

**Professional Fees After Lamie  
Payment From Whom and How: Conversion of a Case,  
Future Retention and Beyond**

**I. Overview: Big Decisions Come In Small Packages**

For a number of years the questions of whether Chapter 7 debtor's counsel could be compensated from a debtor's bankruptcy estate absent that attorney being employed under 11 U.S.C. §327 or 1103 has been unresolved<sup>1</sup>. The U.S. Supreme Court's decision in *Lamie v. U.S. Trustee*<sup>2</sup> finally resolved the split between the Circuits. This issue primarily involves fee requests from attorneys hired by debtors to file Chapter 11 cases for work done for a Chapter 7 estate after the Chapter 11 was converted to a Chapter 7 case although other related issues may arise.

**A. The Lamie Decision**

In *Lamie* the debtor, Equipment Services, Inc., filed a Chapter 11 petition on December 24, 1998. The debtor's counsel promptly sought approval of his retention as counsel for the Chapter 11 estate and his employment was approved on January 26, 1999. The debtor's counsel also properly disclosed he received \$1,000.00 from the debtor for fees and expenses related to the filing of the Chapter 11 and a \$5,000.00 retainer for post petition services. Less than three months into the bankruptcy, the Chapter 11 was converted on motion of the U.S. Trustee to a Chapter 7 proceeding. Counsel for the Chapter 11 debtor continued to provide services to the debtor after the Chapter 11 case was converted to a Chapter 7 proceeding without "the Trustee's

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<sup>1</sup> The Forth, Fifth and Eleventh Circuits had held that the plain meaning of 11 U.S.C. §330 did not permit the payment of professional fees unless a professional was employed under either 11 U.S.C. §327 or 1103, including fees to a debtors attorney. See *In re Equipment Services, Inc.*, 290 F.3d 739 (4<sup>th</sup> Cir. 2002), aff'd, *Lamie v. U.S. Trustee, U.S.*, 124 S.Ct. at 1023; *In re American Steel Products, Inc.*, 197 F.3d 1354 (11<sup>th</sup> Cir.1999); *In re Pro-Snap Distributors, Inc.*, 157 F. 3d 414 (5<sup>th</sup> Cir.1998). The Second, Third and Ninth Circuits held that due to drafting errors in 11 U.S.C. §330(a) that attorney for Chapter 7 debtors and for Chapter 11 debtors attorneys could be compensated by a bankruptcy estate without being employed pursuant to 11 U.S.C. §327. See *In re Ames Dept. Stores, Inc.*, 76 F.3d 66 (C.A.2 1996); *In re Top Grade Sausage, Inc.*, 227 F.3d 123 (C.A.3 2000); *In re Century Cleaning Services, Inc.*, 195 F.3d 1053 (C.A.9 1999).

<sup>2</sup> *Lamie v. U.S. Trustee \_U.S.\_*, 124 S.Ct. 1023 (Jan. 26, 2004)

authorization to do so”<sup>3</sup> and without being retained by the Chapter 7 bankruptcy estate under 11 U.S.C. §327. The debtor’s counsel requested fees for both its pre and post conversion work and that his fees are paid from his pre-petition retainer.

The Bankruptcy, District and Fourth Circuit in *Lamie* all ruled that: (1) the debtor’s counsel was entitled to his pre-conversion fees and (2) 11 U.S.C. §330(a)(1) prohibited a debtor’s attorney from being paid from the Chapter 7 estate for his post conversion fees, absent being retained by the Chapter 7 estate under 11 U.S.C. §327.<sup>4</sup>

**B. Blending the Meats: The Resolution of the Issue.**

The question presented to The Supreme Court in *Lamie* arose from a change in 11 U.S.C. §330(a) which occurred as part of the 1994 amendment to the Bankruptcy Code made by the Bankruptcy Reform Act of 1994 (“1994 Act”). Prior to the passage of the 1994 Act section 330(a) read

“(a) After notice to *any* parties in interest and *to* the United States trustee and a hearing, and subject to sections 326, 328, and 329 *of this title*, the court may award to a trustee, *to* an examiner, to a professional person employed under section 327 or 1103 *of this title*, or *to the debtor’s attorney* –”(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney ... and by any paraprofessional persons employed by such trustee, professional person, or attorney...; and “(2) reimbursement for actual, necessary expenses.” [emphasis added]

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<sup>3</sup> 124 Sup.Ct at 1029. It is unclear from the lower court decisions and the Supreme Court decision whether any of this work was performed or at the request of the Chapter 7 Trustee. However, the 4<sup>th</sup> Circuit noted that the U.S. Trustee also objected to the post conversion fee request on the ground it did not benefit the estate but only the debtor, Equipment Services Inc., 290 F.3d at 743. See also Judge Michael’s concurrence at 290 F.3d at 747.

<sup>4</sup> A second issue addressed by the lower Courts in Lamie but not addressed by the Supreme Court in its decision was whether the post confirmation fees could be paid by the counsel’s retainer. The Fourth Circuit ruled that the portion of the retainer not earned pre-conversion was property of the estate and could not be used to pay post confirmation fees. 290 F.3d at 746. The Bankruptcy and District Courts in Lamie permitted the Debtor’s counsel to be paid his post conversion fees from his retainer. The Fourth Circuit reversed the lower court’s decision on this issue. The Supreme Court did not address the Fourth Circuit’s decision on this issue. See also On-Line Services, Ltd, LLC, 2004 WL 2671669 (Bankr.N.D.Iowa) (Retainer is property of Chapter 7 estate and cannot be used to pay post petition fees of debtor’s counsel).

The language “or to the debtors’ attorney” was critical for Chapter 7 debtor’s counsel and estate counsel of former Chapter 11 debtors to be paid by bankruptcy estates under 11 U.S.C. §330(a) when they were not employed as counsel for the Chapter 7 estate<sup>5</sup> under 11 U.S.C. §327.

The 1994 Act amended section 330(a) to read

“(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103– “(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and “(B) reimbursement for actual, necessary expenses.”

The phrase “or to the debtors attorney” was deleted from this Section for no clear reason.

The Second, Third and Ninth Circuits in reviewing the strange wording of 330(a)(1) after the 1994 Act’s amendment held that 330 (a)(1) was ambiguous<sup>6</sup> and that the deletion of the phrase “or to the debtors attorney” was a scrivener’s error and should not be given any effect. See generally 3 Collier on Bankruptcy 330 LH[5] 330-75 to 330-76 (rev 15<sup>th</sup> ed. 2003).

