

WHAT IS A POOR DEBTOR'S ATTORNEY TO DO?
Getting Paid After Lamie

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Prior to 1994, section 330(a) of the Code authorized the bankruptcy court to allow reasonable compensation and expense reimbursement "to a trustee, to an examiner, to a professional person employed under section 327 or 1107 of this title, or to the debtor's attorney" In 1994, Congress amended the section by (among other things) deleting the words "or to the debtor's attorney."

Three of the circuit courts of appeal decided that, notwithstanding the amendment, bankruptcy courts could allow payment to debtor's counsel out of the estate.² These courts ruled that the amendment rendered the section ambiguous and concluded that the deletion of the reference to debtor's counsel was a scrivener's error.

Three other circuits took the opposite view, holding that the plain language of the amended statute precluded allowances to debtor's counsel out of the estate.³

The Supreme Court resolved the circuit split in favor of the plain language view in Lamie v. United States Trustee.⁴

The facts of Lamie are depressingly familiar. The debtor in possession retained Mr. Lamie with court approval pursuant to section 327. So far, so good, but not for long. The court converted the case to chapter 7 fairly early in the proceedings. This did not deter Mr. Lamie. He continued to represent the debtor, "even though he did not have the trustee's authorization to do so."⁵ He prepared reports of post-petition claims and assets, filed amended schedules, and appeared at a hearing in an adversary proceeding. Proving once again that no good deed goes unpunished, the bankruptcy court, district court, Fourth Circuit, and Supreme Court unanimously

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²In re Ames Dept. Stores, Inc., 76 F.2d 66 (2d Cir. 1996); In re Top Grade Sausage, Inc., 227 F.3d 123 (3d Cir. 2000); In re Century Cleaning Services, Inc., 195 F.3d 1053 (9th Cir. 1999).

³In re Pro-Snax Distributors, Inc., 157 F.3d 414 (5th Cir. 1998); In re American Steel Product, Inc., 197 F.3d 1354 (11th Cir. 1999); In re Equipment Services, Inc., 290 F.3d 719 (4th Cir. 2002).

⁴124 S.Ct. 1023 (2004).

⁵124 S.Ct. at 1029.

agreed that he was not entitled to compensation from the estate.

This article will not discuss the merits of the Lamie decision. The commentators will surely seize the opportunity to sacrifice many trees on the altar of statutory interpretation.⁶ Instead, I will address a more practical question: how can debtor's counsel in a chapter 7 get paid despite Lamie?

The Court itself pointed out one way to solve the attorney's problem. Section 327(e) expressly authorizes the trustee to retain the debtor's attorney "for a specified special purpose other than to represent the trustee in conducting the case."⁷ If the trustee had retained Mr. Lamie and obtained the court's approval under section 327, Mr. Lamie's right to compensation would have been secure.

This solution only works if the trustee is willing to retain the debtor's counsel, and the trustee has no obligation to do so. Further, the trustee's refusal to retain the debtor's attorney does not necessarily take the debtor's attorney off the hook. The debtor has duties following conversion. For example, the debtor must "cooperate with the trustee in the preparation of an inventory, the examination of proofs of claim, and the administration of the estate," Fed. R. Bankr. P. 4002(4), and (under local rules in effect in many districts) must file a list of unpaid administrative expenses incurred during the chapter 11 phase. The debtor will usually need the attorney's help to comply with these requirements. Unless and until the court permits the attorney to withdraw from the representation, the attorney for the debtor has an ethical obligation to assist the debtor in performing these duties, even though the debtor (as distinguished from the estate) probably has no money with which to pay the attorney. The options available to the attorney in this situation are few and unattractive:

- < The attorney could immediately seek leave to withdraw as the debtor's counsel. If the court grants this motion (and there is no certainty that the court would do so), the attorney's problem would be solved, but the trustee and the estate would be hampered because the debtor probably would not supply important information and assistance.

⁶See The Great Pretenders: A Tale of the Rehnquist Court and Code § 330(a)(1), 24 No. 3 Bankruptcy Law Letter 1 (March 2004).

