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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

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In re	Chapter 11
PBA TOUR GEAR, INC., and IAMG HOLDINGS, INC., Debtors.	Case No. 802-82195-dte Case No. 802-82835-dte (Jointly Administered)

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DECISION ON MOTION BY DEBTORS DIRECTING WAXMAN & WINCOTT, P.C. TO DISGORGE ALL FEES PAID BY OR ON BEHALF OF THE DEBTORS

A p p e a r a n c e s :

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Honorable Dorothy Eisenberg
United States Bankruptcy Judge

Before the Court are (a) the Motion by IAMG Holdings, Inc. ("IAMG") and PBA Tour Gear, Inc. ("Tour Gear") (IAMG and Tour Gear referred to collectively as the "Debtors") to Direct Waxman & Wincott, P.C. ("W&W") to Disgorge Fees Paid by or on Behalf of the Debtors (the "Disgorgement Motion"); (b) W&W's Cross-Motion (1) to Approve W&W's Retention as Special Counsel to the Debtors, Effective *Nunc Pro Tunc* as of April 3, 2002, and (2) for Leave to File a Fee Application and Motion Authorizing and Fixing Attorney Compensation Received from the Debtors and/or Third Parties (the "Cross-Motion"); (c) the Debtors ' Reply to the Cross-Motion; (d) W&W's Application for Compensation and Reimbursement of Expenses and Request for a Determination of Reasonableness/Allowance of Compensation (the "Fee Application"), seeking allowance of pre-petition compensation from the Debtors in the amount of $47,132.55 and reimbursement of pre-petition expenses in the amount of $2,867.45, and allowance of post-petition compensation from third parties in the amount of $565,364.95 and reimbursement of post-petition expenses in the amount of $58,329.86, and a Memorandum of Law in Support of the Fee Application (the "W&W Memo of Law"); (e) the Objections to the Fee Application by (1) the Debtors' (the "Debtors' Objection" and the "Debtors' Memo of Law"); and (2) the United States Trustee (the "UST's Objection"); and (f) W&W's Reply to the Objections.

The Court held evidentiary hearings on September 28 and October 14, 2004 with respect to the Disgorgement Motion and the Fee Application, at which time the Court considered documentary evidence and heard testimony from five witnesses on behalf of the Debtors and only one witness on behalf of W&W. At the conclusion of these hearings, the Court permitted W&W and the Debtors to make post-hearing submissions to advance their respective causes.

This

decision constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Bank. P. 9014 and 7052.

FACTS

On April 2, 2002, Tour Gear filed a petition for Chapter 11 relief and on April 22, 2002, IAMG filed a petition for Chapter 11 relief. At their request, the Debtors' cases were subsequently procedurally consolidated and jointly administered. The petitions were both prepared and filed by W&W and signed by Ira Wincott. The actual appearance on behalf of the Debtor was made by William Weber, Esq., an attorney employee of W&W.

At the time of the filing of the petitions, the Debtors were parties to a lawsuit instigated by the Professional Bowlers Association, LLC (the "PBA") in Seattle, Washington (the "PBA Washington Litigation") seeking to terminate a license agreement between them. The filing of the bankruptcy petitions brought the litigation into the Bankruptcy Court as an adversary proceeding. The underlying issue was a disputed license agreement and its interpretation, which was fiercely contested.[1]

On April 12, 2002, W&W submitted its 2016(b) Statement disclosing that Tour Gear paid W&W $24,500 prior to the Tour Gear Filing Date in connection with the Tour Gear Chapter 11

[1]The issue of whether the License Agreement is property of the Debtors' estates was an integral part of these Chapter 11 cases and the subject of two lengthy decisions by this Court. As the parties are fully familiar with the License Agreement and the Court's interpretation of the respective rights of the Debtors and the PBA with respect thereto, the Court will not reiterate the factual findings set forth in its prior decisions, but, rather, directs any and all interested parties to the electronic docket in the adversary proceeding entitled *PBA Tour Gear, Inc. and IAMG Holdings, Inc. v. Professional Bowlers Association, LLC, et al.,* Adv. Pro. No. 802-8168-dte.

case. Additionally, Item 9 of Tour Gear's Statement of Financial Affairs states that prepetition payment to W&W was made as a loan from "IAMG.com by: Douglas Rochler." The same recital was made on behalf of IAMG in its 2016(b) statement. Obviously, IAMG.com or Douglas Rochler, non-debtors, loaned funds to the Debtors so that they could make payment to W&W for legal services performed on behalf of the Debtors. The Debtor did not file a 2016(b) Statement disclosing that W&W was also paid $25,500 in connection with its proposed role as special counsel.

On April 22, 2002, W&W submitted its 2016(b) Statement in connection with the IAMG Chapter 11 case, disclosing that W&W received no remuneration from IAMG prepetition, but that Tour Gear, a related Chapter 11 debtor, paid W&W the sum of $24,500 prior to the Tour Gear Filing Date, which sum was obtained as a loan from Douglas Rochler, the President of IAMG.com, Inc. The 2016(b) Statement further disclosed that the source of any future payments to W&W would be "PBA Tour Gear, Inc., a fully owned subsidiary"of IAMG.

By motions dated May 20 and 21, 2002, respectively Tour Gear and IAMG sought authority to retain W&W as their General Bankruptcy Counsel and Special Counsel (the "Retention Applications") pursuant to Sections 327, 328, 329 and 504 of the Bankruptcy Code and Fed. R. Bank. P. 2014 and 2016.

In support of the Retention Applications, Ira D Wincott, Esq., a partner of the firm, submitted a declaration in each of the Debtors' cases (the "Wincott Declaration"), which are substantially similar and which set forth the terms of the retention by the Debtors of W&W under a Bankruptcy Retainer Agreement and a Litigation Retainer Agreement between W&W and each of the Debtors (collectively, the "Bankruptcy Retainer Agreement" and the "Litigation

Retainer Agreement").

