set out below, I conclude that MB's connections to  
6 and receipt of the postpetition retainer from a creditor who loaned the  
7 debtor money for the retainer did not prevent MB from being  
8 disinterested, but that MB violated the disclosure rules in several  
9 respects and should be penalized \$10,000 for the violations. MB will be  
10 required to disgorge \$20,000: the \$10,000 retainer received postpetition  
11 without court authorization, plus \$10,000 of the prepetition retainer as  
12 a sanction for the seriously deficient disclosures.

#### 13 FACTS

14 The facts are generally not in dispute. In June 2007, debtor was  
15 facing foreclosure of one of his properties. An acquaintance, Dr.  
16 Michael Shirtcliff, referred debtor to MB for advice. Shirtcliff was a  
17 secured creditor of debtor, as well as a person who was interested in  
18 possibly buying one of debtor's properties. Shirtcliff had been a client  
19 of Keith Boyd, a lawyer at MB, in the late 1980s or early 1990s, but had  
20 not had any contact with Boyd for many years.

21 Boyd met with debtor and Shirtcliff on June 14, 2007, to discuss the  
22 upcoming foreclosure sale of debtor's property, scheduled for June 20,  
23 2007, and possible reorganization. When debtor decided to file a  
24 bankruptcy petition, Boyd told debtor he would require payment of a  
25 \$30,000 retainer before he would file the petition, and debtor would need  
26 to pay an additional \$10,000 retainer for RK Short & Associates, Inc.

1 (Short) for financial consulting services.

2 Debtor could not afford to pay the retainers, so Shirtcliff agreed  
3 to loan debtor the funds necessary for the retainers. On June 18, 2007,  
4 MB received a wire transfer of \$30,000 directly from RMS Dental Director,  
5 Inc./Michael Shirtcliff (collectively "Shirtcliff"), which was a loan  
6 from Shirtcliff to debtor. The funds were deposited into MB's trust  
7 account. Because debtor did not have time before filing the petition to  
8 borrow the additional \$10,000 necessary to cover both retainers, MB  
9 agreed that \$20,000 of the funds in the trust account would be allocated  
10 to MB's retainer, and \$10,000 would be allocated to Short for his  
11 retainer.

12 MB filed the chapter 11 petition on debtor's behalf on June 19,  
13 2007. On June 21, 2007, debtor filed his Application to Employ Attorneys  
14 for Debtor. In that application, he represented that he had paid MB a  
15 \$20,000 retainer. He did not mention that he had agreed to pay a \$30,000  
16 retainer and that he still owed \$10,000 of that amount. The application  
17 also represented that MB had no connection with any creditor in the case.

18 Boyd filed an affidavit in support of the application for  
19 employment, which contained the same information as the application. The  
20 engagement letter attached to the affidavit showed that the firm was  
21 requiring a \$30,000 retainer.

22 Also on June 21, MB filed its Rule 2014 Verified Statement. That  
23 statement repeated that the firm had no connection with any creditors,  
24 and represented that the firm had received a \$20,000 prepetition retainer  
25 on June 18. The 2014 statement did not disclose that the money for the  
26 retainer was borrowed, that the retainer came directly from a creditor,

1 or that there was a balance of \$10,000 due for the retainer.

2 After the petition was filed, on June 25, 2007, Shirtcliff wired  
3 another \$10,000 into MB's attorney trust account, which was a loan to  
4 debtor for the remaining \$10,000 for the firm's retainer. Debtor had not  
5 requested authority from the bankruptcy court to borrow the funds, or to  
6 pay any funds to counsel. On that same date, MB issued a check to Short  
7 for his \$10,000 retainer.

8 On July 18, 2007, Boyd signed the Disclosure of Compensation of  
9 Attorney for Debtor, which disclosed that, to date, counsel had received  
10 \$20,000. Boyd listed the source of the compensation as "debtor," without  
11 also explaining that the funds were borrowed and came directly from  
12 debtor's creditor, Shirtcliff. Boyd did not disclose that he had  
13 received any postpetition funds from debtor or from Shirtcliff on  
14 debtor's behalf.

