

Getting Paid From The Chapter 7 Estate

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Introduction

If you practice Bankruptcy law you already know the truth: you're underpaid and under siege by Clients, Trustees and Judges who think that you make too much money. Well do you? If you represent Chapter 12 or 13 Debtors you are already entitled to payment through the Debtor's Plan under §330(a)(4)(B).¹ However, if you represent Chapter 7 or 11 Debtors you face a problem when your Client runs out of money but still needs your services. How can you get paid when the Debtor is without funds but the Estate has collected money? According to the current iteration of §330 of the Bankruptcy Code, you can't. A case pending before the U.S. Supreme Court tries to make sense of this wrinkle and has far-reaching implications.

But first, two (2) scenarios to consider.

Scenario 1

The firm of I.M. Broke represents Mid-Size, Inc., a privately held, struggling company, in their attempt to reorganize under Chapter 11. I.M. is diligent and smart enough to take a fair retainer up-front. However, as often happens in Chapter 11 cases, Mid-Size is ultimately unable to stick to the Plan of Reorganization and has to convert to Chapter 7 to liquidate. Without a heap of assets to sell in a §363 auction, I.M. cannot expect any further payments from the Debtor, although much work will still need to be done.

Scenario 2

I.M. Broke finds that Small Corp. is not a candidate for full-blown reorganization but still badly in need of relief. I.M. takes Small into Chapter 7, but when creditors begin to rattle the Debtor's cage and there is no money left in the corporate coffers, I.M. is left with the unpleasant choice of letting its Client twist in the wind or working for free. Meanwhile, the Trustee is sitting on funds swept from the Debtor's bank account arising from work done before the conversion.

So, what is an honest Bankruptcy lawyer to do?

Ch-Ch-Ch-Changes

In 1994 Congress made sweeping changes to the Bankruptcy laws.² §330 of the Code, governing payments from the Estate, was amended significantly:³ including new standards for evaluation of Fee Applications,⁴ new procedures by which Courts could reduce fee awards in response to objections by third-parties,⁵ and new threshold requirements for receiving fees in the first place.⁶ In short, the changes made by Congress were designed to increase and ensure judicial scrutiny of fee awards, courtesy of your elected representatives in Washington.⁷

When the Code was enacted in 1978, §330(a) specifically identified the "debtor's attorney" as being eligible to receive compensation from the Estate. Thus, prior to the 1994 Amendments §330(a)(1) read as follows:

After notice to any parties in interest, and to the United States trustee and a hearing, and subject to sections 326, 328, and 329, 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 ...*⁸

In 1994 §330(a)(1) was amended to read as follows:

After notice to any 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 ...⁹

Thus, Amended §330(a) omitted the phrase "or to the debtor's attorney" – implicitly removing eligibility for the Debtor's Attorney to receive compensation from the Estate.

Courts in some Federal Circuits have held that the omission of the language "debtor's attorney" means that Chapter 7 Attorneys are simply no longer eligible to receive compensation from the Estate, no matter how beneficial or necessary their efforts.¹⁰ On the other hand, Courts in other Circuits have concluded that Congress inadvertently omitted the phrase "debtor's attorney" from the Amendment, resulting in an

unintended ambiguity. These latter groups of Courts have construed the new §330(a) to permit compensation to Debtors' Attorneys from the Estate.¹¹

Whither §330(a)?

In these authors' opinions, the omission of the phrase "debtor's attorney" from the 1994 Amendments was inadvertent and the result of an obvious drafting error that has rendered §330(a) ambiguous and inconsistent. Accordingly, Courts should overlook the omission and permit compensation for Debtors' Attorneys from the Estate when sufficient assets have been marshaled to make such payment feasible. In this article we expose the drafting flaws in the Amendment and note that major rifts have developed between Federal Circuits trying to resolve the issue. Finally, this article will point out the potential ramifications on the Bankruptcy community if Courts continue to interpret Amended §330(a) to prohibit compensation to Chapter 7 Counsel from within the Estate.

