IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

In Re:	
ALLEN ELIAS,	**Bankruptcy Case No. 02-41640**
Debtor.	

MEMORANDUM OF DECISION

Appearances:

Craig Jorgensen, Pocatello, Idaho, Attorney for Debtor.

Jed Manwaring, EVANS, KEANE, Boise, Idaho, Attorney for State Insurance Fund.

Jim Spinner, SERVICE, SPINNER & GRAY, Pocatello, Idaho, Attorney for Trustee Sam Hopkins.

R. Sam Hopkins, Pocatello, Idaho, Chapter 7 Trustee.

L. D. Fitzgerald, Pocatello, Idaho, Chapter 11 Trustee for Western Fertilizer.

Background

The Chapter 7 Trustee, R. Sam Hopkins, has applied for authority to employ attorney Craig R. Jorgensen as special counsel to pursue a claim against the State Insurance Fund ("SIF") for its alleged failure to defend Debtor Allan Elias and his company, Evergreen Resources, Inc. ("ERI"), in a lawsuit filed by Scott Dominguez for injuries he suffered while employed by ERI. Am. Mot., Docket No. 53. SIF objects. Docket No. 54. It argues that Mr. Jorgensen is not a "disinterested person" as required by 11 U.S.C. § 327(a), and that, as a potential witness in any action against it, he may not ethically serve as Trustee's counsel. The Court conducted a hearing concerning Trustee's application and SIF's objection on April 19, 2005. Minute Entry, Docket No. 60. As the Court suggested, both parties filed post-hearing briefs. Docket Nos. 61, 62, 63. After considering the record in this case, the parties' arguments and the applicable legal authorities, the Court concludes that Trustee's application should be granted for the reasons explained below.[1]

Facts

As a result of its involvement in two adversary proceedings in which Debtor was a party, the Court is familiar with the facts relevant to the issues raised

[1] To the extent required by Rule, this Memorandum constitutes the Court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052; 9014.

here. *See In re Elias* (*Dominguez v. Elias*), Ch. 7 Case No. 02-41640, Adv. No. 03-06058, Mem. Decision (Bankr. D. Idaho Dec. 19, 2003); *In re Elias* (*Kerr-McGee Chemical, LLC v. Elias*), Ch. 7 Case No. 02-41640, Adv. No. 03-06083, Mem. Decision (Bankr. D. Idaho June 30, 2004). Mr. Jorgensen (hereafter "Counsel") has represented Debtor in his bankruptcy case, as well as in the two adversary proceedings.

Counsel also represented Debtor in a state court action filed by Scott Dominguez against Debtor, ERI, and Kerr-McGee Chemical Corporation.[2] While employed at ERI and supervised by Debtor, Mr. Dominguez suffered debilitating injuries after collapsing inside a tank car he had been ordered to clean out. In addition to collecting compensation for his injuries under the Worker's Compensation Law, Idaho Code § 72-101 *et seq.*, Mr. Dominguez sued Debtor and the others under an exception to the Worker's Compensation Law that allows an individual injured by the "wilful or unprovoked physical aggression of his

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[2] The Court takes judicial notice of its files in *In re Elias* (*Dominguez v. Elias*), Ch. 7 Case No. 02-41640, Adv. No. 03-06058 (Bankr. D. Idaho filed Feb. 18, 2003) and *In re Elias* (*Kerr-McGee Chemical, LLC v. Elias*), Ch. 7 Case No. 02-41640, Adv. No. 03-06083 (Bankr. D. Idaho filed Mar. 10, 2003) to elaborate on the facts of the state court lawsuit necessary to decide the pending motion. Fed. R. Evid. 201. The facts to which the Court will refer were presented in the context of motions for summary judgment, and nothing relating to the state court lawsuit was ever in dispute. *See Dominguez*, Adv. No. 03-06058, Mem. Decision (Bankr. D. Idaho Dec. 19, 2003); *Kerr-McGee Chemical, LLC*, Adv. No. 03-06083, Mem. Decision (Bankr. D. Idaho June 30, 2004).

employer . . .” to recover damages. *See* Idaho Code § 72-209(3). Debtor denied the claims, contending that recovery of worker’s compensation benefits was Mr. Dominguez’s sole remedy. Counsel withdrew as Debtor’s attorney before that action went to trial, and when Defendant thereafter failed to appear or appoint new counsel, the state court entered a default judgment in favor of Mr. Dominguez and against Debtor for $23,400,000.

