UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
INACOM CORP., et al.	:	Case No. 00-2426 (PJW)
	:	Jointly Administered
	:	
Debtors.	:	**Objection Deadline: August 29, 2003** **Hearing Date: October 24, 2003 @ 11:00 a.m.**

DEBTORS' LIMITED OBJECTION TO FINAL SUMMARY APPLICATION OF WILLKIE FARR & GALLAGHER FOR (I) FINAL ALLOWANCE OF FEES AND EXPENSES COVERING PERIODS FROM JUNE 16, 2000 THROUGH APRIL 30, 2002, INCLUSIVE, AND (II) OTHER RELATED RELIEF

InaCom Corp., *et al.*, (the "Debtors"), files this limited objection to Final Summary Application of Willkie Farr & Gallagher for (I) Final Allowance of Fees and Expenses Covering Period From June 16, 2000 through April 30, 2002, Inclusive, and (II) Other Related Relief (the "Final Fee Application"), and in support thereof states as follows:

I. INTRODUCTION

1. Willkie Farr & Gallagher ("Willkie") collected a $1.5 million dollar premium on top of its hourly fees for legal services provided to the Debtors - companies it knew to be financially troubled. Willkie did so within 90 days of the Debtors' bankruptcy filing and without providing a retention letter explaining such premium. While it claims that the Debtors understood the special premium billing arrangements, Willkie's own internal documents are inconsistent with any such billing arrangements. In addition, although retained as Debtors' co-counsel under 11 U.S.C. § 327(a), Willkie has never disclosed its receipt of preferential and/or fraudulent transfers, thus calling into question its disinterestedness under sections 327(a) and 101(14) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"). *See In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir.2002). Indeed, it termed as "retainers" a series of transfers which the evidence now clearly

shows were made on account of an antecedent debt. Under these circumstances, and as discussed in more detail below, the Debtors believe there to be compelling grounds to cause Willkie to be disqualified as co-counsel for the Debtors and to ultimately require disgorgement of any post-petition fees that have already been paid. Accordingly, the Debtors file this limited objection to the Final Fee Application.

II. BACKGROUND

2. On June 16, 2000, (the "Petition Date") the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code.

3. On June 21, 2000, the Debtors filed the Application to Retain Willkie as Counsel for the Debtors and Debtors in Possession (the "Application"), Docket No. 22. On October 24, 2000, Docket No. 790, this Court entered an order approving Willkie's retention as co-counsel to the Debtors under section 327(a) of the Bankruptcy Code (the "Willkie Retention Order").

4. On June 11, 2002, the Debtors commenced an adversary proceeding (the "Adversary Proceeding"), Adversary Number 02-04408, against Willkie by filing the Complaint to (I) Avoid and Recover Preferential Transfers Pursuant to 11 U.S.C. §§ 547 and 550, (II) to Avoid and Recover Fraudulent Transfers Pursuant to 11 U.S.C. §§ 548 and 550, and (III) to Disallow Claims Pursuant to 11 U.S.C. § 502(d), Docket No. 3278, (the "Complaint"). The Complaint seeks recovery of preferential transfers and fraudulent transfers totaling $2,900,000.

5. On July 14, 2003, Willkie filed the Final Fee Application, Docket No. 5293.

III. LIMITED OBJECTION

6. The Debtors object, on a limited basis, to the Final Fee Application and request that the Court (i) dismiss the Final Fee Application without prejudice; or (ii) hold any ruling or

determination on the Final Fee Application in abeyance until the Adversary Proceeding is finally concluded. The Debtors' limited objection is made herein on the following grounds:

a. The Adversary Proceeding is currently pending against Willkie for the recovery of avoidable transfers under sections 547 and 548 of the Bankruptcy Code. In light of the Third Circuit Court of Appeals' ruling in *In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir.2002), coupled with the applicable provisions of the Bankruptcy Code and Bankruptcy Rules concerning disinterestedness, the relief requested in the Final Fee Application is premature, and it should not be granted until such Adversary Proceeding is fully concluded.