15 The bankruptcy schedules, also filed on July 18, listed Shirtcliff  
16 as a secured creditor based on a prepetition loan unrelated to the  
17 bankruptcy, but did not list him as an unsecured creditor for the \$30,000  
18 and \$10,000 loans he had made to debtor shortly before and after the  
19 bankruptcy filing.

20 After the August 10, 2007 § 341(a) meeting at which counsel for the  
21 UST questioned debtor about the retainers paid to MB and to Short, Boyd  
22 filed an Amended Rule 2014 Verified Statement on August 15, 2007. The  
23 amended statement disclosed the postpetition receipt of the additional  
24 \$10,000 of the retainer, and that the source of the payment was a loan to  
25 debtor from Shirtcliff. He also filed an Amended Attorney's Disclosure  
26 of Compensation, showing receipt of \$30,000 for legal services, which he

1 stated was a loan to debtor from RMS Dental Director, Inc.

2 On August 24, 2007, Boyd filed a Second Amended Rule 2014 Verified  
3 Statement, which disclosed his previous representation of Shirtcliff and  
4 for the first time set out the exact nature of the payment of the  
5 retainer--that it was wired directly to MB by Shirtcliff.

6 DISCUSSION

7 In order for a professional, including an attorney, to be employed  
8 by the trustee or debtor in possession, the professional must "not hold  
9 or represent an interest adverse to the estate" and must be  
10 "disinterested." § 327(a).

11 To "hold an interest adverse to the estate" means (1) to possess or  
12 assert any economic interest that would tend to lessen the value of  
13 the bankruptcy estate or that would create either an actual or  
14 potential dispute in which the estate is a rival claimant; or (2) to  
15 possess a predisposition under circumstances that render such a bias  
16 against the estate.

17 In re Roberts, 46 B.R. 815, 827 (Bankr. D. Utah 1985), aff'd in part,  
18 modified in part; rev'd in part on other grounds, 75 B.R. 402 (D. Utah  
19 1987); In re Tevis, 347 B.R. 679, 688 (9th Cir. BAP 2006). A person is  
20 "disinterested" if, in part, the person

21 does not have an interest materially adverse to the interest of the  
22 estate or of any class of creditors or equity security holders, by  
23 reason of any direct or indirect relationship to, connection with,  
24 or interest in, the debtor, or for any other reason.

25 § 101(14)(C). These tests overlap, and include "a prohibition on  
26 representing conflicting interests." Tevis, 347 B.R. at 687.

27 The Bankruptcy Code and Rules contain several provisions, discussed  
28 below, requiring professionals to make disclosures. The UST complains  
29 that MB's fees should be disallowed and it should disgorge its retainer

1 because its disclosures were incorrect and incomplete. The UST further  
2 argues that MB's fees for services to the debtor in possession should be  
3 disallowed and it should disgorge its retainer to the extent not used to  
4 pay for prepetition services, because MB became not disinterested and  
5 obtained an interest adverse to the estate when it received the retainer  
6 directly from a creditor of debtor who was a former client of Boyd and  
7 received the unauthorized postpetition retainer.

8 Before applying the law to the facts, there is one factual issue  
9 that must be resolved. MB has been inconsistent in how it characterized  
10 the June 25, 2007, \$10,000 postpetition wire transfer to its trust  
11 account. In an email communication to the UST from Boyd dated August 14,  
12 2007, which was in response to questions about the payment raised by the  
13 UST, Boyd said that the postpetition payment was "as and for the balance  
14 of our retainer." However, Boyd then explained that he had advised  
15 debtor and Shirtcliff that that payment "will be treated differently from  
16 the sums received prior to filing because those funds will not be  
17 earmarked for payment to this firm." In the Amended Rule 2014 Verified  
18 Statement MB filed the next day, MB disclosed that the \$10,000 it  
19 received postpetition was part of its retainer. At oral argument on the  
20 UST's motion to disqualify MB and require disgorgement, Boyd took the  
21 position that the \$10,000 was not part of its retainer, and instead was  
22 simply property of the estate being held in trust.