The state court’s default judgment imposed joint and several liability upon both Debtor and ERI. *Dominguez*, Adv. No. 03-06058, Aff. of Roche, Ex. 5, Docket No. 9. In addition, the judgment acknowledges that, in awarding damages to Mr. Dominguez, the court reduced the damage award by the amounts paid to him by Kerr-McGee and by the worker’s compensation benefits paid to him by SIF. *Id.* It also appears that SIF waived its subrogation rights as against Debtor prior to entry of the judgment. *Id.*, Ex. 4 at 11.

Trustee wants to retain Counsel to press a bad faith claim against SIF based upon its failure to defend Debtor in the state court action, and because it refused to indemnify Debtor for his liability under the default judgment. Mot., Docket No. 53. According to Counsel, the worker’s compensation insurance policy ERI and Debtor purchased for the benefit of ERI’s employees included coverage for employer’s liability, and as a result, SIF was obliged to defend

Debtor and ERI against the claims made by Mr. Dominguez. In Counsel's opinion, the damages that may be recovered from SIF range from the policy limits of $100,000 up to the full amount of the default judgment.

SIF objects to Trustee's employment of Counsel for several reasons. Obj., Docket No. 54. First, regarding any challenge to its standing in this proceeding, SIF asserts that under the Worker's Compensation Law, specifically Idaho Code § 72-223(3), it is subrogated to the rights of Mr. Dominguez to recover the amount of worker's compensation benefits it paid to him, and as a result, it is a creditor in Debtor's bankruptcy case and entitled to be heard on the topic of whom Trustee employs as special counsel. Second, if Counsel is employed, SIF perceives a myriad of potential conflicts of interest related to Counsel's representation of Debtor in the two adversary proceedings mentioned above, as well as in other civil matters involving Debtor's affiliated business entities affected by the fallout from Mr. Dominguez's injuries. SIF contends, therefore, that Counsel is disqualified from employment by a trustee because he is not a "disinterested person." *See* 11 U.S.C. § 327(a) (requiring attorneys to be "disinterested persons"). Third, SIF reminds the Court that Counsel is a creditor in Debtor's bankruptcy case because he is owed $70,000 for prepetition legal fees.

See Application, Docket No. 20.[3] Finally, SIF argues that Counsel's decision to withdraw as Debtor's attorney in the state court lawsuit will be a key component of SIF's defense that Debtor failed to mitigate his damages. In this regard, SIF anticipates Counsel will be a necessary fact witness.

Disposition

A. SIF Lacks Standing.

In *In re Stone*, 03.2 I.B.C.R. 134 (Bankr. D. Idaho 2003), the Court explored the requirement that a party have legal standing in order to object to a professional employment application filed under § 327. In its decision, the Court concluded that creditors and other parties in interest, including the United States Trustee, indeed have standing to object. *Stone*, 03.2 I.B.C.R. at 135. To determine whether a party is a creditor, the Court referred to the definition in § 101(10)(A), which includes those entities holding a claim against the debtor that arose at the time of or before the debtor filed a bankruptcy petition. And while the term "party in interest" is not defined by the Code, the Court concluded that such a party must have a "pecuniary interest in the outcome of the bankruptcy." *Stone*,

[3] Counsel's application states that he would waive his prepetition legal fees so long as Debtor remained in Chapter 11. However, the Court granted the United States Trustee's motion to convert the case to Chapter 7 on October 23, 2002. Minute Entry, Docket No. 22. Counsel has never filed a proof of claim for his prepetition claim.

