# In the United States Bankruptcy Court

## for the Northern District of Iowa

| | |
|---|---|
| LOWELL E. INDVIK and<br>MELVA INDVIK | Bankruptcy No. X88-01247M |
| *Debtor(s).* | Chapter 7 |
| ELDON INDVIK | Bankruptcy No. X88-01246M |
| *Debtor.* | Chapter 7 |

## ORDER RE: EXAMINATION OF ATTORNEYS' FEES

The matters pending are proceedings for the examination of fees paid by debtors to the law firm of Arens & Alexander. At the hearing on April 5, 1990, the court ordered the hearing bifurcated. On April 5, evidence was introduced on two issues: (1) whether a $50,000.00 retainer fee paid to Arens & Alexander was in any part compensation under 11 U.S.C. § 328, and (2) whether the retainer may be examined by the court under 11 U.S.C. § 329 as a fee paid to the firm in contemplation of bankruptcy. These issues have now been submitted for the court's consideration. If the court determines that it may examine the retainer under § 328 or § 329, then further hearing will be necessary to determine whether such fee should be limited under § 328(a) and (c) or § 329(b). If it is determined that the retainer fee paid may not be examined under §§ 328 or 329, further hearing will not be necessary.

This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). The court, having considered the evidence and arguments, now issues these findings of fact and conclusions of law as required by Bankr. R. 7052.

### FINDINGS OF FACT

In 1987, Lowell and Melva Indvik were debtors-in-possession in a chapter 12 case pending in this court identified as case no. 87-00264M. Lowell's brother, Eldon, was then a debtor-in-possession in a chapter 12 case identified as 87-00268M. On November 13, 1987, the three Indviks were in Fayetteville, Arkansas, visiting with John Arens, senior partner of the law firm of Arens & Alexander (the FIRM). The law firm specializes primarily in litigation but it also represents debtors in bankruptcy cases. Bankruptcy representation is normally provided for already existing clients. The Indviks had first encountered Arens at a seminar in Clear Lake, Iowa. Arens made a presentation on financial and legal problems facing farmers. He also discussed solutions, although there was no evidence that bankruptcy was mentioned as one solution. The Indviks traveled to Arkansas to discuss with Arens the prospect of representing them in their legal difficulties.

At the time, motions to dismiss were pending in their bankruptcy cases. The motions were grounded on the debtors' failures to file plans of reorganization within time limits set by the court. Arens recommended to the Indviks that they not resist the dismissals. Arens told the Indviks it would be

better if they were not in bankruptcy, and he suggested that Indviks pursue non-bankruptcy solutions to their financial problems.

It was agreed that Arens would represent the three Indviks. At the November 13 meeting, Arens composed a retention letter addressed to himself which was then signed by the Indviks. The letter was prepared in accordance with the law firm's format for such letters. The complete text of the letter is as follows:

> We wish to retain you and your firm to represent us in litigation with the John Hancock Insurance Co., Forest City Bank and Trust, Production Credit Association, Farmers Home Administration and Forest City Elevator. In that connection, we agree to pay a non-refundable retainer of Fifty Thousand Dollars ($50,000) and have this date paid you Forty Two Thousand, Five Hundred Forty Dollars and Forty-eight Cents ($42,540.48) and will pay the remaining balance as soon as possible. These funds are not from the sale of any secured property and are free of all liens. It is understood that you will fully litigate and that no additional dollars, other than the full retainer, will be required of us except other local counsel and our expenses.
>
> We further understand that if any recovery is made over and above our debt after return of our expenses, including the above retainer and your firm's expenses, that we will then receive sixty percent (60%) and your firm will receive forty percent (40%).

The $50,000.00 non-refundable retainer was transferred to Arens in two payments. The first was on the date of the meeting in the amount of $42,540.48. The second, in the amount of $7,459.52, was paid to Arens on December 22, 1987.

The chapter 12 cases were dismissed by the court on January 19, 1989. Neither Arens nor his firm had appeared in the dismissed chapter 12 cases. In the Indviks' discussions with Arens on November 13, plans to file subsequent bankruptcies were not discussed. Bankruptcy as a general solution to the Indviks problems also was not discussed. However, Arens did tell Indviks that if the trustees' motions to dismiss were granted, there would be no time bar to the Indviks in filing subsequent bankruptcies. The Indviks were unanimous in their respective testimonies that Arens wanted them out of bankruptcy. Melva Indvik testified that at the time of the dismissal of the chapter 12 cases, the Indviks did not know what the future held, and did not intend further bankruptcy filings. Furthermore, they did not know what Arens would do to represent them in resolving the matters entrusted to him.

