

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

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U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF TX
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IN RE:

RUSSELL J. FAIRCHILD

Debtor

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Case No. 02-10536 BY _____ DEPUTY

Chapter 11

EOD

MAR 31 2003

MEMORANDUM OF DECISION¹

This matter is before the Court to consider the objection filed by John E. Stockton (“Stockton”) to the proof of claim filed by Michael Matthews (“Matthews”) in the Chapter 11 bankruptcy proceeding of the debtor, Russell J. Fairchild (“Debtor”). A hearing was held on this matter on November 18, 2002, with each party appearing and presenting evidence and argument. At the conclusion of the hearing, the Court took the matter under advisement. This memorandum of decision disposes of all issues pending before the Court in this contested matter.²

Background

The facts underlying the present dispute arise out of an unsuccessful partnership venture between Stockton and the Debtor, and the resulting disintegration of that business relationship which culminated in the filing of a lawsuit by Stockton against the Debtor pending as cause no. 60,720 before the 75th Judicial District Court of Liberty County, Texas . The Debtor

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 as to other evidentiary doctrines applicable to the specific parties in this proceeding.

² This Court has jurisdiction to consider Stockton’s claim objection 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 this contested matter since it constitutes a core proceeding as contemplated by 28 U.S.C. §157(b)(2)(A), (B), and (O).

116

subsequently sought out and retained Matthews and his law firm, Griffin & Matthews, to represent his interests in this state court litigation.

Under the initial attorneys' fee agreement between the parties,³ the Debtor was required to pay a \$20,000 retainer, plus tender payment for all attorney services at a rate of \$150 per hour. After paying the \$20,000 retainer in installments,⁴ the Debtor was unable to pay the ongoing invoices arising from the rendition of services by Matthews. Though the time for trial was fast approaching, the Debtor's inability to satisfy the mounting invoices was threatening Matthews' continued participation in the case on behalf of the Debtor. Under growing pressure to address the unpaid invoices, the Debtor inquired as to whether Matthews might be willing to continue the representation on a contingency fee basis. Matthews and the Debtor subsequently executed an Attorney's Fee Contract (hereafter, the "Contingency Fee Contract") on June 11, 2001, under which Matthews was entitled to a 50% interest in "the gross amount recovered and/or protected from Plaintiff's [Stockton's] claim."⁵ The agreement defined "the gross amount recovered" to include all "money and/or any and all in kind property recovered and/or awarded client [the Debtor] as partnership property or client's property. This specifically shall mean, without limitation, any and all property interest client has remaining or is awarded at the conclusion of this claim." *Id.*

³ Matthews testified that this original fee agreement was an oral contract.

⁴ Matthews testified that the Debtor initially paid \$5,000, and then later paid the remaining \$15,000 due under the retainer. At the time the Debtor paid the remaining \$15,000, Matthews and his firm were owed substantially more than \$20,000.

⁵ See Matthews' Ex. D-G, ¶5.

The state court litigation did not produce a favorable result for the Debtor. The jury verdict awarded Stockton a net sum of \$645,025.57 based upon imbalanced capital contributions into the partnership, additional actual damages of \$7,500, attorneys' fees, and accrued interest. After the jury verdict was entered in early November, 2001, the Debtor, in an effort to satisfy the contingent fee agreement, apparently deeded to Matthews all of his right, title and interest to a certain piece of real property located in Moss Hill, Texas (the "Moss Hill Property") which had not been directly at issue in the state court litigation.⁶

Almost immediately thereafter, the parties suddenly decided to reverse the transaction. In a purported effort to accommodate the Debtor's desire to repurchase the property,⁷ Matthews executed a warranty deed with vendor's lien which transferred title to the Moss Hill Property back to the Debtor, in exchange for the Debtor's execution of a six-year \$166,000 promissory note and a deed of trust dated November 5, 2001, to secure the payment of the promissory note.⁸ Along with the note and deed of trust, the Debtor also executed a security agreement and a UCC-1 financing statement giving Matthews a security interest in "all of the Debtor's interest in all livestock . . . now owned or hereafter acquired."⁹

⁶ The Court utilizes the word "apparently" here because no deed from the Debtor to Matthews was ever introduced to the Court, despite testimony regarding such deed.

