

Attorneys' Fees

In Re Power Master, Inc.

DDS 10/12/90

The court denied attorneys' fees where there was an undisclosed adverse interest to the debtor. The attorney represented a competitor of the debtor which was owned by debtor's employees. Even though the attorney may not have had actual knowledge of the conflict, knowledge may be imputed to him where he should have known.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
 ) 389-34821-S11  
POWER MASTER, INC., )  
 ) MEMORANDUM DISALLOWING  
Debtor. ) COVINGTON & CROWE'S FEES

The debtor-in-possession ("debtor") objected to payment of fees to Covington & Crowe ("C & C") because of an undisclosed adverse interest at the time of C & C's application for appointment as special counsel. I am denying C & C's application of \$4,823 for legal services. I am also ordering C & C to repay the debtor \$2,517.64 that debtor had previously paid C & C. My reasons follow.

There are two issues. The first is whether this Court should deny attorneys' fees because of a conflict of interest that was not disclosed at the time of the application to employ. The second is whether an attorney should be denied fees where he should have known of the conflict even though he was without actual knowledge.

The debtor is in the business of asbestos consulting and asbestos abatement with several branch offices, including one in Fontana, California. To protect its professional integrity, the debtor would not do both consulting work and abatement work for the same client at the same time. Robert Landreth was branch manager in Fontana and his wife, Pam Landreth, was office manager. As branch manager, Mr. Landreth was responsible for the operation of that branch, including any contacts with attorneys. The Landreths were given training by the debtor in the art of asbestos consulting.

The debtor, through Robert Landreth, hired C & C to represent it in several disputes including those against the City of San Diego and Kaiser Steel. While C & C was not debtor's general counsel, it had an ongoing relationship with the debtor. This Court appointed C & C as special counsel on October 27, 1989 so that C & C could continue as debtor's counsel in its litigation against the City of San Diego. At the time of its application, C & C represented that it had no interest adverse to the debtor or any connections to creditors in the bankruptcy case.

In August 1988, at the request of Mr. Landreth, C & C prepared and filed with the California Secretary of State incorporation documents for Camco Group ("Camco"). C & C also reviewed at least one other document at Camco's request.

Camco's stated business was consulting. The acronym "Camco" stands for "Certified Asbestos Management Consulting O (unknown)." Camco was owned by the Landreths and a third party (who owned a minority share).

There are two lines of cases on whether a court may deny attorneys' fees after a conflict of interest or other ethical violation has been established. See, Kidney Ass'n of Oregon, Inc. v. Ferguson, 97 Or. App. 120, 125-126, 775 P.2d 1383, 1386-1387 (1989). The majority view is that "an attorney may not recover for services rendered if those services are rendered in contradiction to the requirements of professional responsibility". Goldstein v. Lees, 46 Cal. App. 3d 614, \_\_\_\_\_, 120 Cal. Rptr. 253, \_\_\_\_\_ (1975). The minority view is that "at least where no actual conflict has occurred, the court must consider all facts and circumstances . . . includ[ing] whether the attorney's misconduct was intentional and whether it prejudiced his client". Kidney Ass'n, 97 Or. App. at 126, 775 P.2d at 1387 (emphasis in original) (citations omitted).

Even using the less stringent standard, C & C's fees should be denied. C & C assisted debtor's employees in incorporating a business which was a direct competitor of debtor and which also gave the appearance of impropriety. In at least one instance, the debtor lost a consulting job. As soon as the debtor became aware of C & C's representation of

Camco, the debtor fired not only C & C but also Mr. and Mrs. Landreth.

In re Film Ventures Int'l, Inc., 75 Bankr. 251 (Bankr. 9th Cir. 1987) is consistent with this ruling. Film Ventures held that while an attorney who did not disclose a security interest ran the risk of not being compensated, "the Bankruptcy Court was not required to deny legal fees for work actually performed." Id. at 253 (emphasis in original). However, the Court found that the attorney in Film Ventures did not have an interest adverse to the estate, but that he shared the debtor's goal of protecting the estate's interest in his collateral.

C & C maintained that it was never informed or given any information to suggest that Camco was in competition with the debtor. The issue is then whether C & C may be sanctioned for a conflict it should have known of even though without actual knowledge. In order to hold C & C accountable for representing Camco at the same time it represented the debtor, C & C "must have available some factual predicate suggesting a conflict of interest." In re Johnson, 300 Or. 52, \_\_\_\_\_, 707 P.2d 573, 579 (1985). This involves a two part test. The attorney must have knowledge of the facts. However, "knowledge of the predicate facts may be imputed to the lawyer if, by the exercise of reasonable care, such predicate facts should have been known to the lawyer." Id.

(emphasis added). The court then determines whether there was a conflict. The attorney's recognition or nonrecognition of a conflict is not part of the test. Id. 300 Or. at \_\_\_\_\_, 707 P.2d at 580.

C & C represented debtor which it knew was in the asbestos consulting field. C & C also drew up incorporation papers for Camco which C & C knew was in the consulting business and owned by two employees of the debtor. The "A" in Camco stood for "asbestos". Given these facts, C & C satisfied the first prong of the test. The second prong of the test was also satisfied and was discussed above. In addition, it appears the Court never entered an order approving payment by the debtor-in-possession to C & C. Without a court order, any payment was improper and should be returned, except to the extent of the costs.

The debtor's and creditors' committee's objections to allowance of fees to C & C are sustained. The full amount of the fees requested are denied, however, C & C should be reimbursed for its costs.

A separate order will be entered.

DATED this \_\_\_\_\_ day of October, 1990.

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DONAL D. SULLIVAN  
Bankruptcy Judge

cc: Fred M. Granum  
Peter C. McKittrick  
Randall J. Pitre  
Robert J. Vanden Bos  
U. S. Trustee