11 U.S.C. § 327(a)
11 U.S.C. § 328(c)
Rule 2014

In re Hood Lumber Company

Case No. 397-36565-psh11

4/12/99 PSH unpublished

Global Ventures Inc., ("Global") which served as the debtor-in-possession's appointed sales agent, filed an application for compensation based on commissions earned from the sale of the debtor's assets. The Official Creditor's Committee (the "Committee") and the United States Trustee (the "Trustee") both filed objections to the application arguing that certain nondisclosure and conflicts of interest proscribed allowance of one commission and, in addition, the Committee urged disgorgement of another.

At the time the debtor filed its Chapter 11 petition it filed an application to employ Global as its selling agent pursuant to the terms of an exclusive listing agreement. In connection with that application Global filed an affidavit of disinterestedness in which it stated that it had no connection with the debtor, any creditor or any party in interest or their respective attorneys and held no interest adverse to the estate. Global also filed a Rule 2014 Verified Statement for Proposed Professional which contained these standard assurances followed by the disclosure that it had been paid approximately $305,000 by the debtor within a year of the bankruptcy filing for "business consulting services." No objections to the application were filed and the application was approved.

Global's exclusive listing agreement with the debtor expired, by its terms, on February 1, 1998. However, the agreement provided that Global would be entitled to a commission on any sale made within a year thereafter to any entity from whom Global had acquired a signed confidentiality agreement prior to the expiration of the agreement.

In March, 1998 Global presented an offer to purchase substantially all of the debtor's assets under a confirmed plan. The offer was made by an entity called Dimeling, Schreiber and Park ("Dimeling") which had signed a confidentiality agreement with Global prior to January 31, 1998. However, the assets would actually be acquired by an entity to be formed by Dimeling called Quality Veneer Lumber. ("QVL") The offer disclosed that two of Global's principals and one of its independent sales agents were to join QVL as officers and stockholders. As initially presented, the offer stated that it was contingent upon payment to Global of the commission earned under the exclusive listing agreement. However, that language was deleted from the final offer.

The debtor presented a proposed plan incorporating the Dimeling offer. The plan also provided for payment of the commission earned by Global. The Trustee objected to confirmation of the plan on the

grounds that Global was not "disinterested" and therefore not entitled to payment of its commission. The court approved the plan, subject to the Trustee's objection.

After confirmation of the plan Global filed its application for compensation based on the sale of the assets under the plan. The Committee filed an objection to application raising the same "disinterestedness" argument previously raised by the Trustee. In addition, the Committee contended, based on information discovered after confirmation of the plan, that Global had made material nondisclosure on its application for appointment as selling agent and therefore was not entitled to any compensation from the estate. Specifically the Committee contended that Global had failed to disclose that within a year of the filing it had entered into an agreement with the debtor under which it served as the debtors "chief financial officer", that Global was represented both pre and post petition by the law firm which represented the debtor's principal in the bankruptcy, and that it received a payment of $90k from the debtor three days before the bankruptcy filing and that the payment was on account of an antecedent debt.

Global defended against the objections raised by the Committee and the Trustee arguing that it was not disinterested because 1) although its agents were acquiring an interest in the debtor's assets, it was not and 2) its agents did not decide to acquire an interest in the assets until after the expiration of its listing agreement and, therefore, after its employment by the estate ended. In addition it argued that the nondisclosure issues were not material because 1) Global didn't really act as a chief operating officer of the debtor, despite the language of the agreement to the contrary ;2) the Committee was aware that Global had a connection with the law firm representing the debtor's principal and 3) there was no issue of avoidable preference arising from the $90k payment because the debtor was solvent at the time of the payment.

The court found that Global violated Rule 2014 by failing to make full disclosure of all of its connections with the debtor in the initial application and by failing to update its disclosure statement as its connections with the debtor changed. It held that a professional seeking employment under § 327(a) has a duty to disclose <u>all</u> possible conflicts or connections with the debtor to the court and is not permitted to make its own determination as which connections have sufficient weight to merit disclosure. It further held that failure of a professional to make full disclosure, without more, may justify denial of all compensation. However, it concluded that it was not required to deny compensation to a professional who failed to make full disclosure. Rather, it held, the court has discretion to determine whether and to what extent to deny compensation. In exercising its discretion the court should consider 1) the extent of the non-disclosure; 2) whether the non-disclosures were wilful or innocent; 3) the number of conflicts not disclosed and 4) the benefit, if any rendered to the estate by the professional.

Based on these factors the court concluded that Global's application for compensation should be denied. However, it did not require disgorgement of compensation previously allowed and paid. In addition, it allowed Global to recover expenses incurred by it in the marketing of the debtor's assets.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	) Bankruptcy Case No. 397-36565-psh11
HOOD LUMBER COMPANY	)
	) MEMORANDUM OPINION
Debtor	)

This matter came before the court on the objections of the reorganized debtor's creditor's committee (the "Committee") and the United States Trustee ("UST") to payment of commissions to Global Ventures, Inc. ("Global"), which had served as the debtor in possession's appointed sales agent. The UST and the Committee both believe that certain nondisclosures and conflicts of interest proscribe allowance of one commission and the Committee urges disgorgement of another.

The controversy requires this court to exercise one of its most difficult, yet important, duties. The task is difficult because the outcome rests on the facts and circumstances of the specific case which the judge must interpret while applying the law, often being required by those facts to make delicate distinctions. The task is important

because the applicable law reflects Congress' deep concern that the professionals who work in the bankruptcy system adhere to a high moral code of conduct.

This decision being fact sensitive, an understanding of the court's ruling is not possible without a thorough review of the relevant case history.

I. CASE BACKGROUND

The debtor was one of a number of related companies owned and operated by The Morgan Company. Mr. James Morgan was the principal shareholder and president of The Morgan Company. Prepetition The Morgan Company and four of its wholly owned subsidiaries merged into a single company called The Morgan Company. The name of The Morgan Company thereafter was changed to Hood Lumber Company ("Hood"). Hood filed its bankruptcy petition on August 11, 1997. It was anticipated that the newly formed entity would sell most or all of its assets while in chapter 11. At the same time a sister corporation, Bugaboo Timber Company,("Bugaboo") also filed a Chapter 11 petition. Bugaboo was a company formed by the merger, shortly before the filing, of several other of The Morgan Company's wholly owned subsidiaries. According to the schedules filed in their respective cases, the value of each debtor's assets at the time of filing exceeded its scheduled liabilities.

Simultaneously with the petition filings Hood and Bugaboo filed motions asking the court to jointly administer their cases. The motions were based, in part, on their representations that

their "economic interests [were] inextricably intertwined." They jointly owed the sum of $16,000,000.00 to National Bank of Canada ("National Bank") and $1,500,000.00 to General Electric Credit Corporation ("GECC"). In addition, both Hood and Bugaboo had executed indemnification agreements relating to $18,000,000.00 in payment and performance bonds issued by United Pacific Insurance Company ("United Pacific") to insure Bugaboo's performance under certain timber contracts. Mr. Morgan had personally guaranteed a part of the corporate indebtedness.

The court allowed joint administration. On December 5, 1997, the United States Trustee filed a motion to dismiss or convert the Bugaboo case, alleging that the estate was losing money and there was no reasonable likelihood that Bugaboo could successfully reorganize. On December 12, 1997, the Bugaboo case was severed from the Hood case and converted to one under Chapter 7.

Shortly thereafter the Committee sought and obtained an order appointing an examiner who was directed to investigate Hood's prepetition transactions with related entities during the year prior to the bankruptcy filing, with particular emphasis on examination of the status of its solvency as of the date of filing. In his preliminary report, filed June 4, 1998 the examiner concluded that the prepetition transactions among all the related Morgan entities, including James Morgan individually, were so intertwined and poorly documented that it was impossible

to provide the court with any conclusion about the financial condition of the bankrupt entities at the time of filing.[1]

A few weeks later the Bugaboo trustee filed a motion to substantively consolidate the Bugaboo case with the Hood case, arguing that the two entities had been involved in a common enterprise and that because of the nature of their business operations Hood was liable to Bugaboo for virtually all of Bugaboo's losses on its timber contracts. He filed an accompanying $24,000,000.00 proof of claim in the Hood case. Hood disputed Bugaboo's contentions but eventually agreed to pay $2,000,000.00 to the Bugaboo trustee in return for his agreement to withdraw his motion and to abandon any further claims he might have asserted against Hood.

After the Bugaboo case was converted to Chapter 7 United Pacific filed a motion for relief from stay to allow it to cancel the performance bonds it had issued prepetition on Bugaboo's behalf and to foreclose on its collateral. It argued in part that the value of its collateral was substantially less than the amount Bugaboo owed to it. A decision on this motion would affect Hood because, prepetition, it had agreed to indemnify United Pacific for any losses it sustained on those payment and performance bonds. The court found that Bugaboo's bonded timber

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[1] He did conclude that when the bankruptcy schedules were prepared "estimates and short cuts were used in some instances [with the net result being] a series of valuations and reports that have not been completely reliable." The examiner did not file any further reports.

contracts, which constituted the majority in value of United Pacific's collateral, had a negative net value of between $4,000,000.00 and $6,900,000.00 and granted its motion.

Following its success in Bugaboo, and based in part on the court's findings of contract value in that case, United Pacific asserted a contingent, unliquidated claim in the Hood case of $9,700,000.00 of which $1,200,000.00 was identified as secured. Ultimately United Pacific entered into a court approved settlement agreement with Hood and its creditor's committee through which it was granted an allowed unsecured claim of $5,500,000.00 and an allowed secured claim of $1,200,000.00.

