IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
LUFKIN DIVISION

EOD
10/03/2005

IN RE:	§	
	§	
MATTHEW ALAN ALLEN and	§	Case No. 00-90046
CHERI LYNN ALLEN	§	
	§	
Debtors	§	Chapter 7

MEMORANDUM OF DECISION[1]

Before the Court is the Trustee's Motion to Approve Agreement as to the Distribution of Any and All Funds Recovered, if Any, From Cause of Action (the "9019 Motion") and the *Nunc Pro Tunc* Application to Retain Special Counsel for Trustee (the "Employment Application"), both filed by Stephen Zayler, the Chapter 7 Trustee (the "Trustee") in the above-referenced bankruptcy case. An objection to both motions was filed by Texas State Bank (the "Bank"), admittedly a creditor in this bankruptcy case, but the Bank is also the defendant in an action originally filed in the District Court of Shelby County, Texas and originally styled as *Cheri Lynn Wheeler v. Texas State Bank* under cause no. 02-CV-27644 (the "pending litigation") to which both of these contested matters relate. No other party-in-interest objected to the relief sought by the Trustee on behalf of the bankruptcy estate. This Memorandum of Decision disposes of all issues pertaining to both the Employment Application and the 9019 Motion.[2]

---

[1] This Memorandum of Decision is not designated for publication and shall not be considered as precedent, except under the respective doctrines of claim preclusion, issue preclusion, the law of the case or other evidentiary doctrines applicable to the specific parties in this proceeding.

[2] This Court has jurisdiction to consider these contested matters pursuant to 28 U.S.C. §1334(b) and 28 U.S.C. §157(a). The Court has the authority to enter a final order in these matters since each

Background

Cheri Lynn Wheeler ("Debtor") and her then-husband filed a joint petition for relief under Chapter 12 of the Bankruptcy Code on January 10, 2000. The case was subsequently converted to chapter 7 on April 3, 2001, at which time Stephen Zayler was appointed Trustee. A creditors' meeting was subsequently held in the Chapter 7 case from which the Trustee filed a report of no distribution. The Debtors received a Chapter 7 discharge on July 31, 2001.

In 2002, Wheeler commenced the pending litigation against Texas State Bank for two alleged violations of Texas usury laws (the "Assumption Usury Claim" and the "Pleading Usury Claim," respectively). It eventually came to the attention of the Trustee that, because of the timing of the alleged conduct by the Bank, the Assumption Usury Claim could constitute property of the bankruptcy estate. The Trustee filed a motion to reopen the Chapter 7 case, and the case was reopened on October 7, 2004. While the Debtor has formerly disputed the estate's claim of ownership of the Assumption Usury Claim, she and the Trustee negotiated an agreement whereby she and the Estate, who agreed to utilize the Debtor's state court attorney, Mr. Denum ("Proposed Counsel") in the prosecution of the pending litigation under the same 50% contingency fee arrangement as she had earlier negotiated, agreed to split the remaining litigation proceeds after the satisfaction of the contingent fee obligations, with the Estate receiving

---

constitutes a core proceeding as contemplated by 28 U.S.C. §157(b)(2)(A), (B), and (O).

30% of any recovery and the Debtor receiving 20% of any recovery realized. The negotiation of this agreement led to the filing of both the Employment Application and the 9019 Motion by the Trustee.[3] The Bank, ostensibly in its capacity as a creditor of the Debtor, objects to the approval of both the Employment Application and the 9019 Motion. It is the only party-in-interest to have objected to either request of the Trustee.

Discussion

The 9019 Motion

Pursuant to Fed. R. Bankr. P. 9019, a trustee must seek and gain court approval before compromising any potential claim of a bankruptcy estate.[4] The Fifth Circuit has stated that when a bankruptcy court considers the approval of an agreement under Rule 9019, it should "compare the terms of the compromise with the likely rewards of litigation." *Rivercity v. Herpel (In re Jackson Brewing Co.)*, 624 F.2d 599, 602 (5th Cir. 1980). In making that determination, the court must consider:

> (1) the probability of success in the litigation, with due consideration for the uncertainty in fact and law;

---

[3] It should also be noted that the litigation originally commenced in state court has since been removed to this Court and is currently pending as Adversary No. 04-9021.

