New York State Bar Association
Business Law Section
Sub-Committee on Bankruptcy

Getting Compensated as Debtor's Counsel in Small Bankruptcy Cases: Sometimes Easier Said Than Done...

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Introduction

Bankruptcy is an exciting and challenging field of law. But consumer and small business debtors are typically short on funds and saddled with numerous legal and financial problems. These circumstances render it difficult, in many instances, to ensure that counsel is properly and fully compensated for all of the services necessary to properly prosecute a case.

Serving as debtor's counsel is not without risks. Although counsel's legal fees are often afforded priority status over the claims of many other creditors in a bankruptcy case, counsel can find itself competing with other creditors or parties in interest for the limited funds available in a case. This is because, as one court described, "[B]ankruptcy is ultimately a zero sum game: whatever is added as a priority to one constituent's claim comes out of the other similarly situated constituents' pockets." Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 667, 126 S.Ct. 2105, 165 L.Ed.2d 110 (2006). Moreover, because of the limited resources typically available to pay professional fees and the claims of creditors, "In bankruptcy, the scrutiny of attorney fee matters is [] heightened, with judicial oversight of the process." In re All Cases of Musher, 387 B.R. 669, 674 (Bankr. W.D.Pa. 2008).

For these reasons, this outline is designed as an overview of the compensation issues that should be considered by debtor's counsel prior to undertaking the representation of a small business or consumer debtor.

1. Pre-Bankruptcy Advance Payment of Fees and Retainers: Whose Property Is it Anyway?

When a law firm agrees to represent a client, the terms of the firm's engagement are set forth in a contract, which is commonly referred to as a retainer or fee agreement. The fee agreement should delineate, among other things, the scope of services the firm has agreed to provide, the fee arrangement agreed to by the client, and the type of fee deposit received by the firm.

In most bankruptcy cases, at the outset of its engagement, a law firm will require a deposit of funds to be used to ensure payment of all or a portion of the fees incurred by a client. In small bankruptcy cases, this deposit is typically used in one of two ways. It may serve as an advance payment of the fees in full, commonly referred to as a flat fee, or it may serve as a deposit towards the fees to be incurred during the case, commonly referred to as a retainer. If the firm represents a client for a flat fee, the fee is designed to encompass the ordinary services required for a case of that particular size or nature. If the deposit is designed to serve as a retainer, the firm typically renders services on an hourly basis on an agreed upon hourly rate; the fees are charged against the retainer.[1] A full understanding of these terms, and the law

[1] The terms "flat fee" and "retainer" are sometimes used interchangeably in the decisional law. Although a flat fee is designed to represent a type of fee arrangement, i.e., the firm will prepare and complete the case for a flat fee regardless of the hours it takes, the flat fee is in fact a deposit of funds received by counsel prior to the bankruptcy filing. If the issue of ownership of

governing fee arrangements, is crucial to ensuring that the firm is compensated in the manner intended by the firm and the client.

In all bankruptcy cases, a bankruptcy estate is created on the date the bankruptcy petition is filed with the bankruptcy court (the "Petition Date"). The bankruptcy estate consists of all of a debtor's non-exempt[2] property, including any contingent or unliquidated claims of the debtor and intangible property rights, such as rights under a contract or lease. See Section 541 of the Bankruptcy Code, contained in 11 U.S.C. 101 et seq. ("Bankruptcy Code")[3].

Although bankruptcy law is a creature of federal law, a debtor's interest in property is defined by state law. It is only when federal or bankruptcy law conflicts with state law, or applicable non-bankruptcy law requires a different result, that a bankruptcy court may suspend state property rights to determine a debtor's interest in property. See Butner v. U.S., 440 U.S. 48, 99 S.Ct. 914 (1979). As one court recently noted, "[P]re-petition contract rights and property interests should not be analyzed differently or enhanced simply because an interested party is involved in a bankruptcy case." In re Delphi Corp., 2009 WL 637315, *2 (Bankr. S.D.N.Y. 2009).

Understanding these principles is of paramount importance to a debtor's attorney. First, any funds paid to a law firm may be considered property of the bankruptcy estate and, in some circumstances, subject such funds to disgorgement or distribution to other creditors in the case. Moreover, property of the bankruptcy estate may only be administered under the confines of the applicable provisions of the Bankruptcy Code and Rules, as discussed below. Therefore, a law firm's treatment of the funds it receives prior to a debtor's bankruptcy filing must be guided by applicable state and bankruptcy law.

