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## Bankruptcy Law

### The Most Important Issue of All – Getting Paid

Third Circuit clarifies eligibility of debtors' attorneys to receive compensation from the estate

By Henry M. Karwowski

Until 1994, the Bankruptcy Code expressly authorized the award of fees and expenses from the estate to debtors' attorneys. The Bankruptcy Reform Act of 1994, however, omitted debtors' attorneys from the list of officers statutorily entitled to receive such an award.

The change caused courts nationwide to split on two issues: (1) whether debtors' attorneys even remain eligible to receive compensation from the estate and (2) whether debtors' attorneys, in order to receive compensation from the estate, must demonstrate that their services actually benefited the estate, or merely that such services were reasonably likely to benefit the estate.

The Third Circuit recently addressed these issues in *In re Top Grade Sausage, Inc.*, 227 F.3d 123 (3d Cir. 2000). While the decision was generally favorable to debtors' attorneys, the court also prescribed the limiting conditions under which attorneys representing debtors-out-of-possession may receive compensation.

Thus, *Top Grade* may produce cause for concern among attorneys rep-

resenting debtors in cases in which a trustee has been appointed.

#### How the Law Changed

The applicable code section, 11 U.S.C. 330(a), as amended in 1994, contains two significant differences. First, the term "debtor's attorney" no longer appears in the list of officers eligible to receive compensation. Second, a comma, and not the disjunctive term "or," separates the terms "an examiner" and "a professional" in that list.

As a result of the 1994 amendment, §330(a) also contains two additional subsections, among others.

Section 330(a)(3)(C) provides that in determining compensation, the court should consider the nature, the extent and the value of such services, taking into account all relevant factors, including whether the services were necessary to the administration of the case, or beneficial at the time at which the service was rendered toward the completion of the case.

Section 330(a)(4) provides, with exceptions, that a court should not allow compensation for unnecessary duplication of services or services that were not reasonably likely to benefit the debtor's estate nor necessary to the administration of the case. The exceptions, listed in subsection (a)(4)(B), per-

tain to Chapter 12 or Chapter 13 cases in which the debtor is an individual.

Following the 1994 amendment, circuit courts have split with respect to the issue of whether debtors' attorneys even remain eligible to receive compensation from the estate.

Some courts, including the Fifth Circuit and the 11th Circuit, have concluded that the plain meaning of the amended version of §330(a) precludes the award of compensation to debtors' attorneys. See, e.g., *Inglisby, Falligant, Horne, Courington & Nash v. Moore (In re American Steel Product, Inc.)*, 197 F.3d 1354, 1356-57 (11th Cir. 1999); *Andrews & Kurth L.L.P. v. Family Snacks, Inc. (In re Pro-Snax Distribs., Inc.)*, 157 F.3d 414, 425-26 (5th Cir. 1998).

Other courts, including the Ninth Circuit, as well as Judge Lyons of the District of New Jersey, have concluded that the deletion of the term "debtor's attorney" from §330(a) was inadvertent, and hence, that debtors' attorneys remain entitled to receive compensation from the estate. See, e.g., *United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Servs., Inc.)*, 195 F.3d 1053, 1061 (9th Cir. 1999); *In re Brierwood Manor, Inc.*, 239 B.R. 709, 715-16 (Bankr. D.N.J. 1999).

A Second Circuit case, *In re Ames Dep't Stores, Inc.*, 76 F.3d 66, 72 (2d

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Cir. 1996), asserts in dictum: "Where the benefits of services to the estate are the same, it makes no sense to treat performances of such benefits by debtors' attorneys differently than performances by other retained professionals."

### Split Regarding Controlling Standard

Courts have also split over the standard by which courts must assess the services of debtors' attorneys in determining the appropriate amount of compensation. Section 330(a) is not helpful. While subsection (a)(1)(A) provides that a court must consider whether the services were "actual" and "necessary," subsection (a)(4)(A) provides that a court must consider whether the services were "reasonably likely to benefit the debtor's estate."