II. GLOBAL'S EMPLOYMENT AND THE SALE OF HOOD'S ASSETS

In February, 1997 Global had signed an operating agreement with The Morgan Company and James Morgan which provided, in part, that it would provide supervision and general direction of The Morgan Company business activities and consult as its "chief operating officer" regarding matters such as purchase and sale of assets, including timber, employee compensation, and "retention and recruitment matters". It was to aid in improving The Morgan Company's financial condition and recommend and execute its business plans. It had access to The Morgan Company's books and records and all checks over $5000 had to be countersigned by one of its representatives.

At trial Mr. Gordon Boyd, one of Global's principals and its president, testified that during this period in fact James Morgan remained in charge of the Company's operations. However,

prepetition Global was given sweeping power and authority both to access The Morgan Company's business records and to run its business affairs. This agreement was in place when Hood was contemplating bankruptcy and Global took part in those discussions.

On the day Hood filed its petition it filed an application to employ Global as Hood's selling agent. Pursuant to the requirements of Bankruptcy Rule 2014(a) Mr. Boyd filed an affidavit in support of the application in which he included the boilerplate language:

> To the best of my knowledge, neither I nor any one at Global has any connection with the Debtor in this matter, nor with creditors or any party in interest nor their respective attorneys, or accountants except as disclosed in the Rule 2014 Verified Statement for Proposed Professional submitted herewith. We represent no interest adverse to the Debtor or the bankruptcy estate and believe that we can undertake representation of Debtor's interest in this case without any type of restriction.

These standard assurances were followed by the specific disclosures that prepetition Global had been retained by Young and Morgan North, one of Hood's affiliates, to dispose of its 50% ownership interest in a joint venture in Seward Forest Products and that the debtor had paid Global $305,870.00 within a year prior to the filing for "business consulting services, real estate sales commissions, and business unit sales."

The affidavit did not disclose that at the time of Hood's bankruptcy filing Global was represented by the law firm of Davis, Wright Tremaine (DWT). DWT would continue to represent it

in matters outside the Hood case, including the Omak Wood Products Chapter 11 case, in which Global was acting as sales agent. It had represented Global in its prepetition dealings with The Morgan Company, including review of the operating agreement. It did not disclose that DWT also represented Mr. Morgan and would continue to represent him during Hood's bankruptcy.

It did not disclose that prepetition it had served as "chief operating officer" for The Morgan Company and had continued in that position up to Hood's bankruptcy filing.

It did not disclose that within three days of Hood's bankruptcy filing Global had received a payment of $90,545 for past services.

Absent any objections, on October 16, 1997 the court entered an order authorizing Hood to employ Global. Under its exclusive listing agreement, effective through January 31, 1998, it had the right to market all of Hood's assets. The marketing responsibilities included preparing an offering prospectus, contacting prospective buyers, obtaining confidentiality agreements[2] with buyers, providing them with due diligence information, and assisting the seller with evaluation of offers and with negotiations and consummation of any transaction.

[2] Global required execution by any potential buyer of a confidentiality agreement as a prerequisite for release of any confidential information about a particular business it was marketing in which the signator had an interest.

Within 30 days after January 31, 1998 it was to provide Hood with a list of all parties which had signed confidentiality agreements with it prior to that date. It would receive a commission on any assets it sold during the listing period and it would continue to be entitled to a commission on any sale made by anyone within a year after January 31, 1998 to any entity that had signed a Hood confidentiality agreement with it prior to January 31, 1998.[3] It was to bear its own costs.

Global is a closely held corporation whose stock is held by three individuals. Mr. Boyd owns 48.85% of the stock, Mr. Neil Anderson owns 2.3% and a silent partner owns the balance. Mr. Boyd and Mr. Anderson do not have majority control of the company, as its bylaws require a 2/3 vote of the stockholders for any corporate action.

Global has no employees. Instead it markets properties through the use of "independent sales agents".[4] Mr. Boyd and Mr. Anderson were the independent sales agents initially in charge of marketing Hood's assets. On November 12, 1997, Mr. Boyd and Mr. Anderson entered into a Commission Split Agreement with Mr. Stuart Young under which they agreed to split any commission they

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[3] This last provision is common in exclusive listing agreements and is generally referred to as a "tail".

[4] Under their contracts with Global each agent was personally responsible for all expenses incurred as a result of their marketing efforts. On paper Global did not reimburse any expenses under the Hood sales agency contract although it is unclear from the record whether Global or the agents actually paid for the undisputed amount of $30,000 for a wood basket study.

earned from the sale of Hood's assets.

At the time he signed the Commission Split Agreement Mr. Young was not formally affiliated with Global and was not a licenced sales agent or broker. Rather, he had arrived at Global in July and was using office space there, with its permission, while he reviewed various business opportunities it was marketing for the purpose of finding a company which he wanted to purchase or to manage.

On October 24 Mr. Young had signed Global's standard confidentiality agreement. It authorized him access to confidential information of certain wood products companies Global was marketing, namely Hood, Omak Wood Products, Mayr Brothers Company, Atco Lumber Ltd, and Springfield Forest Products, all listed in an addendum A. It identified Mr. Young as "Acquirer" who had "an interest in acquiring or financing all or a part of the outstanding stock and/or assets of Seller identified and incorporated by reference in addendum A". Mr. Young and Mr. Boyd each testified that, despite the language of the confidentiality agreement, when he signed it Mr. Young had no interest in purchasing Hood's assets. Rather, he was considering joining Global as an independent sales agent and his signature on the agreement allowed him access to financial information that

would demonstrate the amount of commissions he could earn working for Global.[5]

Messrs. Boyd, Anderson and Young engaged in extensive efforts to market Hood's assets. It owned a number of mills, plants and other facilities spread over a large geographic area. The agents developed a prospectus for the company which included its history and identified the market segments served by, and the financial histories of, each of the company's facilities. Global also commissioned and paid for a study which identified those geographic areas which would logically provide raw materials to each facility (the wood basket study). It developed a list of potential buyers which it contacted by mail and with follow-up calls. If a potential buyer expressed an interest in the company, after receiving a signed confidentiality agreement, Global sent the entity significant detailed information about Hood.

Among the entities which signed a confidentiality agreement with Global covering Hood prior to January 31, 1998 was the company Dimeling, Schrieber & Park. ("Dimeling"). Dimeling is an east coast investment group which specializes in making equity investments in companies, many of which are in Chapter 11. In November 1997, Mr. Gary Franklin, one of Global's independent sales agents, had advised Mr. Boyd that Dimeling, which was

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[5] No evidence was presented to show whether Mr. Young ever signed confidentiality agreements for any other company Global was marketing.

working with Mr. Franklin on another transaction, might be interested in purchasing a company involved in the wood products industry.

On December 5, 1997, Mr. Boyd spoke briefly by telephone with Mr. Dimeling to inquire of Dimeling's interest. One of the wood products companies Global was marketing, Omak Wood Products, had filed a chapter 11 case in Tacoma, Washington. Another, Mayr Brothers, was not in bankruptcy. During the course of the telephone conversation Mr. Dimeling advised Mr. Boyd that Dimeling was not interested in purchasing either Omak or Hood alone because each was too small. During its marketing efforts Global's agents had begun to think that there might be a prospective purchaser for a combined sale of the three companies.[6] During the phone conversation, at Mr. Boyd's inquiry Mr. Dimeling indicated that he was interested in a possible purchase of these three companies. Mr. Boyd followed up by sending Dimeling a prospectus and confidentiality agreement for each of the three companies, which Dimeling signed on December 10, 1997.

After January 31, 1998 although its listing agreement with Hood had expired,[7] Global continued to work the Dimeling lead.[8]

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[6] In the industry such a combined sale is called a "roll-up".

[7] Hood gave Global no authority, after January 31, 1998, to continue to represent Hood as its selling agent.

[8] It also continued some marketing efforts to others. After (continued...)

From December through most of February, 1998, Mr. Young was in charge of preparing a prospectus which combined information on the three wood products companies.[9] After Mr. Boyd's December call to Dimeling, Global's agents did not again contact Dimeling until a second phone call from Mr. Boyd on February 9. Then Global had Dimeling sign a second confidentiality agreement covering the three companies. They sent the combined prospectus to Dimeling on February 25.

On March 11, 1998, Mr. Boyd, Mr. Anderson and Mr. Young met with Mr. Dimeling to tour the facilities of all three companies. On March 12, as Mr. Dimeling was preparing to board an airplane to return to the east coast, for the first time he advised Mr. Boyd, Mr. Anderson, Mr. Young, Mr. Mayr of Mayr Brothers, and Dick Baldwin, a forest products industry specialist, all of whom had accompanied him on part or all of the tour, that he was prepared to go forward with the purchase of the three companies but only on the condition that these men join the

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[8](...continued)
January 31, 1998 it obtained 6 additional confidentiality agreements covering Hood. Strangely, one of those signing a confidentiality agreement with Global covering Hood, on February 23, 1998, was Mayr Brothers, one of the companies which Global was attempting to sell.

[9] During this period of time and at least up through March 12, 1998, Global's listing agreement with Omak Wood Products had not expired.

company to be formed to acquire them, to be known as QVL, as both equity holders and as managers.[10]

Over the next two or thee days Messrs. Boyd, Anderson, and Young made the decision to join QVL. Upon payment of $500,000 for his respective interest each became the owner of 1.724% of its issued shares and obtained an option to buy additional shares in the future.[11] Under their employment agreement they each received a generous salary plus the potential for additional significant compensation yearly based on a formula which takes into consideration a "target" corporate income. Each had signed a promissory note for their equity share and hoped that income arising from this incentive pay would fund the annual payments due under the notes.

The percentage of commission the three men anticipated receiving from their work on the sale of Hood's assets was very important to the capitalization of QVL as it was to be a source of cash that would be used to contribute to QVL's capital account.

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[10] At trial Mr. Dimeling testified that although he made the offer to these men for the first time on March 12, he would have discussed his need for a management team with Global prior to his touring visit.

[11] The price for the shares was directly proportional to the capitalization of QVL. The men did not receive any bonuses, setoffs, deductions or credits for services to reduce the amount each of them had to contribute for their shares. Global did not become an equity owner in QVL.