A. Fee Agreement Determines Firm's Interest in Fees Paid Pre-Bankruptcy

Since there is little dispute that, in most cases, state law defines the nature of a debtor's and its bankruptcy estate's interest in the fees paid to counsel prior to a bankruptcy filing, it is imperative that any fee agreement entered into by the parties evidence the law firm's and client's intent at the time the agreement was signed. See, e.g., In re King, 392 B.R. 62, 70 (Bankr.

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the funds arises, the state law rules governing retainers is applied by the courts to determine if the fees are property of the bankruptcy estate.

[2] Property that had been deemed by statute to be excluded from the bankruptcy estate is referred to as "exempt" property. A debtor is permitted to retain its interest in exempt property and may exclude exempt property or its value from any distribution to creditors in the bankruptcy estate.

[3] All references to "Section" shall refer to the applicable section of the Bankruptcy Code. Any reference to "Rule" shall refer to the Federal Rule of Bankruptcy Procedure.

S.D.N.Y. 2008) ("Whether a retainer is property of the estate or subject to disgorgement is a function of the intention of the parties and state law.")

As mentioned above, in the average Chapter 7 and 13 consumer bankruptcy case, in which litigation is not contemplated, the most common fee arrangement employed is the use of a flat fee. In a Chapter7 case, the firm is paid a flat fee prior to the Petition Date that is designed to represent all legal services required to fully prosecute the case. Similar fee arrangements are employed in Chapter 13 cases. However, in some Chapter 13 cases, firms will accept payment of a portion of the flat fee through the payment plan approved by the court.

The flat fee paid to a firm is also commonly described as the firm's retainer. But state law recognizes different types of retainers. For this reason, it is imperative that the fee agreement clearly specify the type of retainer agreed to by the parties. For example, some retainers are paid to ensure a firm's availability for the client's engagement. These retainers, referred to as "general," "engagement," or "classic" retainers, are not designed to compensate the firm for services rendered: they compensate the firm for dedicating its time and resources to a particular matter to the exclusion of others. See In re King, 392 B.R. 62, 70 (Bankr. S.D.N.Y. 2008). "Because the general retainer fee is given in exchange for availability, it is a charge separate from fees incurred for services actually rendered. In other words, such fees are "earned when paid" because the payment is made for availability." Levisohn, Lerner, Berger & Langsam v. Medical Taping Systems, Inc., 20 F.Supp.2d 645, 650-651 (S.D.N.Y. 1998). See also Agusta & Ross, v. Trancamp Contracting Corp., 193 Misc.2d 781, 785, 751 N.Y.S.2d 155 (Civ. Ct. N.Y. Cty. 2002). When a firm receives this type of retainer, the entire amount of the retainer is earned upon receipt and the funds do not become property of the bankruptcy estate when the case is filed. In addition, the law firm does not have to apply to the bankruptcy court for permission to use the funds.[4]

Another type of retainer, commonly referred to as a "special" or "security" retainer, is a payment made to an attorney to secure payment of fees for services to be rendered on a particular matter or for a particular time period. The debtor retains an interest in these funds until services are rendered by the attorney; this retainer is considered property of the bankruptcy estate.

Another type of retainer recognized in New York is the "advance payment" retainer. This type of retainer represents fees paid to an attorney for services to be rendered, but title to the funds passes to counsel upon remittance, unless there is an express agreement that the payment will be held in a trust or escrow on the client's behalf. "Funds that are collected as advance retainers do not become property of the estate and are subject to the requirements of § 329 only." In re King, Id. at 70-71.

For these reasons, a firm contemplating representing a debtor should take great care in

[4] However, the fees are still subject to review by the bankruptcy court for reasonableness, as discussed below, pursuant to Section 329. See In re King, Id.

drafting its fee agreement to ensure that it reflects its agreement with the client and the intent of the parties regarding the ownership of the funds paid prior to the bankruptcy filing. In addition, the firm should ensure that the funds are deposited in a manner that reflects that agreement. See, e.g., S.E.C. v. Credit Bancorp, Ltd., 109 F. Supp. 2d 142, 144 (S.D.N.Y. 2000) (Law firm deposited retainer in client trust account. Court found that there was no language in the fee agreement to overcome the presumption that funds deposited in client trust account were intended to transfer ownership to the firm upon receipt of funds.)