The declaration dated May 20, 2002, relating to Tour Gear, (the "Wincott Tour Gear Declaration") set forth the terms of the retention by the Debtors of W&W under the Bankruptcy Retainer Agreement and the Litigation Retainer Agreement. Paragraph 5 of the Wincott Tour Gear Declaration stated that W&W received from Tour Gear and placed in escrow the amount of $24,500 under the Bankruptcy Retainer Agreement for prepetition and post-petition legal services rendered on behalf of both IAMG and Tour Gear, of which $2,500 was set aside for reimbursement of expenses and the balance of $22,000 was to be applied against monthly billings for legal services rendered, subject to Court approval.

Paragraph 6 of the Wincott Tour Gear Declaration indicated that W&W had received from Tour Gear and placed in escrow $25,500 under the Litigation Retainer Agreement for payment of prepetition and post-petition litigation services rendered on behalf of both IAMG and Tour Gear, of which the sum of $7,500 was set aside for the reimbursement of expenses necessarily incurred related to an adversary proceeding to be filed on behalf of IAMG and Tour Gear against the PBA and third parties, and the balance of $18,000 would be applied against monthly billings for legal services rendered, subject to Court approval. Additionally, the Wincott Tour Gear Declaration stated that W&W was to receive a contingency fee equal to 33% of any monetary recovery in the adversary proceeding, less the $18,000 initial payment, subject to approval by the Court.

The Wincott Tour Gear Declaration also stated that Douglas Rochler, President of IAMG.com, Inc., personally guaranteed payment of out-of-pocket expenses over the $7,500 set

aside, incurred in connection with the adversary proceeding to be filed. The Wincott Tour Gear Declaration reveals that IAMG.com, Inc. Is a secured creditor of Tour Gear.

Both the United States Trustee and the PBA filed Objections to the retention of W&W as counsel to the Debtors. The gist of the United States Trustee's Objection to retention was that (a) William E. Weber, Esq., an associate of the firm, was not "disinterested," as he had been an officer, director and general counsel to Tour Gear within two years of the Tour Gear Filing Date, and that the lack of disinterestedness was imputed to W&W pursuant to the Disciplinary Rules of the New York State Bar Association Code of Professional Responsibility; (b) Weber's lack of disinterestedness constituted an appearance of a conflict of interest sufficient to require disqualification of W&W as general counsel; (c) the request by W&W for payment on a monthly basis pursuant to the terms of the Bankruptcy Retainer Agreement and the Litigation Retainer Agreement violated Sections 330 and 331 of the Bankruptcy Code; and (d) the Retainer Agreements provided for interest on legal fees, non-refundable retainer payments, withdrawal of representation without Court authorization and other provisions in conflict with the requirements of the Bankruptcy Code, Federal Rules of Bankruptcy Procedure and Local Rules of this Court.

At a Retention Hearing held on June 11, 2002, the request by the Debtors to retain W&W as general bankruptcy counsel was withdrawn and the Debtors sought only to retain W&W as special counsel to handle the adversary proceeding, the PBA Washington Litigation and the motion for relief from the automatic stay commenced by the PBA against the Debtors. At the conclusion of the Retention Hearing, the Court stated that "the debtor needs to have general

bankruptcy counsel that does not have any doubt cast on its disinterestedness," indicating that had W&W not withdrawn its application, the Court would deny its representation as general bankruptcy counsel.

In regard to the applications for retention as special litigation counsel, the Court indicated what it would and would not approve. The Court further stated that it would conditionally approve W&W's retention as special litigation counsel in regard to the PBA litigation upon the presentation of a proposed order reflecting the appropriate allowed conditions while removing the ones opposed by the United States Trustee and the Court. The Court marked the application to retain W&W as special counsel, "settled, stipulation and order to follow." The Court had contemplated that the Debtors would be represented by other general counsel in negotiating the terms of a Proposed Conditional Order to retain W&W as special counsel. However, no application for retention of general bankruptcy counsel for the Debtors was submitted to the United States Trustee or to the Court at that time. Nor did W&W submit a Proposed Conditional Order pursuant to the Court's direction regarding the retention of W&W as special counsel to the Debtors. No order retaining W&W as special counsel was ever signed by the Court.

Since a Proposed Conditional Order was never presented for signature, the Court was not aware of, nor did it approve, the terms and conditions of any retainer agreement entered into between W&W, the Debtors, and/or any third parties. Additionally, during the time period it represented the Debtors, W&W never filed an interim or final application for compensation and reimbursement of expenses in accordance with 11 U.S.C. §330 and the United States Trustee's Guidelines for Reviewing Applications for Compensation. Nor did W&W disclose any post-petition compensation arrangements with the Debtors or any third parties.

Notwithstanding that W&W was never retained as special counsel to the Debtors and never applied to this Court for an award of compensation and reimbursement of expenses, W&W did represent the Debtors for some time in the adversary proceedings pending between the Debtors and the PBA and did receive substantial sums from the Debtor and/or third parties for legal services rendered both pre and post-petition.

W&W represented that they were qualified to represent the Debtors as both general bankruptcy counsel and litigation counsel.

The Debtors had no cash with which to pay for legal counsel.

By motion dated February 12, 2003, W&W sought to be relieved as counsel to the Debtor. The Court granted W&W's motion by Order dated March 3, 2003.

On or about March 31, 2003, the Debtors retained Shaw, Licitra. Bohner, Esernio, Schwartz & Pfluger, P.C., as general counsel and Rivkin Radler, LLP as litigation counsel. Through their effort, a final settlement with the PBA was reached and all litigation was terminated.