Meanwhile, after the expiration of Global's exclusive listing agreement on January 31, 1998, but prior to the presentation of the Dimeling offer to the court and because Hood and its primary lender, the National Bank, had seen no progress on a sale and thought they had heard nothing from Global, on February 27 Hood entered into an exclusive agreement to employ Hamstreet & Company ("Hamstreet") as its exclusive sales agent to liquidate its assets. It was to be paid a set amount for sale of the Hanel Mill, one of the Hood facilities, depending on whether that facility was operational at the time of sale. In addition, it was to be paid 5% of any distribution made to unsecured creditors and reimbursed for all reasonable and necessary out of pocket costs, expenses and advances made or incurred by it in performing its services under the agreement.

Hamstreet later became the disbursing agent under the terms of the confirmed plan. Its disbursing agent agreement states in part "in lieu of any commission or fees which may be fixed by applicable law...[Hamstreet] shall be entitled to reimbursement of expenses and compensation as provided in Section 4.7 of the Sales Agency Agreement executed by and between [Hood and Hamstreet]". The court is unaware of the amount, if any, paid to date to Hamstreet for its services as disbursing agent, as the agreement does not require court approval of any such postconfirmation payments.

At trial Mr. Hamstreet did not recall any contacts he had with Global between February 1 and the middle of March. After

trial he signed an affidavit in which he stated that he didn't recall the phone call but acknowledged that Global's phone records indicated that Mr. Boyd had called him on February 10 and he thought that more likely than not he had had a discussion with Mr. Boyd about possible purchasers for Hood's assets. But Mr. Boyd admitted that he had not shared information with Mr. Hamstreet about the "roll-up" opportunity with Dimeling. Mr. Dimeling testified that he didn't learn about Hamstreet until March 12.

As required by its agency agreement with Hood, on February 24 Global sent it a list of those entities which had signed confidentiality agreements with it. Its memo stated "[F]ollowing is a list of companies with whom we have executed Confidentiality Agreements regarding Hood Lumber." The list included some entities which had signed agreements after January 31, 1998 but did not distinguish those which signed before January 31 from those which signed after.

On March 16, 1998 Mr. Young and Mr. Anderson met with Mr. Morgan and Mr. Hamstreet and advised them that Global had located a possible purchaser for substantially all of Hood's assets and that it was likely that Mr. Young, Mr. Anderson and Mr. Boyd would be shareholders and managers of the purchaser. DWT was at that meeting representing QVL, although at the time Mr. Hamstreet assumed that DWT was present as Mr. Morgan's counsel, as it had been throughout the case.

By letter of March 22 DWT wrote a letter to the UST, which was written on behalf of QVL and billed to it, presenting its argument as to why Global was entitled to receive a commission for the sale from the estate.

By a letter of March 23 QVL advised the Committee's attorney of the terms of the Dimeling offer, including the involvement of Messrs. Anderson, Boyd and Young as prospective shareholders and managers of QVL. This letter was signed by, among others, Mr. Young as "President" of QVL and included the statement: "...this offer is subject to Global's receipt at Closing [sic] of the commission provided in its approved contract with Hood."

Mr. Anderson testified that between March 12 and the sale closing he worked on behalf of QVL by gathering information for its due diligence review and by accompanying potential insurers and environmental engineers on onsite inspections of the Hood properties.

On March 31, 1998, at a court hearing on a different matter, Hood's attorney mentioned that he had just heard that it had received an offer to purchase substantially all of its assets

from Dimeling for the sum of $20,000,000.[12] No details were provided to the court at that time.

Sometime during this period Mr. Anderson and Mr. Young retained the firm of Bogle and Gates to negotiate their employment contracts with QVL. Bogle and Gates earlier had been employed by Hood during its Chapter 11 to continue a claim against the U.S.A. for delay in awarding a timber contract and received payment from the estate for these services.

The Dimeling offer was reduced to writing in an Asset Sale and Purchase Agreement dated April 6, 1998 and filed with the court. That agreement contained the following language:

> Buyer shall pay, in addition to the purchase price, the theretofore unpaid Buyer Commissions due to the Sales Agent and to Global Ventures, Inc. (Global). The Buyer has signed confidentiality agreements with Global, and this offer is subject to Global's receipt at Closing of the commission provided for in its approved contract with Seller. Two of Global's principals (Gordon Boyd and Neil Anderson) and one of its independent contractors (Stuart Young) are or intend to become minority shareholders and officers of an affiliate of the Buyer, to whom it is contemplated Buyer will assign its rights to purchase the Assets hereunder (Quality Veneer & Lumber, Inc. Hereafter "QVL"). Neither Global nor its other principals intend to have any interest in QVL. Boyd, Anderson and Young will each obtain their interest in QVL in consideration for cash in the same proportion as

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[12] The ultimate sales price was $21,150,000. Hood paid $1,500,000 into two escrow accounts. Of that amount $332,000 was returned after closing to Hood. The balance is being held in escrow for a period of two years to cover any costs or expenses which Hood committed to pay under the contract for remediation of hazardous waste and other indemnified activities. Any money not paid for these purposes after two years is to be refunded to Hood. Thus, to date, Hood has received $19,982,000 from the sale.

> QVL's other shareholders without regard to their ownership interests in Global or participation in the fees paid to it with respect to this sale. The Seller shall cooperate with Global's disclosure to the Court of the fact that two of Global's principals and one of its independent contractors are or intend to become minority shareholders and officers of QVL.
> (Underlines added)

The sale was conditioned upon its incorporation into a plan of reorganization, to be confirmed by June 1, 1998 with closing by June 15, 1998.

On April 24, 1998, the parties filed an amended Asset Sale and Purchase Agreement. The amendments to the above quoted portion of the agreement had deleted the underlined sentence but otherwise remained unaltered.

On May 26 Judge Rossmeisl, Bankruptcy Judge for the Eastern District of Washington, held a hearing in the Omak Wood Products case to determine whether he would approve the terms of Dimeling's purchase of Omak's assets. Among other matters, he inquired into the good faith and fair dealing of the transaction, given that Global was the sales agent and Messrs. Boyd, Anderson and Young had agreed to become associated with QVL. He approved the sale. However, he was not asked to approve the payment of estate funds for Global's commission. The order approving the commission stated that it was to be paid by the buyer.

Hood filed its Third Amended Plan of Reorganization on June 1, 1998.[13] The amended Dimeling Asset and Purchase Agreement was incorporated and constituted the heart of the plan. If the sale closed it would generate any funds available for creditors' payments. There was no question but that by this point Hood was not solvent. Under the plan terms the general unsecured creditors would not be paid in full. This plan also provided that upon confirmation any avoidance claims held by Hood would be waived.

III. OBJECTIONS TO PAYMENT OF GLOBAL'S SALES COMMISSION

The unsecured creditors voted for the plan. The National Bank, which had been The Morgan Company's primary prepetition lender and which had continued, postpetition, to fund Hood's ordinary and necessary operating expenses, including the purchase of mill inventory while Hood attempted to find a buyer, was anxious for consummation of the Dimeling sale. It refused to provide further funding to Hood after the financing order entered June 12, 1998.

At the July 9th confirmation hearing the UST objected to confirmation of the plan because it called for the estate's payment of Global's commission arising from the Dimeling sale. It took the alternative positions that (1) the court should deny

[13] The court had held a disclosure statement hearing on a second amended plan on June 1. It was approved by the court, with changes that same day and Hood filed a Third Amended disclosure statement and plan, taking into consideration those changes.

allowance of any commission pursuant to its authority under 11 U.S.C. § 328(c) as Global was no longer disinterested and held an interest adverse to the estate given that two of its principals and one of its agents had become shareholders and managers of QVL or (2) the court should reduce any commission originally promised to Global pursuant to its authority under 11 U.S.C. § 328(a) as the terms and conditions of Global's employment had proved improvident in light of developments not capable of being anticipated at the time of fixing such terms and conditions.[14]

The court confirmed the plan, with amendments, but specifically reserved for later consideration the allowance of Global's commission for the Dimeling sale.

The sale of Hood's assets to Dimeling closed shortly thereafter. On August 14, 1998, Global filed an application for compensation which sought a total sales commission of $423,000.[15] Pursuant to their agreements with Global, Mr. Boyd, Mr. Anderson and Mr. Young would, collectively, be entitled to 60% of the

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[14] Because the court is deciding the issue before it under §§ 327(a) and 328(c), it finds it unnecessary to address the UST's argument under § 328(a).

[15] Under its sales agency agreement Global is to receive a 2% commission on the amounts received by Hood from the sale. To date, on the amounts Hood has received, Global is seeking an allowance and authorization of payment for $399,640. It also seeks a conditional allowance of its commission on the remaining $1,000,000 holdback, subject to payment to it only with respect to that portion of the $1,000,000 which Hood actually is repaid.

commission, or a total of $253,800.[16] Additionally, as 51% shareholders of Global, Mr. Boyd and Mr. Anderson would receive 51% of the 40% ($169,200) retained by Global, or $86,292.

The Committee filed an objection to Global's application on more than one basis. As with the UST, it urged the court to exercise its authority under 11 U.S.C. § 328(c) to deny Global the Dimeling commission because once Messrs. Anderson, Boyd and Young accepted employment by, and an ownership interest in, QVL Global developed a conflict of interest which precluded it from remaining either disinterested or holding an interest which was not adverse to the estate. Additionally, it requested disgorgement under § 328(c) of the commission of $31,089.50 the court, on March 31, had approved for Global arising from the separate sale of one facility, the North Santiam plywood mill, to Freres Lumber Co., Inc.