However, courts in the Fourth Circuit in the *Lamie* decision as well as the Fifth and Eleventh Circuits, in reviewing the same text, determined that despite the statute’s inconsistent and somewhat confusing wording, held that the statute was plain and unambiguous and that absent approval of employment under either 11 U.S.C. §327 or 1103 by a Court, a professional,

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<sup>5</sup> There is some academic dispute as to whether an attorney or other professional is employed by a bankruptcy estate or a debtor in possession or Trustee in Chapter 7 and 11 proceedings. See generally Rappoport & Bowles, Has The DIP's Attorney Become the Ultimate Creditors Lawyer in Bankruptcy Reorganization Cases, 5 Am.B.Inst. L.R. 47 (1997). For purposes of this article it will be assumed that the bankruptcy estate, either Chapter 7 or 11, employs the professionals under 11 U.S.C. § 327.

<sup>6</sup> By finding that a statute is ambiguous, courts may then consider the legislative history of the statute to determine Congress's intent. See *In re Top Grade Sausage*, 227 F.3d at 129.

including counsel for a debtor could not be paid their *final* professional fees or expenses under 330(a)(1).<sup>7</sup>

In *Lamie* the Supreme Court sided with the Fourth, Fifth and Eleventh Circuits and held that although 11 U.S.C. §330(a)(1) was “awkward and ungrammatical,” it was not ambiguous and its meaning was reasonably plain.<sup>8</sup> The Supreme Court rejected arguments also advanced by debtors’ counsel that: (1) 11 U.S.C. §330(a)(1) by its use of the term “attorney”, when read with 11 U.S.C. §331 permitted debtors’ attorneys to be paid from debtor’s estates; (2) that a literal reading of 11 U.S.C. §330(a)(1) would be absurd; (3) that the otherwise unexplained change in bankruptcy practice showed the deletion of the phrase “or to the debtors’ attorneys” was a scrivener’s error;<sup>9</sup> and (4) that the legislative history of 11 U.S.C. §330(a)(1) supported the contention that no change in the past practice of permitting debtor’s attorney to apply for compensation from a bankruptcy estate was intended by the 1994 amendment “debtor’s attorney” language was inadvertent.<sup>10</sup>

### C. Adding the Spices: Two Potential Consequences of Lamie

The most important consequence of *Lamie* is that it unequivocally resolves the interpretation of 11 U.S.C. §330(a)(1). Now if either a former Chapter 11 Debtor’s counsel in a converted case or a Chapter 7 Debtor’s counsel wants to be compensated from a Chapter 7 Estate

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<sup>7</sup> As noted by the Supreme Court in *Lamie*, 11 U.S.C. §331’s plain language permits a debtor’s attorney to receive interim payments of professional fees. The Supreme Court interpreted this provision as only applying to debtor’s attorney employed by the estate under 11 U.S.C. §327.

<sup>8</sup> *Lamie*, 124 S. Ct. at 1030.

<sup>9</sup> The Supreme Court did have some sympathy for the contention that the change in bankruptcy practice caused by 11 U.S.C. §330’s amendment was not adequately explained by Congress. *See* 124 S. Ct. at 1032. (“it is fair to doubt that Congress would so reward [Debtor’s attorneys] longstanding role without announcing the change in the Congressional record.”)

<sup>10</sup> Indeed the Supreme Court used the muddled legislative history of 11 U.S.C. §330(a)(1) to highlight “the difficulty of relying on legislative history here and the advantage of our determination to rest our holding on the statutory text.”

for work performed for a Chapter 7 estate, they must first be retained by the estate under 11 U.S.C. §327.<sup>11</sup>

The second and possibly unintentional consequence of *Lamie* is that *nunc pro tunc* retention of estate professionals sought a significant amount of time after they begin work in a case may no longer be possible. While several courts<sup>12</sup> have allowed, under limited circumstances, professionals to be retained *nunc pro tunc* and paid for their services performed prior to the court approving their retention, in light of the Supreme Court statements in *Lamie* that retention under §327 is a prerequisite for payment of professional persons, such decisions may be questionable.

While these two consequences are the most direct results of *Lamie*, there are additional issues which must be addressed in light of *Lamie*. These questions are discussed below.

## **II. Are You Special: Employment as Special Counsel by a Chapter 7 Trustee**

Perhaps the simplest solution to the holding in *Lamie* is for Chapter 11 debtor's counsel to be hired<sup>13</sup> by the Chapter 7 Trustee to be hired as special counsel under 11 U.S.C. §327(e). *See Lamie* 124 S.Ct. at 1032 “Sections 327 and 330, taken together, allow chapter 7 trustees to engage attorneys, including debtor's counsel and allow courts to award them fees. *See* §§ 327(a)

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<sup>11</sup> There is an interesting question as to whether a Debtor's attorney could be compensated under 11 U.S.C. §330(a)(1) if a Trustee authorized their work but their employment was not approved by the court under 11 U.S.C. §327. Compare “A debtor's attorney not engaged as provided by §327 is simply not included within the class of persons eligible for compensation.” 124 S.Ct. at 1030 with “Section 327's limitation on debtors incurring debts for professional services without the chapter 7 trustee's approval is not absurd” (emphasis added) 124 S.Ct. at 1032 and “the deletion at issue furthered this reform by ensuring that Chapter 7 debtor's attorney would receive no estate compensation absent the trustee's authorization of their work.” 124 S.Ct. at 1033.

<sup>12</sup> See generally, In re Arkansas Co., 798 F.2d 645 (3<sup>rd</sup> Cir.1986); In re 245 Assocs., 188 B.R. 743 (Bkrtcy. S.D.N.Y. 1995)

<sup>13</sup> Although the Supreme Court in *Lamie* spoke of “the trustee's authorization” to perform services on behalf of the debtor, it is clear that court approval is the key pre-requisite to payment under 11 U.S.C. §330.

and (e).” Unfortunately, there are several serious obstacles to this direct resolution of the *Lamie* issues.