2. Chapter 7: The Flat Fee and Beyond

Pre-Petition Fees: When a Chapter 7 case is filed, a trustee is appointed to administer the case and any property of the bankruptcy estate for the benefit of creditors. Stated in simple terms, it is the Chapter7 trustee's duty to liquidate and marshal the assets of the bankruptcy estate and pay the claims of creditors. Therefore, unless the value of the property collected and distributed exceeds the amount of the claims against the estate, and there is a surplus of funds or property that will be returned to the debtor, a debtor does not typically have an interest in the administration of the case other than complying with its statutory duties, such as attending the Section 341 meeting of creditors. For this reason, in most cases, the services rendered to the debtor-client individually do not benefit the bankruptcy estate and creditors. After the Petition Date, unless counsel undertakes the representation of the bankruptcy estate, counsel can not be compensated from bankruptcy estate assets.

As discussed above, in the average consumer case, counsel require customarily the pre-bankruptcy payment of a fee that is designed to compensate the firm for the services required from the inception of the case through the conclusion of the case. These flat fees are not directly related to the actual amount of time spent in a particular case, such as a fee based upon the hours of work performed. One court described a flat fee as follows:

> When a client and an attorney agree that the attorney will provide certain services (described by a category, a time period, a case, etc.) for a fixed or flat fee, the fee covers the services regardless of the amount of time which the attorney spends performing the services; both the client and the attorney are obligated to the flat fee whether the attorney would have made more or less for the services by charging for them by the hour or charging separately for each service.

In re Mansfield, 394 B.R. 783, 791 (Bankr. E.D. Pa. 2008).

In some districts, the bankruptcy courts have identified, and set forth in local rules and orders, a range of flat fees that have been deemed presumptively reasonable for the average consumer case. They are commonly referred to as "no-look" fees, since such a fee will not invite scrutiny by the court or the U.S. Trustee's Office ("UST"), the branch of the U.S. Department of Justice that oversees bankruptcy cases. There are no published "no-look" fees in the Southern and Eastern Districts of New York.

Since debtors are often cash-strapped and under financial duress, it in not uncommon for a debtor to lack sufficient funds to pay all of the legal fees and expenses needed to file a Chapter7 case. A consumer debtor may be plagued by a wage garnishment, facing eviction, or unable to access the funds in a bank account because a creditor has placed a hold on the account. When a debtor faces such emergent circumstances, it is not uncommon for the debtor to seek immediate assistance from counsel – in the form of a bankruptcy filing – with the promise of full payment of the fees and expenses after the bankruptcy filing. But failing to collect an agreed upon flat fee in full, prior to a bankruptcy filing, may result in the discharge of the balance due after the petition date and is a risky proposition.

For example, in In re Mansfield, 394 B.R. 783 (Bankr. E.D. Pa. 2008), debtor's counsel agreed to accept payment of 50% of his flat fee in four installments after the bankruptcy filing. The court found the balance of the fee was a pre-petition dischargeable debt. Moreover, the court found that the attorney's request for payment of the fee after the bankruptcy filing was a violation of the automatic stay. Id. at 794. The court's finding was premised upon the flat fee nature of the fee arrangement. It found that it is inconsistent with the nature of a flat or fixed fee arrangement, regardless of how the fee is paid (e.g., whether the fee is paid in a lump sum, divided into installment payments, etc...) to apportion the fee among the services performed or the time periods within which they were performed. Id. at 791. Acknowledging a disagreement among the courts on this issue, the Mansfield court stated it joined those other courts which hold that when a flat or fixed fee pre-petition agreement is at issue, the fee must be paid in full prior to the commencement of the debtor's case or the fee is discharged under Section 727(b). Id.

Mansfield is consistent with a plain reading of the Bankruptcy Code. There is no exception to discharge for attorneys fees unless the fees are protected in some fashion, such as when they are deemed non-dischargeable domestic support debt incurred in a matrimonial case. E.g., In re Fickling, 361 F.3d 172, 176 (2d Cir. 2004) (noting pre-petition legal fees are dischargeable); In re Madigan, 312 F.3d 589 (2d Cir. 2002) (legal fees deemed non-dischargeable child support obligation not dischargeable). For these reasons, the failure to collect a flat fee in full, prior to the Petition Date, it a risky proposition for a debtor's counsel.