b. Willkie received payments prior to the Petition Date that are voidable as preferences and/or fraudulent transfers under sections 547 and 548 of the Bankruptcy Code. As a result, Willkie is not a disinterested person and was therefore not properly retained to represent the Debtors as an estate professional under section 327(a) of the Bankruptcy Code.

c. Willkie did not adequately disclose in the Willkie Application and related papers the receipt of preferential and/or fraudulent transfers. Thus, such retention should not have been approved, because Willkie was not disinterested and it should be disqualified. Furthermore, given the evidence known to the Debtors to date, upon such disqualification full disgorgement of all post-petition fees paid will likely be requested.

A. <u>The Final Fee Application Should be Dismissed or Held in Abeyance</u>

7. The Final Fee Application should be dismissed because Willkie was not disinterested at the time of retention. Section 328(c) of the Bankruptcy Code permits this Court to deny allowance of compensation or reimbursement of expenses if, "*at any* time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or holds or represents an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed." (emphasis added) The evidence will show that Willkie received preferential and/or fraudulent transfers. Willkie did not disclose receipt of these avoidable transfers. As such, Willkie is not a disinterested person and therefore could not have

been properly retained to represent the Debtors as co-counsel. *See In re First Jersey Securities, Inc.,* 180 F.3d 504 (3d Cir.1999).

8. Moreover, attorneys selected to represent debtors under section 327(a) of the Bankruptcy Code may not be persons who "hold or represent an interest adverse to the estate," and must be "disinterested persons." *In re Pillowtex, Inc.,* 304 F.3d 246, 250 (3d Cir.2002). The Bankruptcy Code defines a "disinterested person," as someone who "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the Debtor..., or for any other reason." 11 U.S.C. §101(14)(E).

9. At the time of Willkie's retention, no disclosure of the receipt of preferential and/or fraudulent transfers was made, no action for the recovery of alleged avoidable transfers was pending, and the issue was not raised in an objection to the Willkie Application. Subsequent to Willkie's retention, however, the Debtors have determined that Willkie was the proper subject of claims for recovery of preferential and/or fraudulent transfers. Evidence discovered through the Debtors' prosecution of the Complaint will show that not only did Willkie have an interest materially adverse to the interests of the Debtors' estates and creditors at the time of the filing of the Willkie Application, but that it knew or should have known of this materially adverse interest at that time.

10. In *In re First Jersey,* the Third Circuit Court of Appeals clearly stated that a "preferential transfer to [Debtor's Counsel] would constitute an *actual conflict of interest* between counsel and the debtor, and would require the firm's disqualification." *In re First Jersey*, 180 F.3d at 509 (emphasis in original). The *First Jersey* court ultimately held that counsel was disqualified to represent the debtor, because he had received a preferential transfer. *See id.* at 513.

11. More recently, the Third Circuit Court of Appeals addressed a similar issue in *In re Pillowtex,* 304 F.3d 246 (3d Cir.2002). In *Pillowtex*, the Third Circuit Court addressed whether the bankruptcy court abused its discretion in approving the retention of a law firm as counsel for the chapter 11 debtor, where such firm's receipt of funds from the debtor was within the 90-day preference period and may have been a preferential transfer. The Third Circuit Court held that when a facially plausible claim of a substantial preference exists, a bankruptcy court *cannot avoid the clear mandate of section 327(a)* of the Bankruptcy Code when approving a professional's retention. *See id.* at 255.

12. In *Pillowtex,* the law firm of Jones Day Reavis & Pogue ("Jones Day") was retained as the debtor's chapter 11 bankruptcy counsel. The U.S. Trustee argued that payments of fees by the debtor to Jones Day within the 90 days before bankruptcy may have constituted avoidable preferences. The U.S. Trustee further argued that the receipt of such payments by Jones Day would constitute a conflict of interest with the debtor's creditors and the debtor's bankruptcy estate. As such, the U.S. Trustee maintained that Jones Day may have been disqualified from serving as the Debtor's bankruptcy counsel, because it may have held or represented an interest adverse to the estate or an interest materially adverse to the interests of creditors. Without ruling on the validity of the preference allegation, the Third Circuit Court reversed both lower courts and remanded for the purpose of determining whether or not a preference existed, which would be grounds for Jones Day's disqualification. *Id.* At 255.