**A. Practical Issues: Will The Trustee Hire You?**

One of the most critical changes in the retention of estate professionals arising from *Lamie* is the requirement that when a Chapter 11 case is converted to a Chapter 7 case, the Chapter 7 Trustee must formally “re-hire” under 11 U.S.C. §327 any profession which worked for the Chapter 11 debtor. *See Lamie* 124 S.Ct. at 1029 (noting termination of debtor as debtor in possession, terminates a professional’s retention under 11 U.S.C. §327 as a debtor-in-possession professional). Unless the Trustee acts to retains you as a professional you may not be compensated for your efforts on behalf of the Debtor post conversion. *See In re Weinschneider*, \_F.3d\_ 2005 WL 89490 (7<sup>th</sup> Cir. Jan. 18, 2005)

**B. Retention Standards Under 11 U.S.C. §327(e)**

11 U.S.C. §327(e) provides:

(e) The trustee, with the court’s approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does 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.

Under this provision, Trustee can hire an attorney “that has represented the Debtor, for a specified special purpose”, if the attorney does not represent or hold any interest adverse to the estate and the appointment is in the best interest of the estate. *See In re DeVlieg, Inc.*, 174 B.R. 497 (N.D.Ill. 1994).

On of the leading cases in the area of former Chapter 11 counsel being special counsel for a subsequently appointed Trustee is *In re United Utensils Corp.*, 141 B.R. 306 (Bkrtcy. W.D.Pa. 1992). In this case the court was confronted with the question of whether a law firm which

represented a bankruptcy estate in a Chapter 11 proceeding could represent a subsequently appointed bankruptcy trustee, in actions against the debtor's former officers and shareholders. The court in considering the objection of a former officer to the employment on the grounds that the proposed retention violated his individual attorney client privilege with the special counsel held that the law firm did not individually represent the individual officer and sole shareholder through its representation of the debtor corporation during the Chapter 11. The *United Utensils* court held that the firm could be employed as special counsel to the trustee under Section 327(e) unless the officer/shareholder could produce specific evidence of an attorney client relationship independent of the attorney client relationship between the debtor and the law firm.

The full extent of ethical issues surrounding an appointment as special counsel can best be seen in the case of *In re DeVlieg Inc.* 174 B.R. 497 (N.D. Ill. 1994). Here, counsel for a Chapter 11 bankruptcy estate were fired by the DIP, after the debtor's counsel filed suit against several insiders of the debtor, including the debtor's sole officer. However, this firing did not go unnoticed and the DIP was quickly replaced by a Chapter 11 trustee who sought to hire the Chapter 11 estate's former attorneys as the trustee's special counsel to pursue the law suits which got them fired. Not surprisingly some of the insiders who fired the attorneys in the first place objected to this employment. The Bankruptcy Court approved the employment and the insider appealed. After reviewing 11 U.S.C. §327(e) the District Court ruled that the attorneys neither held nor represented an adverse interest to the estate and that their employment should be authorized. However, in a footnote to the opinion the court noted:

The concern with former counsel for the debtor is that they will not be in a position [to be objective in advising a trustee].... In the present case, this concern does not appear to be implicated: as evidenced by the timing and apparent circumstances of the filing of the LBO litigation, [the attorneys] may actually have begun acting in the interest of the estate (and, in doing so, not necessarily

following the directions of its then-client, the debtor) even before a chapter 11 trustee had been appointed. Thus the usual concern with the employment of former counsel for the debtor, residual loyalty to that client, would not appear to be a problem here.... In so noting, however, the court does not pass on whether such behavior would comply with applicable standards of professional responsibility.

This footnote shows the confusion this situation can generate for courts in this area. To the extent the *DeVlieg* suggests that counsel for Chapter 11 bankruptcy estates have an ethical duty other than to the bankruptcy estate as their client, such a ruling appears to be wrong and against the weight of authority. However, as the presenters of this program are not judges or the heads of your state bar associations, this analysis will mean little if your state's bar association adopts the *DeVlieg* analysis as to where you owe your legal duties.

### **III. Are You Ethical? Special Ethical Issues In Lamie Situations**

Assuming a Trustee cannot or will not retain former counsel of a Chapter 11 debtor ("Former Counsel"). Former Counsel must be aware of what duties they owe a Chapter 7 Trustee after a conversion under Federal and State law.

#### **A. State Law Duties to Former Clients: Involuntary Servitude Under Lamie?**

While there is some variation between states in the exact language most if not all states have codified some version of the ABA's model rule of professional conduct as the basis of an attorney duties to their former client. Model Rule 1.9 provides:

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client (1) whose interests are materially adverse to that person; and (2) about whom the lawyer had acquired information protected by

Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter shall not thereafter: (1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

Under Rule 1.9 attorneys owe a duty to their former client to:

1. Maintain confidentiality; and
2. Not represent any other party in a “substantially related matter” to the matter he represented his former client in.

*See generally Russell – Stanley Holdings Inc. v. Buenanno*, 210 F.Supp 2d 395 (S.D.N.Y. 2002); *Tekni-Plex, Inc. v. Mayner & Landis*, 651 N.Y.S. 2d 954 (N.Y. 1996); *In re PGH International, Inc.*, 222 B.R. 401 (Bkrcty. D.Conn. 1998)

The Trustee appointed in a bankruptcy case succeeds to the confidentiality and loyalty duties discussed above for corporate debtors but not necessarily for individuals. *In re Irwin Jager*, 213 B.R. 578 (Bkrcty. C.D. Cal. 1997). This means in most cases former debtor’s counsel will be prohibited from representing other defendants in the bankruptcy case.

Further, under most state laws, former clients have access to files maintained by their former counsel although the exact terms of that access varies from state to state. *See Sage Realty Corporation v. Proskarier Rose Goetz & Medelsohn*, 666 N.Y.S. 3d 985 (Ct. App.NY 1997), *on remand*, 743 N.Y.S. 2d 72 (Sup. Ct. N.Y. 2002); (client liable for costs of assembly and delivery of documents); *In re Karr*, 722 A. 2d 16 (Ct App. D.C. 1998) (failure to turn over client files constitutes a disciplinary violation).

**B. Duties to Former Clients Under Bankruptcy Law: You Probably Do Not Have the Right to Remain Silent**

In addition to State Law, the Federal Bankruptcy Code, Rules and case law impose numerous duties on former counsel to Chapter 11 debtors to perform post conversion.

1. 11 U.S.C. §542(e)

11 U.S.C. §542(e) provides:

Subject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee.