And Then There Was The Scrivener's Error ...

Congress' 1994 Amendments omitted the phrase "debtor's attorney" in the first place at which the list of persons eligible for distributions appears, while continuing to use the word "attorney" later in that same section. This has led to much confusion.

Careful examination of §330(a)(1) reveals that the two segments of its central sentence are disjointed: while the statute does not identify Debtors' Attorneys as being entitled to receive payment from the Estate, it specifically refers to "attorneys" as being eligible for "reasonable compensation" later in the text.¹² Because the first segment excludes Attorneys while the second one includes them, the result is a conundrum and more likely the result of a drafting error than an intention to make a wholesale change in the law.

Drafting Error or Conspiracy to Deny Compensation?

The interpretation of this omission as a mere error is bolstered by examining the first list of persons eligible to receive compensation under §330(a).¹³ Post-1994, the initial list of "eligible persons" no longer includes the Debtor's Attorney.¹⁴ However, this simply ends the list with "professional person employed under section 327 or 1103" and leaves the reader expecting a follow up. To make the section grammatically correct Congress would have had to insert the conjunction "or" immediately before the term "professional person," indicating that this was the end of the line.¹⁵ Amended §330(a) lacks such a conjunction and leaves the reader wondering where the "or" went.¹⁶

For example, consider that Amended §330(a)(1)(A) uses "the" to modify the list of eligible recipients in rather than "a," "an," or "any."¹⁷ Merriam-Webster's online dictionary defines "the" as "a function word to indicate that a following noun or noun-equivalent is definite or has been previously specified by context or circumstance."¹⁸ Hence, the use of "the" must refer to the list of persons specifically identified in §330(a)(1), which orphans the word "attorney" in §330(a)(1)(A) without prior reference, again suggesting an error in drafting rather than an intentional omission.¹⁹

Where Chapter 7 Attorneys Fear to Tread

One possible explanation for retention of the word "attorney" in Amended §330(a)(1)(A) may be found by examining §330(a)(4)(B), added in 1994.²⁰ That section provides:

[I]n a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on the consideration of the benefit and necessity of such services to the debtor and other factors set forth in this section.²¹

The conclusion reached by certain Courts is that the word "attorney" retained in §330(a)(1)(A) must refer to the Debtor's Attorney, but while it results in a right to compensation for Chapter 12 and 13 Attorneys in §330(a)(4)(B), it has the opposite ramification for Chapter 7 Attorneys in §330(a)(1)(A).²² Under the canons of statutory construction, goes the reasoning;²³ Attorneys not specifically identified (e.g. Chapter 7 Attorneys) must have been precluded from compensation.²⁴

However, in order to accept this interpretation it is also necessary to assume that the two sections at issue use the term "attorney" in a parallel manner: this is not the case at all. §330(a)(4) has nothing to do with what parties are eligible for compensation. It is solely concerned with how to calculate reasonable compensation for those parties.²⁵ First, §330(a)(4)(A) lays out general limits governing the extent of compensation.²⁶ Then, §330(a)(4)(B) carves out an exception to the general rule for Chapter 12 and 13 Attorneys.²⁷ The fact that this section employs different standards to determine the level of compensation for Attorneys does not suggest that non-listed Attorneys are not entitled to be compensated.²⁸ Instead, it suggests only that the level of compensation for other types of Debtors' Counsel should be determined under the general rule set forth in §330(a)(4)(A).²⁹

Clash of the Federal Circuits

The 1994 Amendments to §330 have been the source of some dissent and disagreement among the Circuits. Currently there is a split on the issue of whether a Chapter 7 Attorney may be compensated by the Estate.