23 The court finds that the \$10,000 paid postpetition was intended to  
24 be, and was treated by the parties as, part of the retainer. It was paid  
25 as part of the borrowing arranged to fund the retainer. MB certified in  
26 the August 15, 2007, Amended Attorney Disclosure that the retainer was



1 \$30,000 and that the \$30,000 had been paid. The only way that could be  
2 correct is if the \$10,000 paid postpetition was part of the retainer.

3 1. Disclosures

4 A professional's application for employment must give certain  
5 information, including, as relevant here, "any proposed arrangement for  
6 compensation, and, to the best of the applicant's knowledge, all of the  
7 person's connections with the debtor, creditors, [or] any other party in  
8 interest[.]" Fed. R. Bankr. P. 2014(a). The application must be  
9 accompanied by a verified statement of the person to be employed  
10 describing any connections with debtor, creditors, or other parties in  
11 interest. Id. The purpose of the application

12 is to provide the court (and the United States Trustee) with  
13 information necessary to determine whether the professional's  
14 employment meets the broad tests of being in the best interest of  
15 the estate . . . . To that end, a failure to disclose any fact  
16 which may influence the court's decision may result in a later  
17 determination that disclosure was inadequate and sanctions should be  
18 imposed[.]

19 9 Collier on Bankruptcy ¶ 2014.03 (15th ed. Rev. 1997).

20 Debtors' attorneys are also subject to the requirements of § 329,  
21 which requires that any attorney representing a debtor file "a statement  
22 of the compensation paid or agreed to be paid" for bankruptcy services,  
23 if any payment or agreement was made within a year before bankruptcy, and  
24 "the source of such compensation." § 329(a). Counsel must file this  
25 statement whether or not the attorney applies to the court for  
26 compensation. Rule 2016 implements this requirement, and provides that  
27 counsel for a debtor must file, within 15 days of the order for relief,  
28 the statement required by § 329. Fed. R. Bankr. P. 2016(b).

29 In disclosing the fee arrangement, "the applicant must disclose 'the

1 precise nature of the fee arrangement,' and not simply identify the  
2 ultimate owner of the funds." In re Park-Helena Corp., 63 F.3d 877, 881  
3 (9th Cir. 1995). An applicant must

4 lay bare all its dealings . . . regarding compensation . . . .  
5 [The] fee revelations must be direct and comprehensive. Coy, or  
6 incomplete disclosures . . . are not sufficient.

7 Id. (quoting In re Saturley, 131 B.R. 509, 516-517 (Bankr. D. Me. 1991)).

8 The purpose of the required disclosures is to allow the court to  
9 "conveniently and carefully scrutinize any adverse interests" of the  
10 professional. In re Film Ventures Intern., Inc., 75 B.R. 250, 253 (9th  
11 Cir. BAP 1987). See also In re Granite Partners, L.P., 219 B.R. 22, 35  
12 (Bankr. S.D.N.Y. 1998) ("Proper disclosure allows the court to decide, in  
13 an informed manner, whether the retention should be approved.") Thus,  
14 any arguable conflict must be disclosed, "if only to be explained away."

15 Id. It is not for counsel to interfere with the court's function by  
16 choosing "which connections impact disinterestedness and which do not."

17 Id. Accord In re Mehdipour, 202 B.R. 474, 480 (9th Cir. BAP 1996),  
18 aff'd, 139 F.3d 1303 (9th Cir. 1998) ("Professionals must disclose all  
19 connections with the debtor, creditors and parties in interest, no matter  
20 how irrelevant or trivial those connections may seem.").