Under this provision a debtor's records held by third parties, whether technically property of a debtor or not, are subject to turnover to the debtor under 11 U.S.C §542(e). *See generally In re Foster*, 188 F.3d 1259 (10<sup>th</sup> Cir. 1999); *Matter of RimSat Ltd.*, 98 F.3d 956, 965 (7<sup>th</sup> Cir. 1996); *In re Hechinger Investment Company of Delaware*, 285 B.R. 601 (D.Del.2002). The legislative history of § 542(e) clearly states that the provision was intended to deprive attorneys, accountants and other third parties holding a debtor's records of the leverage acquired under state laws to receive full payment of professional fees over the debts of other creditors when the information withheld is necessary to the administration of the estate. H.R. 95-595, 95<sup>th</sup> Cong., 1<sup>st</sup> Sess. 369-70 (1977), U.S.Code Cong. & Admin.News 1978, p. 5963; S.Rep. No. 95-989, 95<sup>th</sup> Cong., 2d Sess.84 (1978), U.S. Code Cong. & AdminNews 1978, P. 5787; *see, e.g., In re Highland Park Assoc. Ltd. P'ship*, 132 B.R. 358, 358 (Bankr. N.D.Ill.1991), *quoting In re Norson Med. Ref.Lab., Inc.*, 10 B.R. 165, 168 (Bankr. N.D.Ill. 1981); *In re Matassini*, 90 B.R. 508, 509 (Bankr.M.D.Fla. 1988).

Further, unlike the turnover provisions of 11 U.S.C. §543 which specifically provides that a court shall compensate a custodian, as defined by 11. U.S.C. §101(11), for its reasonable fees,

expenses and costs in connection with a turnover of the debtors' property, 11 U.S.C. §542(e) does not authorize the payment of any expenses which might be incurred in the turnover of the Debtors' records although courts may recognize the existence of a valid lien held by former counsel under state law on the files turned over. *In re American Metrocomm Corporation*, 274 B.R. 641 (Bkrtcy. D.Del. 2002). *See also In re Hyde*, 222 B.R. 214, 218-219 (Bkrtcy S.D.N.Y.1998), *rev'd on the grounds*, 235 B.R. 539 (S.D.N.Y.1999) (burden of turnover on accountant holding debtors records not a ground for objection to turnover of debtors records under 11 U.S.C. §542(e)).

2. 11 U.S.C. §341

11 U.S.C. §341 requires that in cases where the Chapter 11 case is converted to a Chapter 7 case that a representative of the Debtor's entity appear at a meeting of creditors. If the Debtor is not an individual, state laws and local rules may require representation by counsel at that creditors meeting.

3. 11 U.S.C. §521

11 U.S.C. §521 provides:

The debtor shall:

(1) file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs;

(2) if an individual debtor's schedule of assets and liabilities includes consumer debts which are secured by property of the estate—

(A) within thirty days after the date of the filing of a petition under chapter 7 of this title or on or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, the debtor shall file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that

such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;

(B) within forty-five days after the filing of a notice of intent under this section, or within such additional time as the court, for cause, within such forty-five day period fixes, the debtor shall perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph; and

(C) nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title;

(3) if a trustee is serving in the case, cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title;

(4) if a trustee is serving in the case, surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under section 344 of this title; and

(5) appear at the hearing required under section 524(d) of this title.

This provision requires Debtors and their agents, including potentially their counsel, to cooperate with a Chapter 11 Trustee and is another statutory basis for former Debtor's counsel to cooperate with the Trustee.

#### 4. Bankruptcy Rule of Procedure 2004

Bankruptcy Rule 2004 provides:

##### (a) Examination on motion

On motion of any party in interest, the court may order the examination of any entity.

##### (b) Scope of examination

The examination of an entity under this rule or of the debtor under § 343 of the Code may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt

adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefore, and any other matter relevant to the case or to the formulation of a plan.

(c) Compelling attendance and production of documents

The attendance of an entity for examination and for the production of documents, whether the examination is to be conducted within or without the district in which the case is pending, may be compelled as provided in Rule 9016 for the attendance of a witness at a hearing or trial. As an officer of the court, an attorney may issue and sign a subpoena on behalf of the court for the district in which the examination is to be held if the attorney is admitted to practice in that court or in the court in which the case is pending.

(d) Time and place of examination of debtor

The court may for cause shown and on terms as it may impose order the debtor to be examined under this rule at any time or place it designates, whether within or without the district wherein the case is pending.

This section gives debtors significant powers to investigate a debtors financial affairs and if necessary could be used against a reluctant former counsel. *See generally, Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343 (1985); *In re Duratech Indus.*, 241 B.R. 283 (E.D.N.Y. 1999).

5. 11 U.S.C §330

Finally, there is the most important reason for a debtors former counsel to cooperate, the Court's authority to monitor and supervise court appointed counsel's fees and actions. *See Matter of Grabill Corp.*, 983 F.2d 773 (7<sup>th</sup> Cir. 1993). If a debtor's former counsel refused to cooperate with a chapter 7 or 11 trustee a court could find that such a refusal was a breach of the former counsel duty to the debtor and reduce the compensation to which the former counsel

would otherwise be entitled. *See generally In re Crivello*, 134 F.3d 831 (7<sup>th</sup> Cir. 1998); *In re Downs*, 103 F.3d 472 (6<sup>th</sup> Cir. 1996) (reducing or disallowing legal fees due to debtor's counsel's failure to perform required duties).

#### **IV. Are You Getting Paid: Are the Retainers or Caveouts the Answer Under Lamie**

As noted in the overview above the Supreme Court did not directly address the issue of whether post conversion legal fees could be paid out of a pre-petition retainer paid to the attorneys by the Debtor. The only reference by Supreme Court made to retainers is acknowledgement that: "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."

One line of authority headed by *In re Channel Master Holdings, Inc.*, 309 B.R. 855 (Bkrcty.D.Del. 2004) holds that the Supreme Court's acknowledgement of the practice of pre-petition retainers, means that post conversion fees can be paid out of pre-petition retainers. This line of reasoning was also adopted by the District Court's decision in *Lamie*. The *Channel Master* Court reasoned that even though retainers were property of the estate, the debtors' former counsel was entitled to have all of its fees, which were expended on behalf of the debtor, *including those expended post conversion*, paid from the retainer. On February 28, 2005 Judge Boroff, of the Bankruptcy Court for the District of Massachusetts, issued an excellent opinion, a copy of which is attached hereto as *Exhibit A* explaining and following *Channel Master*.

The other line of authority, which comes out of the Court of Appeals decision in *Lamie*, holds that as the unearned portion of a debtor's counsel's retainer is part of the debtor's estate, and that once a case is converted, that retainer can only be used or distributed for estate expenses. These cases hold that unless the debtor's now former counsel is retained by the estate,

the retainer cannot be used to pay its post conversion fees. *See also On Line Services, Ltd., LLC*, 2004 WL 2671669 (Bankr. N.D. Iowa 2004).