[4] FED. R. BANKR. P. 9019(a) states that:

> On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the Untied States trustee, the debtor and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.

(2) the complexity and likely duration of the litigation and any attendant expense, inconvenience and delay, and

(3) all other factors bearing on the wisdom of the compromise.

Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (In re Cajun Elec. Power Coop., Inc.), 119 F.3d 349, 356 (5th Cir. 1997). Some "other factors" which have been identified as properly falling under the third consideration include the best interests of the creditors and the extent to which the settlement is truly a product of arms-length bargaining.[5] *Id. citing Conn. Gen. Life Ins. Co. v. United Companies Fin. Corp. (In re Foster Mortgage Corp.)*, 68 F.3d 914, 917 (5th Cir. 1996).

Applying this analytical framework to the present case, it is important to note that the analysis of the merits of the 9019 Motion does not rest upon a comparison of the terms of the compromise with the likely rewards of the pending litigation. It is instead based upon an examination of the potential benefits of the compromise to the Estate as compared to the benefits it might expect to receive from pursuing the litigation regarding the ownership of the claims asserted in the pending litigation.

The likely result of litigation between the Estate and the Debtor over the ownership of the usury claims, particularly the Assumption Usury Claim, is unclear. Indeed, the issue of ownership of property acquired by the Debtor in the period after the filing of her chapter 12 petition but before converting to chapter 7 is considerably more

[5] No party alleges that this proposed settlement is the result of anything less than an arms-length negotiation.

complex than the Bank pretends. It involves a less-than-seamless interplay between various Bankruptcy Code sections including §§103, 1207, 1226, 348 and 541. Although §1207 defines the scope of the Chapter 12 estate broadly to include claims such as the Assumption Usury Claim, which arise between the filing and the subsequent conversion of the Chapter 12 case, that section has limited application in defining the scope of a Chapter 7 bankruptcy estate, even if the Chapter 7 case is the result of a conversion from Chapter 12.[6] Thus, the likelihood of success on the merits of the Trustee's ownership claims is murky at best. That is particularly true given the particular circumstances of this case in which the bankruptcy estate's ability to obtain a result in its favor through any litigation process appears remote in light of the uncontested fact that this Estate has no assets with which to litigate the ownership issue.

While the likelihood of the Estate successfully litigating to validate its ownership of the Assumption Usury Claim appears tenuous, the likelihood of the Estate successfully asserting an interest in the Pleading Usury Claim appears almost impossible. Indeed, the Estate does not assert any ownership claim to that cause of action. Yet through the execution of this compromise, the Trustee has effectually gained an interest in both usury

---

[6] Texas State Bank cites three cases that allegedly support its position that the ownership issue is uncomplicated and that the estate clearly owns the Assumption Usury Claim. *In re J.A.V. AG. Inc.*, 154 B.R. 923, 926 (Bankr. W.D. Tex. 1993); *In re Hart*, 151 B.R. 84, 86 (Bankr. N.D. Tex. 1993); *In re Brownlee*, Bankr. S.D. Iowa 1988). Two of those cases, while supporting the Bank's position in dicta, contain facts which are inapposite. *In re J.A.V. AG. Inc.* and *In re Hart. In re Brownlee* reaches the conclusion that the Bank seeks by relying on precedent which is no longer applicable under the current version of the Bankruptcy Code. Suffice it to say that the determination of the ownership issue is not so clear as Texas State Bank has asserted.

claims and has also placed the Estate in a more favorable litigation position by aligning itself with an individual person in the prosecution of the litigation. There is clearly a strategic factor in the exercise of the Trustee's business judgment in this context which is clearly intended to enhance the viability of the Estate's claims in the pending litigation against the Bank. Thus, while the probability of success in litigating the ownership claim is unclear, the probability of success by the Estate in the underlying litigation is actually enhanced by the Trustee's decision to compromise the ownership issues.

