

Commercial Fraud Task Force Committee

The ABI Commercial Fraud Task Force Committee facilitates information sharing, training, and education between ABI members and the public-private sector to combat commercial bankruptcy fraud.



***Semper Fidelis*¹, Faithful or Foolish: The Legal, Professional and Ethical Dilemma of Debtor Counsel after Appointment of a Chapter 11 or 7 Trustee**

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“Most good lawyers live well, work hard and die poor.”² As punitive as public opinion and perception of the legal profession is, the fact *is* nearly everyone likes *his or her* lawyer. The majority of us, with notorious exceptions, are ethical and do a credible job at policing ourselves. And sometimes we pay a price for doing what is right.

What is seriously lacking among our profession, both bench and bar, is a can-do attitude of practicality. Clients are not interested in their lawyer’s pedigree; his class rank, the school she attended, academic or professional accomplishments, or any of a number of other indicia of legal stature we lawyers use to judge the relative prowess of one another professionally. By far and away the two things clients want most in their lawyer is honesty and results. If you have those two characteristics as a lawyer you will have more work than you can do, a reputation that is your best professional asset and outstanding advertisement. Caveat: A reputation is easier to keep than to recover.

This article is not peppered with case citations. It addresses, and does not pretend to solve, a rather thorny problem that is of seemingly moderate interest and significance until it is you who have been conscripted by conscience and ethics³ to ply your trade involuntarily without compensation.

The unreported case of *In Re Hampton Village Inc.*, 122 Fed. Appx. 717; 2004 WL 2913130

¹Latin for “always faithful” and the motto of the United States Marine Corps whose members commonly use the abbreviated form “semper fi” as between themselves.

²Daniel Webster

³A sign that hung on the wall of the weight room in which I spent too much of my time as a student/ athlete read, “There is no right way to do the wrong thing.” That truism applies to much in life besides proper weight training.

represents a sort of perfect storm/odyssey,⁴ the union of which can leave debtor counsel with an empty purse and a moral and professional Pyrrhic⁵ victory. *Hampton Village* was commenced as an involuntary chapter 7 and was converted to a chapter 11. Later, after unproductive litigation threatened to consume the case, a chapter 11 trustee was appointed with the consent of the debtor-in-possession (DIP). Debtor counsel assisted the newly appointed trustee in the transition of the case from a DIP to a trustee operated one. Counsel spent several hours interspersed over a handful of days to properly complete the transition process, the majority of which went unrecorded and hence never showed up in the final fee application. There were numerous telephone conferences with the trustee and his lawyer as well.

Thereafter, debtor counsel filed their final application for compensation, which application drew an objection from the major [secured] creditor who had a serious dislike of the debtor's sole shareholder. Things had gotten personal.

After a lengthy trial in which debtor counsel was cross-examined at length, the bankruptcy court granted the application excepting a small portion that represented mainly services performed after the chapter 11 trustee was appointed. Counsel argued unsuccessfully that ethical constraints⁶ dictated that they participate in the orderly transition from DIP to a trustee-run case and should therefore be paid for their services. The bankruptcy court, relying on *In the Matter of Pro-Snax Distributors Inc.*, 157 F. 3d 414 (5th Cir. 1998) essentially said "I feel your pain, but 'no.'" *Pro Snax* and a few cases of similar ilk⁷ hold that 11 U.S.C. §330(a) says what it says (or doesn't say) and debtor counsel cannot be compensated from the estate of the debtor absent an appointment as counsel to the trustee in some capacity.⁸ Not surprisingly, the Ninth Circuit's decision *In Re Century Cleaning Services Inc.*, 195 F.3d 1053 (C.A. 9 1999) stands alone in its holding that §330 is ambiguous and that debtor counsel can be compensated from the estate.

⁴Not to be confused with the epic work of Homer wherein he chronicles the seemingly endless wanderings of Odysseus.

⁵A victory that is accompanied by enormous losses and leaves the winners in as desperate a condition as if they had lost. Pyrrhus was an ancient general who, after defeating the Romans in a battle, told those who wished to congratulate him, "One more such victory and Pyrrhus is undone."

⁶See Rules of Professional Conduct of the Louisiana State Bar Association. Rules 1.2 "Scope of Representation and Allocation of Authority Between Client and Lawyer", 1.4 "Communication" and in particular 1.16 "Declining or Terminating Representation" sub parts (c) and (d) dictate and impact the manner in which a lawyer is to withdraw from representation. All states have similar rules of conduct.

⁷*Lamie v. U.S. Trustee*, 540 U.S. 526; 124 S. Ct. 1023; 157 L. Ed. 2d 1024 (2004); *In Re Weinschneider*; 395 F. 3d 401 (C.A. 7 2005); *In Re American Steel Prod., Inc.*, 197 F. 3d 1354 (C.A. 11 1999).

⁸Intentionally not discussed are the myriad of opinions and endless speculation as to why the words "or to the debtor's attorney" were omitted from 11 U.S.C. §330(a).

From a practical stand point *Lamie v. U.S. Trustee*, 540 U.S. 526; 124 S. Ct. 1023; 157 L. Ed. 2d 1024 (2004) overshadows the whole of the focal issue discussed. *Lamie* held that no fees are payable from the estate to chapter 7 debtor counsel. If a case converts from chapter 11 to 7 debtor counsel faces the same dilemma as he does after the appointment of a chapter 11 trustee. The authority relied upon for not allowing compensation to chapter 7 debtor counsel is the same [§330(a)] as that which dictates a *Pro Snax* result. The services for which compensation was sought in *Pro Snax* and *Lamie* were different, however the consequences are the same. Debtor's attorney is simply not named in §330 as one of the privileged few and unless debtor counsel has some specie of court approved role or is formally retained he will very likely, as the bankruptcy court stated in *Hampton Village*, have Hobson's choice⁹ when it comes to the decision whether or not to represent debtors in chapter 11 cases; you undertake their representation with the virtual certainty of no post-trustee or post-conversion compensation or take nothing at all.