03.2 I.B.C.R. at 135 (quoting *In re Norris*, 91 I.B.C.R. 25, 26 n.3 (Bankr. D. Idaho 1991)).

SIF contends it has standing as a creditor or as a party in interest, and relies upon the Worker's Compensation Law for support. It believes that under Idaho Code § 72-223(3), it is subrogated to the rights of Mr. Dominguez and may seek reimbursement from Debtor for the amount of worker's compensation benefits it paid him. Idaho Code § 72-223(3) provides:

> If compensation has been claimed and awarded, the employer having paid such compensation or having become liable therefor, shall be subrogated to the rights of the employee, to recover against such third party to the extent of the employer's compensation liability.

Idaho Code § 72-223(2) allows injured employees or their employers to pursue actions against third parties who either caused or contributed to the employee's injuries, notwithstanding that the employee has already collected worker's compensation benefits under the statute from his or her employer. *Runcorn v. Shearer Lumber Prods., Inc.*, 690 P.2d 324, 330 (Idaho 1984); *Schneider v. Farmers Merchant, Inc.*, 678 P.2d 33, 35 (Idaho 1984).

The Idaho Supreme Court has explained that Idaho Code § 72-223

> provides that an *employer* may be subrogated to the rights of the employee to the extent that the employee has received compensation benefits. . . . [H]owever,

> the right of an employer to such subrogation and its ability to obtain reimbursement from the employee [is] limited. . . . [W]hen an employer's negligence, together with the negligence of a third party nonemployer tortfeasor, concurrently contributed to the injury of an employee, *neither the employer not [sic] his surety may obtain reimbursement for worker's compensation benefits* from an employee who recovers damages from a third party tortfeasor.

Schneider, 678 P.2d at 35–36 (quoting *Tucker v. Union Oil Co. of California*, 603 P.2d 156, 169 (Idaho 1979)) (emphasis added, internal citations omitted). Stated another way, if the employer was not negligent, the employer is subrogated to the employee's right to recover from a third party that caused the employee's injuries, to the extent of any compensation benefits the employer paid. On the other hand, if the employer was also negligent, the employer loses its right to reimbursement and the third party tortfeasor is entitled to a credit against the employee's judgment against him or her for the amount of compensation benefits the employee received. *Barnett v. Eagle Helicopters, Inc.*, 848 P.2d 419, 421–22 (Idaho 1993); *Schneider*, 678 P.2d at 36. Under those circumstances, the employer's surety is also denied any reimbursement from the employer for benefits paid. *Runcorn*, 690 P.2d at 330.

When measured against these statutes and state court decisions, it is clear that SIF's subrogation argument under Idaho Code § 72-223 lacks merit.

First, the statute creates subrogation rights between the employer and employee, not between a surety and the employer, as SIF argues. Nor is there a "third party" involved here. Under the statute, a third party is "some person other than the employer . . . ." Idaho Code § 72-223(1). An employer is anyone who has "hired or contracted the services of another." Idaho Code § 72-102(12)(a). In this case, ERI was Mr. Dominguez's employer; Debtor was ERI's principal. As between Debtor and ERI, there is no "third party" from whom Mr. Dominguez recovered. Idaho Code § 72-223(3) is therefore not applicable here.

Nor is SIF entitled to reimbursement because Debtor was found liable under an exception to the exclusive remedy provision under Idaho's Worker's Compensation Law. For employees injured during the course and scope of their employment, workmen's compensation provides the exclusive remedy of an employee against his employer unless the injury was caused by the wilful or unprovoked physical aggression of the employer. *Selkirk Seed Co. v. State Ins. Fund*, 18 P.3d 956, 961 (Idaho 2001) (citing Idaho Code § 72-209(3)); *Yeend v. United Parcel Serv., Inc.*, 659 P.2d 87, 88 (Idaho 1983). An employee is entitled to simultaneously pursue a claim for worker's compensation benefits and an action alleging that the injury was caused by the employer's wilful or unprovoked physical aggression. *Kearney v. Denker*, 760 P.2d 1171, 1173 (Idaho 1988)

(explaining that the filing of a claim for worker's compensation benefits does not constitute a waiver by the employee of the employee's right to attempt to prove an intentional tort).