⁷ 124 S.Ct. at 1031-32. The Court also cited section 327(a) as a basis for the trustee's retention of the debtor's attorney. It is not clear, however, that the trustee could hire the debtor's lawyer under section 327(a). The attorney who represented the debtor in possession in the chapter 11 phase of the case may not be a "disinterested person" within the meaning of section 101(14) during the chapter 7 phase, because the attorney probably has some unpaid fees from the chapter 11 phase and is therefore a "creditor," and because the interests of the debtor may be "materially adverse" to the interest of the estate after conversion. Further, if the trustee could hire the debtor's lawyer under section 327(a), section 327(e) would be surplusage.

- < The attorney could help the debtor comply with its post-confirmation obligations and absorb the expense of doing so as a cost of doing business. This is not a palatable alternative for the attorney. Further, this would encourage bankruptcy attorneys to increase their hourly rates to reflect this risk, thus increasing the extent to which administratively solvent estates subsidize insolvent estates.

- < The attorney could do the work and attempt to get paid by way of a “substantial contribution” claim under section 503(b)(3)(D). This would likely fail, because the section by its terms applies only to chapter 11 cases, not cases converted to chapter 7, and is available only to “a creditor, an indenture trustee, an equity security holder, or a committee”

Lamie also affects cases that begin under chapter 7, in addition to cases which are converted from chapter 11 to chapter 7, because section 330(a) applies equally to both categories of cases. The Supreme Court suggested that these effects will be imperceptible:

It appears to be routine for debtors to pay reasonable fees for legal services before filing for bankruptcy to ensure compliance with statutory requirements. So our interpretation accords with common practice. Section 330(a)(1) does not prevent a debtor from engaging counsel before a chapter 7 conversion and paying reasonable compensation in advance to ensure that the filing is in order. Indeed, the Code anticipates these arrangements.⁸

The situation may not be as simple as the Supreme Court suggests.

It is true that most consumer bankruptcy attorneys represent their clients on a “flat fee” basis. In Hawaii, however, and possibly in other states, the term “flat fee” is at best a misnomer. In 2002, Haw. R. Prof. Conduct 1.15(d) was amended to provide that “all fee retainers are refundable until earned.” The drafter’s comments make it clear that the change was intended to apply to fee payments which are characterized as “flat fees.”

The new rule makes sense. If a client hires a lawyer to file a bankruptcy petition and pays a “flat fee” in advance, but the attorney quits before completing the work, the client is entitled to a refund. Therefore, the client has some interest in the “flat fee” until the lawyer has finished the job. Under this interpretation, the so-called “flat fee” looks and functions more like a retainer which is earned as the work is done.

The bankruptcy problem arises because, in a consumer bankruptcy case, the lawyer’s work usually is not done when the petition is filed. If nothing else, the lawyer usually must represent the client at the meeting of creditors under section 341. Therefore, the debtor has an

⁸124 S.Ct. at 1032.

interest in the legal fee at the date of the petition. That interest is property of the estate.⁹

If section 330 does not authorize payment of the debtor's counsel out of estate property, what authority permits the use of the "flat fee" for that purpose? One might argue that the attorney has a security interest in the flat fee which is perfected by possession, and that the attorney is entitled to his "collateral" under section 725. But this theory would require the attorney or the trustee to file one or more motions which they do not currently file and which, if required, would drive up the cost of a consumer bankruptcy case for no good reason.

The 1994 amendment to section 330 is not a model (to put it mildly) of statutory drafting. Lamie resolved the issue of statutory interpretation but created a variety of practical problems. There is little reason to hope that Congress will solve the problems. The dispute about section 330 has existed for a decade, but Congress has failed to do anything about it and the long-pending Bankruptcy Reform Act does not address the issue. Bankruptcy courts and bankruptcy practitioners should prepare to struggle with these problems for a long time.

⁹. Indian Motorcycle Assoc. III Ltd. Partnership v. Massachusetts Housing Finance Agency, 66 F.3d 1246, 1255 (1st Cir. 1995); 3 Collier on Bankruptcy ¶ 329.04[1][e] (15th ed. rev.2003).