On or about April 1, 2004, the Debtors filed the Disgorgement Motion, and on or about June 21, 2004, W&W filed the Cross-Motion seeking to be retained *nunc pro tunc.* After a hearing held on July 6, 2004, the Court found that W&W failed to comply with a number of conditions placed on the record at the Retention Hearing, which the Court had made clear must be complied with before the retention would be authorized by the Court. Primarily, the conditional order of retention would have imposed on W&W a duty to provide an application and proposed order authorizing any payments prior to accepting any payments from the Debtors or any third parties. Since W&W had already acknowledged receipt of monies without obtaining

an Order of Retention or providing any application and request to be paid for work performed on behalf of the Debtors' estate, and provided no showing of any excusable neglect, the Court denied W&W's request for *nunc pro tunc* retention as special litigation counsel. By Order dated August 6, 2004, (the "August 6th Order"), the Court found no "excusable neglect" relieving W&W from the general rule that an order of retention must be entered before any legal services are performed by an attorney on behalf of a debtor for which compensation is to be paid.

The August 6th Order also directed W&W to file an application, pursuant to the provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, so that the Court would have a basis for considering whether to award any compensation and reimbursement of expenses in connection with legal services that W&W rendered as Special Counsel to the Debtors, together with a Memorandum of Law setting forth its justification for seeking compensation and reimbursement of expenses without having been officially retained. The Fee Application and Memorandum of Law W&W filed on August 6, 2004 and the Debtors' objection and UST's objection were filed thereafter.

No application for approval of any fees was ever made to the Court.

Pursuant to the Court's direction that W&W report what fees it received and from whom, it was revealed that W&W did receive $393,266.43, in addition to the initial payments revealed in the 2016(b) statement, from IAMG.com, Inc. or Douglas Rochler, and from several other third parties, subsequent to the filing of the petition.

Principals of these third parties, some of whom were creditors of the Debtor's estate testified that they expected to be repaid by the Debtor from proceeds of the litigation, whether by settlement or judgment, even though they would not expect reimbursement if they were not

successful.

There was no agreement in writing with any third party in connection with the alleged repayment to them for money provided to W&W for legal fees and out of pocket expenses on behalf of the Debtors.

None of the witnesses considered the advances to W&W for legal fees to be a gift or a gratuitous transfer.

There was no disclosure to the Court by W&W of its arrangements with third parties as to payments made to W&W for legal fees in connection with the Debtors' bankruptcy cases.

W&W failed to disclose its relationship with the parties who were paying it for legal services to the Debtor.

ISSUES PRESENTED

The only issues before the Court at this time are whether W&W should be directed to disgorge the payments it received; whether disgorged funds, if any, are property of the Debtor's estate; and the extent to which W&W is entitled to any additional payment for services provided to the Debtor as either general bankruptcy counsel or litigation counsel.

DISCUSSION

1. Compensation to W&W Absent Order of Retention

The Bankruptcy Code provides that a debtor-in-possession may employ a professional, including an attorney, with the Bankruptcy Court's approval. 11 U.S.C. §§ 327(a), 1103(a). Further, the Bankruptcy Court cannot award interim or final compensation unless it has

authorized the attorney's employment under Sections 327 or 1103. *In re 245 Associates, LLC,* 188 B.R. 743, 749 (Bankr. S.D.N.Y. 1995). The Bankruptcy Court must, therefore, formally approve an attorney's retention ***prior to the time*** that the attorney renders services compensable to the estate. *Id.; In re Robotics Resources R2, Inc.,* 177 B.R. 61, 62 (Bankr. D. Conn. 1990); *In re Brown,* 40 B.R. 728, 730 (Bankr. D. Conn. 1984), *In re Sapolin Paints Inc.,* 38 B.R. 807, 817 (Bankr. E.D.N.Y. 1984).

In the Second Circuit, this represents a *per se* rule, and forbids allowing compensation to any professional for services rendered prior to the attorney's retention by an order of the Bankruptcy Court. *See, e.g., In re Futuronics Corp. v. Arutt, Nachamie & Benjamin (In re Futuronics, Inc.),* 655 F.2d 463, 469 (2d Cir. 1981), *cert. denied,* 455 U.S. 941, 102 S.Ct. 1435, 71 L.Ed.2d 653 (1982); *Smith v. Winthrop, Stimson, Putnam & Roberts (In re Sapphire Steamship Lines, Inc.),* 509 F.2d 1242, 1245-46 (2d Cir. 1975); *In re Progress Lektro Shave Corp.,* 117 F.2d 602, 604 (2d Cir. 1941); *In re Rogers-Pyatt Shellac Co.*, 51 F.2d 988, 991 (2d Cir. 1931).

One significant reason for the *per se* rule is that it enables the court to review attorneys' potentially disqualifying conflicts or relationships unaffected by the emotional pressure which inevitably arises in their favor after the services have been rendered. *Rogers-Pyatt,* 51 F.2d at 992; *accord, In re Northeast Dairy Co-op. Fed'n, Inc,* 74 B.R. 149, 154 (Bankr. N.D.N.Y. 1987). It is undisputed that W&W was never retained officially as either general counsel or special counsel to the Debtors.

The attorney who renders services without an order of retention has another avenue for compensation: *nunc pro tunc* retention. *245 Associates,* 188 B.R. at 750. *Nunc pro tunc*

retention circumvents the *per se* rule. Consequently, as a general rule, the Second Circuit prohibits *nunc pro tunc* retention orders, *In re Corbi,* 149 B.R. 325, 333 (Bankr. E.D.N.Y. 1993); *In re Rundlett,* 137 B.R. 144, 146 (Bankr. S.D.N.Y. 1992), unless the attorney's belated disclosure does not reveal any disqualifying connection with the case and the attorney demonstrates "excusable neglect" or "unavoidable hardship." *Rogers-Pyatt,* 51 F.2d at 992; *In re Rundlett,* 137 B.R. at 146; *Robotics Resources,* 117 B.R. at 62; *In re French*, 111 B.R. 391, 394 (Bankr. N.D.N.Y. 1989); *Northeast Dairy,* 74 B.R. at 166; *Brown*, 40 B.R. at 731.