Some courts, including the Second Circuit, have required only that the attorney's services were reasonably likely to benefit the estate. See, e.g., *Ames*, 76 F.3d at 71; *Roberts, Sheridan & Kotel, P.C. v. Bergen Brunswick Drug Co. (In re Mednet, MPC Corp.)*, 251 B.R. 103, 108 (B.A.P. 9th Cir. 2000). In *Ames*, the Second Circuit reasoned that Congress, in enacting §330, had departed from the doctrine of "economy of administration." *Ames*, 76 F.3d at 71. It reasoned, further, that Congress, in enacting §330(a)(3)(C), authorizing compensation for services beneficial at the time of service, and §330(a)(4)(A), authorizing compensation for services "reasonably likely to benefit the debtor's estate," had moved further toward "greater equity in estate management."

Meanwhile, other courts, including the Fifth Circuit, have required that the services resulted in an identifiable, and tangible, benefit to the estate. See, e.g., *Pro-Snax*, 157 F.3d at 426. The Fifth Circuit reasoned that "[§330] require[s] that — at the time the services are performed — the chances of success must outweigh the costs of pursuing the action."

### Top Grade

In *Top Grade*, two businesses, one a sausage manufacturer and distributor and the other a delivery operation, filed

separate petitions under Chapter 11 of the Bankruptcy Code after their owner, a family, had incurred considerable debt in the criminal defense of its patriarch. 227 F.3d at 125.

The law firm that conducted that defense — Walder, Sondak & Brogan, now a judgment creditor — filed a motion for the appointment of a Chapter 11 trustee for both debtors. The Bankruptcy Court granted the motion. Following the appointment of a trustee and trustee's counsel, the

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## Following the Bankruptcy Reform Act of 1994, circuit courts have been split on whether debtors' attorneys even remain eligible to receive compensation from the estate.

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debtors sought to retain Hellingring Lindeman Goldstein & Siegal as their counsel, and the court approved the appointment.

The debtors' attempted reorganization failed, and the court ultimately converted both cases to Chapter 7. Following conversion, Hellingring Lindeman filed a Chapter 11 fee application, to which the trustee, the United States Trustee, and Walter, Sondak each filed objections.

The court denied Hellingring Lindeman's application, on the ground that "[the firm's services were either duplicative of services rendered by the Trustee or rendered solely for the benefit of the debtor and not of the estate." It reasoned that "for a debtor's attorneys to receive compensation from the estate, they must show that their services provided a benefit for the estate."

Following timely appeal, the District Court affirmed the decision and raised, *sua sponte*, the issue of whether a Bankruptcy Court, pursuant to the 1994 amendment to §330(a), may even award compensation to a debtor's attorney.

The District Court held that omission of the term "debtor's attorney" from the amended language of the section was inadvertent, and that notwithstanding the omission of the term, services by a debtor's attorney benefiting the estate remain compensable.

Hellingring Lindeman appealed the decision to the Third Circuit.

### Circuit Finds for Debtors' Attorneys

In addressing the split in authority regarding eligibility, the Third Circuit held that, despite the 1994 amendment, debtors' attorneys remain entitled to receive compensation from the estate.

The Third Circuit found that reading the current version of §330(a) to omit the term "debtor's attorney" would render the statute "ambiguous and inconsistent" with other Bankruptcy Code sections.

The court observed, first, that, while the initial paragraph of §330(a)(1) omits the term "debtor's attorney," §330(a)(1)(A) does contain the term "attorney." "As §330 now reads then, the second half of the sentence seems to partially permit what the first half prohibits."

Second, the circuit court rejected the potential explanation that "debtors' attorneys are not the only attorneys whose services could benefit the estate." It noted that, in the previous version of §330(a), the second list of officers was intended to parallel the first list. It also noted that the list of officers in §330(a)(1)(A) is modified by the term "the," as opposed to the terms "a," "an," or "any," and determined that use of the word "the" refers to "the universe of officers listed in §330(a)(1), thereby leaving the word 'attorney' in §330(a)(1)(A) without prior reference."