21 The disclosure rules are literally applied, and "[n]egligent or  
22 inadvertent omissions 'do not vitiate the failure to disclose.'" Park  
23 Helena Corp., 63 F.3d at 881 (quoting In re Maui 14K, Ltd., 133 B.R. 657,  
24 660 (Bankr. D. Haw. 1991)). Failure to comply with the disclosure rules  
25 is sanctionable, "even if proper disclosure would have shown that the  
26 attorney had not actually violated any Bankruptcy Code provision or any  
Bankruptcy Rule." Id. at 880. "A bankruptcy court must be able to rely

1 on the veracity of the representations by an attorney in an application  
2 for employment." In re Lewis, 113 F.3d 1040, 1045 (9th Cir. 1997).

3 MB's disclosures failed to meet the requirements in more than one  
4 way.

5 First, the application for employment and the original Rule 2014  
6 Verified Statement failed to meet the requirements of Rule 2014. Neither  
7 set out the details of the proposed arrangement for compensation,  
8 including that the funds for the retainer came from a loan to debtor, and  
9 that the prepetition retainer was only a portion of the retainer agreed  
10 to be paid. Instead, the application simply states at paragraph 6 that  
11 "Applicant has paid MB a retainer of \$20,000 for attorneys fees and  
12 costs." Although the fee agreement attached to the application for  
13 employment showed that a \$30,000 retainer was required, the firm failed  
14 to explain the discrepancy between the agreed retainer (\$30,000) and the  
15 actual prepetition retainer (\$20,000).

16 Second, the application for employment and the original and Amended  
17 Rule 2014 Verified Statements also did not disclose that Shirtcliff, a  
18 creditor with both secured and unsecured claims against the estate, had  
19 been a former client of Boyd. There can be no question that Boyd was  
20 aware that Shirtcliff was a former client, and that Shirtcliff was a  
21 creditor in this case. After all, Shirtcliff was the person who referred  
22 debtor to Boyd and Shirtcliff attended the first meeting debtor had with  
23 Boyd.

24 Third, the application and Rule 2014 Verified Statement failed to  
25 disclose Shirtcliff as the direct source of the funds MB received into  
26 its account for debtor's retainer. Even if the funds belonged to debtor

1 because debtor had borrowed them, direct payment by the creditor to  
2 counsel constitutes a connection between counsel and the creditor that  
3 must be disclosed.

4 Fourth, the July 18, 2007, Disclosure of Compensation of Attorney  
5 for Debtor violated Rule 2016 in various ways. It represented that  
6 counsel had received \$20,000 as a retainer. By July 18, 2007, MB had  
7 actually received both the \$20,000 prepetition wire transfer and the  
8 \$10,000 postpetition wire transfer. Counsel was required by Rule 2016 to  
9 disclose the entire amount of the retainer that had been received by the  
10 date of the disclosure, not just the prepetition portion of the retainer.  
11 Counsel's failure to disclose receipt of the postpetition retainer in the  
12 initial Disclosure of Compensation of Attorney for Debtor left the UST  
13 and the court ignorant of the unauthorized loan to debtor for that  
14 retainer, and of the unauthorized payment of those funds to counsel. MB  
15 failed to disclose receipt of that payment until after the § 341(a)  
16 meeting, which was two months after receipt.

17 Under Rule 2016, counsel was required to disclose not only  
18 compensation that had been paid, but also any compensation promised to be  
19 paid. In re Fraga, 210 B.R. 812, 822 (9th Cir. BAP 1997). To be  
20 correct, the disclosure should have reported that the amount received  
21 prior to the filing of the initial statement was \$30,000. It erroneously  
22 described the amount received prior to the filing of the statement as  
23 \$20,000, and left blank the balance due. Even if one were to accept that  
24 in the July 18, 2007, disclosure MB erroneously intended to disclose only  
25 the amount paid prepetition, the initial disclosure should have indicated  
26 that \$20,000 had been received and the balance due was \$10,000.