While *Kearney* supports an inference that an employee can recover both compensation benefits and intentional tort damages because the employee need not make an election of remedies, Idaho has not decided whether a surety is entitled to reimbursement in a case involving such a recovery. In other jurisdictions allowing the simultaneous pursuit of such remedies, at least one allows the employee to keep both the compensation benefits and any damages awarded. 6 Arthur Larson, *Larson's Workers' Compensation Law* § 103.2 (2004) (citing *Jones v. VIP Dev. Co.*, 472 N.E.2d 1046 (Ohio 1984)). Other jurisdictions require an offset to be taken to avoid double recovery, and set off the employee's damages in the amount of worker's compensation benefits paid. *Id.* (citing *Gagnard v. Baldridge*, 612 So. 2d 732 (La. 1993) and *Fed. Ins. Co. v. Sanfatex, Inc.*, 897 F. Supp. 932 (E.D.N.C. 1995)).[4] The Court has found no authority,

[4] For example, in *Gagnard*, the court explained that it did not believe an employee injured by his employer's intentional acts should forego the guaranteed benefits afforded under the compensation act, and instead viewed damages imposed upon an employer for intentional acts as a type of sanction. 897 F. Supp. at 735–36. But, neither did the court wish to countenance a double recovery. *Id.* at 736. Because compensation benefits were statutorily mandated and must be paid, the court determined that a set-off against the damage award for those items that were the same under both obligations was appropriate. *Id.* As in the majority of jurisdictions, Idaho's

either in Idaho or from other jurisdictions, to support SIF's contention that it is entitled to reimbursement of the benefits it paid from an employer found liable for intentional tort damages under the exception to the exclusivity rule.

Moreover, the state court already accounted for the benefits paid by SIF in the damage award. It avoided a double recovery by reducing Mr. Dominguez's damage award by the amount of compensation benefits paid by SIF, together with certain settlement amounts paid by Kerr-McGee. It did not also order Debtor to reimburse SIF in addition to the set-off. If SIF believed it was entitled to reimbursement from Debtor, it certainly could have asserted that right in connection with the state court's entry of the default judgment, but it did not.

Also, Counsel for Mr. Dominguez represented to the state court that SIF had "waived its subrogation rights" and that it would therefore be appropriate for the court to deduct the amounts SIF had paid in compensation benefits from the amount of Mr. Dominguez's judgment. *Dominguez*, Adv. Proc. No. 03-6058, Aff. of Roche, Ex. 4 at 11, Docket No. 9. The state court presumably relied upon

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compensation act is compulsory. Idaho Code § 72-201 (declaring that all common law actions against employers are abolished); *Larson's Workers' Compensation Law* § 102.01[1] (explaining that in all states except New Jersey and Texas, compensation acts are compulsory). Idaho also allows employees to pursue simultaneous actions for compensation benefits and intentional torts. *Kearney*, 760 P.2d at 1173. However, Idaho has not decided the issue presented in *Gagnard*, and there is no authority suggesting in such a case that a surety should be entitled to reimbursement from the intentional tortfeasor for the benefits it paid.

counsel's representation when it entered its judgment, and this Court should be able to rely upon it as well. If SIF waived its subrogation rights in the state court action and failed to assert any right of reimbursement, as the record seems to show, SIF should be equitably estopped from taking a position inconsistent with its earlier position before the state court that it had waived any subrogation rights and had no claim for reimbursement. *See In re Pich*, 00.4 I.B.C.R. 183, 185–86 (Bankr. D. Idaho 2000) (applying judicial estoppel to prevent the debtor from claiming a homestead exemption in property he earlier represented to the county would not be used for residential purposes).[5]

Under these facts, SIF is not entitled to reimbursement from Debtor for amounts paid to Mr. Dominguez; SIF is not a creditor of Debtor's bankruptcy estate.[6]