Although the firm had been retained by the Indviks, Arens instructed his staff not to do any substantive work on the files until the bankruptcies had been dismissed. Time records reveal that other than some phone calls, a review of documents, and research, little work was done on the files until after the dismissals.

Arens believed that the primary matter which would engage the firm's attentions was the Indviks' claims against Forest City Bank & Trust. The Indviks had filed a lawsuit, acting pro se, which was then pending. The law firm intended to continue with this suit but amended it to state more sophisticated theories of lender liability. It was the Indviks' and the law firm's hope that not only would the suit prevent a recovery by bank from the Indviks, but would result in an affirmative recovery by the Indviks. The possibility of affirmative recovery was covered by the retention letter.

With regard to the representation of the Indviks as to other creditors, various plans were devised. As to the claims of Production Credit Association and Farmers Home Administration, it was Arens' belief

that the Indviks should consider restructuring efforts under federal law. Arens also discussed remedies against FmHA under the Federal Tort Claims Act. However, Arens felt disputes with FMHA could be resolved short of litigation. John Hancock Insurance Co. was foreclosing its mortgage on Indvik property which was the homestead of either Lowell and Melva or Eldon. Arens believed that because John Hancock was a passive lender, there was little in the way of a defense that the Indviks could assert. Discussions revolved primarily around debtors' purchase of the homestead at sheriff's sale. This strategy resulted from the law firm's statutory research on Iowa homestead and mortgage foreclosure law.

Arens wanted to deal with the Indviks' creditors outside of bankruptcy. He told the Indviks he would not handle their problems if they were involved in bankruptcy. At the time of the retention letter, the Indviks were also indebted to creditors other than those previously mentioned.

Arens testified that there was no agreement regarding the firm's scope of employment outside of the retention letter. Arens said that under the retention letter his firm had no obligation to file bankruptcy cases for the Indviks and at the time of the retention there was no intent to file any such cases. Arens testified that the scope of his firm's employment was discussed in the letter of retention and that the firm was retained to litigate with those creditors listed in the letter.

Lowell Indvik's understanding of the scope of representation was somewhat more general. He believed that for the retainer fee, Arens would take care of the Indviks "in general" by doing whatever was necessary to save the farm and get things "on the right track." Lowell Indviks' understanding of the words "fully litigate" as used in the retention letter was that Arens would take care of the Indviks' problems. To "take care of" meant to do whatever necessary, including bankruptcy. However, Lowell Indvik was not able to testify that a bankruptcy filing was discussed between the Indviks and Arens.

Eldon Indvik believed that the retention agreement obligated the firm to handle all of the Indviks' problems and take care of lawsuits, bankruptcy, or "whatever." Lowell Indvik also thought that the fee agreement provided for such representation and was without limitation as to the time period in which such problems arose.

Melva Indvik's understanding of the term "fully litigate" as contained in the retention letter was for the firm to work with the creditors to make a settlement; she understands "litigate" to mean when you bring an action against them. When the present chapter 12 bankruptcies were later filed, she believed that the retainer covered them. However, when she signed the letter of retention, she had no thought as to whether the $50,000.00 retainer would cover an eventual bankruptcy and had no thought about filing a later bankruptcy.

The law firm's efforts on behalf of the Indviks in the plan originally contemplated by Arens were not fully successful or complete, although settlements were worked out with some creditors. Two events took place which prevented the Indviks from resolving all matters completely. First and foremost, Forest City Bank & Trust failed and its assets were taken over by the Federal Deposit Insurance Corporation (FDIC). Research by Arens firm indicated that claims against Forest City Bank & Trust were not recoverable from FDIC absent certain limited circumstances which Arens did not believe existed in the Indviks' case. The centerpiece of Arens' litigation strategy had, therefore, crumbled. The second event was the financial inability of the Indviks to purchase their homestead at the sheriff's sale which was conducted as part of the John Hancock Insurance Co. foreclosure. It was initially believed that the Indviks would obtain sufficient funds from an inheritance to purchase a 40-acre homestead at the sheriff's sale.