⁷ There was no testimony regarding when the Debtor first contemplated a bankruptcy filing. It could be completely coincidental that the Moss Hill transfer to Matthews clearly constituted an avoidable transfer and that the reconveyance of the property to the Debtor and the concurrent execution of a note and security documents for Matthews' benefit repositioned Matthews as the holder of an allowed secured claim at the start of the bankruptcy case vis-a-vis the large, unsecured claim which Stockton would undoubtedly file in the case.

⁸ See Matthews' Ex. D-A, D-B, and D-E.

⁹ See Matthews' Ex. D-C and D-D.

Less than ninety days after that re-transfer of the property, on January 23, 2002, the Debtor filed his voluntary petition for relief under Chapter 11 in this Court. On June 19, 2002, Matthews filed Claim #15 in the amount of \$166,000 as a secured claim collateralized by the Moss Hill Property. On August 30, 2002, Stockton filed his objection to that claim, alleging, among other grounds, that the fee agreement between the Debtor and Matthews was unreasonable and unsupported by adequate consideration.

Discussion

A proof of claim, if it is executed and filed in accordance with the Federal Rules of Bankruptcy Procedure, constitutes *prima facie* evidence of the validity and amount of that claim, FED. R. BANKR. P. 3001(f), and is deemed allowed unless a party in interest objects under 11 U.S.C. §502(a). A proof of claim, however, does not qualify for that *prima facie* evidentiary effect if it is not executed and filed in accordance with the Bankruptcy Rules. *See First Nat'l Bank of Fayetteville v. Circle J. Dairy (In re Circle J Dairy, Inc.)*, 112 B.R. 297, 300 (W.D. Ark. 1989). Rule 3001 generally sets forth the requirements for filing a proof of claim, and one of those requirements states that:

when a claim . . . is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim.

FED. R. BANKR. P. 3001(c).

Likewise, if a creditor claims a security interest in property of the debtor, Rule 3001(d) requires the creditor to accompany his proof of claim with evidence that the creditor perfected a security interest.

Hence, the burden of persuasion under the bankruptcy claims procedure always lies with the claimant, who must comply with FED. R. BANKR. P. 3001 by alleging facts in the proof of claim that are sufficient to support the claim. If the claimant satisfies these requirements, the burden of going forward with the evidence then shifts to the objecting party to produce evidence at least equal in probative force to that offered by the proof of claim and which, if believed, would refute at least one of the allegations that is essential to the claim's legal sufficiency. See *Lundell v. Anchor Const. Specialists, Inc. (In re Lundell)*, 223 F.3d 1035, 1041 (9th Cir. 2000); *Sherman v. Novak (In re Reilly)*, 245 B.R. 768, 773 (B.A.P. 2^d Cir. 2000). This can be done by the objecting party producing specific and detailed allegations that place the claim into dispute, see *In re Lenz*, 110 B.R. 523, 525 (D. Colo. 1990); by the presentation of legal arguments based upon the contents of the claim and its supporting documents, see *In re Circle J Dairy*, 112 B.R. at 300; or by the presentation of pretrial pleadings, such as a motion for summary judgment, in which evidence is presented to bring the validity of the claim into question, see *In re Frontier Airlines, Inc.*, 112 B.R. 395, 399-400 (D. Colo. 1990). If the objecting party meets these evidentiary requirements, then the burden of going forward with the evidence shifts back to the claimant to sustain its ultimate burden of persuasion to establish the validity and amount of the claim by a preponderance of the evidence. See *In re Consumers Realty & Development Co.*, 238 B.R. 418 (B.A.P. 8th Cir. 1999); *In re Alleghany International, Inc.*, 954 F.2d 167, 173-74 (3^d Cir. 1992).

With respect to claim #15, Matthews failed to comply with the general requirements of Rule 3001 because he failed to attach sufficient documentation in support of its \$160,000.00

claim.¹⁰ This deficiency, however, does not cause claim #15 to be disallowed; rather, it is merely deprived of any *prima facie* validity which it could have otherwise obtained. *See In re Los Angeles Int'l Airport Hotel Assoc.*, 196 B.R. 134, 139 (B.A.P. 9th Cir. 1996). Accordingly, the burden of going forward with the evidence never shifted to Stockton at the hearing and, without the benefit of any presumption, Matthews bears the sole burden of establishing the validity of its \$166,000 claim by a preponderance of the evidence.