Excusable neglect has generally been defined as the failure to timely perform a duty due to circumstances which were beyond the reasonable control of the person whose duty it was to perform, such as when a party fails to meet an obligation due to unique or extraordinary circumstances. *In re Bennett Funding Group, Inc.*, 213 B.R. 234, 242 (Bankr. N.D.N.Y. 1997). However, the United States Supreme Court had occasion to interpret the term "excusable neglect" in *Pioneer Investment Services Co. v. Brunswick Associates LP*, 507 U.S. 380, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993), as that term is used in Rule 9006(b)(1) of the Federal Rules of Bankruptcy Procedure regarding late claims. In *Pioneer*, the Supreme Court expanded the definition of "excusable neglect" to include "inadvertence, mistake, or carelessness." *Pioneer*, 507 U.S. at 388, 113 S.Ct. at 1495. In *In re 245 Associates, LLC,* 188 B.R. 743 (Bankr. S.D.N.Y.1995), the Court held that the *Pioneer* definition of excusable neglect should be applied to employment applications. *245 Assoc.*, 188 B.R. at 751; see also *In re Singson*, 41 F.3d 316, 319-20 (7th Cir.1994) (applying *Pioneer* standard to nunc pro tunc employment applications). The court found that authorization of a *nunc pro tunc* application would be allowable in cases where the applicant does not have a conflict of interest and demonstrates excusable neglect under

the more liberal *Pioneer* test. *245 Assoc.*, 188 B.R. at 752.

Here, the Court has previously determined to deny W&W's motion for *nunc pro tunc* retention as Special Counsel to the Debtors, as W&W failed to demonstrate that its failure to comply with the Court's directive to submit for signature a proposed Conditional Order of Retention was due to excusable neglect. This Court did not find circumstances beyond W&W's reasonable control or inadvertence, mistake, or carelessness. Rather, W&W wilfully chose to ignore the Court's directive and, therefore, the Court was not aware of, and did not approve, the terms and conditions of any retainer agreement entered into between W&W and the Debtors and/or any third parties. The Bankruptcy Code is clear about the need to disclose all facts in regard to the payment of fees and the relationship of the parties and to continue disclosure if and when there is a change.

Section 330 of the Bankruptcy Code explicitly provides that, after notice has been given to any parties in interest and after a hearing has been held, the Court may award reasonable compensation to the debtor's attorney for the actual and necessary services which the attorney has rendered. *In re Nana Daly's Pub, Ltd.*, 67 B.R. 782, 785-86 (Bankr. E.D.N.Y. 1986). Similarly, Section 331 of the Bankruptcy Code explicitly provides, that after notice and a hearing, the Court may award interim compensation to professionals. 11 U.S.C. § 331. The Bankruptcy Code's procedure for court approval of all legal fees paid to professionals is based on sensible and logical reasons. *Nana Daly's Pub,* 67 B.R. at 786. It gives the court an opportunity to monitor the case and control costs involved in the reorganization process, provides the creditors and other parties in interest an opportunity to be apprised of unusual expenditures, particularly those for attorneys and other professionals' fees, and to preserve

available funds wherever necessary to fund a plan of reorganization. *Nana Daly's Pub,* 67 B.R. at 786. Stated another way, the Bankruptcy Code prohibits the award of compensation to attorneys until there has been an opportunity for notice and a hearing. During the time period it represented the Debtors, from approximately April 3, 2002 until March 3, 2003, W&W never filed either an interim or final application for compensation and reimbursement of expenses in accordance with 11 U.S.C. §§ 330 or 331.

2. Prepetition Retainer Payments.

W&W seeks authority to keep the prepetition retainer payments it received as general counsel and special counsel to the Debtors.

In accordance with Section 329(a) of the Bankruptcy Code, any attorney representing a debtor in a bankruptcy case, ***whether or not such attorney applies for compensation in such case,*** must file with the Court a statement of the compensation paid or agreed to be paid for services in connection with the case, which payment or agreement was made within one year before the commencement of the bankruptcy case. *In re D.L.I.C., Inc.*, 120 B.R. 348, 349 (Bankr. S.D.N.Y. 348) (emphasis supplied). This Court has the authority to require that excessive retainers be refunded to the estate if the funds are deemed property of the Debtors' estate. Id.

The Court must decide whether the two retainers paid by Tour Gear to W&W, in the total amount of $50,000, should be regarded as property of the estate. The Court must look to New York law to determine whether the retainer fees paid prior to the commencement of these Chapter 11 cases are property of the estate. *D.L.I.C.*, 120 B.R. at 350.

> The New York State Bar Association Committee on Professional Ethics, Opinion 570 (1985) concluded that attorneys may agree with their clients to treat fee advances as client funds with the result that such funds must be deposited in a client trust account. Absent such an agreement, the New York State Bar Association Committee on Professional Ethics states that attorneys may deposit advance fee payments in their general trust accounts. *See* Brickman, *The Advance fee Payment Dilemma: Should Payments Be Deposited to the Client Trust Account or to the General Office Account*, 10 Cardozo L. Rev. 647 (1989). According to the Brickman article, along with New York, the District of Columbia, Florida, Hawaii, Illinois, Maryland and Pennsylvania conclude that retainers may be treated as advance payment of fees, belonging to the attorney when transferred. 10 Cardozo L. Rev at 655 n. 48. In such case, the client retains no interest in the retainer and it does not become property of the estate and is subject only to disclosure under 11 U.S.C. § 329. *See In re McDonald Bros. Construction, Inc.*, 114 B.R. at 1000. Therefore it is a question of fact as to whether or not a specific retainer was intended by the parties as a security retainer, which may be property of the estate, or an advance payment, which belongs to the attorney and is not property of the debtor client's estate.