Terry Zelinski, an attorney with the law firm, worked on both the Indviks' claims against the Forest City Bank and on the eventual bankruptcy. Ms. Zelinski also conducted the original intake interview" with the Indviks to learn about their particular circumstances. Ms. Zelinski first discussed bankruptcy with the Indviks in early August, 1988 after it was learned that the Indviks would have insufficient funds to purchase part of the property foreclosed on by John Hancock. Arens was still against the decision to file bankruptcy, but other members of the firm convinced him it should be done.

Ms. Zelinski said it was hoped even then to avoid bankruptcy provided the Indviks' obtained a loan to make the homestead purchase. However, the Indviks were not able to obtain one. The present bankruptcy petitions were filed on August 17, 1988 accompanied by disclosure of compensation forms. These forms were filed in each case and were signed by David G. Nixon of the Arens & Alexander firm as well as by Indviks' Iowa counsel. The disclosures were identical and stated:

> The undersigned states that he is attorney for the debtor and that the total compensation paid or promised (if such payment or agreement was made after one year before the date of the filing of the petition in this case) for services rendered or to be rendered in this case is as follows:
>
> Paid: -0-
>
> Promised: Hourly Fees & Expenses
>
> Total: Hourly Fees & Expenses, the Source of Such Compensation Paid or Promised is: Unencumbered Assets of the Estate

Although the law firm takes the position that it had no legal obligation under the retainer agreement to file the present bankruptcies without payment of further fees, it was the decision of the firm to file the bankruptcy without charge to the Indviks. There is no evidence that the firm's position or the decision to file notwithstanding it were discussed with Indviks. As the "disclosure states", hourly fees and expenses were to be paid out of unencumbered assets of the bankruptcy estate.

Arens & Alexander never filed application with the court for appointment as the chapter 12 counsel in either case. However, on October 21, 1988, they did send sufficient documents to local Iowa counsel, James E. Murphy, for execution by him and filing with the court. These were never filed by Murphy; the omission was only recently discovered by Arens & Alexander. The documents included an application to admit to practice, a proposed order for admission pro hac vice, an application for approval of employment of attorney, an affidavit in support of employment of attorney, and a proposed order authorizing employment.

During the course of the chapter 12 cases, the Indviks filed a motion for substitution of counsel. By motion of the debtors, these chapter 12 cases were converted to chapter 7 cases in January, 1989. on order of the court, Arens & Alexander filed fee applications in each case itemizing their time and expenses.

Section I, page 5 of the applications stated as follows:

> Awards in Similar Cases: Applicant does not normally submit fee applications inasmuch as Applicant usually receives full compensation unrelated to the filing of bankruptcy proceedings. Such fee arrangements typically take the form of a non-refundable fee payment in return for unlimited representation by the Applicant in certain enumerated

> areas for any particular client. If bankruptcy proceedings are instituted, the Applicant sometimes seeks payment from the bankruptcy estate where doing so would not jeopardize the feasibility of the plan of reorganization.

This application was signed by David G. Nixon, then an attorney for the firm of Arens & Alexander. Terry Zelinski testified that her understanding of this provision was that such bankruptcy representation was provided without charge when the original retainer agreement provided bankruptcy as a particular area of representation. John Arens testified that under the fee application in question, the firm had no obligation to provide bankruptcy work without further fees but did so because it did not want to abandon the clients.

## DISCUSSION

I.

The matter of compensation for legal services is generally a matter of contract between the parties. Stanley v. City of Indianola (Matter of Condemnation of Lands), 261 Iowa 146, 153 N.W.2d 706, 711 (1967). The contract may be express, or it may be implied from the conduct of the parties. Kurtenbach v. TeKippe, 260 N.W.2d 53, 56 (Iowa 1977). Formerly in Iowa, a contract was construed in accordance with the laws of the state where it was made. County Savings Bank v. Jacobson, 202 Iowa 1263, 211 N.W. 864 (1927). However, absent the parties' own determination, Iowa courts now apply the "most significant relationship" test in determining which state's laws govern a contract. Cole v. State Auto & Casualty Underwriters, 296 N.W.2d 779, 781 (Iowa 1980) ; Joseph L. Wilmotte & Co. v. Rosenman Bros., 258 N.W.2d 317, 326 (Iowa 1977) reh'g. denied (1977).