Post-Petition Fees: In the average consumer case, a debtor's counsel will not be called upon to render services to the debtor beyond the tasks performed in all cases, such as preparing and filing the documents, accompanying the debtor to the meeting of creditors, and related routine services. However, in some cases, extraordinary services are required, such as defending a non-dischargeability lawsuit brought against the debtor or responding to an in-depth investigation of the debtor by the trustee. Once again, the terms of the fee agreement can be instrumental to determining counsel's rights and obligations to the debtor regarding post-bankruptcy legal services for, at least, two reasons.

First, the firm's obligation to render extraordinary services is largely governed by the terms of the fee agreement unless there is applicable law to the contrary. For example, it is not uncommon for fee agreements in consumer bankruptcy cases to exclude representation in an adversary proceeding brought against the debtor unless a separate fee agreement is entered into

by the parties. But local rules, decisional law, and a bankruptcy judge's preference may affect the ease with which a firm can decline to render additional services. For example, in the Eastern District of New York, Bankruptcy Local Rule 2090-2 contains a procedure that must be followed when a firm declines to defend a debtor in an adversary proceeding. The procedure includes providing the court with a copy of the relevant portion of the fee agreement that excludes representation in adversary proceedings.[5] A copy of the rule is attached as Appendix A. Moreover, although there may not be a similar rule in all of the districts, bankruptcy judges may exercise discretion in determining when, and under what circumstances, an attorney can cease, or withdraw from, representing a debtor after the bankruptcy filing. A sample motion to withdraw for non-payment in a Chapter7 case, that was granted by the court, is annexed hereto as Appendix B.

Second, the courts will look to the terms of the fee arrangement to determine whether, and under what circumstances, a debtor agreed to pay fees to counsel after the bankruptcy filing. For example, in the recent case In re Kasperek, 399 B.R. 591 (Bankr. W.D.N.Y. 2009), debtor's counsel refused to defend the debtor against a motion for the turnover of property without payment of an additional fee. When the attorney failed to appear in court and assist the debtor, the Chapter 7 trustee moved the court to disgorge the attorney's fees. The court granted the trustee's motion.

In ruling against the attorney, the Kaparasek court placed great weight on the wording of the fee agreement. The court acknowledged an attorney's ability to specify the services agreed to between the parties. But the fee agreement in question stated that the attorney agreed to render legal services for all aspects of the bankruptcy case except for the following services: negotiations with secured creditors to reduce to market value, defending dischargeability actions, judicial lien avoidances, relief from stay motions, any other adversary proceeding, and preparing and filing motions for avoidance of liens on household goods. It did not mention turnover motions. The court stated

> Counsel may ... structure a retainer arrangement that contemplates the payment of additional fees in the event that the client desires supplemental services. But when an attorney represents that he has accepted a specific fee as consideration for designated legal services, the court will hold him to that commitment.

Id. at 594-595.

Unfortunately, the attorney's omission in the fee agreement cost him his fees.

Kaparasek highlights the importance of carefully delineating in the fee agreement the services to be provided under a flat fee agreement because the list of services will impact a

[5] At the time of this writing, the author did not locate a similar local rule in the Southern, Northern, and Eastern Districts.

firm's ability to seek additional fees for post-petition services. Any services the firm intends to carve-out of the fee arrangement should be clearly specified. See also In re All Cases of Musher, 387 B.R. 669, 674 (Bankr. W.D. Pa. 2008).

Although some courts, such as the Western District of New York, have identified services the court has deemed are basic services for a case, there are no mandatory services that must be provided to a debtor by debtor's counsel in New York. See Western District Local Bankruptcy Rule 2016. In fact, the Kaparasek court articulated the principle that an attorney may contract to provide a lesser level of service than is commonly considered typical in a consumer case. "Rather, the obligations of the debtor's attorney are more accurately defined by the retainer agreement that counsel must describe in the statements required by 11 U.S.C. § 329 and Bankruptcy Rule 2016." Id. at Ftnt.1.

It is worth noting if counsel must render services post-petition, and the fees incurred are properly chargeable to the debtor, fees earned post-petition are not dischargeable. E.g., In re Chase, 372 BR 133 (Bankr. S.D.N.Y. 2007).