D.L.I.C., 120 B.R. at 350-51. Lawyers may legally charge for their availability. *Augusta & Ross v. Trancamp Contracting Corp.*, 193 Misc.2d 781, 785, 751 N.Y.S.2d 155, 158 (Civ. Ct., Queens Co., 2002). Simply for making themselves available to a client, attorneys may recover a fee, without regard to the actual time, effort, or energy that they expend. *Id.* These types of agreements are called "general retainers" or "engagement retainers" *Levisohn, Lerner, Berger & Langsam v. Medical Taping Systems, Inc.*, 20 F. Supp. 2d 645, 651 (S.D.N.Y. 1998); *In re Sather*, 3 P.3d 403. 410 (Sup.Ct. Colo.2000) (en banc). In "general retainer" or "engagement retainer" arrangements, the lawyer is being compensated simply for his promise to be available to the client when needed. *See, e.g., Atkins & O'Brien, LLP v. ISS Int'l Serv. Sys., Inc.*, 252 A.D.2d 446, 678 N.Y.S.2d 596 (1st Dept. 1998); *Wong v. Michael Kennedy, P.C.*, 853 F. Supp. 73, 79-80 (S.D.N.Y. 1994) ("A general retainer is an agreement pursuant to which the client

agrees to pay the attorney a fixed sum in exchange for the attorney's promise to be available to perform, at an agreed price, ***any*** legal services that arise during a specified period. Because the general retainer fee is given in exchange for availability, it is a charge separate from fees incurred for services actually rendered. In other words, such fees are earned when paid because the payment is made for availability.") (emphasis in original); *Cabrera v. DeGuerin,* 1999 WL 438473 (E.D.N.Y. 1999).

A special retainer is an agreement between attorney and client pursuant to which the client contracts to pay a specified fee in exchange for specified services; the fee may be calculated on an hourly, percentage or other basis, and may be payable in advance or as billed. *Wong v. Michael Kennedy, P.C.,* 853 F. Supp. 73, 79 (S.D.N.Y. 1994), *citing* Lester Brickman and Lawrence A. Cunningham, *Nonrefundable Retainers Revisited,* 72 N.C.L.Rev. 1, 6 (1993) [hereinafter "Brickman"]. A nonrefundable retainer is a specific type of special retainer which allows an attorney to keep an advance payment regardless of whether the specified services are rendered. *Id.* at 8. It is this type of agreement that the New York Court of Appeals found invalid in *Matter of Cooperman,* 83 N.Y.S.2d 465, 611 N.Y.S.2d 466, 644 N.E.2d 1069 (1994).

Here, the intent of the parties can be ascertained from the provisions of the prepetition retainer agreements. The Bankruptcy Retainer Agreements provide that the $24,500 paid to W&W by Tour Gear is non-refundable and earned upon receipt, as W&W agrees to make itself available for representation of the Debtors in connection with their Chapter 11 cases. Notwithstanding the foregoing, the Bankruptcy Retainer Agreements also provide that the said $24,500 retainer will be credited to periodic billing. Of the $24,500 paid to W&W, $2,500 was to be placed into an escrow account maintained by W&W to be used for reimbursement of

disbursements incurred in connection with the bankruptcy proceedings.

The Court finds the Bankruptcy Retainer Agreements to be special retainer agreements since they specify the legal services to be rendered (i.e., representation in connection with the bankruptcy cases). Therefore, under *Cooperman*, the $24,500 cannot be deemed to be non-refundable and may be considered to be property of the estate.

The Litigation Retainer Agreement provides that the $25,500 paid to W&W by Tour Gear is also non-refundable and earned upon receipt, as W&W agrees to make itself available for representation of the Debtors in connection with the PBA Litigation. The Litigation Retainer Agreements also provide that although "this sum is considered by the parties to be earned upon receipt, . . . it will be credited to periodic billings." Of the $25,500 paid to W&W, $7,500 was to be placed into an escrow account maintained by W&W to be used for reimbursement of disbursements incurred in defending or prosecuting the PBA Litigation. In addition to the non-refundable retainer of $25,500, the Debtors agreed to pay to W&W a contingency fee. In calculating the Contingency Fee, the Debtors were to receive credit for any legal fees paid, including the "non-refundable" retainer fee.

The Court finds the Litigation Retainer Agreements to be special retainer agreements since they specify the legal services to be rendered (i.e., representation of the Debtors in connection with the PBA Litigation). Therefore, under *Cooperman*, the $25,500 cannot be deemed to be non-refundable and may be considered to be property of the estate.

The prepetition retainers totaling $50,000 are property of the estate pursuant to Section 541. Therefore, the Court may determine whether the payment of these retainers is excessive. Based on a review of the record as for the litigation retainer, the Court finds that W&W may

keep the entire retainer in the amount of $25,500. However, W&W may only keep $22,000 of the general retainer in connection with the preparation and filing of the Debtors' Chapter 11 petitions, and performing other general bankruptcy work between April 2, 2002 and June 11, 2002, the date of the retention hearings.

3. Fees Paid to W&W Pursuant to Postpetition Retainer.

W&W contends that notwithstanding the fact no order of retention was entered on its behalf, there are grounds for compensating W&W under Section 503 and 329 of the Bankruptcy Code. This Court has already ruled that it is impermissible to award compensation to an unretained attorney for the Debtor as an administrative expense claim pursuant to Section 503. (Tr. 9/28/04 Hrg., pp. 38-39). Courts routinely hold that authorizing attorneys like W&W to be compensated pursuant to Section 503(b)(1)(A) would contravene Congress' intention that attorneys obtain prior court approval. *In re Rheam of Ind.*, 137 B.R. 151, 162-63 (Bankr. E.D. Pa. 1992) (citing *In re F/S Airlease II, Inc., v. Simon*, 844 F.2d 99, 108-09 (3rd Cr. 1988)). The authority for granting attorneys fees a administration expenses stems from §503(b)(2), which allows "compensation and reimbursement under section 330(a) of this title." 11 U.S.C. §503(b)(2). As stated by the Second Circuit in *Cushman & Wakefield v. Keren, Ltd. Partnership. (In re Keren Ltd. Partnership.),* 189 F. 3d 86 (2d Cir. 1999):

> [Cushman & Wakefield] further contends that its brokerage commission should have been allowed as an administrative expense pursuant to 11 U.S.C. § 503(b)(1)(A). (Such expenses are given priority pursuant to 11 U.S.C. § 507(a)(1).) Section 503(b)(1)(A) requires allowance of administrative expenses including 'the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.' Section 503(b),

> however, contains a specific provision for the allowance of expenses such as brokerage commissions. That provision, ***Section 503(b)(2), permits administrative priority for 'compensation and reimbursement' to, inter alia, professionals that have received preapproval by a bankruptcy court.***

Id., 189 F.3d at 88 (emphasis supplied). Pursuant to the holding in *Keren Ltd. Partnership*, this Court is constrained from awarding any compensation to W&W pursuant to Section 503(b), since it was not retained by the Bankruptcy Court.