Regardless, the objecting creditor appealed the order granting counsels' pre-chapter 11 trustee fees. The game was afoot. Debtor counsel decided not to appeal being content with the award but did file a pleading styled "Answer to Appeal" in which they pointed out they had nothing to appeal but were filing the pleading to preserve their right to return to the bankruptcy court to ask for more fees and expenses incurred in defending the appeal of their fee award.¹⁰ It was noted on appeal that the "Answer to Appeal" contained the requisite information to satisfy Bankruptcy Rule 8001. There is no procedure for answering an appeal in federal practice. A cross appeal is appropriate in normal practice.

The district court affirmed, and in a footnote provided that counsel could file any motion they deemed appropriate requesting additional fees and expenses directly as a result of counsels' strenuous argument that they should be allowed additional fees for defending the appeal.

The creditor appealed to the Fifth Circuit and debtor counsel filed no notice of appeal being of the opinion that they had nothing to appeal. The Fifth Circuit affirmed the fee award but found that since debtor counsel had not filed a notice of appeal, the *Pro Snax* issue was not properly before the court and remanded the matter to the bankruptcy court for further consideration of whether debtor counsel should be compensated from the estate for successfully defending their fee award on appeal. Upon remand, and relying on *Pro Snax*, the bankruptcy court denied the motion of the debtor counsel-turned-pro-bono-defacto-chapter-11-trustee-transition-attorney-turned-defendant-turned-appellee-turned-involuntary-servant of all parties in interest except themselves. It was finally over. Or was it? The faithfulness of counsel yielded them nothing but grief.

⁹ The choice of taking what is offered or nothing at all. *Webster's Revised Unabridged Dictionary* © 1996, 1998 MICRA, Inc. [After Thomas Hobson (1544?-1630), an English keeper of a livery stable, from his requirement that customers take either the horse nearest the stable door or none.]

¹⁰ Counsel even went so far as to object to the trustee's Motion for Final Decree asserting and preserving their intention to request compensation at a later date after all appeals were final.

The question is squarely framed thus: What if anything can the lawyer do to protect against the pedantic *Pro Snax* and its all-too-accurate application of the letter of §330? There is no silver bullet, but there are “offensive-defensive” measures that can be taken to avert being subjected to a form of involuntary servitude¹¹ or a “split the baby”¹² decision in which a court awards part of the fee requested as a salve to help numb the pain that comes from not eating of the fruit of one’s labor.

The first-day order appointing counsel to the DIP could contain a provision that specifically states that if a trustee is appointed or the case is converted, debtor counsel will be special counsel to the trustee (chapter 11 or 7) for the limited purpose of assisting in the transition from a DIP case to either a chapter 11 or 7 trustee-run case. At the appropriate time, counsel would be required to file an application or motion requesting compensation.

Failing that, when debtor counsel files his or her final application for compensation for services performed, whether for pre-trustee fees or pre- and post-trustee fees, he should include a request to be appointed special counsel for the purpose of defending any appeal from any order granting fees and expenses while acting in the capacity of debtor counsel. At least then if the bankruptcy court denies that request issue is joined for appeal purposes.

A second mechanism, and this can be used in addition to that mentioned in the preceding paragraph, is to file an application for appointment as special counsel under §327(e). Care should be taken to articulate what counsel has and will contribute to the administration of the case past, present and future. It is very likely that the court would entertain such a motion on an expedited basis if a hearing is requested at that juncture. Counsel may want to provoke an actual hearing “on the front end” to draw out and engage any potential adversaries or parties opposing counsel’s appointment lest he or she knit himself or herself into a position from which the lawyer cannot readily withdraw.

Chapter 11 cases have aspects of them that move at blinding speed, and before one has time to fully appreciate the posture of the case he may well have unintentionally and uncontrollably lurched into a quasi-fiduciary or legal relationship from which he cannot readily extricate himself and for which he cannot under current law be compensated. A hearing also results in a form of judgment or order that could have *res judicata* effectiveness, which further insulates the practitioner from later challenges to his special counsel role.

Other possibilities exist like arguing counsel has made a substantial contribution to the estate or the reorganization or perhaps filing a *nunc pro tunc* application. Personally these give me no

¹¹The 13th Amendment argument that debtor counsel being forced to defend the appeal of their fee award without compensation was a sort of involuntary servitude drew no attention from the court in *Hampton Village* which in retrospect was likely merciful blessing.

¹²See 1 Kings 3:16-27, Holy Bible, in which Solomon was faced with deciding between to women who were competing over which was the true mother of a child.

comfort. Once counsel is debtor counsel, he is forever tainted and held hostage by his integrity and the scrivener's error in §330.

Practical lawyers and judges can fashion orders that protect against the kind of unfairness that can result from the necessarily rigid application of §330 as done in the pedantic *Pro Snax*.

Second guessing debtor counsel in situations like those addressed in this paper and who acted honestly in good faith can be summed up best by what President, then General, Eisenhower said concerning some of the critical decisions he had to make alone during WWII: "Its easy to be a farmer when your plow is a pencil and you're a thousand miles away from the cornfield."

Like the U.S. Marine Corps, being faithful to one's duty and calling as a professional will not always result in a good-guy-gets-the-girl ending. But that is not what really matters anyway.

Semper Fi.