It reasons that Global had become intimately familiar with Hood's finances and operations through its prebankruptcy position as chief operating officer and as its sales agent. After they accepted Dimeling's offer Global's agents used all of this information to benefit Dimeling at Hood's expense because they had a financial interest in assuring that the Dimeling offer closed. Through its agents it ceased working for Hood and began

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[16] These dollar amounts assume that Hood receives a refund of the full $1,000,000 held back for remediation. Messrs Anderson and Boyd will each receive 37.5% of 60% and Mr. Young will receive 25% of 60%.

working for QVL, including hiring DWT, its attorney and Mr. Morgan's counsel during the Hood bankruptcy proceeding, to represent QVL. Two of the agents also used the services of one of Hood's attorneys, Bogle and Gates, in taking steps to protect their interests in QVL. Under these circumstances it became impossible for Hood, its creditors or the court to know whether the best price was obtained for Hood's assets.

The Committee also took the position that Global should be denied any fees because at the time of its appointment it was not either disinterested or without any interest adverse to the estate, contrary to 11 U.S.C. § 327(a). It asserts that Global was never qualified to be appointed as Hood's sales agent as (1) it had been an officer of Hood; (2) it had received a payment of $90,545 just three days before the filing for past services, which payment was potentially avoidable as a preferential transfer; (3) it had been represented by DWT in a number of matters, including review of its prepetition operating agreement with The Morgan Company and that DWT was counsel for James Morgan, would represent Mr. Morgan during the Hood bankruptcy and would continue to represent Global in the Omak Wood Products case; and (4)it had an agent, Mr. Young, whose primary motivation was not to provide sales services to clients but to find a management or ownership interest for himself in a company.

Further, it alleged that denial of all fees was justified as, upon application for appointment, Global violated the

requirements of Bankruptcy Rule 2014(a) by failing to disclose facts which would have revealed its disqualification.

Finally, it argued that although obtaining a buyer for Hood's assets, Global's fees should be denied or reduced because its delay and negligence in addressing the interest shown by Dimeling led to confusion for, and damage to, Hood. Although Global did not have authority after January 31, 1998 to continue to represent Hood, it continued to attempt to obtain a buyer for Hood's assets, sharing confidential information about Hood with several prospective purchasers while providing little, if any, information to Hood about these ongoing attempts, particularly those involving the Dimeling offer. Hood was damaged by Global's paucity of information because, having not received any indication from it that a potential sale of assets was in progress, it obtained the appointment of Hamstreet as sales agent, thus facing the possibility that it would have to pay two commissions for one sale. After Hamstreet was appointed it heard little or nothing from Global until it was informed of the Dimeling offer on March 17.

IV. APPLICABLE LAW

A. JURISDICTION

The issue before me arises out of 11 U.S.C. § 330. Consequently, the court has jurisdiction to make the decision pursuant to 28 U.S.C. § 1334. The matter being a core matter under 28 U.S.C. §157(b)(2)(A), the court has jurisdiction to enter a final order.

B. 11 U.S.C. §§ 327(a) and 1107

Section 327(a) acts prospectively. Before a professional may be appointed to provide service on behalf of the estate he must have (1) demonstrated that he has met the substantive conditions of the statute and (2) been appointed under a court order.[17] It provides that "...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".

This section also applies to professionals retained by a debtor in possession in Chapter 11 by virtue of § 1107(a), which, with certain limited exceptions, grants it all the rights, and obligates it to perform all the duties, of a trustee.

Courts have agreed in theory that, with three exceptions,[18] each of which is identified through specific Code provisions, § 327(a) establishes two preconditions for court approval of

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[17] In re Capitol Metals, Co., Inc., 228 B.R. 724 (9th Cir. BAP 1998).

[18] The exceptions are: (1) § 327(c), which allows employment if the professional would otherwise have been disqualified for having been employed by or represented a creditor, unless, upon objection, the court finds the professional has an actual conflict; (2) § 327(e), which allows employment of an attorney for a special purpose despite having represented the debtor; and (3) § 1107(b), which allows employment by a debtor in possession although having been employed by, or represented the debtor prepetition. See, e.g. In re Crivello, 134 F.3d 831, 835 (7th Cir. 1998).

employment on behalf of the estate.[19] These statutory preconditions are to be rigidly applied and cannot be waived.[20] First, the professional must be disinterested. Second, the professional may not hold or represent an interest adverse to the estate. Several courts have commented that these two tests appear to overlap within the context of 11 U.S.C. § 101(14)(E).[21] This fact is unremarkable. Of importance is what constitutes the content of each test, as together "they serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."[22]

In a case decided under the Bankruptcy Act the Ninth Circuit stated: "We start with the well established principle that those

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[19] Rome v. Braunstein, 19 F.3d. 54, 62(1st Cir. 1994); In re BH & P Inc., 949 F.2d 1300, 1314 (3rd Cir. 1991); In re Granite Partners, L.P., 219 B.R. 22, 32 (Bankr. S.D.N.Y. 1998); In re Tinley Plaza Associates, L.P., 142 B.R. 272, 277 (Bankr. N.D.Ill. 1992); In re Rusty Jones, Inc., 134 B.R.321, 342(Bankr. N.D.Ill. 1991).

[20] In re The Leslie Fay Companies, Inc., 175 B.R. 525, 532 (Bankr. S.D. N.Y. 1994); In re Tinley Plaza Associates, L.P., 142 B.R. 272, 277 (Bankr. N.D.Ill. 1992); In re The Cropper Company, 35 B.R. 625, 629 (Bankr. M.D.Ga. 1983) quoting 3 Collier on Bankruptcy ¶ 327.04[4][e](15th Ed. 1998) (footnotes omitted).

[21] In re BH & P Inc., 949 F.2d 1300, 1314 (3rd Cir. 1991); In re Martin, 817 F.2d 175, 181 (1st Cir. 1987); In re The Leslie Fay Companies, Inc., 175 B.R. 525 ,532 (Bankr. S.D.N.Y. 1994).

[22] In re Crivello, 134 F.3d 831, 835 (7th Cir. 1998) quoting Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).

performing duties in the administration of a bankrupt's estate are not acting as private persons, but as officers of the court.[23]

When read together, §§ 327(a) and 328(c) demonstrate that the professional, having been appointed, must meet these conditions on an ongoing basis.[24]

C. 11 U.S.C. §§ 101(10),(14)

Section 101(14) defines a "disinterested person" to be one that

> (A) is not a creditor, an equity security holder, or an insider;
> (B) is not and was not an investment banker for any outstanding security of the debtor;
> (C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;
> (D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and
> (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason.

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[23] In re York International Building, Inc., 527 F.2d 1061, 1061 (9th Cir. 1975) quoting Callaghan v. R.F.C., 297 U.S. 464 (1936).

[24] In re Olsen Industries, Inc., 222 B.R. 49, 58 (Bankr. D.Del. 1997); In re Rusty Jones, Inc., 134 B.R. 321, 342 (Bankr. N.D.Ill. 1991); In re Diamond Mortgage Company of Illinois, 135 B.R. 78, 89 (Bankr. N.D.Ill. 1990).

This section is a "guideline for the court to follow in its sound discretion to insure that persons employed shall have the essential character of independence and disinterestedness which is required." [25]

Under (A) a professional is not disinterested if a "creditor". "Creditor" is another term of art defined in § 101(10) to mean an

> (A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;
> (B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this title; or
> (C) entity that has a community claim.

Subsection (E) is the "catch-all" section. This subsection was adopted from old Bankruptcy Rule 10-202(c)(2)(D). "It appears broad enough to include anyone who in the slightest degree might have some interest or relationship that would color the independent and impartial attitude required by the Code."[26] "The purpose of the rule is to prevent a conflict without regard to the person's integrity. Conflicting loyalties may arise even from remote or indirect associations. The goal should be not to

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[25] In re Rusty Jones, Inc., 134 B.R. 321, 342 (Bankr. N.D.Ill. 1991); See also, In re Roberts, 46 B.R. 815, 829 (Bankr. D.Utah 1985), aff'd in relevant part and rev'd in part, 75 B.R. 402 (D.Utah 1987).

[26] 3 Collier on Bankruptcy ¶ 327.04[4][e] (15th Ed. 1998); See also In re BH & P Inc., 949 F.2d 1300, 1309 (3rd Cir. 1991); In re Glenn Electric Sales Corp., 99 B.R. 596, 601 (D.N.J. 1988).

prevent actual evil in this particular case, but the tendency to evil in all cases."[27]

D. INTERESTS ADVERSE TO THE ESTATE

Unlike the term "disinterested", this term is not defined by the Code. Yet there appears to be a consensus among courts throughout the country that Judge Clark's ground breaking definitions merit adoption. To "hold an interest adverse to the estate" means (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate. To "represent an adverse interest" means to serve as agent or attorney for any individual or entity holding such an adverse interest."[28]

"Even when business transactions are 'mutually beneficial' to both sides such transactions involve adverse interests. In other words, a business transaction need not ripen into an actual dispute to have adverse interests involved."[29] On the other hand,

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[27] In re Roberts, 46 B.R. 815 (Bankr. D.Utah 1985), aff'd in relevant part and rev'd in part, 75 B.R. 402 (D.Utah 1987) quoting In re Sambo's Restaurants, Inc., 20 B.R. 295, 297 (Bankr. C.D.Cal. 1982).

[28] In re Roberts, 46 B.R 815, 827 (Bankr. D.Utah 1985), aff'd in relevant part and rev'd in part, 75 B.R. 402 (D.Utah 1987). See also, In re Fondiller, 15 B.R. 890 (9th Cir. BAP 1981).

[29] In re The Cropper Company, 35 B.R. 625, 631 (Bankr. M.D.Ga. (continued...)

interests are not considered 'adverse' merely because it is possible to conceive a set of circumstances under which they might clash.[30]

E. CONFLICTS OF INTEREST

Taken together, the requirements of disinterestedness and lack of an interest adverse to the estate constitute the Bankruptcy Code's standard for conflicts of interest. Attorneys are familiar with Codes of Conduct which prohibit conflicts of interest. Realtors also have a Code of Ethics and Standards. The standard to be applied in bankruptcy is stricter than these Codes as bankruptcy conflicts may not be waived by the client upon disclosure.[31]

In struggling to apply this standard for conflicts three camps have arisen: those courts which have delineated between "potential" and "actual" conflicts, finding disqualification only

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[29](...continued)
1983).