In attempting to prove the validity of his claim, Matthews submitted the following documents into evidence:

- (a) **Ex. D-A** — Warranty Deed with Vendor's Lien conveying the subject property from Matthews, grantor, to the Debtor as grantee. In this warranty deed, Matthews specifically reserves a vendor's lien.
- (b) **Ex. D-B** — Deed of Trust from the Debtor, grantor, to Bill Richey, Trustee (also indicating that Matthews is the lender or beneficiary).
- (c) **Ex. D-C** — Security Agreement whereby the Debtor grants to Matthews a security interest in his cattle as further security for a promissory note of \$166,000.
- (d) **Ex. D-D** — Financing Statement evidencing that Matthews filed his security agreement with the county clerk in Liberty County, Texas.

¹⁰ Matthews attached three documents to his Claim #15:

- (1) the first page of a Deed of Trust granted from the Debtor to Matthews;
- (2) a Security Agreement granted by the Debtor to Matthews in "[a]ll of the Debtor's interest in all livestock of every kind," allegedly executed to secure the Debtor's \$166,000 obligation under the promissory note; and
- (3) a Financing Statement reflecting that the Security Agreement has been filed for record with the County Clerk in Liberty County.

The cumulative effect of these documents, however, does not establish the amount of the debt allegedly owed to Matthews. Only the first page of the Deed of Trust was attached and it references a promissory note for \$166,000, but offers no proof of the same. The other two documents establish only that Matthews has been given a security interest in the Debtor's cattle to secure the undisclosed note. Such documents do not establish the existence of a debt. Thus, the documents attached to Matthews' claim are insufficient to prove the amount of the claim and, accordingly, Claim #15 is not entitled to any presumption of validity.

- (e) **Ex. D-E** — Promissory Note evidencing that the Debtor owes and promises to pay \$166,000 to Matthews. The promissory note states that it is secured by (1) a vendor's lien retained in the Warranty Deed from Matthews to the Debtor, (2) a Deed of Trust from the Debtor to Bill Richey, Trustee (and indicating that the lender/beneficiary is Matthews), and (3) a security interest in the Debtor's cattle.
- (f) **Ex. D-F** — a notice from the Court which fails to list either Matthews or the law firm of Griffin & Matthews as parties entitled to receive notice.
- (g) **Ex. D-G** — the contingency fee contract entered into between the Debtor and Matthews.

Those documents, together with the testimony presented, fail to establish by a preponderance of the evidence that Matthews is entitled to a \$166,000 claim against this Estate.

First of all, it is well established that an attorney is not entitled to recover a contingent fee, as stipulated by a contract, unless the contingency occurs. *Lee v. Cherry*, 812 S.W.2d 361 (Tex. App. – Houston [14th Dist.] 1991, writ denied); *In re Willis*, 143 B.R. 428, 431-32 (Bankr. E.D. Tex. 1992) and cases cited therein. As the Fifth Circuit has recognized in construing contingent fees under Texas law:

Although it is unclear what constitutes the defining moment at which the contingency occurs, *compare Lee*, 812 S.W.2d at 363 (contingency occurs after "reduction to judgment") *with White*, 371 S.W.2d at 600 (contingency occurs after "prosecuting or defending to final judgment all suits") *and Carroll*, 168 S.W.2d at 240, 242 (contingency occurs after "successful termination of the litigation"), we believe that at minimum, the contingency cannot occur before judgment is affirmed on appeal or when the time for filing an appeal has lapsed.

Marre v. U.S., 117 F.3d 297, 308, n. 19 (5th Cir. 1997).

In the present case, it is uncontested that the judgment issued by the state court in Liberty County is still subject to the Debtor's appellate rights. At the time of the claims hearing, the Debtor had

preserved his right to present a motion for new trial and, in the absence of the granting of a new trial by the district court, the likelihood of an appeal seems certain. Certainly the time for filing an appeal has not lapsed. It further appears as if Matthews still has considerable services which he has yet to render under the contract. Thus, under applicable precedent, it would seem that the contingent fee contract remains executory in nature and that any fee claim arising therefrom remains a contingent claim because the contingency upon which it is based has not yet occurred. *Willis*, 143 B.R. at 432.

Secondly, even if Matthews is correct that the fee claim is no longer executory due to the entry of the judgment, he is precluded from recovering any sums from this estate due to the plain and unambiguous language of the contingent fee contract. Paragraph 7 of the contingent fee contract between the parties states that “[i]f Attorney fails to make settlement *or to win a favorable verdict*, Client shall not be required to pay for the legal services of Attorney, except for the actual expenses as outlined above.” *See* Matthews’ Ex. D-G (emphasis added). There was no settlement and the judgment entered by the Liberty County District Court, awarding a net recovery of \$645,025.57 to Stockton against the Debtor, can hardly be considered a “favorable verdict.”¹¹ This was acknowledged at the hearing by Matthews in the following discourse:

Durkay — “Now, in fact, the jury verdict was a disappointment, correct?”