The second *Cajun Electric* standard — the complexity and likely duration of the litigation and any attendant expense, inconvenience and delay — also militates in favor of the Trustee's decision to settle the ownership dispute. Setting aside any reasonable disagreement about the difficulty of proving the Estate's ownership claim, the evidence is clear and convincing that such ownership litigation would not in all likelihood occur at all since the Estate has no money available with which to litigate even that issue, much less the actual litigation of the underlying claims against the Bank. The Court certainly has no authority to compel the Trustee to do the necessary legal work without compensation for such legal services. He cannot be compelled to serve on a contingent fee basis and the Court agrees with the Trustee's assessment that, given the status of the pending litigation, the chances of retaining outside counsel on a contingency basis appear extremely remote.

Yet, through the agreement (and, of course, the corresponding Employment Agreement), the Estate obtains the services of a well-known and experienced attorney who is thoroughly familiar with the issues presented in the pending litigation and such

valuable services are obtained at virtually no cost to this insolvent estate. The fee arrangement is admittedly somewhat higher than in most cases but, again, there is no downside for the Estate to agree to such a percentage. The Estate is obtaining skilled counsel under circumstances which allows it to proceed expeditiously to trial in the pending litigation with virtually no risk, while avoiding the possible abandonment of the claims altogether due to the insolvent nature of the Estate. Seeing the "big picture" portrayed by the circumstances of this case, the soundness of the Trustee's business judgment regarding the costs and the risks of proceeding with the ownership litigation cannot be seriously questioned.

In considering any other issues that bear on the wisdom of the compromise, the Court must consider the best interests of the creditors of this Estate. While the settlement agreement deals only with the ownership issues and not the merits of the underlying usury claims, it seems likely that this settlement agreement improves the probability of success in the pending litigation, and that does have a bearing on the Trustee's effort to maximize the chances of a distribution to creditors in this case. The Estate's prosecution of the Assumption Usury Claim is not without some risk, but it seems likely that the compromise agreement enhances the Estate's chances to procure a recovery for the benefit of creditors. Whereas creditors were originally anticipating no recovery in this no-asset Chapter 7 case, the current developments provide the possibility of some recovery with little risk and no advanced costs. The fact that no creditor other than the usury defendant has objected to the approval of the agreement suggests that the proposed

settlement is fair and equitable to the parties which are likely to benefit from any potential recovery. While the Bank's opposition to the Motion can be dismissed as simply another legitimate means by which it has elected to pursue its litigation strategy, its opposition cannot be legitimately viewed as a balanced and reasoned view of what is in the best interests of this Estate and its other creditors.

For all of the foregoing reasons, the Court approves the Trustee's Motion to Approve Agreement as to the Distribution of Any and All funds Recovered, if Any, From Cause of Action.

The Employment Application

Professional persons are generally required to seek court approval before providing services to a bankruptcy estate. 11 U.S.C. §327. In order to obtain court approval, a professional person must not hold or represent an interest adverse to the estate. 11 U.S.C. §327(a). However, with the court's approval a trustee may employ a professional person who has previously represented the debtor if that would be in the best interest of the estate. 11 U.S.C. §327(e). The Trustee filed this *nunc pro tunc* employment application in order to meet the requirements of the Bankruptcy Code and to validate the capacity of Proposed Counsel to represent the interests of the Estate in the pending litigation. The Bank again objected to the relief, asserting that the Proposed Counsel's representation of the Debtor presents a conflict of interest with the Estate and that any approval of his employment by the Estate would be improper.

Yet any conflict of interest presented by the prior disagreement over the ownership of the usury claims has been resolved by the approval of the 9019 Motion. Because the Estate and the Debtor will now share any recovery from the pending litigation on the basis agreed upon, the fact that Proposed Counsel previously advocated the Debtor's position with regard to the ownership claims has been ameliorated and the Trustee is now seeking to approve his employment in recognition of the fact that Proposed Counsel is now free to proceed to conduct the pending litigation against the Bank with full allegiance to the Estate. With approval of the 9019 Motion, the employment authorization seems fully justified under the factual circumstances and the parameters of 11 U.S.C. §327(e).