W&W's alternative argument is that it is entitled to compensation and reimbursement of expenses pursuant to Section 329 of the Bankruptcy Code.

Section 329 provides as follows:

> Debtor's transactions with attorneys.
>
> (a) Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.
>
> (b) If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to–
>
> (1) the estate, if the property transferred--
>
> (A) would have been property of the estate; or
> (B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title; or
>
> (2) the entity that made such payment.

11 U.S.C. § 329. Bankruptcy Rule 2016 implements Section 329. Rule 2016(b) provides as

follows:

> (b) **Disclosure of Compensation Paid or Promised to Attorney for Debtor.** Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 15 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. . . . A supplemental statement shall be filed and transmitted to the United States trustee within 15 days after any payment or agreement not previously disclosed.

Fed. R. Bankr. P. 2016(b). Thus, under Section 329 and Rule 2016(b), W&W had a continuing duty to disclose any and all retainer agreements and/or payments received from any source in payment of the Debtors' legal fees. *See, e.g., Matter of Olsen Industries, Inc.*, 222 B.R. 49 (Bankr. D. Del. 1997), *aff'd in part, rev'd in part,* 230 F.3d 1349 (3d Cir. 2000) ("Professional employed in bankruptcy case is under continuing obligation to supplement its employment disclosure statement if circumstances change.")

W&W filed a Rule 2016(b) statement along with both the Debtors' petitions, in which it disclosed that it had received from both Debtors money which had been funded as a loan by Douglas Rochler, President of IAMG.com, Inc. The schedules filed indicate IAMG.com, Inc. is a secured creditor of Tour Gear. W&W did not file supplemental Rule 2016(b) disclosure statements. Thus, W&W violated its duty under Rule 2016(b) to disclose any compensation not previously disclosed.

W&W contends it is entitled to keep the fees received postpetition pursuant to the postpetition retainer. According to W&W, Section 329(a) and Rule 2016(b) require disclosure only when fees are paid or agreed to be paid by the ***debtor***, not when received from investors or creditors**.** However, as noted in *Matter of Kero-Sun, Inc.*, 58 B.R. 770 (Bankr. D. Conn. 1986),

"the statutory language is not so limited; it requires disclosure of the '***source of such compensation***.'" *Kero-Sun,* 58 B.R. at 778 (emphasis supplied). "If Section 329(a) were intended primarily to address payments by debtors, the foregoing phrase would be superfluous." *Id. See also, In re WPMK, Inc.,* 42 B.R. 157 (Bankr. D. Hawaii 1984) ("An attorney representing a debtor should not receive payment, either directly or indirectly, from any of the creditors.") As the Court stated in *Kero-Sun:* "The doctrine in this Circuit has uniformly been to decide Bankruptcy Code and Rule disclosure violations with an inflexible standard. *Id.*, at 779-80, *citing General Motors Acceptance Corp. v. Updike (In re H.L. Stratton, Inc.),* 51 F.2d 984 (2d Cir. 1931).

With respect to the fees paid to W&W post-petition pursuant to the post-petition retainer agreements entered into among W&W, the Debtors, and third parties, W&W argues that Section 327 approval of its employment is not required when the fees are paid by third parties and do not come from funds belonging to the estate. Rather, W&W maintains that under the provisions of Section 329, it need only demonstrate to the Court that the amounts paid were not excessive under the facts and circumstances. This argument is erroneous as a matter of law and of fact.

In *In re Land,* 116 B.R. 798 (D.Colo.1990), *aff'd,* 943 F.2d 1265 (10th Cir.1991), a case in which the brother of the debtor paid the majority of attorney fees incurred in connection with a civil action that the debtor initiated against a lender, the district court found that the fees were paid from estate property, and agreed with the bankruptcy court's determination that the funds were advanced on behalf of the estate with an expectation of reimbursement. *Land,* 116 B.R. at 805. The *Land* court concluded that this "indicates, if not established, a relationship or nexus, between the source of funds and the estate. There is a link, an evident relationship, between the

funding agent and the property of the estate." *Id.* The *Land* court distinguished its decision from that in *In re Boh! Ristorante, Inc.*, 99 B.R. 971, 943 (9th Cir. BAP 1989), where the post-petition payments of the debtor's attorney fees by its principal's former spouse were found to be a "gift," and thus were excluded from its estate. Accordingly, the court ordered the attorneys to return the compensation received from debtor's family members as the appropriate remedy for its failure to obtain court approval of its employment. *See also In re Trinsey,* 121 B.R. 462 (Bankr. E.D. Pa. 1990), *rev'd on other grounds,* 43 B.R. 355 (E.D.Pa. 1992) ("Fees paid to attorneys not appointed by bankruptcy court, by third parties working with individual debtor to maintain post-petition litigation on behalf of debtor's debtor-corporation, constituted 'property of the estate,' expended 'in connection with' debtor's case, and thus attorneys were entitled to retain only reasonable value of their services, with any excess recoverable by debtor's estate; though third parties did not seek financial reimbursement from debtor, payment was not a gift, but rather was in furtherance of third parties' interest in ultimately obtaining estate property.")