[30] In re TWI International, Inc v. Vanguard Oil and Service Co., 162 B.R. 672, 675 (S.D.N.Y. 1994); In re Olsen Industries, Inc., 222 B.R. 49, 56 (Bankr. D.Del. 1997); In re The Leslie Fay Companies, 175 B.R. 525, 532 (Bankr. S.D.N.Y. 1994); In re Kelton Motors, Inc., 109 B.R. 641, 650 (Bankr. D.Vt. 1989).

[31] The concept of waiver is difficult to apply "when the client, the estate, is a fiduciary for another group, the creditor body; and where the client's decisions with respect to retention of professionals...are subject to review, notice, and hearing". In re Diamond Mortgage Corp. of Illinois, 135 B.R. 78, 90 (Bankr. N.D.Ill. 1990).

with the latter,[32] those courts which recognize the distinction but have concluded that even "potential" conflicts are disqualifying,[33] and those courts which refuse to recognize any such a distinction.[34]

More recently a few courts have recognized that this debate "may be more semantic than substantive"[35] with the facts of the particular case being determinative without the necessity of labeling. "Rather than worry about the potential/actual dichotomy it is more productive to ask whether a professional has

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[32] In re Martin, 817 F.2d 175, 182 (1st Cir. 1987); In re American Printers & Lithographers, Inc., 148 B.R. 862, 866 (Bankr. N.D.Ill. 1992); In re Diamond Mortgage Corp of Illinois, 135 B.R. 78, 91 (Bankr. N.D.Ill. 1990); In re Stamford Color Photo, Inc., 98 B.R. 135, 137-38 (Bankr. D.Conn.1989); In re Waterfall Village of Atlanta, Inc. 103 B.R. 340, 344 (Bankr. N.D.Ga. 1989). (An "actual" conflict is the representation of "two presently competing and adverse interests" while a "potential" conflict occurs where the competition "may become active if certain contingencies arise"); In re Oliver Stores, Inc., 79 B.R. 588 (Bankr. D.N.J. 1987); In re Marine Power & Equip. Co., 67 B.R. 643, 653 (Bankr. W.D.Wash. 1986).

[33] In re Bohack, 607 F.2d 258, 263 (2d Cir. 1979); In re Philadelphia Athletic Club, Inc., 20 B.R. 328, 334 (E.D.Pa. 1982); In re Watson, 94 B.R. 111, 116 (Bankr. S.D.Ohio 1988; In re Lee, 94 BR 172, 178 (Bankr. C.D.Cal. 1988); In re Parkway Calabasas, Ltd., 89 BR 832 (Bankr. C.D.Cal. 1988); In re Glenn Elec.Sales Corp., 89 BR 410, 413 (Bankr. D.N.J. 1988), aff'd, 99 B.R. 596 (D.N.J. 1988); In re Codesco, Inc., 18 B.R. 997, 999 (Bankr. S.D.N.Y. 1982).

[34] In re Kendavis Industries, Inc., 91 B.R. 742, 744, 755-56 (Bankr. N.D.Tex. 1988).

[35] In re The Leslie Fay Companies, 175 B.R. 525, 532 (Bankr. S.D. N.Y. 1994); See also, In re BH & P Inc., 949 F.2d 1300, 1315 (3rd Cir. 1991)(the third circuit emphasizes the importance of taking all the circumstances of a case into consideration); In re Granite Partners, L.P., 219 B.R. 22 (Bankr. S.D.N.Y. 1998); But see §327(c) which seems to recognize a distinction between a "potential" and "actual" conflict.

'either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors–an incentive sufficient to place those parties at more than acceptable risk–or the reasonable perception of one.'"[36]

My review of the cases confirms Judge Brozman's observation. The Martin court's test places the court's focus where it should be: on identifying any "divided loyalties and affected judgments"[37] under the particular facts.

Finally, Congress has found that within the bankruptcy context one conflict of interest is sufficiently harmful to the estate to criminalize. 18 U.S.C. § 154 states:

> A person who, being a custodian, trustee, marshall, or other officer of the court -
> (1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;
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> * * *
>
> shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant.

F. 11 U.S.C. § 328(c)

Unlike Section 327(a), Section 328(c) acts retrospectively by authorizing the court to deny compensation for past services for failing to satisfy the requirements of § 327(a). Appellate

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[36] In re The Leslie Fay Companies, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994) quoting In re Martin, 817 F.2d 175, 180-81 (1st Cir. 1987).

[37] In re Granite Partners L.P., 219 B.R. 22, 33 (Bankr. S.D.N.Y. 1998).

courts have held that an order allowing interim compensation is not a final, appealable order.[38] Consequently, on that basis, upon entry of a final compensation order the court may order disgorgement of some or all of interim fees awarded. Additionally, §328(c) gives the court a statutory basis for exercising its discretion to deny fees already awarded, if appropriate. It provides:

> Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title, if, at any time during such professional person's employment under section 3327 or 1103 or this title, 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.

Courts generally agree that this subsection requires of the professional continual scrutiny during service to assure avoidance of a disqualifying interest. If the professional initially qualifies to serve under § 327(a) but fails to remain qualified, the court may deny fees.

How is § 328(c) to be applied where the professional, although appointed, is later found to have been initially unqualified? The two circuits which have directly addressed this issue are split. In In re Federated Department Stores, Inc., the Sixth Circuit held that a valid professional appointment under §

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[38] Spears v. United States Trustee, 26 F.3d 1023, 1024 (10th Cir. 1994); In re Westwood Shake & Shingle, Inc., 971 F.2d 387 (9th Cir. 1992).

327(a) is a prerequisite for any award of compensation under either § 330 or § 328(c).[39]

The professional fared better in the Seventh Circuit. It had conceded that, although appointed, it was never disinterested. The court interpreted "at any time during...employment" in §328(c) to include the period of onset of employment. Accordingly, "[i]f a bankruptcy court errs in approving a professional person's employment, that person is either 'not a disinterested person' or 'represents or holds an interest adverse to the interest of the estate' for the entire duration of that person's employment. Under the plain language of the provision, §328(c) covers questions about whether this erroneously employed professional merits compensation. Thus, a bankruptcy court has discretion in denying that professional's fees."[40]

Believing that the Seventh Circuit's analysis more accurately reflects the language and intent of §§ 327(a) and 328(c), this court will exercise its discretion to determine the appropriateness of any sanction to be imposed under the section,

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[39] In re Federated Department Stores, Inc., 44 F.3d 1310, 1320 (6th Cir. 1995). See also, In re Mehdipour,, 202 B.R. 474 (9th Cir. BAP 1996); In re EWC, Inc., 138 B.R. 276, 282-83 (Bankr. W.D.Okla. 1992).

[40] In re Crivello, 134 F.3d 831, 837 (7th Cir. 1998).

whether the appointed professional was never qualified or whether it became disqualified after appointment.[41]

In exercising this discretion, which reflects the permissive language of the section itself, courts generally have rejected a brightline rule.[42] Rather, the court balances many factors, all of which arise from the circumstances of the individual case. Factors to be considered include the extent of any disclosures made at the time of appointment, whether any failure to disclose was willful or innocent, the number of disqualifying conflicts, and the benefit provided to the estate by the services rendered. The court may not always be able to determine the effect of the conflict on the results achieved or

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[41] In In re Mehdipour, 202 B.R. 474, 478 (9th Cir. BAP 1996) our circuit's bankruptcy appellate panel, in dicta, states "[T]he bankruptcy court does not have authority to allow the employment of a professional in violation of § 327, and the employment is void ab initio". As the statement was dicta, this court respectfully declines to follow it.

[42] Rome v. Braunstein, 19 F.3d 54, 62 (1st Cir. 1994); In re Prince, 40 F.3d 356, 360 (11th Cir. 1994); Gray v. English, 30 F.3d 1319, 1323-24 (10th Cir. 1994); In re BH & P Inc., 949 F.2d 1300, 1315 (3rd Cir. 1991); In re Cook, 223 B.R. 782 (10th Cir. BAP 1998); In re Garnite Partners L.P., 219 B.R. 22, 41 (Bankr. S.D.N.Y. 1998); In re Rusty Jones, Inc., 134 B.R. 321, 346-47 (Bankr. N.D.Ill. 1991); In re Diamond Mortgage Corp., 135 B.R. 78, 96 (Bankr N.D.Ill. 1990); In re Kendavis Industrial Int'l Inc., 91 B.R. 742, 762 (Bankr. N.D.Tx. 1988); In re Roger J. Au & Son, Inc., 71 B.R. 238, 242-43 (Bankr. N.D. Ohio 1986); In re GHR Energy Corp., 60 B.R. 52, 68 (Bankr. S.D.Tex.1985); In re Roberts, 46 B.R. 815, 846-48 (Bankr. D.Utah 1985), aff'd in relevant part and rev'd in part, 75 B.R. 402 (D.Utah 1987); But cf. In re Unicast, Inc., 214 B.R.979, 988 (Bankr. N.D.Ohio 1997)(harm to the estate is irrelevant) and In re Chou Chen Chems., Inc., 31 B.R. 842, 850-51 (Bankr. W.D.Ken.1983) (favoring denial of all compensation if conflict exists, regardless of benefit from services rendered).

the results which might have been achieved.[43] Under these circumstances the court need not speculate as to the result of the conflict.[44] Additionally, the court must be sensitive to protecting the integrity of the bankruptcy process.