The 3rd and 9th Circuits have held that Amended §330 does not deprive Attorneys of the right to receive compensation from the Estate.³⁰ The 2nd Circuit agreed with that interpretation.³¹

For Compensation: Top Sausage Can't Be Beat

The *Top Sausage* case ultimately decided by the 3rd Circuit is illustrative.³² There, Debtor's Attorneys filed Fee Applications following conversion of a Chapter 11 case.³³ Both the Case and United States Trustee had objections, but only to certain time entries in the Fee Applications submitted.³⁴ Acting *sua sponte*, the Bankruptcy Court raised the issue of whether Debtor's Counsel were eligible to receive compensation at all and ruled from the bench that they were not, denying compensation for services rendered during the reorganization.³⁵ The 3rd Circuit unanimously reversed; concluding that the Attorneys were eligible for compensation arising from services reasonably likely to benefit the Estate.³⁶ In so doing the 3rd Circuit noted that based on the fact that the entire structure of §330(a) would be rendered inconsistent by the omission of "debtor's attorney" from Amended §330(a)(1) and, furthermore, given the dearth of legislative history indicating its intent to do so, Congress did not intend to change the long-standing practice of compensating Debtors' Attorneys through the Estate.³⁷

Likewise, the 9th Circuit concluded that Debtor's Attorney may receive compensation for services beneficial to the Estate via Amended §330.³⁸ In that case, *Century Cleaning*, Debtor's Counsel filed a Fee Application relating to post-petition services.³⁹ The Case Trustee agreed, filing a Notice of Intent to Permit Compensation. However, the United States Trustee filed an objection, stating that Amended §330 did not permit Attorney's Fees to be paid through the Estate.⁴⁰ The Bankruptcy Court and Bankruptcy Appellate Panel agreed.⁴¹ A divided 9th Circuit reversed, holding that a Chapter 7 Debtor's Attorney may be compensated from the proceeds in the Estate because Amended §330 was not only "substantially ambiguous," but the lack of legislative history and policy considerations to the contrary indicated that Congress committed a drafting error when it revised the section.⁴²

These decisions and other like them have collectively and resoundingly concluded that the omission of the phrase "debtor's attorney" from the first list of eligible persons in Amended §330(a)(1) was inadvertent and, accordingly, Attorneys may be awarded compensation from the proceeds of the Estate. Moreover these Circuits have reasoned that to construe Amended §330 as intentionally precluding compensation to Debtors' Attorneys would require a "fundamental change in the law that was not mentioned in legislative history."⁴³

Against Compensation: The Plain Meaning of "Plain Meaning"

The 4th, 5th and 11th Circuits have taken a contrary position,⁴⁴ concluding emphatically that Amended §330 is unambiguous as written and that there is no need to delve into the legislative history to interpret the section.⁴⁵ In fact, these Courts abide by the well-settled rule that Bankruptcy Courts must apply the "plain meaning canon of statutory construction" when interpreting the Code.⁴⁶ Specifically, "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute."⁴⁷ These Circuits have also held that that the language of Amended §330 is not only textually clear but conclusive in its meaning.

The most notable of the cases produced by the 4th, 5th and 11th Circuits is currently being reviewed before the High Court.⁴⁸ In *Equipment Services*, when a Chapter 11 case was converted, Debtor's Counsel filed a Fee Application for sums arising from both pre and post-conversion activity on behalf of the Debtor.⁴⁹ The United States Trustee objected to the post-conversion fees relying on the view that Amended §330 no longer permitted compensation for Debtor's Attorneys from the Estate.⁵⁰ The Bankruptcy Court and District Court agreed.⁵¹ A divided 4th Circuit also agreed.⁵² Instead the 4th Circuit permitted only pre-conversion fees accrued while the Debtor was in Chapter 11, disallowing the balance of the Fee Petition.⁵³ Although the Court acknowledged the omission of "debtor's attorney" from Amended §330(a)(1), it nonetheless reasoned that the omission did not render the status ambiguous because of the reference to "attorney" in section 330(a)(1)(A).⁵⁴ Instead, reasoned the Court, the retention of "attorney" in Amended §330(a)(1)(A) simply preserved the right of the Case Trustee to hire Counsel as a "professional person" as designated in §327(a).⁵⁵ The 4th Circuit went even further by stating that the "omission of the conjunction 'or' in §330(a)(1) after the word 'examiner,' is an oversight that is as consistent with the *deliberate* deletion of the words 'debtor's attorney' as it is with the inadvertent deletion of those words from that section."⁵⁶ (Emphasis in original). The Court concluded its argument by pointing out that Amended §330(a) has been in effect for over eight years and Congress has yet to revoke or change it due to an alleged "scrivener's error."⁵⁷