As stated in *In re Trinsey*:

> Read together, *Land* and *Boh* indicate that whether a third-party payment constitutes a transfer of estate property depends on the motive of the funding agent. An expectation of reimbursement from the Debtor thus gives rise to the existence of a relationship between the funding agent and the estate property sufficiently close enough to link the fund to the estate. *See Land,* 116 B.R. at 808. In contrast, a gratuitous payment on the Debtor's behalf negates any inference of such a relationship. *See Boh,* 99 B.R. at 923.

*Id.,*121 B.R. at 467. Here, it is clear that there is a relationship or nexus between the source of funds and the estate, as required by *Land.* The payments made to W&W post-petition pursuant to the amended retainer agreements were made by third parties who had an interest in furthering

the Debtors' reorganization and protecting their interest in these bankruptcy proceedings by obtaining a recovery in the Debtors' adversary proceeding against the PBA. Indeed, a successful outcome in the adversary proceeding was the centerpiece of the chapter 11 cases.

The Court must determine whether the funds were advanced by third parties on behalf of the estate with an expectation of reimbursement, as in *Land* and *Trinsey,* or whether the advances were gifts or gratuitous transfers, as in *Boh! Ristorante,* or whether there was a waiver of reimbursement by said third-party funders.

W&W's legal fees under the non-approved and unreported Amended Retainer Agreements were funded by Infotech Concepts, Inc. ($121,500.00); Jerome Stevens Pharmaceuticals, Inc. ($20,000); Giovanni Realty, Ltd. ($81,500.00); SNTN Funding ($8,500.00); Dorothy and Nunzio James Grella ($135,766.43) and Kourosh Ashourzadeh, D.O., P.C. ($25,000). The principals of Infotech Concepts, Inc., William Forte and Robert LiPori,[2] each testified that Infotech expected to be reimbursed for the advances of legal fees from any recovery or settlement in the adversary proceeding. Mr. LiPori testified that Stanley Waxman, Esq. stated at the meeting held at the Fox Hollow Inn that if the PBA litigation was successful, the investors in the PBA litigation would get their monies back first; and if the PBA litigation was unsuccessful and there were no monies, Mr. LiPori had no expectation of getting his money back. Although Mr. Forte was not present at the Fox Hollow meeting, he testified that it was his understanding that "we had an excellent case against the PBA, and after we came to a settlement or we won the case, all the legal fees would come back first to the people that put them up." (Tr. 9/28/04 Hrg. p. 127). Mr. Giovanni Giannuzzi, the principal of Giovanni Realty, also testified

[2]Messrs. LiPori and Forte are also equity security holders of IAMG Holdings.

that he expected to get back the legal fees that he advanced to W&W plus the principal owed by the Debtors.[3] The expectation was based on listening to Mr. Weber and Mr. Wincott discuss the merits of the PBA litigation in a meeting held in the offices of W&W shortly after the Fox Hollow Inn meeting.

The Debtors, represented by new general bankruptcy counsel, sought approval for a super-priority lien on behalf of a loan to the Debtors made by Mr. Rochler by way of Order to Show Cause, dated March 21, 2003. By contrast, while the Debtors were represented only by W&W, both as purported bankruptcy counsel and litigation counsel, the third parties were providing funds to W&W pursuant to W&W's unapproved proposed retainer agreements. None of the evidence suggests that the third parties were advised that it was possible to request and obtain authority from the bankruptcy court to be repaid from the Debtors' estate for their advances to counsel in payment of legal fees.

W&W presents a scenario that would indicate that IAMG.com, a related entity, was the entity in interest in the success of Debtors' proceedings and that the payments made to W&W were from IAMG.com and were only on its behalf. There is no evidence to support this conjecture by W&W. Even if this were the case, there is no indication that the funder, whoever it was, intended the monies paid to counsel to be a gift and not to be a loan to the Debtor in order to pursue its legal remedies in the bankruptcy case. In fact, if W&W believed it was retained to benefit IAMG.com independently, W&W would have a conflict of interest since IAMG.com was the Debtor's secured creditor.

Since W&W indicated, in the petition and statement of affairs of both Debtors filed in

[3]Mr. Giannuzzi was a pre-petition creditor of the Debtors in the amount of $200,000.00. He also is an equity security holder of IAMG Holdings, Inc.

this Court, that the payment of attorney's fees was made by a third party as a loan to the Debtor, there does not appear to be any different explanation for the further advances and payments made to W&W other than as a loan on behalf of the Debtors. There is no evidence to support a finding that the third parties made a gift to W&W, although the third parties admit and acknowledge that they were advised that, in the event the litigation was not successful, they would not receive any repayment of the funds advanced. However, that does not preclude a finding that they believed and were advised that, in the event that the litigation was successful, the monies advanced on behalf of the Debtors' litigation costs would be reimbursed from the bankruptcy estates. Since the monies were not provided as a gift, no logical conclusion can be be drawn from the advance of funds by third parties other than that they were loans to the Debtors by way of payment to the Debtors' counsel, in order to pursue the litigation on behalf of the Debtors' estates.

The Court finds that the payments made by third parties to be loans to the Debtor, just as initially indicated in the original disclosure as to compensation. As such, these sums received by W&W from third parties are to be disgorged and turned over to the estate. The third parties may file claims within the Debtor's cases as to any monies claimed to be due to them.