1           The disclosure also listed the source of compensation as "debtor,"  
2 without explaining that the funds for the compensation came from a loan  
3 to debtor by Shirtcliff, which funds were wired directly to counsel from  
4 Shirtcliff (and not received directly from debtor). Although counsel may  
5 be correct that the money for the retainer belonged to debtor, because  
6 debtor had agreed to pay Shirtcliff back, nonetheless the payment came  
7 directly from the creditor and that fact should have been disclosed.

8           MB acknowledges that there were problems with its disclosures. But  
9 it argues that it did not need to disclose that the retainer was paid  
10 with money that had been loaned to debtor. It also argues that it did  
11 not need to disclose its prior representation of Shirtcliff, because the  
12 connection with Shirtcliff was not a current connection at the time of  
13 the disclosure.

14           Both § 329(a) and Rule 2016 require that debtor's counsel disclose  
15 the source of compensation. That includes the fact that the funds for  
16 the compensation have been borrowed. It certainly includes the fact that  
17 a creditor paid the compensation directly to counsel, even if there was  
18 an agreement by debtor to pay those funds back. Regardless of whether  
19 that circumstance will affect the court's decision to authorize  
20 employment, it is not debtor's nor the attorney's place to decide whether  
21 the circumstance is worth mentioning. Granite Partners, L.P., 219 B.R.  
22 at 35. Information that the funds for the retainer were borrowed and  
23 came directly from the creditor likely would have triggered some  
24 questions by the court and the UST. Thus, that information should have  
25 been disclosed. Park-Helena Corp., 63 F.3d at 881 (the fee applicant  
26 must disclose the precise nature of the fee arrangement).

1 Further, the fact that Shirtcliff had not been a client for 15 years  
2 does not vitiate the requirement that the firm disclose all connections  
3 with a debtor's creditors. Rule 2014 does not require disclosure of only  
4 current connections; it requires disclosure of "all of the person's  
5 connections" with creditors. As the Ninth Circuit noted in Park-Helena  
6 Corp., Rule 2014(a) "assists the court in ensuring that the attorney has  
7 no conflicts of interest and is disinterested[.]" 63 F.3d at 881. The  
8 court cited with approval In re EWC, 138 B.R. 276, 280-281 (Bankr. W.D.  
9 Okla. 1992), in which the Oklahoma bankruptcy court noted that "[n]o  
10 matter how old the connection, no matter how trivial it appears, the  
11 professional seeking employment must disclose it." 63 F.3d at 882.  
12 Here, prior representation of a current creditor, even representation  
13 that occurred long ago, needed to be disclosed.

14 MB argues that any lack of disclosure was inadvertent and not done  
15 to mislead the court. That argument does not absolve MB of the  
16 consequences of inadequate disclosure. "Even a negligent or inadvertent  
17 failure to disclose fully relevant information may result in a denial of  
18 all requested fees." Park-Helena, 63 F.3d at 882.

19 I conclude that counsel violated both Rules 2014 and 2016. Although  
20 I do not believe that MB intended to mislead the court or interested  
21 parties, the disclosure violations were significant, and the facts that  
22 were not disclosed were known to the firm. The person charged with  
23 completing the disclosures had a duty to learn the facts and assure that  
24 the disclosures were accurate. In this case, either the person  
25 completing the disclosures failed to learn the facts, or failed to make  
26 sure that the disclosures accurately reflected the known facts.

1 Further, MB did not correct the disclosures on its own. The  
2 disclosures were corrected only after the UST spent a good deal of time  
3 at the § 341(a) meeting attempting to learn the true facts about the  
4 arrangement for compensation. MB's lack of disclosure, while not  
5 intentionally misleading, was at the least unforgivably sloppy. The  
6 failure to lay out the facts of prior representation and the arrangement  
7 for compensation, including the postpetition payment of the remaining  
8 retainer, left the UST without sufficient information to make an informed  
9 decision about whether to oppose employment and left the court without  
10 sufficient information to make an informed decision about whether to  
11 grant the application to employ MB.

