The Honorable Christopher M. Alston
Chapter 11
Location: Seattle
Hearing Date: May 6, 2016, 9:30 AM
Response Deadline: May 2, 2016

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

In re

NORTHWEST TERRITORIAL MINT, LLC
Debtor.

Bankruptcy No. 16-11767-CMA

DIANE ERDMANN'S RESPONSE TO MOTION FOR AUTHORITY TO WITHDRAW AS ATTORNEY FOR DEBTOR

Interested Party Diane Erdmann hereby responds to the motion of The Tracy Law Group PLLC ("TTLG") for authority to withdraw as attorney for Debtor (the "Motion"). As part of the Motion, Debtor's counsel seeks guidance from the Court on what actions it should take with respect to Ms. Erdmann's funds it is holding as an advanced cost retainer (the "Retainer"). The Chapter 11 Trustee, Mark Calvert ("Trustee"), the official unsecured creditors' committee ("UCC") and creditors Bradley Cohen and Cohen Asset Management, Inc. (collectively, "Cohen") have filed unsupported responses to the Motion, requesting that the Retainer be paid to the Trustee and into the registry of the Court alternatively. Ms. Erdmann requests that this Court allow Debtor's counsel to comply with applicable state law and the governing rules of professional conduct and return her funds, which are indisputably not property of the estate.

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STATEMENT OF FACTS

For purposes of this response, many of the material facts are outlined in the declaration of Todd Tracy submitted in support of the Motion. Ms. Erdmann supplements those facts herein as supported by her declaration filed concurrently ("Erdmann Decl."). Due to the state court action of Mr. Cohen against Debtor and its owner, Mr. Hansen, TTLG believed it had to receive its retainer from a source other than the Debtor or Mr. Hansen. Therefore, despite already having a check from the Debtor in the amount of $150,000, TTLG insisted on the day of filing for a different source of funds. Ms. Erdmann, who is the girlfriend of Mr. Hansen, but who has kept her finances separate from Mr. Hansen, was asked to come up with $150,000 to serve as TTLG's advanced cost retainer for filing the above-captioned chapter 11 proceeding. Ms. Erdmann reluctantly marshalled her assets to satisfy this last minute request. Ms. Erdmann transferred $50,000 from her individual checking account by wire transfer, and liquidated her own personal property for the remaining sum of $99,460, for which she received a cashier's check from Mr. John Drummey payable to Ms. Erdmann. Ms. Erdmann endorsed this check over to TTLG.

It was always the intent and understanding of TTLG and Ms. Erdmann that the Retainer was to remain the property of Ms. Erdmann, and that TTLG was accepting payment from a third party pursuant to RPC 1.8(f). Ms. Erdmann therefore made demand for the return of the unused portion of the Retainer upon learning that TTLG would be withdrawing from representation.

ARGUMENT AND AUTHORITIES

The law and facts relevant to this dispute are clear and straightforward. The Retainer came from Ms. Erdmann's own funds—namely, funds from her individual checking account and a negotiable instrument payable to her that she endorsed to TTLG. Accordingly, the

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Retainer is not property of the estate. Under Washington law, TTLG has an unquestionable duty to return the Retainer to Ms. Erdmann. If either the Trustee's, UCC's or Cohen's request is abided by, the Court would be forcing TTLG to violate RPC 1.14. *See* WSBA Ethics Opinion 1575.[1] Finally, the Court lacks jurisdiction over this dispute and should instead allow TTLG to comply with its state law duties and return Ms. Erdmann's funds.

(1) An Advanced Cost Retainer from a Third Party is not Property of the Estate.

Ms. Erdmann does not believe a genuine dispute exists as to whether the Retainer comprises property of the estate. The closest any party comes to arguing this point is the Trustee's response, which merely makes the unsupported statement that he "has reason to believe that the source of the retainer was property of the Debtor." ECF No. 89 at P.1. Putting aside the factual inaccuracy and lack of support for this statement, it has no outcome on this controversy.