Finally, if in fact a debtor's counsel's services are needed to assist the Chapter 7 Trustee in some fashion, under certain circumstances, a debtor's counsel may be compensated from estate assets after the bankruptcy filing. The most common scenario in which this arises is when the debtor has a personal injury action or the sale of real estate pending prior to the bankruptcy filing. In those instances, it is often cost-effective to permit the attorney to perform the work necessary to complete the matter. But such representation can not continue unless counsel is first retained by the trustee pursuant to Section 327. Lamie v. U.S. Trustee, 540 U.S. 526, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) (holding that in a Chapter7 proceeding, a debtor's attorney not retained under § 327 is not eligible for compensation from the estate). See also In re Burch, 292 B.R. 490, 495 (Bankr. W.D.N.Y. 2003) (Prior to awarding fees from the estate, the court requires that the attorney must have been appointed under Section 327 and must have obtained the pre-consent of the Chapter7 trustee before performing any services.) With limited exceptions, there is no authority in the Bankruptcy Code to pay a Chapter7 debtor's counsel from estate assets unless counsel has been retained by the trustee.

3. Chapter 13: To Apply or Not to Apply: That is the Question!

As in Chapter 7 cases, a trustee is appointed in Chapter 13 cases to administer the case for the benefit of creditors. But unlike in Chapter 7 cases, the Chapter 13 Trustee distributes monthly payments that are paid by the debtor under a payment plan. The Chapter 13 trustee does not liquidate or sell property to pay creditors: the trustee uses the debtor's post-bankruptcy income to pay the claims of creditors. Therefore, unlike in Chapter7 cases, a Chapter13 debtor's post-bankruptcy income is property of the bankruptcy estate and subject to the jurisdiction of the bankruptcy court. Moreover, as discussed below, the Bankruptcy Code permits a Chapter 13 debtor's counsel to be compensated from property of the bankruptcy estate.

Pre-Petition Fees: In the average case, the services rendered by Chapter 13 debtor's

counsel is more extensive than in Chapter7cases. For example, a payment plan must be drafted and approved by the court, and the claims filed by creditors must be scrutinized to ensure their accuracy. But as in Chapter7 cases, "the Courts have long recognized that Chapter 13 cases may and often do require similar services of attorneys in routine cases. Flat fee arrangements therefore may be particularly appropriate for such cases." In re Bellamy, 379 B.R. 86, 94 (Bankr. D. Md. 2007) (citations omitted). A respected commentator has described the rationale for the use of flat fees as follows:

> Three or four hours of attorney time and a like number of hours of paralegal time in an experienced debtors' attorney's office can produce excellent results in a "typical" Chapter 13 case. Another lawyer who less regularly handles Chapter 13 cases might double or triple the time investment to produce the same or less desirable results. Applying normal lodestar methodology can penalize the efficient volume counsel by reducing the fee in each case while rewarding the inefficient practitioner with higher fees.

Keith M. Lundin, *Chapter 13 Bankruptcy* § 294.1, at 294-22 to -23 (3d ed. 2000 & Supp.2004).

As in Chapter7 cases, in many courts around the country, "no-look" or presumptive fees have been established by the courts by either local rule or order for Chapter 13 cases. Such fees are typically flat fees that are presumed to be reasonable in the typical Chapter13 case. There are no such published fees in the Eastern and Southern Districts of New York.

The same issues discussed above regarding the importance of specifying the scope of services and the types of retainers agreed to by the parties in the fee agreement apply to Chapter13 cases and need not be repeated. However, unlike in Chapter7 cases, a firm may receive the balance of a flat fee after the Petition Date under the appropriate circumstances. Moreover, since creditors are paid from a Chapter13 debtor's post-petition stream of income for payment – and not its pre-petition assets – there is less of a risk that a pre-bankruptcy fee deposit could be subject to the claims of other creditors.

Post-Petition Fees: The Bankruptcy Code authorizes Chapter13 debtor's counsel to apply to the court for fees. Section 330(a)(4)(B) provides in relevant part that the court may allow reasonable compensation for the debtor's attorney for representing the debtor's interests in connection with the case based upon a consideration of the benefit and necessity of such services to the debtor "and the other factors set forth in this section." The only other factors set forth in Section 330 are set forth in Section 330(a)(3).