13. The situation in this case with Willkie is similar to that which was before Third Circuit Court in *Pillowtex*. Like Jones Day, Willkie was retained under section 327(a) of the Bankruptcy Code as Debtors' co-counsel. Similarly, the Debtors' argue that Willkie received payments that may have constituted avoidable preferences. However, in the instant case (as

instructed by the Pillowtex decision), the Debtors are in the process of seeking a final judicial determination as to whether or not Willkie received preferential and/or fraudulent transfers, and whether such transfers present an actual conflict requiring Willkie's disqualification. Accordingly, based upon this Court's controlling authority, the Final Fee Application is premature, and cannot be ruled upon.

B. Willkie Received Avoidable Transfers

14. Prior to the Petition Date, Willkie performed legal services for the Debtors. Between March 16, 2000 and the Petition Date (the "Preference Period"), the Debtors transferred exactly $2,900,000 to Willkie. Willkie received a total of five wire transfers (the "Transfers") in the Preference Period, including the day before the Petition Date. The Transfers are:

DATE OF PAYMENT	DATE CLEARED	AMOUNT OF PREFERENTIAL TRANSFER
March 23, 2000	March 23, 2000	$1,500,000.00
April 25, 2000	April 25, 2000	$500,000.00
May 15, 2000	May 15, 2000	$500,000.00
June 6, 2000	June 6, 2000	$250,000.00
June 15, 2000	June 15, 2000	$150,000.00
Total:		**$2,900,000.00**

15. Not only are the amounts of the first two Transfers not justified by Willkies' own time records, but the timing of the Transfers and the lack of invoices to the Debtors is unusual in this case.[1]

[1] Notably, the last 4 Transfers made to Willkie by the Debtors were so without an invoice being generated or sent.

16. On June 24, 2003, Jack H. Nusbaum of Willkie testified in deposition that he expected payment from the Debtors upon rendering a single invoice for the lump sum of $2 million.[2] Mr. Nusbaum testified as follows:

> Q: Turn to the invoice on the second pa0ge of Exhibit – 10, when did you understand payment, the $2 million to be due?
>
> A: Upon rendering of the invoice.

Nusbaum Deposition at 88. Rather than being paid immediately upon receipt of the invoice, the Debtors paid Willkie in two (2) separate payments, 30 and 60 days past due.

17. Another material concern of the Debtors is that Willkie's own billing records contain obvious extraordinary time charges for Mr. Nusbaum. The billing records reflect *single daytime entries* for Mr. Nusbaum in the amount of 2,264 hours. When asked, Mr. Nusbaum could not explain these time entries:

> Q: Below, under "Nusbaum Partner, 2/24" there is an entry for 999 hours?
>
> A: Right
>
> Q: The first entry for February 24, do you see that?
>
> A: Yes.
>
> Q: Did you work 999 hours on February 24?
>
> A: Is that a serious question?
>
> Q: Yes.
>
> A: No.
>
> Q: Alright, can you explain how 999 got listed twice on February 24th for yourself?

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[2] Mr. Nusbaum was designated by Willkie pursuant to Fed.R.Civ.P.30(B)(6) as the person knowledgeable to testify with respect to pre-petition payment issues.

A: I cannot, other than to tell you that this is a computer-generated entry having nothing to do with my time entries, having no correlation to the time records that I submit to accounting. It's a software requirement to make debits and credits equalized.

Q: How would the computer know, to generate for February 24, two entries for 999 hours, and below that an entry for 266 point 52 hours?

A: I haven't a clue, although the amounts would suggest that that was the amount of the premium. I have no idea how that number of hours, broken down as they are, are generated.