Two circuit courts, citing Colliers on Bankruptcy with approval, have held that "[i]n the absence of actual injury or prejudice to the debtor's estate, this sanction [denial of fees] should not be rigidly applied." They concurred, however, that "[i]n exercising the discretion granted by the statute we think the [bankruptcy] court should lean strongly toward denial of fees, and if the past benefit to the wrongdoer fiduciary can be quantified, to require disgorgement of compensation previously paid that fiduciary even before the conflict arose.[45]

G. BANKRUPTCY RULE 2014(a)

This rule requires that any application to be employed under § 327(a) be accompanied by a verified statement signed by the person seeking employment "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

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[43] Rome v. Braunstein, 19 F.3d 54, 62 (1st Cir. 1994).

[44] Id.

[45] In re Prince, 40 F.3d, 356, 359 (11th Cir. 1994); Gray v. English, 30 F.3d 1319, 1324 (10th Cir. 1994).

States trustee". The requirements of this rule are to be strictly construed.[46]

The precursor to this rule under the Bankruptcy Act was General Order 44, which contained similar requirements. In interpreting that Order the Ninth Circuit held that the applicant has a duty to reveal all his connections with all parties in interest. He has no right to withhold information because it does not appear to him that there is a conflict.[47] Without doubt, disclosure is compelled where the applicant had contemplated and discussed a specific situation involving a potentiality for a conflict.[48]

Disclosure of relationships is crucial to the proper functioning of the adversarial system. "...the American system is one of adversarial justice, in which courts make clear and comparatively simple choices between conflicting claims. The adversary system requires as a minimum condition a clear identification of the parties to a dispute...the conflict of interest rule defines and protects the boundaries of competing interests within the framework of any given litigation. Proper judicial perspective may be gained only by knowing exactly where

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[46] Rome v. Braustein, 19 F.3d 54, 59 (1st Cir. 1994); In re Arlan's Dep't Stores, Inc., 615 F.2d 925, 933 (2d Cir. 1979) (decided under General Order 44).

[47] In re Haldeman Pipe & Supply Company, 417 F.2d 1302 (9th Cir. 1969); In re Coastal Equities, Inc., 39 B.R. 304, 308 (Bankr. S.D.Cal. 1984).

[48] In re BH & P, Inc., 949 F.2d 1300, 1317 (3d Cir. 1991).

those boundaries lie. The [professional] working under the burden of a conflict of interest does a disservice to his court and runs the risk even of subverting the justice system. If a [professional] holds himself out as representing one party, but in reality represents another, either in addition to or instead of his stated retainer, that [professional] distorts the judicial perspective . . . Judges direct their thinking and frame their decision along the lines presented to them, the only lines they are allowed to know. If a conflict of interest exists a court decision may impact in an unintended way or touch a party not meant to be reached by the judicial hand."[49]

In a case decided under the Code the Ninth Circuit Bankruptcy Appellate Panel has held that so important is the duty to disclose that the failure of the applicant to disclose completely his connections is grounds for denial of compensation, wholly apart from the act of representing conflicting interests.[50]

Reading Bankruptcy Rule 2014(a) together with §§ 327(a) and 328(c) it is evident that any fact in connection with a party

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[49] In re Chou-Chen Chemicals, Inc., 31 B.R. 842, 851-853 (Bankr. W.D.Ken. 1983).

[50] In re Film Ventures International, Inc., 75 B.R. 250 (9th Cir. BAP 1987); See also, Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994); In re Futuronics Corp., 655 F.2d 463, 469 (2d. Cir. 1981); In re Arlan's Dep't. Stores, Inc., 615 F.2d 925, 933 (2nd Cir. 1979); In re the Leslie Fay Companies, Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994); In re Granite Sheet Metal Works, Inc., 159 B.R. 840, 847 (Bankr. S.D.Ill. 1993);In re Environdyne Industries, Inc., 150 B.R. 1008, 1021 (Bankr. N.D.Ill. 1993).

in interest which would be relevant to the court's determination of whether the professional had a conflict of interest must be disclosed and that the duty to disclose continues beyond the initial stage of application to employ.[51]

In conjunction with the appointed professional's ongoing responsibility to remain free of conflicts while serving the estate, Local Form 1114 of the United States Bankruptcy Court for the District of Oregon requires that the professional file with the court an amended verified statement at any time during the service that his connections with the parties listed in Bankruptcy Rule 2014(a) change.

Professionals acting on behalf of the estate are officers of the court and fiduciaries. Failure to make disclosure of all relationships constitutes a breach of fiduciary duty to the court.[52] If the professional is a corporation "[i]t is equally apparent that in practice these fiduciary responsibilities fall not upon the inanimate corporation, but upon the officers and managing employees who must conduct the [corporation's] affairs

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[51] Rome v. Braunstein, 19 F.3d 54, 57-58 (1st Cir. 1994); In re Granite Partners, L.P., 219 B.R. 22 (Bankr. S.D.N.Y. 1998); In re Unitcast, Inc., 214 B.R. 979, 986 (Bankr. N.D.Ohio 1997). In re Tinley Plaza Associates, L.P., 142 B.R. 272 (Bankr. N.D.Ill. 1992); In re EWC Inc., 138 B.R. 276, 282 (Bankr. W.D. Okla. 1992); In re Rusty Jones, Inc., 134 B.R. 321 (Bankr. N.D.Ill. 1991); In re Diamond Mortgage Corporation of Illinois, 135 B.R. 78, 97 (Bankr. N.D.Ill. 1990).

[52] In re Sunshine Pizza Exchange, Inc., No. 385-05356-Sll, page 9 (Bankr. Dist. Or. Aug. 26, 1988); In re Roberts, 46 B.R. 815, 839 (Bankr. D.Utah 1985), aff'd in relevant party and rev'd in part, 75 B.R. 402 (D.Utah 1987).

under the surveillance of the court.[53] The professional remains a fiduciary as long as it seeks compensation from the court.[54] The court has no duty to search the file to determine for itself that a prospective professional is not involved in conflicts of interest.[55] And it behooves the applicant naught that failure to disclose arose from a good faith belief that a relationship did not cause a conflict.[56] The "decision [whether to disclose] should not be left to [the professional] whose judgment may be clouded by the benefits of the potential employment."[57] It is the court's responsibility to determine the nature of the applicant's connections, after full disclosure.

As mentioned in the discussion involving § 328(c), a minority of courts have held that if an initial conflict is disclosed after the professional has been employed, the professional's appointment is void and the court must disqualify him and order disgorgement of any compensation granted during the

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[53] Wolf v. Weinstein, 372 U.S. 633, 650 (1963).

[54] In re Coastal Equities, Inc., 39 B.R. 304, 309 (Bankr. S.D.Cal. 1984).

[55] Wolf v. Weinstein, 372 U.S. 633, 650 (1963); In re Coastal Equities, Inc., 39 B.R. 304, 309 (Bankr. S.D.Cal. 1984).

[56] In re Glenn Electric Sales Corp., 99 B.R. 596, 600 (D.N.J. 1988).

[57] Rome v. Braunstein, 19 F.3d 54, 59 (1st Cir. 1994).

time the conflict existed.[58] For the reasons stated, this court disagrees with this per se rule and will not apply it.

V. ANALYSIS

A. PRELIMINARY ISSUES OF AGENCY

Global contends, in part, that the UST and Committee's concerns about any conflict of interest it is alleged to have had are misguided as it never sought, nor has it had, any interest in QVL, and its agents entered into their individual contractual relationships with QVL after its agency agreement with Hood had expired.

A corporation can act only through its agents. No evidence has been presented to show that Messrs. Boyd, Anderson and Young have not acted as Global's agents at all times before this court. Through the activities of its agents after January 31 it held itself out as Hood's authorized representative. It is a logical inconguity for Global now to make the argument that it is not bound by the acts of its agents after January 31 while simultaneously presenting itself to the court for approval, under § 330, of a commission earned by the activities of those very

[58] In re Federated Department Stores, Inc., 44 F.3d 1310, 1320 (6th Cir. 1995); In re EWC, Inc., 138 B.R. 276, 282 (Bankr. W.D.Okla. 1992); In re Tinley Plaza Associates, L.P., 142 B.R. 272, 278 (Bankr. N.D.Ill. 1992).

agents, an important part of which took place after January 31.[59]

Under Oregon law, a principal who receives the benefit of its agent's acts is held to have ratified those acts.[60] Under bankruptcy law, once appointed under § 327(a) Global and its agents remained fiduciaries of the estate until allowance and payment of its final fee request. The fee it receives is based on the extent to which it can show that its activities, through its agents, met the fiduciary standards elaborated under §§ 327(a) and 328(c).

B. GLOBAL VIOLATED BANKRUPTCY RULE 2014(a)

Global had an initial and continuing duty, through its Rule 2014(a) verified statement, to reveal all its connections with all parties in interest.[61] Although it filed a 2014 verified statement when it applied to be appointed, it did not make all the necessary disclosures, and it filed no further statements

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[59] Global's inconsistency is highlighted by another argument it makes in support of receipt of the commission, that but for the agents' personal arrangements with QVL the sale of Hood's assets to the Dimeling group would not have closed.

[60] Bank of Oregon v. Highway Products, Inc., 598 P2d 318, 41 Or. App. 223 (Or.App. 1979). "[Oregon] law applies because the authority of an agent derives from state law . . . ."; Acton v. Merle Norman Cosmetics,Inc., 163 F.3d 605, n.3 (9th Cir. 1998) citing Mallot & Peterson v. Director, Office of Worker's Compensation Programs, 98 F.3d 1170, 1173, n.2 (9th Cir. 1996).

[61] In re Haldeman Pipe & Supply Company, 417 F.2d 1302, 1302 (9th Cir. 1969).

after its appointment although, as new connections developed, updated statements should have been filed.