Bankruptcy Code § 330(a)(3) provides that the court shall consider the following factors when determining the reasonableness of the compensation sought:

- the nature, the extent, and the value of such services,
- the time spent on such services;
- the rates charged for such services;

- whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of the case;
- whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
- whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
- whether the compensation is reasonable, based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

In Chapter11 cases, applications for fees are routinely filed with the court. Such applications, discussed below, are filed pursuant to Section 330(a)(1). That section specifically requires notice and a hearing prior to an award of fees by the court; Section 330(a)(4)(B) does not contain such a requirement. See Lamie v. United States Trustee, 540 U.S. 526, 537, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) (finding that Chapter13 debtors' attorneys are awarded fees under § 330(a)(4)(B) rather than § 330(a)(1)). Yet despite the absence of a hearing and notice, Chapter13 fee applications are not as routinely filed as Chapter11 fee applications in New York. This may be due to the fact that the custom and practice is, in the average case, to either collect a flat fee prior to the Petition Date, or collect all or a portion of a flat fee through the payment plan approved by the court.

In fact, some courts have enacted local rules and orders that address requests for fees by Debtor's counsel in Chapter 13 cases. For example, Southern District of New York Local Bankruptcy Rule 3015-1(b) provides in relevant part that an attorney who intends to seek payment of fees under the debtor's plan as an administrative expense must give notice to the trustee, court, and all creditors. However, if the plan specifies the timing and amount of payment to the attorney, and the plan is transmitted to all parties in interest, notice of the plan is deemed adequate notice of the attorney's fee request. Since a plan or summary of a plan must be provided to all creditors and parties in interest in a Chapter13 case, it is obviously less costly for debtor's counsel to provide for payment of post-petition fees in the plan than to apply to the court for an award of fees. See also General Order M-362 of the Southern District of New York Bankruptcy Court, which became effective on January 5, 2009. That order requires the use of a new model plan, annexed hereto as Appendix C, that contains a provision that addresses the post-petition payment of attorneys fees.

Chapter 13 debtor's counsel's fees are typically deemed administrative expenses pursuant to Section 507. As such, the fees are given priority over the claims of most of the other creditors and are often paid in full by the Trustee before the claims of other creditors. It is for this reason that many practitioners will, under the appropriate circumstances, accept payment of the balance

of their fee under the plan.[6]

It is not uncommon for the Chapter 13 Trustee or the UST to review the reasonableness of legal fees of a debtor's attorney, either informally with counsel or through an objection or motion to the court. But the court may raise the issue sua sponte as well. Rule 2017(b) provides that a bankruptcy court may determine whether any payment of money by the debtor, or any agreement therefor, to an attorney after the Petition Date is excessive. Any such determination must be done on notice to the attorney and pursuant to a hearing. Section 329 also provides the court with the authority to review, among other things, the reasonableness of a fee agreement between a debtor and its counsel whether or not such attorney applies to the court for compensation.

If an application to the court must be filed in a Chapter13 case, the application must comply with the terms of Rule 2016. Moreover, although there are elaborate and detailed rules governing Chapter 11 fee applications, as discussed below, no such rules exist for Chapter 13 fee applications. In addition, it is important to note that many courts view Chapter 13 fee applications very differently from fee applications in Chapter 11 cases. Because of what is considered the routine set of services required in every Chapter 13 case – preparation of schedules, attend meeting of creditors, prepare plan, etc... – some courts do not believe that the classic lodestar method[7] of fee determination is applicable to all legal services rendered in Chapter 13 cases. See, e.g., In re Eliapo, 468 F.3d 592, 599 (9th Cir. 2006) (discussing the propriety of seeking fees above the presumptive fees published by the local court); In re Argento, 282 B.R. 108, 116-17 (Bankr.D.Mass.2002) (approving a combination of the initial fixed fee and the lodestar method for extraordinary services); In re Szymczak, 246 B.R. 774, 781 (Bankr.D.N.J.2000) ("Because use of the lodestar method for calculating legal fees does not achieve fair and reasonable results for debtor's counsel in Chapter13 cases, bankruptcy courts should divide services into two categories: work that is standard or normal and customary in a Chapter13 case and work that falls outside of this standard.")

The Chief Judge of the Western District of New York bankruptcy court summarized his view of supplemental Chapter 13 fee requests as follows:

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[6] A large number of debtors – the statistics vary by district – do not complete their plan payments. Such a debtor will have its case dismissed or converted to a Chapter7 case. If a case is dismissed or converted, it is much more difficult to collect the balance of a legal fee than if the firm is receiving a monthly check from the Chapter 13 Trustee in a successful case. Therefore, if a firm is unsure of a debtor's likelihood of success, it may require full payment of its fee prior to filing the case.