Nusbaum Deposition at 75-76 (emphasis added).

18. Furthermore, Willkie's billing records identify actual fees incurred in the approximate amount of $1,070,000 from March 23, 2000 through June 15, 2000. Willkie, however, received $2,900,000 in wire transfers during the same time period, and thus received a premium of greater than $1.5 million from a troubled company unable to pay its other creditors. Mr. Nusbaum confirmed this conclusion:

Q: If I told you that your premium was in excess of $1.5 million, would you disagree with that?

A: I understood it to be approximately $1.5 million dollars.

Q: And, that would be ..., more than three times your actual time for the matter?

A: That would sound right, approximately three. Actually three or four, depending on how you calculate it.

Nusbaum Deposition at 81.

19. Despite the abnormalities surrounding the engagement and billing between Willkie and the Debtors, absolutely no paperwork documenting Willkie's retention was executed.[3] Mr. Nusbaum so testified stating:

> Q: At the point Willkie Farr was engaged to represent InaCom for the first time on this Compaq deal, was any type of retention letter set?
>
> A: No, not that I'm aware of.

Nusbaum Deposition at 37.

20. Standing alone, the numerous irregularities detailed above demonstrate that the Debtors' claim against Willkie for recovery of preferential and fraudulent transfers is more than plausible. In addition to such irregularities, the Transfers meet all the elements of a preference under section 547 of the Bankruptcy Code, thus making the likelihood that the Debtors' will succeed in their claim for recovery of the Transfers probable. Further, the evidence in support of the Debtors' claims under section 548 for fraudulent transfer is equally compelling.

C. Willkie Failed to Disclose Receipt of Voidable Preferences

21. On June 21, 2000, the Debtors filed the Willkie Application. In the Willkie Application, Willkie represented that it did not have an interest materially adverse to the interest of the Debtors' estates or to any of the class of creditors or equity security holders, and it did not disclose that transfers it received constituted potential preferential and fraudulent transfers.

22. In the Affidavit of Paul V. Shalhoub in Support of the Willkie Application (the "Shalhoub Affidavit"), Mr. Shalhoub, another Willkie partner, stated that since January of 2000, Willkie received fees, expenses, and retainers aggregating approximately $2,900,000 from the

[3] Title 22, Part 1215.1 of the *New York Compilation of Codes, Rules and Regulations* ("22 NY ADC 1215.1") now requires any attorney wishing to collect a fee of any kind for representing a client to provide such client a written letter of engagement either (a) before commencing representation or (b) within a reasonable time if such notification isn't practicable at the time of the commitment. Although 22 NY ADC 1215.1 was enacted shortly after Willkie's engagement

Debtors. The Shalhoub Affidavit further stated that approximately $900,000 of this total amount was received in three separate payments in the form of "retainers" for the filing of the Debtors' bankruptcy. Like the Willkie Application, the Shalhoub Affidavit failed to disclose that payments to Willkie constituted potential preferential and/or fraudulent transfers.

23. On October 24, 2000, the Willkie Retention Order authorized the retention of Willkie as Debtors counsel pursuant to sections 327(a). The Willkie Retention Order also authorized Willkie's retention *nunc pro tunc* to the Petition Date. Thereafter, Willkie was co-counsel to the Debtors with Pachulski, Stang, Ziehl, Young & Jones, P.C. Willkie's status as a professional retained under section 327(a) of the Bankruptcy Code never changed until Willkie withdrew as Debtors' counsel in response to the Adversary Proceeding and the Motion of the Acting United States Trustee (A) to Disqualify (1) Willkie Farr & Gallagher LLP, (2) Deloitte Consulting L.P., (3) Deloitte & Touche LLP, and (4) Ernst & Young LLP ("The Conflicted Professionals"); (B) To Disgorge Compensation and Reimbursement Paid to the Conflicted Professionals; and (C) To Deny Compensation and Reimbursement Due the Conflicted Professionals and Objection to any Subsequently-Filed Request by the Conflicted Professionals for Approval of Compensation and Reimbursement.[4]

24. The Debtors do not seek to re-visit the issues surrounding Willkie's retention in this Limited Objection, nor do the Debtors challenge at this time the merits of the Final Fee Application. Rather, the Debtors submit that it is possible to do so in light of the fact that Willkie's retention was based upon an incomplete and inaccurate disclosures and that the Court, and all other parties in

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of the Debtors, Willkie met none of its requirements.