Courts that have examined whether a prepetition retainer is property of the estate have agreed that it is a question of state law. *In re King*, 392 B.R. 62, 71 (Bankr.S.D.N.Y.2008); *In re Chatkhan*, 496 B.R. 687, 693 (Bankr. E.D.N.Y. 2012); *In re McDonald Bros. Const., Inc.*, 114 B.R. 989, 996 (Bankr. N.D. Ill. 1990). Washington law accordingly governs. It is clear that an advanced cost or security retainer paid by a client remains that client's property even though it is deposited into an attorney's IOLTA account. RPC 1.15A. An attorney only comes into ownership once services have been performed. RPC 1.15A(c)(2). In a bankruptcy case, the fees must be approved prior to the ownership of the funds transferring. 11 U.S.C. §330. Both inside and outside of bankruptcy, the unused portion of an advanced cost retainer must be returned to

[1] The Ethics Opinion is attached to this response as Exhibit 1 for the Court's convenience.

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the client. RPC 1.15A; 11 U.S.C. §329(b)(2) (requiring the return of compensation to "the entity that made such payment"). However, if a third party has paid the funds being held in trust by a Washington attorney, such funds remain the property of the third party and must be refunded the third party upon request. Ethics Opinion 1575 addressing the need to return funds belong to non-client; RPC 1.15A.

While there appears to not have been a case specifically addressing this issue by the Ninth Circuit Court of Appeals, one Bankruptcy Appellate Panel (BAP) opinion is instructive. *In re BOH! Ristorante, Inc.*, 99 B.R. 971 (B.A.P. 9th Cir. 1989). The court in *BOH!* was looking at whether debtor's counsel's fee application should be denied as sanctions for failing to become properly employed by the court. *Id*. at 972. The retainer from which the debtor's counsel sought to be paid was supplied by a non-debtor third party. *Id*. In addressing the issue in dispute the Court repeatedly acknowledged that it was the non-debtor third party that was entitled to the funds. *Id*. at 973 ("fees paid by a third-party to a professional employed by a debtor-in-possession may be recovered by the third-party . . ."). Indeed, as the opinion notes, upon the bankruptcy court initially denying the debtor counsel's motion for *retroactive* appointment it "required the funds to be returned to Ms. Mir [the non-debtor third party]." *Id*. at 971.

Thus, the only potential dispute here is whether the Retainer came from the Debtor or from Ms. Erdmann. It indisputably came from Ms. Erdmann. As recognized by TTLG and evidenced in the Erdmann Decl. the funds came from (1) her individual checking account, and (2) a negotiable instrument payable to her that she endorsed over to TTLG. No party has presented (or can present) evidence to the contrary. While parties may be "suspicious" about

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the ultimate source of the funds, this suspicion has no bearing on the Court's decision and may be addressed at a later time.

In sum, the Retainer is not property of the estate, but is the property of Ms. Erdmann. Accordingly, TTLG holds it pursuant to its obligations under RPC 1.15A (holding property belonging to a third party) and must return the Retainer to Ms. Erdmann pursuant to its obligations under RPC 1.15A(f) ("a lawyer must promptly pay or deliver to the client or third person the property which the client or third person is entitled to receive."). As such, not only do the Trustee, Committee and Cohen's proposals run counter to bankruptcy law, they would cause TTLG to violate the rules of professional conduct by which it is governed. *See* Ethics Opinion 1575.

(2) At Best, Trustee May Have Speculative Claims Against Ms. Erdmann Under a Fraudulent Conveyance Theory

As noted in the Trustee's response, he believes that the ultimate "source" of the Retainer may be property of the Debtor, though he notably provides zero support for such contention. One may infer that the Trustee is implying that Ms. Erdmann was the recipient of a fraudulent conveyance or other avoidable transfer that would permit the Trustee to recover the funds that comprised the Retainer. On this basis the Trustee requests the Retainer be turned over to him. This is akin to asking for a prejudgment writ of garnishment against Ms. Erdmann despite: (1) no complaint having been filed against her, (2) no motion being brought pursuant to Fed. R. Civ. P. 64,[2] and (3) the Trustee making no showing of a likelihood he will prevail on the merits as required by applicable state law. Indeed, the Bankruptcy Court for the Northern

[2] Fed. R. Civ. P. 64 expressly incorporates state law for prejudgment writs, making RCW 6.26.010, et. seq. applicable.