The court believes Iowa law is controlling in this case. Although the contract was made in Arkansas, it was for the legal representation of Iowa citizens. The legal services involved litigation pending in Iowa or which would normally eventually be pending in Iowa. There is no evidence that any litigation was taking place or would take place against the Indviks in Arkansas. Because the contract for legal services was to be performed within the state of Iowa on behalf of Iowans, this court believes the state with the most significant relationship to the contract for legal representation was Iowa.

None of the parties to this proceeding has made an issue of whether the retention letter was a contract or whether it was the entire contract. A retention letter may serve as a contract. Baumrin v. Cournoyer, 448 F.Supp. 225, 228 (D. Mass 1978). The letter was signed by the Indviks but not by anyone from the law firm. However, the absence of a signature for Arens & Alexander did not prevent the letter from becoming a binding contract among the parties. This is so because Arens & Alexander accepted and acted on Indviks' letter. Henderson v. Henderson, 136 Iowa 564, 114 N.W. 178, 179 (1907).

There is no proof that the letter was not the entire contract or that it was modified subsequent to its execution. Based upon the evidence presented, the court finds that the letter of November 13 was the retention and compensation contract between the firm and the Indviks.

II.

The court must decide whether the agreement between the parties required Arens & Alexander to file bankruptcy cases on behalf of the Indviks and to represent them in such cases. This requires interpretation of the terms "litigation" and "fully litigate" in the first paragraph of the letter. The court need not resort to construction of a contract where the intent of the parties is expressed clearly and

unambiguously. Weik v. Ace Rents, Inc., 249 Iowa 510, 87 N.W.2d 314 (1958). Reference to the common meanings of the terms "litigation" and "litigate" leads this court to believe that, as used in the letter of November 13, these terms are ambiguous.(1)

As used in the letter, these terms could involve state or federal court lawsuits with regard to debt collection, foreclosure of liens and any Indvik counterclaims. They could also include the filing of bankruptcy cases in federal court.

Upon consideration of the evidence, the court finds that the intention of the parties was that the agreement cover only the former and that the parties did not intend the agreement to cover the filing of bankruptcy. The only discussion between John Arens and the Indviks regarding bankruptcy concerned the dismissal of the Indviks' pending bankruptcy cases. Arens told Indviks he would not represent them if they were in bankruptcy. He recommended trying to solve their financial problems outside of bankruptcy. When Arens met with the Indviks, they were having financial difficulties which involved already existing state court litigation or potential state or federal court litigation. The only evidence in support of the theory that filing of bankruptcy was included in the fee arrangement was the Indviks' belief that Arens & Alexander would do whatever was necessary to solve their problems. This interpretation of the agreement, however, is overly broad. The court believes it was the intent of the parties that Arens & Alexander represent Indviks in an effort to solve their financial problems through negotiation and state and federal court litigation, but not by the filing of a bankruptcy case. The court will not, therefore, examine the retainer fee under 11 U.S.C. § 328.

III.

The remaining issue is whether the Indviks paid Arens & Alexander $50,000.00 in legal fees in contemplation of bankruptcy. Although the Indviks had no intent to file a second bankruptcy case when they made the payments to Arens & Alexander, the court believes the payment was nonetheless made in contemplation of bankruptcy.

The governing Bankruptcy Code provision is 11 U.S.C. § 329. This Code section permits the court to examine for reasonableness, payments of compensation made to attorneys within one year prior to the filing of bankruptcy if the payment is made "for services rendered or to be rendered in contemplation of or in connection with the case. . ." The applicable Bankruptcy Rule is 2017(a). Section 329(a) is derived from § 60(d) of the Bankruptcy Act.(2)

Cases construing § 60(d) are helpful in the application of 11 U.S.C. § 329. In determining whether the debtor contemplated bankruptcy in making a transfer to an attorney, the court must consider the state of mind of the debtor, not the attorney. Tripp v. Mitschrich, 211 Fed. 424, 427 (8th Cir. 1914). The court must determine whether the "thought of bankruptcy was the impelling cause of the transaction" with the attorney. Conrad, Rubin & Lesser v. Pender, 289 U.S. 472, 477 (1932). The court must also ask whether the services by the attorney were "so wholly separate from any exigency of bankruptcy as to indicate that the thought of bankruptcy was in no sense controlling." Id.