[4] Willkie was dismissed without prejudice from the Disqualification Motion by Stipulation entered September 11, 2002, Docket No. 3733.

interest, were deprived of the opportunity to assess facts relevant to Willkie's disinterestedness. Nonetheless, the Debtors object, on a limited basis, to Willkie's Final Fee Application.

IV. CONCLUSION

25. In light of the pending Complaint, the Debtors object to the final determination of allowance of the Final Fee Application on a limited basis. In the event of a judicial determination of one or more preferential and/or fraudulent transfers, and thus, an actual conflict, the Court will be obliged to disqualify Willkie and possibly cause disgorgement of all fees paid post-petition. The timing of the Final Fee Application, coupled with the pending status of the Adversary Proceeding, makes Willkie's request for final disbursements premature. The Debtors request therefore, that the Court deny the relief requested in the Final Fee Application and dismiss it without prejudice or, in the alternative, hold any such determination in abeyance until the final resolution of the Adversary Proceeding.

WHEREFORE, the Debtors request that this Court issue an order (i) dismissing the Final Fee Application without prejudice or (ii) holding a determination thereon in abeyance until the Adversary Proceeding is concluded and granting such other relief that this Court deems appropriate.

Respectfully submitted,

Duane D. Werb (#1042)
WERB & SULLIVAN
300 Delaware Avenue
Wilmington, Delaware 19801
Telephone: (302) 652-1100
Facsimile: (302) 652-1111
ddwlaw@dca.net

Special Counsel for InaCom Corp., on behalf of the estates of Debtors InaCom Corp., et al.

Jean R. Robertson (OH #0069252)
Edmund W. Searby (OH #0067455)
Matthew A. Salerno (OH#0070847)
McDONALD HOPKINS CO., LPA
2100 Bank One Center
600 Superior Avenue, E.
Cleveland, Ohio 44114
Telephone: (216) 348-5400
Facsimile: (216) 348-5474
jrobertson@mcdonaldhopkins.com
esearby@mcdonaldhopkins.com
msalerno@mcdonaldhopkins.com

Special Counsel for InaCom Corp. and its affiliated Debtors, on behalf of the estates of Debtors InaCom Corp., et al.

CERTIFICATE OF SERVICE

I hereby certify that, on this 29th day of August, 2003, a copy of the above and foregoing ***Debtors' Limited Objection to Final Summary Application of Wilkie Farr & Gallagher for (I) Final Allowance of Fees and Expenses Covering Periods From June 16, 2000 through April 30, 2002, Inclusive, and (II) Other Related Relief*** was filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system, and copies of this Memorandum will also be sent via facsimile to the following parties:

Via Hand Delivery
James L. Patton, Jr.
Robert S. Brady
Curtis J. Crowther
YOUNG CONAWAY STARGATT
& TAYLOR LLP
The Brandywine Building
1000 West Street, 17th Floor
Wilmington, DE 19899-0391

Via Overnight Delivery
Paul Shalhoub
Willkie Farr & Gallagher
The Equitable Center
787 Seventh Avenue
New York, NY 10019

Via Hand Delivery
Bonnie Glantz-Fatell, Esq.
Blank, Rome, Comisky & McCauley LLP
Chase Manhattan Centre
Suite 800
1201 Market Street
Wilmington, DE 19801

Counsel to the Official Committee
of Unsecured Creditors

Via Hand Delivery
Joseph J. McMahon, Jr.
844 King Street, Room
Wilmington, DE 19801

Office of the United States Trustee

/s/ Duane D. Werb
Duane D. Werb (#1042)