As to whether the employment application should be approved *nunc pro tunc,* the facts of this case, as outlined above, present the "rare or exceptional circumstances" under which the legitimacy of such an approval is recognized. *Fanelli v. Hensley (In re Triangle Chemicals, Inc.)*, 697 F.2d 1280, 1289 (5th Cir. 1983).[7] The Trustee could not

---

[7] See also *Farinash v. Vergos (In re Aultman Enterprises)*, 264 B.R. 485, 491 (E.D. Tenn. 2001) which outlines other useful issues to consider in this context such as whether:

(1) the debtor, trustee or committee expressly contracted with the professional person to perform the services which were thereafter rendered;
(2) the party for whom the work was performed approves the entry of the *nunc pro tunc* order;
(3) the applicant has provided notice of the application to creditors and parties in interest and has provided an opportunity for filing objections;
(4) no creditor or party in interest offers reasonable objection to the entry of the *nunc pro tunc* order;
(5) the professional satisfied all the criteria for employment pursuant to 11 U.S.C. §327 and Rule 2[014] of the Federal Rules of Bankruptcy Procedure at or before the time services were actually commenced and remained qualified during the period for which services were provided;
(6) the work was performed properly, efficiently, and to a high standard of quality;
(7) no actual or potential prejudice will inure to the estate or other parties in interest;

have timely brought the employment application because he was not aware of the existence of the underlying claim. The Estate will clearly benefit from the prior legal services of the Proposed Counsel regarding the preparation of the suit for trial and the only concern regarding his fidelity to the Estate has now been irrevocably removed by the resolution of the ownership issues. Besides, any prior adversity between the Proposed Counsel and the Estate was not fundamental to the merits of the claims to be asserted against the usury defendant in the litigation. Further, the contingent fee arrangement will protect the Estate from prejudice by avoiding the normal consequences of a *nunc pro tunc* application — the immediate creation of an administrative expense for services rendered prior to the application — and, given the pre-trial status of the pending litigation, there is no reason to anticipate any negative ramification arising from the granting of *nunc pro tunc* treatment. No independent creditor has objected to the proposed nunc pro tunc treatment and, again, there is significant reason to suspect that the Bank's opposition is rooted more in the implementation of its litigation strategy than in any concern for the protection of the employment processes contemplated by the Bankruptcy Code. Accordingly, the Court concludes that the Employment Application should be approved and that the employment authorization should relate back to the time at which the

---

(8) the applicant's failure to seek pre-employment approval is satisfactorily explained; and
(9) the applicant exhibits no pattern of inattention or negligence in soliciting judicial approval for the employment of professionals.

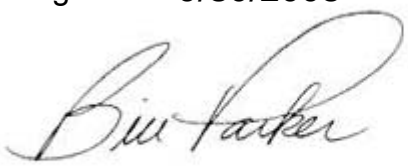
bankruptcy estate was created.[8]

Conclusion

For the reasons stated above, the Court concludes that the Trustee's Motion to Approve Agreement as to the Distribution of Any and All Funds Recovered, if Any, From Cause of Action should be granted. The Court also concludes that the *Nunc Pro Tunc* Application to Retain Special Counsel for Trustee, should be granted in part, such that the authorization for Mr. Denum's employment shall be granted on a *nunc pro tunc* basis back to April 3, 2001.

This memorandum of decision constitutes the Court's findings of fact and conclusions of law[9] pursuant to Fed. R. Civ. P. 52, as incorporated into contested matters in bankruptcy cases by Fed. R. Bankr. P. 7052 and 9014. Separate orders shall be entered consistent with this opinion.

Signed on 9/30/2005



THE HONORABLE BILL PARKER
CHIEF UNITED STATES BANKRUPTCY JUDGE

---

[8] While the Trustee has requested *nunc pro tunc* employment back to the time of the original chapter 12 filing, his authority to seek employment authorization relates back only to the date of the creation of the Chapter 7 estate — April 3, 2001.

[9] To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. To the extent any conclusion of law is construed to be a finding of fact, it is hereby adopted as such. The Court reserves the right to make additional findings and conclusions as necessary or as may be requested by any party.