12 I conclude that an appropriate sanction for the nondisclosure in  
13 this case is the reduction of the allowed fees by \$10,000 and the  
14 requirement that MB disgorge \$10,000 from the prepetition retainer. I  
15 chose the substantial sanction of \$10,000 in order to impress on counsel  
16 the need in the future to take great care in investigating the facts, to  
17 make thorough and accurate disclosures, and to correct any inadvertent  
18 mistakes promptly and without the need for pressure from the UST. In  
19 addition, MB must pay to the trustee the \$10,000 received postpetition,  
20 because the court never authorized a postpetition retainer.

21 2. Qualification for employment

22 The question of qualification to be employed as counsel for debtor  
23 in possession is a separate question from whether the disclosures made in  
24 connection with the application for employment or thereafter were  
25 adequate. If a professional is not qualified to be employed under § 327,  
26 employment cannot be approved regardless of the accuracy and extent of

1 disclosures. "[I]f, at any time during the employment, the person  
2 represents or holds an interest adverse to the estate with respect to the  
3 subject matter of the employment or if such person is not  
4 disinterested[,]" the court may deny compensation. 3 Collier on  
5 Bankruptcy ¶ 327.04[4] (15th ed. Rev. 2006) (footnotes omitted).

6 (a) Interest adverse to the estate and disinterestness - Shirtcliff

7 The UST argues in her trial memorandum that:

8 This Chapter 11 case appears to be planned for Dr. Shirtcliff's  
9 benefit and financed by him. Due to Mulheim Boyd's receipt of a  
10 pre-petition retainer and an unauthorized post-petition retainer  
11 from Dr. Shircliff (sic), Mulheim Boyd is not disinterested and/or  
12 holds an interest adverse to the estate in violation of § 327(a).

13 United States Trustee's Memorandum in Support of (1) Motion to Disqualify  
14 Counsel for Debtor-In-Possession and for Disgorgement of Retainer; (2)  
15 Motion to Disqualify Financial Consultant and for Disgorgement of  
16 Retainer at 10:19-23.

17 In determining whether counsel represents an interest adverse to the  
18 estate, we look to the Oregon rules governing professional conduct. In  
19 re Tevis, 347 B.R. 679, 688 (9th Cir. BAP 2006); LBR 9010-1.A.1.a.; LR  
20 83.7. Two of Oregon's Rules of Professional Conduct are potentially  
21 pertinent with respect to Shirtcliff, debtor, and MB.

22 First, ORPC 1.9 governs representation of former clients. That rule  
23 prohibits a lawyer from representing a person if the lawyer has  
24 previously represented a client "in the same or a substantially related  
25 matter in which that person's interests are materially adverse to the  
26 interests of the former client unless each affected client gives informed  
consent, confirmed in writing." ORPC 1.9(a). Here, the evidence is that  
Boyd had represented Shirtcliff approximately 15 years earlier, in



1 connection with Shirtcliff's bankruptcy. That is not a matter  
2 substantially related to debtor's bankruptcy. There is no indication  
3 that there is any connection between the two cases, other than that  
4 Shirtcliff referred debtor to his former attorney and is a creditor in  
5 this case. Therefore, Boyd is not disqualified under ORPC 1.9 by reason  
6 of his prior representation of Shirtcliff.