The Third Circuit recognized that, had it wished to authorize payment for all attorney services performed for officers of the estate, Congress could have modified the term "attorney" with the

term "any," as it did with the term "paraprofessionals."

Third, the court observed that §330(a)(4)(A) authorizes compensation only for unique or necessary services, or services reasonably likely to benefit the estate and that §330(a)(4)(B) establishes a liberal standard for attorneys representing individual Chapter 12 or Chapter 13 debtors.

Consequently, the Third Circuit held that "recognition by Congress that this discrete class of debtors' attorneys [in Chapter 12 or 13 cases] need to be excepted from the regular, more stringent standards for compensation evidences Congress's belief that debtors' attorneys in general remain eligible for compensation under the customary standard." Reading §330 to preclude eligibility, it concluded, would create an inconsistency in the Bankruptcy Code.

Finally, the Third Circuit noted that §329 contemplates the pre-petition payment of fees by the debtor, and that a debtor's payment of a pre-petition retainer remains property of the estate. Reading §330 to prevent application of the pre-petition retainer to post-petition services, it concluded, would create yet another inconsistency.

The Third Circuit held, accordingly, that "because the statutory scheme would be rendered inconsistent if we were to read §330(a) to omit debtors' attorneys and because the legislative history does not manifest an intent by Congress to change the long-standing practice of compensating debtors' attorneys ... debtors' attorneys may still receive an award of compensation from

the estate for services rendered and expenses incurred."

#### Circuit Adopts Lenient Standard

In addressing the split regarding the controlling standard, the Third Circuit rejected the argument that a debtor's attorney must show an actual benefit "lest the state be taxed twice for services that only the Trustee should have rendered." Section 330(a)(4)(A), it determined, already protects the estate from unnecessary duplication of services.

Hence, it opted to evaluate Hellring Lindeman's application, "not by some heightened standard or by hindsight," but rather, pursuant to the standards set forth in §330(a)(4)(A)—i.e., it required Hellring Lindeman to prove only that its services were reasonably likely to benefit the debtor's estate.

In reviewing the record, however, the Third Circuit held that the services failed to meet this standard. The fee application provided that the services included, *inter alia*:

- meeting with the debtors' principals and previous counsel for the purpose of ascertaining the history of the cases;
- reviewing and preparing pleadings;
- attending court hearings;
- conducting conference calls and meetings; and
- researching legal issues.

After asserting that "[i]t is primarily the duty of the Chapter 11 Trustee to help the parties reach an acceptable

reorganization plan," and that "[t]he debtor's attorneys must bring something unique to the negotiations in order to receive compensation from the estate," the Third Circuit held that it was unable to ascertain any particular service not performable by the trustee or his staff.

The circuit court also noted that the Bankruptcy Court had determined that the debtors had insisted that Walter, Sondak not receive fair compensation. Given this finding, as well as the nature of the services performed, the Third Circuit concluded that "it is difficult to see how Hellring Lindeman's services could have been considered reasonably likely to benefit the estate." On these grounds, the Third Circuit affirmed the District Court's judgment.

Despite the adverse result in *Top Grade*, and although §330(a)(4)(B) already seems to provide for their compensation in Chapter 12 and 13 cases, prospective debtors' attorneys will find encouragement in the Third Circuit's analysis.

First, unlike their counterparts in certain circuits, debtors' attorneys in this circuit may still receive compensation from the estate. Moreover, in order to receive compensation, such attorneys need only prove that their services were reasonably likely to benefit the estate.

Nevertheless, attorneys representing debtors-out-of-possession must recognize that, in order to receive compensation from the estate, they must now prove that their services qualify as "unique," and not performable by the trustee. ■