Initially it failed to disclose that under its operating agreement, in place at the time of Hood's filing, it was Hood's chief operating officer. In explaining this omission Global's president, Mr. Boyd, testified that Global was given the title of chief operating officer to allow it access to the Morgan Company's financial records. He stated that despite the title, Global did not, in fact, function as an officer of the Morgan Company because "it was made very clear to [Global] at the beginning of [the] relationship with Mr. Morgan that there was only going to be one person making decisions [at the Morgan Company] and that was Jim Morgan . . . When it came to the bottom line Jim had the authority and he wasn't going to relinquish it, and he made that real clear to everybody around."

Mr. Boyd' statement reveals the primary mistake which Global made when it prepared its verified statement. It took upon itself the responsibility of deciding whether an admitted connection to a party in interest was of sufficient weight to merit disclosure. By doing so it overthrew its own required duty, that of full disclosure, and replaced it with one usurped from the court, the responsibility for determining the importance of the disclosed connections. In fact, Mr. Boyd's own testimony revealed that Global was far more than an officer in name only. It was just because of its position as "chief operating officer"

that it had access to all of Hood's financial records. In his position as both Global's president and Hood's chief operating officer, Mr. Boyd had day to day knowledge of Hood's operating position. Indeed, Global had to have been actively involved in running the company because its agent had to countersign all Morgan Company/Hood checks over $5000.

It failed to disclose that just three days before the filing it was paid $90,545 for an antecedent debt. At trial Mr. Boyd explained that he did not include this information in Global's statement because on August 7, 4 days before the filing and a day before Global was paid, he had had a discussion with Mr. Morgan and with Mr. Kennedy, Hood's attorney, during which he was assured that there was no issue of a preferential transfer because Hood was solvent.

By not disclosing this transfer Global again ignored its own duty and usurped the court's. This nondisclosure was particularly egregious in light of the fact that at the time it filed its verified statement Global had just had a conversation with Hood's principals which revealed that it was both familiar with the concept of an avoidable transfer and concerned about it.

It initially failed to disclose the connections between itself, Mr. Morgan and the law firm of DWT. The rule requires that the applicant disclose all connections with all parties in interest and <u>their respective attorneys.</u> DWT was representing it at the time of filing, it had represented it when Global signed its operating agreement with The Morgan Company, DWT was then

representing it in the Omak Wood Products Chapter 11 and in other nonbankruptcy matters, and DWT had been Mr. Morgan's counsel and would continue to represent him during Hood's bankruptcy proceeding.[62]

After Messrs. Anderson, Boyd and Young agreed to join QVL as both shareholders and employees, it immediately should have filed a supplemental 2014(a) statement with the court, providing all the details of this arrangement and disclosing that prior to closing its agents would be working for QVL. At that point, given this development, the disclosure as to Mr. Young should have included the fact that when he first approached Global his interest was not in becoming a sales agent but in finding a company in which he could have either an ownership or management interest and that he had signed a confidentiality agreement with Global indicating his interest as an acquirer of Hood's assets. Global's supplemental statement also should have revealed that during this period DWT would be representing QVL and Bogle and Gates would be representing Anderson and Young individually.

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[62] The Committee argues that because DWT wrote a letter to the UST on March 22 in which it analyzed why Global should receive its commission, DWT represented Global during the Hood bankruptcy. However, Mr. Waggoner, a member of DWT and counsel for Mr. Morgan, testified that he wrote that letter on behalf of QVL, not Global. The court believes Mr. Waggoner in part because it recognizes that QVL had economic reasons for wanting court approval of Global's commission. Messrs Boyd, Anderson and Young intended to use their share of the commission to contribute to QVL's capital account. Absent evidence to the contrary the court concludes that DWT did not represent Global in the Hood bankruptcy.

From the revelation as early as March 16 to Mr. Hamstreet and Mr. Morgan that the three agents intended to join QVL it's clear that Global did not intend to conceal this new relationship. But that is not the point. Once its agents decided to join QVL Global had a duty, under Rule 2014(a), to file with the court a full disclosure of all aspects of this new relationship. Executing this duty quickly and completely was particularly crucial in light of Dimeling's condition that the sale be approved through a plan of reorganization by June 1. The complete details of the agents' personal arrangements with QVL became available to the court and creditors in drips and drabs, some being obtained only through discovery by the Committee. Without full disclosure neither the court nor creditors had the knowledge which was necessary to thoroughly analyze all aspects of the proposed asset purchase in a timely manner.

It is irrelevant that Global may have failed in good faith to make full disclosure, either upon appointment or subsequently. It is the failure to disclose itself, not the state of mind of the nondisclosing party, which denies the court and all parties in interest the opportunity to review the connections with an eye for conflicts of interest. For this alone the court may deny compensation to Global.[63]

[63] In re Film Ventures International, Inc., 75 B.R. 250 (9th Cir. BAP 1987).

The Committee asserts that when applying for appointment initially Global had a duty under Rule 2014(a) to reveal that Mr. Young contacted Global for the primary purpose of finding a management or ownership position with another company. The court disagrees. Bankruptcy Rule 2014(a) does not require of an applicant a sweeping revelation of all facts about its business affairs. Required disclosure is limited to 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 circumstances of Mr. Young's initial business arrangement with Global do not fall within the category of required disclosures at that time.

C. GLOBAL WAS NOT DISINTERESTED WHEN APPOINTED UNDER § 327(a)

11 U.S.C. § 101(14)(D) states that a disinterested person is one that "is not and was not, within two years before the date of the filing of the petition,...an officer... of the debtor...". From February, 1997 up to the filing, Global's president, a shareholder and its agent, Mr. Boyd, was Hood's chief operating officer. For this reason alone Global was not disinterested.

11 U.S.C. § 101(14)(A) states that a disinterested person is one that is not a creditor. The definition of "creditor" in § 101(10) includes an entity "that has a claim against the estate of a kind specified in section...502(h) . . . " By inclusion of reference to § 502(h), a "creditor" includes one who holds a claim arising from recovery by the estate of property under §

550. Section 550(a) anticipates recovery by the estate of properties under a number of Code sections, including § 547.

A "creditor" must hold a "claim", which is defined, in part, under 11 U.S.C. § 101(5) as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured;". A contingent claim is one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor.[64]

Global was paid $90,545 three days before the filing on account of an antecedent debt. It's president, Mr. Boyd, thought that this payment could be vulnerable to avoidance as a preferential transfer under § 547. He was right. With assurances from Hood's attorney of Hood's solvency he may have concluded that any avoidance action brought against Global under § 547 would be unsuccessful. Yet at the time Hood filed bankruptcy Global remained exposed to the possibility of such an action.[65] This being the case, Hood's payment to Global simply changed its status from a creditor which held an undisputed, liquidated claim to a creditor which held an undisputed,

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[64] Siegel v. Federal Home Loan Mortgage Corporation, 143 F.3d 525 (9th Cir.1998; In re Sylvester, 19 B.R. 671 (9th Cir. BAP 1982).

[65] Hood's Chapter 11 history demonstrates that whether it was solvent on filing was questionable and probably unknowable. Further, 11 U.S.C. § 547(f) presumes a debtor insolvent within 90 days of its filing.

liquidated contingent claim. Its claim was contingent upon avoidance of the payment as preferential. The court concludes that at the time of Hood's filing Global was not disinterested because it was one of Hood's creditors.

Being disinterested is one of the two conditions which an applicant must meet before being appointed under § 327(a). Courts should strictly adhere to both conditions as they constitute the means of assuring that professionals offer and maintain undivided loyalty and unaffected judgment to the estate. Because it was not disinterested Global did not meet the conditions of § 327(a) for appointment to provide services on behalf of the estate.

D. GLOBAL HELD AN INTEREST ADVERSE TO THE ESTATE WHEN APPOINTED UNDER § 327(a)

The court believes that at the time of its appointment Global, having just received a potential preferential transfer from Hood, possessed an economic interest that tended to lessen the value of the estate and that created a potential dispute in which the estate would be a rival claimant. For this reason it held an interest adverse to the estate when appointed.

The court does not believe that the fact that prepetition Global had been an officer of the debtor, without more, created an interest for Global adverse to the estate <u>at that time</u> nor does it believe that the evidence presented regarding either the circumstances surrounding Mr. Young's presence at Global prior to its appointment as sales agent for Hood nor DWT's prepetition

joint representation of both Global and Mr. Morgan, without more, created an adverse interest.

E. AFTER APPOINTMENT GLOBAL DEVELOPED ADDITIONAL INTERESTS ADVERSE TO THE ESTATE

The evidence indicates that during the latter part of 1997 Global's agents developed the idea that there was an opportunity to sell more than one of the wood products businesses it was marketing to one purchaser in a roll-up. They have testified that they believed that the market at that time for such a sale was potentially better than the market for selling any one of the businesses. It goes without saying that a roll-up also would generate more than one simultaneous commission.

After Dimeling, in early December, 1997, indicated an interest in purchasing three of the companies, Global initiated steps to assure its consummation. Mr. Young was put in charge of preparing a combined company prospectus which Global sent to Dimeling on February 25 after it had obtained a second signed confidentiality agreement from it. Mr. Boyd later admitted that at the time he sought the second signed confidentiality agreement from Dimeling he had forgotten that Dimeling had signed one in December.

Global was acting without authority from Hood after January 31 and it did not communicate any information to Hood about any of its continuing activities until one phone call from Mr. Boyd to Mr. Hamstreet on February 10 of which Mr. Hamstreet has no independent recollection. Mr. Boyd testified that during

that call, for unknown reasons, he did not tell Mr. Hamstreet about the Dimeling contact although it was only a day after Mr. Boyd had placed an important call to Mr. Dimeling during which the latter indicated his continuing interest in a purchase.

Global did not send the required list to Hood of those entities which had signed confidentiality agreements with it until February 24. One of the purposes of the list was to provide Hood with the names of those entities which had signed confidentiality agreements with Global while operating as Hood's agent so that Global would be assured of receiving a commission for any ultimate sale to one of them. The list was inaccurate in that it contained the names of some entities which had not signed confidentiality agreements with Global until after January 31. Another obvious purpose for providing the list to Hood was that it would allow Hood, through another agent, to follow up on the leads generated by Global. Not receiving this list until late February put Hood and Hamstreet at a disadvantage in pursuing leads.