Matthews — “Oh sure. To . . . I think you’re talking about to me?”

Durkay — “Yes.”

Matthews — “Sure, yes.”

Durkay — “And to Mr. Fairchild?”

Matthews — “Yes.”

¹¹ The Final Judgment in the State Court Litigation awarded a net recovery of \$437,525.57 to Stockton, which was to first be satisfied out of the sale of the partnership assets, plus \$200,000 in attorneys’ fees and a specific damages award of \$7,500.

Again, the happening of the contingency specified in a contingent fee contract is a condition precedent to the right of an attorney to recover for his services and the precise event which was contemplated must happen. *See, e.g., Carroll v. Hunt*, 140 Tex. 424, 428, 168 S.W.2d 238, 239-40 (Tex. Comm'n App. 1943, judgment adopted); *see also, Butler v. King*, 91 S.W.2d 862 (Tex. Civ. App. – El Paso 1936, no writ); 7A C.J.S. *Attorney & Client* § 321 (2002) and cases cited therein. This is not an unjust result for Matthews because he and his firm voluntarily agreed to represent this Debtor on a contingency fee basis, and therefore they chose to assume the risk of unsuccessful litigation and consequent non-payment if the designated contingency event never occurred. *See Gisbrecht v. Barnhart*, 535 U.S. 789, 122 S.Ct. 1817, 1829, 152 L.Ed.2d 996 (2002) [“It is in the nature of a contingent-fee agreement to *gamble* on outcome and hours of work — *assigning the risk of an unsuccessful outcome to the attorney*, in exchange for a percentage of the recovery from a successful outcome that will (because of the risk of loss the attorney has borne) be higher, and perhaps much higher, than what the attorney would receive in hourly billing for the same case.”] (Scalia, J., dissenting) (second emphasis added). Thus, even if the contract is deemed to have been fully performed by Matthews, he is not entitled to any recovery of attorney’s fees under its precise terms because the designated contingency event has never occurred.

Finally, under the assumption that the claim has matured, Matthews has failed to demonstrate that he “recovered and/or protected” property of the Debtor equivalent to an amount of \$332,000 which would be necessary to create a fee award of \$166,000 under the contingent fee contract. While the state court judgment clearly awards several pieces of property to the Stockton-Fairchild Partnership, and such items are clearly defined in the contingent fee contract

so as to be included within the definition of the “gross amount recovered,” Matthews failed to introduce any evidence regarding the value of any of these partnership properties; nor did Matthews or the Debtor testify as to the value of any property awarded to the Debtor individually. Clearly the Court is precluded from assigning an arbitrary value to these items.

Further, to the extent that the Moss Hill Property was used to calculate the amount, Matthews has failed to demonstrate by a preponderance of the evidence that the Moss Hill Property was at risk in the state court litigation and thus can be legitimately used as a basis for calculating the earned fee. At the hearing before this Court, Matthews was specifically asked whether, in his opinion, the Contingency Fee Contract granted him 50% of whatever property the Debtor owned following the entry of judgment in the state court litigation, or whether the scope of the contract was limited to 50% of the property sought by Stockton, but successfully resisted and thereby awarded to or retained by the Debtor following the state court judgment.¹² Matthews