**V. Ill-equipped and Unprepared: Lamie and the Individual Chapter 11 Debtor's Attorney**

The essence of the Bankruptcy Code is to breathe new life into the debtor's economic future. Much like Chapter 13, Chapter 11 allows the individual debtor to propose and file a plan of reorganization. This exclusivity period is not absolute, however, and creditors can file their own plan after a fixed time has expired. Debtors can propose a plan that makes distributions from property of the estate, although the provisions of Chapter 11 do not require the use of estate property to fund the plan. Moreover, the Chapter 11 individual debtor receives his discharge when the bankruptcy court confirms the plan, though satisfaction of the plan's terms is still required.

Unlike Chapter 7, where the individual debtor's own role is more mechanical and focused on technical compliance with the Code, Chapter 11 requires a certain degree of sophistication from the debtor, who is now a debtor-in-possession. From cram down to confirmation, the intensified burdens of an individual debtor in Chapter 11 fall upon not only the debtor, but his attorney as well.

- Substantial Duties – The Heightened Role of the Individual Chapter 11 Debtor's Attorney

11 U.S.C. § 327(a) governs a trustee's or debtor in possession's ("DIP") employment of an attorney, and requires court approval. The DIP has a fiduciary duty of undivided loyalty and exclusive allegiance to the beneficiaries of the estate and its equity holders, secured creditors and unsecured creditors. The attorney's role with respect to the DIP's fiduciary duties is vital, as counsel is charged with guiding the DIP through the reorganization and effecting the appropriate bankruptcy strategy. The attorney's influence, however, is sharply limited by the fact that the

final decisions rest with the DIP, and counsel must abide by those wishes. The inherent tension between the DIP's discretion and the attorney's obligation to acquiesce is further aggravated by the attorney's duty to creditors to maximize the estate and the individual debtor's desire to maximize its own assets.

At the heart of Chapter 11 is the presumption that the debtor is capable of reorganization, and that the individual will continue to function financially, unless there is cause for the appointment of a trustee. 11 U.S.C. §§ 1104, 1108. This assures that principals of the debtor-in-possession will ordinarily exercise considerable control over the business. The attorney's role in this process intensifies, and counsel is forced to balance the objectives of the estate with those of the DIP.

As a general principle, attorneys owe no duty to nonclients. As a result, counsel for the DIP would not have any fiduciary duty to the beneficiaries of the estate because they are not clients. More importantly, the Bankruptcy Code does not provide for or identify any such duty. *See Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434, 457 (D. Utah 1998). The court in *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434 (D. Utah 1998) expressly delineated that the attorney's client is the DIP, and not the estate. Indeed, the bundle of decisions that have imposed a fiduciary duty to the estate upon the DIP's attorney base this determination on a sort of duty-by-proxy. In other words, the attorney owes fiduciary duties to the estate by virtue of the DIP's own duties to the estate and its beneficiaries. *See e.g., In re Brennan*, 187 B.R. 135, 150 (D. N.J. 1995) (“[F]iduciary duty of the debtor's professionals is derivative of the debtor's fiduciary duty.”).<sup>14</sup>

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<sup>14</sup> *See also, In re Whitney Place Partners*, 147 B.R. 619, 620-21 (N.D. Ga. 1992) (“[T]he status of the client and the attorney may often overlap in a Chapter 11 case, as the debtor's attorney must take conceptual control of the case and provide guidance for management of the debtor, not only to discern

Some of the more common conflicts which exemplify the contrasting duties of the individual DIP's attorney are those which involve exemptions, absolute priority, post-petition property, and discharge.

**A. Exemptions and Absolute Priority**

In a Chapter 11, the DIP's obvious goal is to retain as many of his possessions as possible. 11 U.S.C. § 522(b) authorizes individual debtors to exempt certain property from the bankruptcy estate, however, "[n]o property can be exempted unless it first falls within the bankruptcy estate." *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 1835, 114 L.Ed.2d 350 (1991). Despite the label of "exempt," any such property still falls within the jurisdiction of the bankruptcy court via 11 U.S.C. § 541(a). Section 541(a) generally encompasses all property, both legal and equitable, including exempt property. This annexation of exempt property in section 541(a)'s definition clarifies that the bankruptcy court has jurisdiction over exempt property, whether claimed under state, bankruptcy, or federal nonbankruptcy laws. This inclusion also complicates the attorney's position in aiding the DIP's decision to seek certain exemptions.

A claim to an exemption may be restricted in chapter 11 by the absolute priority rule of section 1129(b)(2)(B)(ii), which may prohibit an individual debtor from confirming a plan under which the debtor, as a holder of a claim junior to other creditors, proposes to receive a distribution of estate property when the unsecured creditors are not being paid in full. The friction between exempt property and the absolute priority rule erupts when a class of unsecured creditors has rejected an individual Chapter 11 debtor's plan where the debtor has proposed retention of only exempt property. The bankruptcy court in *In re Gosman*, 282 B.R. 45 (Bankr.

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what measures are necessary to achieve a successful reorganization, but to assure that, in so doing, compliance with the Bankruptcy Code and Rules is sought rather than avoided.").

S.D. Fla. 2002) tackled this issue head-on. In *Gosman*, the individual debtor sought confirmation of its plan through cramdown and proposed the retention of some exempt property while distributing nonexempt assets to creditors. The bankruptcy court denied confirmation, because of § 1129(b)(2)(B)(ii)'s use of the term "any property" as opposed to "property of the estate." The court found this seemingly prosaic distinction to be confirmation that Congress did not intend to exclude exempt property from the absolute priority rule. Similarly, in *Wolfberg v. Knupfer*, the Ninth Circuit held that a chapter 11 individual debtor could not claim a homestead exemption, despite the confirmed plan's provision that the residence would be sold, unless the debtor modified the plan. 37 Fed.Appx. 891 (9th Cir. 2002). The determining factor being the debtor's effort to exempt some sale proceeds violated the binding effect of the confirmation. *Id.*

In contrast to both of these decisions, is the recent opinion from *In re Henderson*, 2005 WL 428520 (Bankr. M.D. Fla.), where the court observed that a debtor's interest in exempt property can never be junior to the interest of the creditors, including those of dissenting unsecured creditors, because unsecured creditors cannot reach exempt property outside bankruptcy. Furthermore, the court did not require the debtor to forfeit his exemption rights, and held that exempt property could not be subjected to the absolute priority rule. *Id.*

As an attorney for the DIP, the split in decisions darkens an already muddy area. The attorney has the conflicted duty to maximize values for creditors and to maximize her client's exemptions. Moreover, when it comes to exemptions, the attorney is dangerously juxtaposed between seeking the benefits of the estate and the achieving the goals of her client.