7 Second, counsel are prohibited from accepting compensation from one  
8 other than the client, except under certain circumstances. ORPC 1.8(f).  
9 Here, the funds for the retainer came directly to the firm from  
10 Shirtcliff rather than from debtor. The UST argues that the way the  
11 payment was made constitutes payment of the retainer by Shirtcliff, a  
12 creditor of the estate, rather than by debtor. I disagree. The evidence  
13 is that the money from Shirtcliff was a loan to debtor, for which debtor  
14 is obligated to Shirtcliff. There is no evidence that Shirtcliff  
15 intended to pay the retainer himself, on his own behalf, that the two  
16 payments were anything other than loans to debtor, or that Shirtcliff is  
17 expecting to or actually is controlling the litigation. While there is  
18 no dispute that Shirtcliff was interested in purchasing property from the  
19 estate and that he made a series of loans to debtor, that evidence does  
20 not establish that this case was planned "for Dr. Shirtcliff's benefit."  
21 There is not an adverse interest arising from the way the retainer was  
22 paid.

23 (b) Interest adverse to the estate and disinterestedness -  
24 postpetition retainer

25 The firm's receipt of a portion of its retainer postpetition, which  
26 was the proceeds of an unauthorized postpetition loan, requires a

1 different analysis.

2 A debtor in possession may obtain unsecured credit without court  
3 approval if the incurring of debt is in the ordinary course of business.  
4 § 364(a). The loan from Shirtcliff to debtor for the postpetition  
5 payment was not in the ordinary course of business. Therefore, in order  
6 for debtor to obtain postpetition unsecured credit, he was required to  
7 seek court approval. § 364(b). He did not do that, but instead incurred  
8 the debt postpetition without the court's knowledge or authorization.

9 MB's receipt of the unauthorized \$10,000 postpetition retainer,  
10 which came from the unauthorized loan, put the firm in possession of  
11 property that must be turned over to the trustee.<sup>2</sup> Although the failure  
12 of MB to promptly obtain the necessary court approval for the \$10,000  
13 postpetition unsecured loan and approval of a postpetition retainer is  
14 troubling, the court concludes that the facts do not give MB an adverse  
15 interest or prevent it from being disinterested. There is no evidence  
16 that MB caused Shirtcliff to wire the \$10,000 to its trust account  
17 postpetition. It has left the money in its trust account, which  
18 indicates that MB recognized that the money was potentially property of  
19 the estate that could only be disbursed by court order.

20 This case is distinguishable from an earlier case involving Boyd in  
21 which the firm he was with at the time was required to disgorge  
22 postpetition fee payments made without court authorization. In re  
23 Thurmond, Case No. 683-07538-W7 (Aug. 29, 1991). In this case, MB

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24  
25 <sup>2</sup> The issue of whether the estate is entitled to retain the  
26 proceeds of an unauthorized postpetition loan is not before the court.  
There are different approaches to dealing with unauthorized postpetition  
borrowing. See 3 Collier on Bankruptcy ¶ 364.03[2] (15th ed. Rev. 2007).

1 received an unauthorized postpetition retainer which it deposited into  
2 its trust account; it did not receive postpetition payments on account of  
3 its fees. It must disgorge the unauthorized retainer because it has no  
4 right to the retainer.

5 MB is being separately sanctioned for its failure to promptly and  
6 adequately make disclosure of the \$10,000 received postpetition. The  
7 receipt of the money, which it did not solicit, is not a basis for  
8 disqualifying it entirely from employment as counsel for the debtor in  
9 possession.

#### 10 CONCLUSION

11 MB's disclosures violated both Rules 2014 and 2016. I conclude that  
12 the appropriate sanction for those violations is disgorgement of \$10,000  
13 of the prepetition retainer received from debtor and disallowance of  
14 \$10,000 of fees. In addition, MB must disgorge the \$10,000 retainer  
15 received postpetition. MB may apply for fees for its services as counsel  
16 to the chapter 11 debtor in possession. When the court determines the  
17 amount of those fees allowable as an administrative claim, it will reduce  
18 the allowance by the \$10,000 sanction because of the inadequate  
19 disclosures.

20 Ms. McClurg should prepare the order.

21 ###

22 cc: Keith Y. Boyd  
23 Carla G. McClurg  
24 Tara Schleicher  
25  
26