Nor is SIF a "party in interest." As in *Stone*, the fact that SIF may be the target of a potential lawsuit by the bankruptcy estate does not mean that it

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[5] In *Pich*, the Court explained that the doctrine of judicial estoppel "precludes a party from gaining an advantage by taking one position, and then seeking a second advantage by taking an incompatible position." *Pich*, 00.4 I.B.C.R. at 186 (quoting *Rissetto v. Plumbers & Steamfitters Local 343*, 94 F.3d 597, 601 (9th Cir. 1996)). The doctrine is intended to protect the courts from manipulation and may be invoked by a court at its discretion. *Id.*

[6] While not conclusive on this issue, it should also be noted that SIF never filed a proof of claim in this bankruptcy case, and the bar date for filing a timely proof of claim has long since passed.

holds a financial stake in the administration of Debtor's bankruptcy, or that it has a monetary interest in the outcome of the bankruptcy case. Should Trustee recover from SIF as a result of any lawsuit, those funds would be distributed to the creditors of Debtor's bankruptcy estate. SIF would not be entitled to share in that distribution.

In the Court's opinion, SIF lacks standing to object to Trustee's application to employ Counsel.[7]

B. Counsel May Be Employed Under § 327(e).

Trustee seeks to employ Counsel under 11 U.S.C. § 327(e) to represent the bankruptcy estate's interest in its potential claim against SIF. This assignment represents a "special purpose, other than to represent the trustee in conducting the case . . . , " and is permitted by § 327(e). SIF is incorrect in its contention that Counsel must therefore meet the strict "disinterested" standard for professionals employed under § 327(a). *Film Ventures Int'l, Inc. v. Asher* (*In re Film Ventures Int'l, Inc.*), 75 B.R. 250, 252 (B.A.P. 9th Cir. 1987); *Stone*, 03.2 I.B.C.R. at 135. Instead, as the Court noted in *Stone*, the "Code 'authorizes

[7] The Court claims no particular expertise in the interpretation and application of Idaho's Worker's Compensation Law. But even if the Court has erred in its decision concerning SIF's rights, it would be a harmless error. The Court has an independent obligation under § 327 to determine whether Trustee's application satisfies the statute's requirements. *Stone*, 03.2 I.B.C.R. at 135. To satisfy its duty, the Court will consider the substance of SIF's objections to Counsel's application.

employment of an attorney in certain cases, notwithstanding the attorney's prior connection with the debtor, in order to permit the utilization of special knowledge and experience which may be of substantial benefit to the estate.'" *Stone*, 03.2 I.B.C.R. at 135 (quoting *In re Salmon River Canal Co., Ltd.*, 93 I.B.C.R. 208, 209 (Bankr. D. Idaho 1993)). Section 327(e) requires only that the attorney's employment foster "the best interest of the estate," and that the proposed attorney "not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed." 11 U.S.C. § 327(e); *Film Ventures Int'l, Inc.*, 75 B.R. at 252 (observing that the debtor's prepetition attorney may represent the bankruptcy estate for a special purpose so long as the attorney holds no adverse interest within the scope of the representation).

Counsel has, for the past seven years, represented Debtor and his business entities in various legal proceedings resulting from Mr. Dominguez's accident. Undoubtedly, Trustee seeks to take advantage of Counsel's intimate knowledge of the facts and circumstances surrounding the bankruptcy estate's potential claim against SIF. Absent good cause, to require Trustee to choose a different attorney would create an unnecessary duplication of costs and legal fees, and potentially delay prosecution of the estate's claim.