## **B. Post-Petition Property**

Under § 541(a), the estate is normally comprised only of property and interests therein belonging to the debtor at the time the petition is filed. In general, property not then owned but subsequently acquired by the debtor does not become property of the estate, but becomes the

debtor's, clear of all claims that are discharged by the bankruptcy proceedings. *Patrick A. Casey, P.A. v. Hochman*, 963 F.2d 1347, 1350 (10th Cir. 1992). Unlike Chapter 13, the post-petition personal earnings of a debtor are not part of the estate. Compare 11 U.S.C. § 541(a)(6) with 11 U.S.C. § 1306(a) (1994). This may change if the current bankruptcy bill is passed.

Individual debtors and their bankruptcy estates are under the law separate entities, meaning that not all interests in property acquired post-petition by individual debtors constitute property of the estate. *In re Myrvold*, 44 Bankr. 202, 204 (Bankr. D. Minn. 1984), *aff'd*, 784 F.2d 862 (8th Cir. 1986). This is buttressed by Internal Revenue Code § 1398, which expressly creates a separate taxable entity when an "individual" files a petition for relief under either Chapter 7 or Chapter 11 of the Bankruptcy Code. 26 U.S.C. § 1398. As such, unlike debtors that are corporations or partnerships, or cases commenced under Chapter 12 or 13, both an individual debtor and the bankruptcy estate in Chapter 11 will separately realize, compute, and report their respective tax obligations.

Some courts, however, read § 541(a)(6) as excluding from the Chapter 11 estate only that portion of an individual debtor's future wages that has been approved by the bankruptcy court in the first instance after a § 503(b)(1)(A) analysis. Other cases take a more take a more bright-line approach and simply exempt any earnings that occur post-petition. *See In re Powell*, 187 B.R. 642 (Bankr. D. Minn. 1995) (holding that post-petition earnings under section 541(a)(6) were not property of individuals' Chapter 11 estate; wages were derived exclusively in debtors' capacity as employees); *In re Vedia*, 150 B.R. 393 (S.D. Tex. 1992) (100% of doctor/DIP's post-petition earnings were within section 541(a)(6) exception); *but see In re Angobaldo*, 160 B.R. 140 (Bankr. N.D. Cal. 1993) (splitting post-petition earnings between those attributable to debtor's post-petition services and those attributable to profits from estate assets).

The division in authorities generally falls along two lines: Those which essentially conclude that post-petition earnings of an individual debtor constitute property of the estate, *see In re Harp*, 166 Bankr. 740 (Bankr. N.D. Ala. 1993); *In re Herberman*, 122 Bankr. 273 (Bankr. W.D. Tex. 1990), and those which determine that post-petition earnings such as wages from outside employment fall within the scope of the earnings exception and are therefore personal property of the individual debtor and excluded from the bankruptcy estate. *See In re Fitzsimmons*, 725 F.2d 1208 (9th Cir. 1984); *In re Molina Y Vedia*, 150 Bankr. 393 (S.D. Tex. 1992); *In re Cooley*, 87 Bankr. 432 (Bankr. S.D. Tex. 1988).

Although creditors often point to the DIP's fiduciary obligation to the bankruptcy estate to support the proposition that post-petition wages earned by the debtors constitute property of the estate and should, to some extent, be available for distribution to creditors. This contention, however, was soundly rejected in *In re Molina Y Vedia*: "Property of the estate is not determined by the debtor-in-possession's fiduciary obligations to the estate; rather, the scope of the debtor-in-possession's fiduciary obligation is determined by the property constituting the estate. Irrefutably, the debtor-in-possession owes no obligation to the estate for non-estate property." *Id.* at 400. Moreover, as *In re Powell* pointed out, "the separate entity concept mandates that to the extent that an individual debtor derives income from wages earned postpetition which is independent of that derived from the estate in general, the individual bears personal responsibilities in connection with the income so derived." *Id.* at 647. As such, any view that would necessarily exclude only a portion of a DIP's future earnings "threatens the fresh start of individuals who are generally in immediate need of their wages in order to merely survive." *Id.*

So, once again the attorney is pulled in different directions. Although one line of cases makes clear that the DIP's obligations extend only the pre-petition property, other courts treat

post-petition earnings as an interest in property acquired by the estate after the commencement of the case, regardless of the source. Whose benefit does the attorney serve? Even 11 U.S.C.S. § 541 cannot be the cornerstone of guidance due to the myriad of judicial interpretations.

- Conflicts and Consequences – Counsel v. Trustee

While the above discussion highlighted the natural conflicts that arise between a DIP, the estate and the attorney, those situations presume that the case proceeds without a trustee. However, in certain circumstances a trustee may be appointed for cause under 11 U.S.C. § 1104.

In such a case, the role of an attorney is severely – if not fatally compromised. Although *Lamie* benignly hypothesizes that a trustee may employ the debtor's attorney as special counsel under 11 U.S.C. § 327(e), it fails to realize the near impossibility of such a remedy in an individual Chapter 11 case. After *Lamie*, it seems that there is no statutory basis to pay the debtor's attorney. Thus, either the DIP proceeds *pro se*, or counsel takes the case *pro bono*. Even if *Lamie* allowed appointment of special counsel for an individual Chapter 11 case, could the DIP's attorney even qualify? What specific duties would the representation be limited to? As a result, the attorney's duties are irreconcilable with any corresponding duties to the estate. Second, the natural tension between the DIP and the attorney is amplified by the imposition of a trustee, who now also wants to maximize the estate and minimize the various debtor protections discussed previously. Surrounding all of this is the fact that a debtor can and necessarily must still file and present his plan, and defend, if necessary his discharge, assert and protect his claimed exemptions and advance his entitlement to post-petition property. Is it realistic to believe that an individual debtor could weave its way, *pro se*, through this labyrinth or that an attorney would continue with the representation of an individual debtor for free?