Additionally, the Court has discretion to order disgorgement of any post-petition payments when an attorney fails to satisfy his obligations under disclosure and reporting requirements of the Bankruptcy Code and Bankruptcy Rules by failing to fully disclose the nature and circumstances of his fee arrangement with the debtor. *See, e.g., Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis),* 113 F.3d 1040 (9th Cir. 1997); *Turner v. Davis, Gillenwater & Lynch (In re Inv. Bankers, Inc.),* 4 F.3d 1556, 1565 (10th Cir.1993) ("[A]n

attorney who fails to comply with the requirements of 329 forfeits any right to receive compensation for services rendered on behalf of the debtor . . . and a court may order an attorney sua sponte to disgorge funds already paid to the attorney.") W&W contends that the fact that the post-petition payment of the Debtors' legal fees was made by third parties obviates the requirement of retention as well as disclosure. However, as stated by the Ninth Circuit in *Lewis*:

> The bankruptcy court may order the disgorgement of any payment made to an attorney representing the debtor in connection with a bankruptcy proceeding, irrespective of the payment's source. *See, e.g., In re Walters,* 868 F.2d at 668 ('[A]ny payment made to an attorney for representing a debtor in connection with a bankruptcy proceeding is reviewable by the bankruptcy court notwithstanding the source of payment.'); *In re Crimson Invs.*, 109 B.R. at 400 ('The Bankruptcy Court may order the return to the Debtor of any payment made to an attorney representing the Debtor or in connection with a bankruptcy proceeding, irrespective of the source of payment.')

Lewis, 113 F. 3d at 1046. Moreover, "[e]ven a negligent or inadvertent failure to disclose fully relevant information may result in a denial of all requested fees." *Neben & Starrett, Inc. v Chartwell Financial Corp. (In re Park-Helena Corp.),* 63 F.3d 877, 881 (9th Cir.1995). *Accord, In re Land,* 116 B.R. 798 (D. Colo. 1990), *aff'd,* 943 F.2d 1265 (10th Cir. 1991). The disclosure rules are applied literally, even if the results are sometimes harsh. *Park-Helena,* 63 F.3d at 881. A disclosure violation may result in sanctions regardless of actual harm to the estate. *Id.*

In sum, the third parties who funded the PBA litigation did not make or intend to make a gift to W&W, but instead had an expectation that they would be reimbursed from any recovery in the adversary proceeding. Consequently, W&W must disgorge the compensation it received

from third parties post-petition and return it to the Debtors' estates.

CONCLUSION

The Court has jurisdiction of this matter under 28 U.S.C. §1334 and 11 U.S.C. §§329, 330, 549 and 550. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(E). This decision contains the Court's findings of fact and conditions of law pursuant to Fed. R. Bankr. P. 7052.

The general rule is that court approval of the employment of counsel for a debtor-in-possession is the *sine qua non* to counsel getting paid. *In re Monument Auto Detail, Inc.*, 226 B.R. 219, 224 (9th Cir. BAP 1998).

Pursuant to 11 U.S.C. §329 and Fed. R. Bankr. P. 2016, attorneys representing a debtor-in-possession have a continuing duty to make disclosure of all compensation received, regardless of the source of the funds.

W&W was not retained pursuant to 11 U.S.C. §327 and did not comply with its obligations under 11 U.S.C. §329 and Fed. R. Bankr. P. 2016. Since W&W has failed to comply with the statutory requirements for retention and disclosure contained in the Bankruptcy Code and Rules, it cannot avoid the consequences by relying on the equitable doctrines of unjust enrichment and quantum meruit.

Notwithstanding the foregoing, bankruptcy courts generally have substantial discretion in fashioning sanctions, as long as they exercise that power with restraint and the sanction imposed is commensurate with the egregiousness of the conduct. *In re Downs*, F.3d 472, 479 (6th Cir. 1996).

In view of the facts that (a) initial disclosure was made regarding the payment of a

$50,000 prepetition retainer to W&W, and (b) an attempted application was made for W&W's retention *nunc pro tunc*, the Court will exercise its discretion and authorize compensation to be paid to W&W, in an amount not to exceed $22,000, in connection with the preparation and filing of both Debtors' Chapter 11 petitions, defending the PBA's motion for stay relief and performing other general bankruptcy services between the Tour Gear Filing Date (April 2, 2002) and the date of the Retention Hearing (June 11, 2002), at which time the Court denied W&W's retention as general counsel.

Consequently, W&W must disgorge the remaining portion of the prepetition retainer attributable to general bankruptcy services performed after June 11, 2002. The Court will also authorize W&W to keep the prepetition retainer in the amount of $25,500 for legal services rendered to the Debtors in connection with the adversary proceeding against the PBA.

As set forth above, in view of the fact that (a) W&W was not properly retained as special counsel to the Debtors, pursuant to 11 U.S.C. §327, to prosecute the adversary proceeding against PBA, and (b) W&W violated the provisions of 11 U.S.C. §329(a) and Fed. R. Bankr. P. 2016(b) by failing to disclose the Amended Retainer Agreement and file a statement of the compensation paid to W&W by third parties for services it rendered to the Debtors post-petition, the Court cannot authorize any additional compensation to W&W for legal services rendered to the Debtors as general counsel or as special counsel.

The Court recognizes that W&W was instrumental in obtaining an injunction that prohibited entities other than the Debtors from utilizing the PBA's logo on certain products. The injunction preserved the value of the Master License for the benefit of all of the creditors of the estates, as well as the third party funders, pending the outcome of the PBA litigation. It is

unlikely that the third parties who funded the litigation had an expectation that W&W would absorb such costs and expenses. If the Court were to forbid any reimbursement of out-of-pocket costs and expenses, the Debtors would receive a windfall to the unfair detriment of W&W. Consequently, W&W may take the appropriate steps to assert a claim for the out-of-pocket costs and expenses it incurred in connection with obtaining the injunction. A proof of claim, with the appropriate supporting documentation, must be filed within fifteen (15) days from the entry of this decision. Of course, any party in interest has the right to object to such a claim pursuant to 11 U.S.C. §502. The Court makes no determination as to the priority to be given such a claim under 11 U.S.C. §507 as that issue is not now before it.

The Debtors' attorneys shall settle an Order in accordance with this decision within seven (7) days of its entry.

Dated: Central Islip, New York
July ***5***, 2005

/s/ Dorothy Eisenberg
DOROTHY EISENBERG
UNITED STATES BANKRUPTCY JUDGE