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District of Illinois specifically addressed an argument about whether the potential for an estate to establish a claim to a retainer could cause a retainer to be considered property of the estate. *In re McDonald Bros. Const., Inc.*, 114 B.R. 989 (Bankr. N.D. Ill. 1990). Rejecting this argument, the court reasoned that, "funds transferred prepetition may come into the estate upon the appropriate action being taken in the bankruptcy proceeding. However, until that action is taken, the rights of the parties to the transferred funds are not affected by Code. It is the recovery of the funds involved in an "avoided" transfer, not the potential for recovery, that causes the funds to be considered part of the estate." *Id*. at 997.

As outlined in Ms. Erdmann's declaration, the source of the funds that comprise the Retainer are not avoidable. Indeed, the majority of the funds originate from life insurance proceeds received by Ms. Erdmann on her former husband's policy. Accordingly, even if the Trustee had filed a complaint, he would not be entitled to a prejudgment writ of garnishment.

CONCLUSION

As explained herein, the Retainer is not property of the estate as it indisputably originated from Ms. Erdmann, a non-debtor. Accordingly, the Court cannot require TTLG to deposit it with the Court or transfer it to the Trustee and indeed lacks jurisdiction over the Retainer. Matter of Fed. Shopping Way, Inc., 717 F.2d 1264, 1272 (9th Cir. 1983) ("where property is outside the possession of the bankruptcy court and is held adversely to the trustee, the court, absent consent, has no jurisdiction to adjudicate conflicting claims of title to the property, even where one of the claims is asserted by the trustee himself.") (citing *Cline v. Kaplan,* 323 U.S. 97, 98-100, 65 S.Ct. 155, 156-157, 89 L.Ed. 97 (1944)). The Trustee, UCC and Cohen cannot circumvent procedural and jurisdictional safeguards to avail themselves to

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Ms. Erdmann's property. Wherefore, Ms. Erdmann respectfully request this Court to find that the Retainer is not property of the estate and to allow TTLG to comply with its state law obligations to return the Retainer to Ms. Erdmann pursuant to RPC 1.15A.

DATED this 2nd day of May, 2016.

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By /s/ *Daniel J. Bugbee*
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EXHIBIT 1

WSBA

Advisory Opinion: 1575
Year Issued: 1994
RPC(s): RPC 1.14
Subject: Disposition of unearned fees paid by a nonclient held in lawyer's trust account

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You ask whether a non-client who has paid a retainer to a lawyer for the benefit of a client, may obtain a refund of the unused portion of that retainer.

The Committee was of the opinion that the non-client, under the circumstances is entitled to a refund because the money belongs to the non-client. RPC 1.14 requires an attorney to promptly notify a client of the receipt of funds (RPC 1.14(b)(1)) and "promptly pay or deliver to the client as requested by a client the funds . . . In the possession of the lawyer, which the client is entitled to receive." There is nothing in the facts presented which indicates that the payor was gifting the funds directly to the client. Rather, third party/payor was helping to pay the lawyer for services rendered. Because the funds are trust funds, and the ownership of those funds are the property of the payor until the funds are earned by the lawyer, the lawyer is under an obligation pursuant to RPC 1.14 to return them to the payor.

Advisory Opinions are provided for the education of the Bar and reflect the opinion of the Committee on Professional Ethics (CPE) or its predecessor, the Rules of Professional Conduct Committee. Advisory Opinions issued by the CPE are distinguished from earlier RPC Committee opinions by a numbering format which includes the year followed by a sequential number. Advisory Opinions are provided pursuant to the authorization granted by the Board of Governors, but are not individually approved by the Board and do not reflect the official position of the Bar association. Laws other than the Washington State Rules of Professional Conduct may apply to the inquiry. The Committee's answer does not include or opine about any other applicable law other than the meaning of the Rules of Professional Conduct.