When All Else Fails ... Consider The Policy Implications

Policy considerations also favor allowing Debtors' Attorneys to receive compensation through the Estate under the auspices of Amended §330(a). Such considerations, stated explicitly and implicitly throughout the Code and case law, include:

1 The policy against depriving Debtors of competent representation in connection with the filing Chapter 7 Petitions, preparation and amendment of Schedules, communication with creditors and participation in Rule 2004 examinations; 58

2 Preventing a "race" by overzealous creditors eager to take advantage of an un-represented debtor to pry special treatment out of the Estate or tie up the Debtor with long-term, one-sided Reaffirmation Agreements; and, ultimately⁵⁹

3 Preservation of the assets of the Estate for the benefit of all parties, a job best done by the Debtor's chosen Counsel: this policy also dovetails with the overall role of the Case Trustee who must marshal and distribute non-exempt assets.⁶⁰

Interpreting Amended §330(a)(1) so as to eliminate the possibility of post-Petition (or post-Conversion) compensation for certain Attorneys would significantly alter the ability of Debtors to secure Counsel in the first place – to say the least, a fundamental change in Bankruptcy law, which is designed to maximize the distribution of the Debtor's non-exempt assets while allowing for a genuine "fresh start" for the honest Debtor.⁶¹ Contrary interpretations will only lead to an increase in *pro se* cases, including those which become *pro se* on a *de facto* basis when the Attorney departs due to his/her inability to be compensated.⁶² Moreover, for those brave souls who do brave the perils of Amended §330, Counsel will be even more skittish about standing by their Clients, simply in order to avoid the risk of expending time and resources without any prospect for compensation.⁶³ Finally, since dealing with *pro se* Debtors also do not aid the administration of the Code or the efficiency of the Courts, there is no particular benefit to either group in this harsh interpretation either.⁶⁴ With all these factors and more in the balance, it seems highly unlikely that Congress intentionally made such a sweeping change in §330 without commenting on, or indeed without so much as mentioning, that change at some point during the enactment of the 1994 Amendments.⁶⁵

Conclusion

In short, Amended §330 is ambiguous and its legislative history devoid of an explanation. The evidence suggests that the deletion of the phrase "debtor's attorney" in the statute was inadvertent and that the deletion conflicts with Code's policies of allowing reasonable compensation for services beneficial to the Bankruptcy Estate and encouraging the use of competent Counsel by Debtors. Should the High Court be unwilling to overlook Congress' omission in this regard, the effects on the Bankruptcy community will be profound.

1 See 11 U.S.C. §330(a)(4)(B) (2003).

2 Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994).

3 11 U.S.C. §330 (2003).

4 See 11 U.S.C. §330(a)(3) (2003).

5 See 11 U.S.C. §330(a)(2) (2003).

6 See 11 U.S.C. §330(a)(4) (2003).

7 See, e.g., 140 CONG. REC. S14, 597 (Oct. 7, 1994) (statement of Sen. Metzenbaum).

8 See 11 U.S.C. §330(a) (1978).

9 See 11 U.S.C. §330(a) (2003).

10 See e.g., *In re Kinnemore* 181 B.R. 520, 521 (Bankr. D. Idaho 1995) (omission of "debtor's attorney" from (a)(1) coupled with (a)(4)(B) meant that a chapter 7 debtor's attorney could no longer be paid from the bankruptcy estate).