## **VI. Chapter 11 Trustee Issues Under Lamie [Materials to be Distributed on Site]**

**VII. Chapter 13 Debtor's Counsel: The Other Lamie Shoe: Is Employment Regulated by 11 U.S.C. § 327(a)**

As noted in a recent article in the Column<sup>15</sup>, in the case of *Lamie v. U.S. Trustee* \_\_\_ U.S. \_\_\_, 124 S.Ct. 1023 (2004), the United States Supreme Court held that a Chapter 7 Debtor's attorney who was not employed by the Chapter 7 estate under 11 U.S.C. § 327 cannot be paid by the estate stating:

“Adhering to conventional doctrines of statutory interpretation, we hold that § 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by § 327. If the attorney is to be paid from estate funds under § 330(a)(1) in a chapter 7 case, he must be employed by the trustee and approved by the court.”<sup>16</sup>

An interesting question not directly or clearly answered in *Lamie* was whether this decision requires a Debtor's Chapter 13 Counsel to be hired under 11 U.S.C. § 327(a) in order to be paid in a Debtor's Chapter 13 estate.

**A. The problems facing the Chapter 13 Debtor's Attorney**

The initial issue facing a Debtor's Chapter 13 debtor's attorney is whether they need to be retained as counsel for the Debtor Chapter 13 estate under 11 U.S.C. § 327. Although by its terms 11 U.S.C. § 327 does not apply to the retention of professionals in Chapter 13 cases<sup>17</sup> this

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<sup>15</sup> Bowles, *Watching Sausage Being Made - The Supreme Court, Not the FDA: Lamie v. U.S. Trustee* 23 AmBanks, Inst. J.30 (May 2004)

<sup>16</sup> \_\_\_ U.S. \_\_\_, 124 S.Ct. 1023, 1032 (2004)

<sup>17</sup> 11 U.S.C.A. § 327

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

(b) If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if

necessary in the operation of such business.

issue arose in the recent case of *In re Gutierrez*, 309 B.R. 488 (Bankr. W.D. Tx. 2004) when a Chapter 13 Trustee used 11 U.S.C. § 327 to attack a pre-petition claim of a Chapter 13 debtor's attorney.

The second issue confronting Chapter 13 debtor attorneys is, even if 11 U.S.C. § 327 does not directly require them to be retained under its provisions, must a Chapter 13 debtor's counsel be still retained under 11 U.S.C. § 327 in order to be paid from a Chapter 13 debtor's estate? That issue was recently addressed in the case of *In re Moore*, \_\_\_ B.R. \_\_\_ 2004 WL 1801192 (Bankr. N. Ala 2004).

**B. In re Gutierrez: 11 U.S.C. § 327 means what it says. Chapter 13 Debtors counsel do not need to be retained under 11 U.S.C. § 327.**

The *Gutierrez* decision arises in a rather unusual context. In 2001 the Debtor filed a Chapter 13 ("Original 13") which was ultimately dismissed. At the time of the dismissal the debtor's counsel was owed \$1,195.00 by the Debtor in unpaid fees for the Original Chapter 13. In June of 2003 the Debtor, *with the same attorney*, filed a New Chapter 13 ("New 13"). One of the claims in the New 13 was an unsecured nonpriority claim of the Chapter 13 debtor's attorney for his unpaid \$1,195.00 in fees from the Original 13.

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(c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

(d) The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does 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.

(f) The trustee may not employ a person that has served as an examiner in the case.

11 U.S.C. § 327

After the case was filed, the Chapter 13 Trustee in *Gutierrez* objected to the unsecured claim of the Chapter 13 debtor's attorney arguing that: 1) the claim should be disallowed as the Chapter 13 debtor' attorney received a reasonable fee in the Original 13<sup>18</sup>; 2) that the claim should be disallowed because the Chapter 13 debtor's attorney could not have been retained under 11 U.S.C. § 327 because the Chapter 13 debtor's attorney held a pre-petition claim against the Debtor and was therefore not a disinterested person<sup>19</sup>; and 3) that the debtor's Chapter 13 attorney had an actual conflict of interest with the Debtor by virtue of no pre-petition claim under applicable state law.

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<sup>18</sup> The Court overruled this ground finding the fees charged in the Original 13 were reasonable under 11 U.S.C. § 502(b)(4)

<sup>19</sup> 11 U.S.C. sec. 101(14) defines a "disinterested person" as:

(14) "disinterested person" means person that--

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not an investment banker for any outstanding security of the debtor;

(C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;

(D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and

(E) 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 an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason;

The *Gutierrez* Court, after finding the fees from the Original 13 were reasonable rejected the Chapter 13 Trustee other two arguments. The Court held that 11 U.S.C. § 327 does not apply to the retention of Chapter 13 Debtor's attorney either by its terms or as a condition for payment of professional fees from the Chapter 13 estate stating:

“The rules change, however, in chapters 12 and 13. Under those chapters, the debtor's lawyer, even though clearly not retained by “the trustee” (and so clearly not bound by section 327(a)), nonetheless gets paid out of property of the estate. See 11 U.S.C. § 330(a)(4)(B); see also 11 U.S.C. § 1306 (property of the estate in chapter 13 includes the debtor's post-petition earnings). The Trustee suggests that the debtor's attorney in a chapter 13 case should be subject to the same standard of disinterestedness in the interest of preserving the integrity of the process and to avoid unseemly conflicts. The court declines the invitation to extend the reach of section 327(a) beyond its plain language. Congress was no doubt aware of the anomaly of paying the debtor's attorney with property of the estate, yet not binding that attorney by the strictures of section 327(a). The unique language of section 330(a)(4)(B) confirms that much. Finding no ambiguity in the statute to justify judicial intervention, the court declines to invent a limitation not present in the statute itself.”<sup>20</sup>

Finally the Court held that while 11 U.S.C. § 327 did not govern whether an attorney could be employed as a Chapter 13 debtor's attorney, traditional state court ethical standards did govern the ability of an attorney to represent a Chapter 13 debtor where the attorney had a pre-petition claim against the debtor<sup>21</sup>.

The *Gutierrez* Court, reviewing this issue under the applicable Texas Disciplinary Rules of Professional Conduct held that there was no conflict of interest in a Chapter 13 attorney being owed pre-petition fees by a Chapter 13 debtor which prohibited the counsel's representation of the Chapter 13 debtor absent unusual circumstances. The Court also found that to the extent a

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<sup>20</sup> 309 B.R. at 500 - 501. See also: In re Busetta - Silvia 300 B.R. 543, 549 - 550 (Bankr. D. N.M. 2003).