¹² As evidenced by this question from Stockton’s counsel to Matthews, there appears to be an ambiguity in the Contingency Fee Contract in Paragraph 5, which initially states that the contingent fee shall be computed “on the basis of the gross amount recovered and/or protected *from Plaintiff’s claim.*” *See* Matthews’ Ex. D-G (emphasis added). The “gross amount recovered” is then defined as all “money and/or . . . property recovered and/or awarded client as partnership property or client’s property.” These two provisions indicate that the contingency fee will be determined based only upon the value of money or property that (a) belongs to either the Debtor or the Stockton-Fairchild Partnership following the state court judgment, and (b) that was at risk in the State Court Litigation. However, the next sentence in Paragraph 5 seems to indicate that Matthews is entitled to 50% of whatever property interest the Debtor retains after the State Court Litigation, even though such property was never sought by Stockton nor at risk during the State Court Litigation. *See Id.* [“This specifically shall mean, without limitation, any and all property interest client *has remaining* or is awarded at the conclusion of this claim.”] (emphasis added). Accordingly, because “the express wording is subject to two or more reasonable interpretations, the contract is ambiguous.” *Fox v. Parker*, 2003 WL 132424, at *3 (Tex. App. — Waco January 15, 2003, no pet.); *see also National Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983). To solve that ambiguity, the Court must determine the true intentions of the parties, *Coker*, 650 S.W.2d at 393, and parol evidence may be introduced to discern the parties’ intent. *See CBI Indus.*, 907 S.W.2d at 520; *Lake Charles Harbor and Terminal Dist. v. Board of Trustees of Galveston Wharves*, 62 S.W.3d 237, 243 (Tex. App. — Houston [14th Dist.] 2001, pet. denied) [“Only where a contract is first determined to be ambiguous may the courts consider the parties’ interpretation and admit extraneous evidence to determine the true meaning of the

answered that the contract entitled him to receive 50% of any property that the Debtor retained after the state court judgment, *provided* that Stockton was seeking that property in the state court litigation. It is clear that the final judgment entered in the state court litigation is silent with respect to the disposition of the Moss Hill Property, and Matthews failed to introduce any evidence demonstrating that the Moss Hill Property was being sought by Stockton's state court action. Thus, even under Matthews' own interpretation of the fee contract, the Moss Hill Property would be excluded from any calculation of the earned fee. Further, even if the Moss Hill Property could be utilized for such calculation, Matthews again failed, as he did with the other referenced properties, to introduce any evidence regarding the value of the Moss Hill Property. Thus, whether upon principles of sheer relevancy or due to the insufficiency of evidence regarding its value, the retention of the Moss Hill Property by the Debtor does not establish Matthews' entitlement to a \$166,000 fee.

In fact, the only evidence establishing the \$166,000 amount in any respect is the recitation of that amount in the promissory note signed by the Debtor.¹³ While the promissory note constitutes some evidence to establish the asserted claim amount, it is insufficient, in the face of an objection, to establish that amount by a preponderance of the evidence pursuant to the contractual formula upon which it is supposedly based. Without specific testimony regarding the value of the properties upon which the contingent fee is to be calculated, the Court is unable to conclude that Matthews "recovered and/or protected" any specified amount of property during

instrument."]. Therefore, it is appropriate for the Court to consider Matthews' testimony regarding his interpretation of the Contingency Fee Contract.

¹³ See Matthews' Ex. D-E. This amount is transposed into the security documents executed contemporaneously with the promissory note. See Matthews' Ex. D-A, D-B, and D-C.

the state court litigation with Stockton, much less that \$332,000 of property was recovered or protected for the benefit of the Debtor which would engender a \$166,000 fee under the terms of the contingent fee contract.

Accordingly, for the reasons expressed herein, the Court finds that Matthews has failed to satisfy his burden of establishing, by a preponderance of the evidence, the amount and validity of his \$166,000 proof of claim against this estate. Consequently, the objection filed by John E. Stockton to that claim must be sustained and Claim #15 filed by Michael Matthews is hereby denied in its entirety.¹⁴

This memorandum of decision constitutes the Court's findings of fact and conclusions of law¹⁵ pursuant to Fed. R. Civ. P. 52, as incorporated into contested matters in bankruptcy cases by Fed. R. Bankr. P. 7052 and 9014. A separate order will be entered which is consistent with this memorandum.

SIGNED: MAR 31 2003



BILL PARKER
UNITED STATES BANKRUPTCY JUDGE

cc: **John Durkay, Atty. for John Stockton**
Don Martin, Atty. for Michael Matthews

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¹⁴ Stockton proffered other arguments regarding the propriety of Claim #15, including the argument that Matthews was legally precluded from any claim allowance because the Contingency Fee Agreement was per se unreasonable. *See Archer v. Griffith*, 390 S.W.2d 735, 739 (Tex. 1965). Because of the Court's conclusion that the claimant failed to sustain his burden of proof, the Court need not reach the alternative arguments and objections raised by Stockton.

¹⁵ 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.

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CHASHA BAKER TRAYLOR

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS

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FACSIMILE TRANSMITTAL

March 31, 2003

To: John Durkay 409-838-5177
Don Martin 409-832-1000

Re: Fairchild 02-10536

NO. OF PAGES: 13 (inc cover sheet)

COMMENTS:

Memorandum of Decision.