11 See e.g., *In re Top Grade Sausage*, 227 F.3d 123, 129 (3d Cir. 2000) (concluding that debtor's attorney may still receive compensation from estate).

12 See 11 U.S.C. § 330(a)(1) (2003).

13 See *In re Brierwood Manor, Inc.* 239 B.R. 709, 716 (Bankr. D. N.J. 1999).

14 See 11 U.S.C. §330(a)(1) (2003).

15 See *Brierwood Manor*, 239 B.R. at 716.

16 See 11 U.S.C. §330(a)(1) (2003).

17 See *id.*

18 See Merriam-Webster, Incorporated, *Merriam-Webster Online Dictionary* (2003) (available at <http://www.m-w.com/home.htm>) (accessed November 19, 2003).

19 See *id.* See also *In re Miller*, 211 B.R. 399, 402 (Bankr. D. Kan. 1997).

20 See e.g., *Century Cleaning*, 195 F.3d 1053, 1064 (9th Cir. 1999) (Thomas, J. dissenting); See *In re Fassinger*, 191 B.R. 864, 865 (Bankr. D.Or. 1996).

21 11 U.S.C. §330(a)(4)(B)

22 See *Century Cleaning*, 195 F.3d at 1057 n.3.

23 *expressio unius est exclusio alternius*

24 See *Century Cleaning*, 195 F.3d at 1057 n.3.

25 See *id.*

26 11 U.S.C. §330(a)(1)(A).

27 11 U.S.C. §330(a)(1)(B).

28 See *Century Cleaning*, 195 F.3d at 1057 n.3.

29 See *id.*

30 See *Top Grade Sausage*, 227 F.3d 123 at 127-30; See also *Century Cleaning*, 195 F.3d 1053 at 1057-61.

31 See *In re Ames Dep't Stores*, 76 F.3d 66, 71-72 (2nd Cir. 1996) (in dictum).

32 See *Top Grade Sausage*, 227 F.3d at 130.

33 See *id.* at 126.

34 See *id.*

35 See *id.*

36 See *id.* at 130.

37 See *id.*

38 See *Century Cleaning*, 195 F.3d at 1061.

39 *See id.* at 1055.
40 *See id.*
41 *See id.*
42 *See id.* at 1061.
43 *See* Miller, 211 B.R. at 402.
44 *In re* Equipment Services, Incorporated, 290 F.3d 739, 742 (4th Cir. 2002) *cert. granted, rev'd sub nom.* Lamie v. United States Trustee, 123 S.Ct. 1480 (2003); Inglesby, Falligent, Horne, Courington & Nash, P.C. v Moore (*In re* Am. Steel Prod.), 197 F.3d 1354, 1356 (11th Cir. 1999); Andrews & Kurth L.L.P. v. Family Snacks, Inc. (*In re* Pro-Snax Distrib., Inc.), 157 F.3d 414, 424-26 (5th Cir. 1998).
45 *See* Equipment Services, 290 F.3d at 739.
46 Am. Steel Prod., 197 F.3d at 1356.
47 *Id.* *quoting* United States v Ron Pair Enter. Inc., 489 U.S. 235, 109 S.Ct. 1026 (1989).
48 Lamie, 123 S.Ct. 1480 (2003).
49 Equipment Services, Inc., 290 F.3d at 742.
50 *Id.*
51 *Id.* at 743.
52 *Id.* at 745-46.
53 *Id.* at 747.
54 *Id.* at 745.
55 *Id.*
56 *Id.*
57 *Id.* at 745-46.
58 Century Cleaning, 195 F.3d at 1060.
59 *Id.*
60 *Id.*
61 *Id.* at 1060-61.
62 *Id.* at 1064 (Thomas, J., dissenting) (discussing probable consequences of denying compensation to debtors' attorneys).
63 *Id.*
64 *Id.*
65 *Id.* at 1061.

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