All of these facts suggest to the court that after the initial contact with Dimeling Global's agents, with either spoken or unspoken intention, developed and worked toward three goals: (1) to keep control of all aspects of the Dimeling opportunity;[66] (2) to assure, through that control, the ultimate purchase of the

[66] This made sense if only for the reason that it continued in its position as sales agent in the Omak Wood Products Chapter 11.

three roll-up companies; and (3) to earn the three commissions related to that purchase. Unfortunately for Hood, because Global had not informed it of any serious developments toward identifying a purchaser and its funding bank was increasingly unwilling to continue that role, on February 27 it obtained court approval of a contract for a second sales agent which committed it to payment of another commission. A little over two weeks later Global's agents met with Mr. Morgan and Mr. Hamstreet and announced that it had a likely purchaser of its assets but with conditions. First, the sale had to be part of a roll-up. Second, it had to be approved by the court through a plan of reorganization by June 1 with closing by June 15. Third, the ultimate purchaser insisted on including Messrs. Boyd, Anderson and Young in its organization and they had accepted.[67]

This situation put the estate in a very difficult position. No one, outside Global, had had any time to acquire a sense of the market for Hood's assets, either individually or as part of a roll-up,[68] and, if Hood were interested in pursuing the Dimeling offer, no one would have time to do so. No one

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[67] Interestingly, unbeknownst to everyone at that time, QVL had already obtained an attorney, Mr. Waggoner of DWT, who attended that meeting on its behalf, not on behalf of Mr. Morgan.

[68] In his deposition Mr. Anderson later stated that Global had never put a price on the assets but had stated a range in which it thought they could be sold. This range started out at from $25-30 million in August, 1997. Thereafter Hood incurred ongoing losses. One plywood mill was separately sold for $1,554,475. By February, 1998 Global thought the range was from $18-$20 million.

understood all the ramifications of Global's agents' acceptance of positions with the purchaser and might not prior to the sales' closing.

At that point the estate could be assured that its welfare was being fully heeded only if Global had been consistently providing, and would continue to provide, loyal and disinterested service to Hood as long as it was an officer of the court. The evidence later showed that, on the contrary, it was subject to significant conflicting interests. The monetary incentive to close the roll-up, alone, could have created divided loyalties. But there is no question that once the three agents became both owners and managers of QVL, Global could not act without bias against the estate. This bias could evidence itself in a number of ways.

With that decision the agents' monetary incentives to see the Dimeling deal closed increased substantially. Besides receiving the commissions, they would obtain lucrative management positions with QVL. They intended to use the commissions to partially fund their equity interests in QVL.

Mr. Boyd, having been Hood's chief operating officer, was in a position to share with Dimeling every detail of its operations while not sharing it with any other interested purchasers.

The Committee correctly points out that the price for Hood's assets could have been negatively affected by the fact that the agents' annual incentive pay from QVL, which could be

considerable and which they planned to use toward their note payments for their equity interests, would decrease QVL's income stream from the purchased assets.

Under the Asset Sale and Purchase Agreement QVL's principals must determine how much of the $1 million holdback from the purchase price it will claim for the costs of remediation. Principals of QVL include Messrs. Boyd, Anderson and Young. It is in Hood's interest that the holdback be minimal while in the interest of QVL that it be maximized.

There is other evidence of divided loyalties. Mr. Young testified that shortly after the three agents decided to join QVL he began to assist it in its due diligence. On March 23 he signed a letter sent to the Committee as President of QVL in which he conditioned the Dimeling purchase on receipt of Global's commission from the estate.

Hood's first plan of reorganization, filed with the court on January 15, 1998, before Dimeling made its purchase offer, contained no provision in which Hood waived any avoidance claims it held. Its second plan, which contained the Dimeling Asset Sale and Purchase Agreement, contained this provision. The importance of this change surfaced when it was later disclosed that Global had received a $90,545 payment for past services just three days before Hood's filing.

Dimeling's first Asset Sale and Purchase Agreement filed with the court bound it to pay Global's commission. Two weeks

later the parties amended the agreement to eliminate that commitment.

At a minimum, after its appointment Global developed an interest adverse to the estate through the conflicts created when Messrs Boyd, Anderson and Young accepted management and ownership positions in the purchaser of Hood's assets, QVL. F. REMEDY

Global argues that the sale to Dimeling would not have closed had its three agents, who had the management skills QVL needed, not accepted the offer of management and ownership in the purchaser. The sale significantly benefited the estate and Global should receive its commission.

Dimeling made its management and ownership offer to two other men besides Messrs. Boyd, Anderson and Young. These men were skilled in the wood products business and associated with Mayr and Omak. No one will know whether the roll-up sale would have closed if the three Global agents had not accepted Dimeling's offer.

There is no question that the sale benefited the estate, as well as Mr. Morgan individually, who had personally guaranteed a portion of its indebtedness. The sale proceeds paid the secured creditors, all administrative and priority claims and will pay a small portion toward the general unsecured debt.

There is also no question that Global failed to provide initial and subsequent full disclosure under Bankruptcy Rule 2014(a), was not disinterested and held an interest adverse to the estate when appointed, in violation of § 327(a), and

developed further interests adverse to the estate after being appointed, in violation of § 328(c).

Despite these Code and rule violations, applying the legal standards which this court has adopted, it has discretion, under all the facts and circumstances, to determine an appropriate allowance under § 330. Whether the fiduciary's activity has provided a benefit to the estate is only one factor which it must weigh in determining the appropriate allowance. Other factors it should consider include the extent of any failure to provide required disclosures and its potential impact on the estate, whether any failure was willful or innocent and the number and seriousness of any disqualifying conflicts.

Once a conflict has been identified, neither the court nor the interested parties to the estate need identify the extent of any damage it actually caused the estate.

> "[T]he incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent."[69]

Under all the facts and circumstances the court has determined that it must deny Global's request for allowance of

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[69] Woods v. City Nat. Bank & Trust Co. of Chicago, 312 U.S. 262, 268 (1941).

the commission arising from the sale of Hood's assets to Dimeling. Although there were several Code and rule violations which, when viewed whole, dictate this outcome, two violations cry out for more comment.

The conflict which Global developed when its agents accepted QVL's management and ownership offers was grave. It placed the estate and its creditors at an unacceptable risk that their best interests would become of secondary importance. From and after that date Global, through its agents, acted for both the buyer and the seller. The seriousness of this conflict when the estate fiduciary, as here, has purchased an interest in estate assets, is reflected by the content of 18 U.S.C. § 154.[70]

Global might argue that the broker's commission was approved, under similar facts, in In re Mehdipour.[71] The facts of that case are distinguishable. The court had no issues of nondisclosure before it. There was no question but that the broker was disinterested and held no interest adverse to the estate when its agent found the purchaser. The agent did not obtain either an ownership or employment interest in the asset. The asset sale was shown to have been for fair market value and

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[70] Under Ninth Circuit case law Global was an officer of the court. 18 U.S.C. § 154 criminalizes the activity of an officer of the court who knowingly purchases any property of the estate.

[71] 202 B.R 474 (9th Cir. BAP 1996).

resulted in payment of either all or almost all of the estate's indebtedness.

It is true that the estate has received benefit from the funds off the Dimeling sale. But this court cannot say, given the circumstances, that the estate did not suffer actual injury or prejudice because neither it nor the creditors knows whether, under the circumstances, the estate obtained the maximum value possible in the market for its assets. Further, the estate is paying Mr. Hamstreet under his own sales agency agreement. As he is also providing services as disbursing agent under the same agreement it is impossible for the court to know whether, or to what extent, the estate has incurred additional expense because of Global's failure to keep Hood fully informed of its ongoing negotiations with Dimeling.[72]

Second, it appears that Global might well have received an avoidable payment in the amount of $90,545. Failure to disclose this transfer, which Global had identified as potentially avoidable before it filed its 2014(a) statement with the court, was egregious. That there may have been an intentional attempt to assure the finality of this transfer through silence is supported by the fact that Hood's plan was changed, after the Dimeling offer was presented to the court, to waive the estate's

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[72] Any possibility that Hood may not have incurred additional expense from what appears now to be the unnecessary retention of Mr. Hamstreet as sales agent arises from no act of Global's but from Mr. Hamstreet's waiver of any fees he might otherwise have been entitled to as disbursing agent under the confirmed plan.

avoidance claims. The court does not believe was a coincidence.[73]

Although in our circuit, failure to provide full disclosure under Rule 2014(a) is in itself a basis for denial of requested fees or commissions, this court will not require Global to disgorge the commission it earned from the sale of the North Santiam Plywood Mill to Freres Lumber Company. That sale benefited the estate and Freres signed a confidentiality agreement with Global prior to January 31, 1998. Although, at the time of that sale Global was not disinterested and, being a creditor, held an interest adverse to the estate, Global had no conflict of interest as to that purchaser and had no incentive, as to that property, other than to obtain the highest and best price available for the estate.

Finally, because the estate received benefit from the Dimeling purchase and should not obtain a windfall, it should be required to reimburse Global and its agents for the direct marketing expenses incurred during the six month period it was authorized to act on Hood's behalf. Global should prepare and file with the court, with service on Hood, the UST and the

[73] The court recognizes that Hood's representatives probably played a role in this concealment as, despite knowing of the presumption of insolvency in § 547, and knowing of its lack of financial records, they insisted Hood was solvent upon filing and later agreed to the changed plan language to waive its avoidance claims.

Committee, an itemized statement of those expenses, by date incurred.

This memorandum opinion contains the court's findings of fact and conclusions of law and pursuant to Fed. R. Bankr. P. 7052, and they will not be separately stated.

Polly S. Higdon
Chief Bankruptcy Judge