There must be "more than a simple consciousness of insolvency." Tripp v. Mitschrich, 211 Fed. at 427. In construing 60(d) of the Act, the Eighth Circuit has stated:

> Contemplation thus means more than the knowledge that a bankruptcy proceeding either by or against the debtor is impending. It means that in making the transfer the debtor is influenced by the possibility or imminence of such a proceeding. There must be some relation as of cause and effect between the knowledge of his condition and the transfer.

> The latter must to some extent at least be attributable to his financial condition. This may be illustrated by gifts in contemplation of debt such are not simply gifts made in light of the possibility that one may soon die. They are made because of a consciousness of this fact. In the case both of contemplation of death and in contemplation of bankruptcy proceedings, the possibility in each case must be upon the mind as an element leading to the result, to-wit, the transfer. In a case under section 60d the debtor must of course be confronted with the possibility of a bankruptcy proceeding. But there must be more. There must be a transfer induced at least to some extent by such a situation.

Tripp v. Mitschrich, 211 Fed. at 427.

At the time they met John Arens, the Indviks had already filed bankruptcy proceedings. They were under pressure of efforts to dismiss those cases. The cases were, of course, brought about by the debtors' grave financial conditions. John Arens convinced the Indviks not to resist the dismissals. They agreed to hire Arens & Alexander to litigate with their creditors in an effort to restore or improve their financial positions. The debtors hired the firm to help save their assets. It was an alternative to bankruptcy. Yet, the hiring of the firm was brought about by the financial problems of the debtors and their efforts to resolve those problems.

At best, it can be said that the Indviks did not consider a further bankruptcy as an option. However, the court doubts this is the case. They were advised by Arens that the dismissal of the case would not prevent a later filing. Bankruptcy was always was always available, even though it was thought not to be the best option and was perhaps not even an option that the Indviks were considering at the time they retained Arens & Alexander. Nonetheless, it was a tool which could be used if the litigation efforts of Arens & Alexander failed. This is exactly what came to pass.

One may not specifically intend bankruptcy but rather desire only extrication from financial difficulties through the efforts of an attorney. But transfers to such attorneys have been held to have been made in contemplation of bankruptcy. Conrad, Rubin & Lesser v. Pender, 289 U.S. at 477 (1932); In the Matter of J. J. Bradley & Co., Inc., 6 B.R. 529, 535 (Bankr. E.D. N.Y. 1980).

The court believes that at the time they retained Arens & Alexander, the Indviks did not specifically intend another bankruptcy filing. They hired Arens & Alexander to negotiate or litigate the Indviks' out of financial difficulties. The work of Arens & Alexander was intended to prevent their financial destruction. Their concern over their financial conditions prompted the transfer of funds to Arens & Alexander. There was the required connection between the debtors' financial problems and the transfer of fees.

## CONCLUSIONS OF LAW

Indviks' transfer of $50,000.00 to the law firm of Arens & Alexander was not made as compensation for retaining Arens & Alexander to file a bankruptcy case or cases, and thus the transfer is not subject to examination under 11 U.S.C. § 328.

The transfer of $50,000.00 from Indviks to Arens & Alexander was made in contemplation of bankruptcy within the meaning of 11 U.S.C. § 329.

## ORDER

IT IS ORDERED that the clerk shall set a telephone status conference for the purpose of the court's setting a hearing to determine the reasonableness of the fees paid by Indviks to Arens & Alexander.

SO ORDERED ON THIS 27th DAY OF SEPTEMBER, 1990.

William L. Edmonds
Chief Bankruptcy Judge

---

1. "Litigate" has been defined as "to make the subject of a lawsuit; contest at law" or "to carry on a lawsuit." "Litigation" has been defined as "the act or process of litigating" or "a lawsuit." The Random House Dictionary of the English Language, 837 (Unabridged ed. 1983).

2. Section 60(d) of the Bankruptcy Act provided: "If the debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney and counselor-at-law, solicitor in equity or proctor in admiralty for services to be rendered, the transaction shall be re-examined by the court on petition of the trustee or any creditor and shall [only] be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate." The bracketed and underlined treatment of the word "only" shows changes made to the section by the Bankruptcy Act of 1938. The word "only" was moved from the bracketed to the underlined position in the sentence.