The fact that Counsel may be a creditor in this case does not disqualify him. In *Stoumbos v. Kilimnik*, 988 F.2d 949, 964 (9th Cir. 1993), the court found no conflict of interest existed when the trustee sought to employ an attorney under § 327(e) who at the same time represented a creditor in the bankruptcy case. The court noted that, for purposes of taking action against a third party, the interests of the bankruptcy estate and the creditor coincided, for if special counsel recovered any money for the benefit of the estate, his creditor client would ultimately receive a greater distribution in the bankruptcy case. *Stoumbos*, 988 F.2d at 964. That reasoning also applies here. Counsel is a creditor, but his interests as a creditor, as well as in accepting employment on a contingent fee basis to sue SIF, are the same: maximizing any potential recovery.[8]

Nor is the Court concerned with Counsel's prior or continued representation of Debtor and his business entities in other litigation, both in this Court and others. SIF mentions Counsel's representation of Debtor in connection with *In re Western Fertilizer, Inc.*, Case No. 00-40991 and a related adversary

[8] Counsel has filed no proof of claim in this case. He could still file a claim, although it would be tardy, and if allowed he could be entitled to participate in distributions to creditors. *See* 11 U.S.C. § 726(a)(3) (providing for distributions on account of tardily filed claims). Even if Counsel forgoes his claim, his interests are aligned with the estate because, under the fee agreement, the bankruptcy estate is not obligated to advance any funds to Counsel, including costs, unless there is a recovery. Am. Mot. at 4, Docket No. 53.

proceeding, *Fitzgerald v. Jorgensen, et. al.*, Adv. No. 02-6144, as well as Counsel's representation of Debtor in his bankruptcy case and the state court litigation. However, the litigation SIF cites is, in effect, concluded. And while Counsel may continue to represent Debtor and ERI in other civil proceedings, his role in those cases does not appear to reflect any adverse interest, either to Debtor or to the bankruptcy estate, in relation to his assignment as special counsel for Trustee.

The Court is somewhat concerned, however, about the notion that Counsel could be disqualified if SIF is able to call him as a witness. But even assuming the state court endorsed such a strategy, Counsel's disqualification under the Idaho Rules of Professional Conduct is not absolute. Idaho Rule of Professional Conduct 3.7 states that:

> (a) A lawyer shall not act as *advocate at a trial* in which the lawyer is likely to be a necessary witness unless:
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> (1) the testimony relates to an uncontested issue;
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> (2) the testimony relates to the nature and value of legal services rendered in the case; or
>
> (3) disqualification of the lawyer would work a substantial hardship on the client.

I.R.P.C. 3.7 (emphasis added). Under the Rule, Counsel would likely not be prohibited from representing the bankruptcy estate during pre-trial matters even if

he is called as a witness at trial. Should the issue arise prior to trial, Counsel could assume a dual role under the circumstances set forth in the Rule. But the commentary to the Rule explains that the relevant inquiry is fact specific, and depends upon the nature of the case and the tenor of the lawyer's testimony. So only the state trial court, not this Court, could determine whether Counsel should be disqualified if it appears he is a necessary witness. This Court should not speculate about whether Counsel will be disqualified, and should not deny Trustee the attorney of his choice based solely upon what might, as opposed to what will, transpire in the state court action.

Finally, Trustee and Counsel have revised the original representation agreement to require that if Counsel can not represent Trustee, Counsel will associate with another attorney to protect the interests of the bankruptcy estate under the circumstances. Supp. Brief, Docket No. 62. If that occurs, of course, Trustee should seek further Court approval of any new representation arrangement.[9]

[9] To be fair, Counsel should be aware that his disqualification as the attorney for Trustee in a state court action would be a relevant factor in the Court's review of any proposed compensation he may seek in this case. *See* 11 U.S.C. § 330(a)(1)(A) (limiting professional compensation to a "reasonable" amount "for *actual*, necessary services.").

Conclusion

For these reasons, Trustee's application to employ Craig R. Jorgensen as special counsel under § 327(e) to represent the bankruptcy estate in pursuing a claim against SIF will be granted. SIF's objection to the application is overruled. A separate order will be entered.[10]

Dated: June 10, 2005

Honorable Jim D. Pappas
United States Bankruptcy Judge

[10] Counsel must yet submit a verified statement containing the information required by Fed. R. Bankr. P. 2014(a). While some of the required information was set forth in the motion, the Rule mandates a separate verification filed by the person to be employed.