<sup>21</sup> 309 B.R. at 496-97.

technical conflict could be found to exist it could be waived by the debtor after full disclosure<sup>22</sup>. The Court found there was no conflict in this case and overruled the Trustee's objection.

**C. In re Moore: Lamie means what it says: Estate professionals cannot be paid from estate funds unless retained under 11 U.S.C. § 327.**

However, while *Gutierrez* case forcefully states that Chapter 13 debtors attorney need not comply with 11 U.S.C. § 327 in order to represent a Chapter 13 debtor and be paid their professional fees, this analysis of the applicable law is not universally followed as noted by the holding in *In re Moore*; \_\_\_ - B.R. \_\_\_ 2004 WL 1801192 (Bankr. N.D. Ala. July 29, 2004).

The facts of *Moore*, like *Gutierrez*, are somewhat unusual. In 1994, the Debtor filed suit against Indies House, Inc. and Southern Housing, Inc. ("Defendants") for damages related to the purchase of a mobile home. The Debtor employed counsel in this state court action to prosecute this suit ("State Court Counsel"). The State Court Counsel was also never retained as a professional under 11 U.S.C. § 327 in the Debtor's Chapter 13 case and apparently had no knowledge of the Debtor's Chapter 13 filing. In 1996, the Debtor filed a Chapter 13 petition but did not list the state court action as an asset. The Debtor won its case at trial but the Defendant appealed<sup>23</sup> and ultimately lost in the Alabama Supreme Court in 2000. On October 31, 2001, the Debtor made his final payment under his Chapter 13 plan to the Trustee. On November 14, 2001, the State Court Counsel negotiated a settlement of the State Court lawsuit for \$25,000.00 and received that sum from the Defendants. The State Court Counsel retained \$10,000 as his professional fees and paid the remaining \$15,000 to the Debtor.

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<sup>22</sup> Id. at 498-99.

<sup>23</sup> Not surprisingly one of the grounds for the Defendants appeal was that the Debtor was judicially estopped from prosecuting the lawsuit due to his failure to schedule the lawsuit. This defense was ultimately rejected by the Alabama Supreme Court. 2004 WL 1801192, \*1.

On October 16, 2002, after not making payments to the Chapter 13 Trustee for nearly a year the Debtor's Chapter 13 was converted to a Chapter 7. The Chapter 7 Trustee then filed suit against the State Court Counsel to recover the \$25,000 payment<sup>24</sup>. As part of this action the State Court Counsel attempted to retain the \$10,000.00 in legal fees he was owed by the Debtor.

The *Moore* Court, relying heavily on *Lamie*, held that the State Court Counsel had no right to be compensated from the Debtor's bankruptcy estate stating:

“Under 11 U.S.C. § 327(a), “the trustee, with the court’s approval, may employ one or more attorneys, ... or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee’s duties under this title”. With respect to attorneys hired by a debtor, the Supreme Court recently held that, “the statute authorizes an award of compensation to one of three types of persons: trustees, examiners, and § 327 professional persons. A debtor’s attorney not engaged as provided by § 327 is simply not included within the class of persons eligible for compensation.” *Lamie v. U.S. Trustee*, --- U.S. ----, 124 S.Ct. 1023, 1030, 157 L.Ed.2d 1024 (2004).

Additionally, this Court has held that “the Code sets out specific rules for professionals to comply with in order to be compensated. Absent compliance with the Code and Rules, an attorney has no ‘absolute right’ to an award of compensation.” *In re Federal Roofing Co., Inc.*, 205 B.R. 638, 644 (Bankr.N.D.Ala.1996) (citation omitted). Thus, from the plain language of the statute and from the cases interpreting the applicability of that statute, only those attorneys who are employed pursuant to § 327 may receive compensation from the estate.

In this case, Defendant received \$25,000 from Southern Housing, which was property of the estate. Defendant retained \$10,000 as compensation and gave the remainder to the Debtor. This was an improper disposal of property of the estate, paying an unapproved attorney. “In the absence of compliance with the Code and Rules, the Court believes that where fees have been paid to an unapproved attorney, the return of the compensation is the most

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<sup>24</sup> The *Moore* court quickly ruled the \$25,000.00 was property of the estate, the State Court Counsel was liable for turnover of the \$25,000.00 and that the Chapter 7 trustee could pursue the action. This left the State Court Counsels legal fees as the final issue in *Moore*.

appropriate remedy.” *In re Federal Roofing Co., Inc.*, 205 B.R. 638, 644 (Bankr.N.D.Ala.1996). Therefore, the Court finds that Defendant received improper compensation from the estate, being an unapproved attorney, and that amount of \$10,000 must be returned to the estate.<sup>25</sup>

This decision, although made in a very unusual context, seems to require that the State Court Counsel had to be retained under 11 U.S.C. § 327 in order to be paid from a Chapter 13 estate. This decision stands in stark contrast to the *Gutierrez* decision. While *Moore* can possibly be distinguished from the typical Chapter 13 case as the turnover action was brought after the case was converted to a Chapter 7 proceeding, such a distinction ignores the fact that the only time the State Court Counsel could have been retained was during the Chapter 13 as he had completed his representation of the Debtor nearly a year before the case converted.

**D. And the answer is?**

From the statements made by the U.S. Supreme Court in *Lamie* to the effect that 11 U.S.C. § 330 does not greatly impact Chapter 13 practice<sup>26</sup>, and the wording of 11 U.S.C. §§ 327 and 330(a)(4)(B), it appears that the holding of *Gutierrez* is correct and that Chapter 13 debtor’s counsel *do not need* to apply for retention under 11 U.S.C. § 327 in order to be paid from the Chapter 13 estate or comply with its provisions in order to be hired. However, in light of the extremely poor wording of 11 U.S.C. § 330 and decisions such as *Moore* Chapter 13 debtor’s attorney should carefully review this issue and take steps through their local courts to clarify this issue as it does not appear litigation over this question will end in the foreseeable future.

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<sup>25</sup> 2004 WL 1801192 at \*6.

<sup>26</sup> “Compensation for debtors attorneys in Chapter 12 and 13 bankruptcies for example, is not much disturbed by § 330 as a whole. See, e.g.; 11U.S.C. § 330(a)(4)(B) (‘In a Chapter 12 or Chapter 13 case in which the debtor is an individual, the Court may allow reasonable compensation to the debtors attorney’)” 124 S.Ct. at 1031.