[7] The lodestar method "calculates attorneys' fees by multiplying hours reasonably expended against a reasonable hourly rate." Wal-Mart Stores, Inc. v. Visa U.S.A., Inc., 396 F.3d 96, 123 n. 27 (2d Cir.2005).

In most Chapter 13 cases, this court will not require the attorneys for a debtor to submit time records relative to their services. Rather, as a general rule, the court relies upon the recommendation of the trustee and upon the court's understandings about the normal and customary costs of representation. In the present instance, the debtor's attorney originally sought fees in the amount of $1,600. In the absence of any objection, this sum falls within the upper range of what the court has deemed to be reasonable. Although this court has never set an absolute limit on legal fees in a Chapter 13 proceeding, I have always scrutinized an atypically high request for fee allowances, particularly in the context of objection from the trustee. When such scrutiny is required, a fair consideration of the fee request is possible only upon a review of time records of services rendered throughout the case.

Entitlement to an additional fee depends not only upon the performance of an unexpected legal task, but also upon the totality of all services rendered. Thus, the mere delivery of extra services will not necessarily justify additional fees, where the total compensation package is otherwise reasonable. The court appreciates that when counsel customarily charges a fixed fee, some particular cases may demand less work than other particular cases. In as much as frequent practitioners expect to retain a greater return in the easier cases, they should not expect extraordinary compensation in any but the truly extraordinary case.

The nature of Chapter 13 practice is such that it demands intensive communication with clients, creditors, and the trustee. For attorneys like the applicant who maintain a large Chapter 13 practice, the presentation of case-specific time records may be cumbersome and time consuming in itself. For this reason, the court will generally allow flat fees that fall within an acceptable range. Of course, if attorneys prefer, they may chose to submit time records for the services rendered in each of the cases for which they provide representation.

In the present instance, I accept the position of the Chapter 13 trustee that the originally reported fee of $1,600 appears to be reasonable for customary services in a Chapter13, and that those customary services would typically include the additional work that the debtor's counsel provided in the present instance. However, the court is also willing to consider any supplemental fee request, if supported by the time records of counsel.

In re Johnson, 331 B.R. 534, 535 (Bankr. W.D.N.Y. 2005).

The Johnson opinion reflects the view of the courts discussed above that a court may require a strong showing by a debtor's counsel that any fees sought above what the court perceives as a customary or reasonable fee is appropriate under the circumstances of a case. Based upon the foregoing, any fee applicant should be prepared to address such inquiry by the court or Chapter 13 Trustee.

4. Chapter 11: Not for the Faint of Heart or the Underfunded

In recent years, there has been an increase in the use of Chapter 11 for individual and small business debtors for a number of reasons. First, when the Bankruptcy Code was amended substantially in 2005, a number of high-income debtors became ineligible for Chapter 7. Second, the increase in real property values rendered a number of property owners ineligible to serve as Chapter 13 debtors. At the time of this writing, a Chapter 13 individual debtor may not have more than $1,010,650 in secured debt and $336,900 in unsecured debt pursuant to Section 109(e). Because of the appreciation in property values, and the ease with which borrowers obtained credit, individual debtors with high levels of debt have been forced to commence Chapter11 proceedings to enlist the protection of the bankruptcy court. Finally, the adoption of the small business debtor provisions of the Bankruptcy Code have provided a mechanism for streamlining the Chapter11 process, making it more affordable and accessible to a greater number of potential debtors. For these reasons, small business and individual Chapter 11 cases filings have become more commonplace.

Chapter 11 cases require typically the greatest amount of legal services after the Petition Date than Chapter 7 or 13 cases. Therefore, since the amount of legal services required of a debtor's counsel is much more extensive, requests for the approval of fees after the Petition Date are fairly common. However, unlike in Chapter 13 cases, the rules governing such requests have been extensively addressed in the applicable statutory and decisional law, local rules and orders, and by the UST. The following is a brief overview of the issues that relate to compensation that counsel should be aware of before representing a Chapter 11 debtor.

A. Representing a Chapter 11 Debtor: Who Is Qualified?

Unlike in Chapter 7 and 13 cases, there is no trustee appointed when a Chapter 11 bankruptcy petition is filed. Pursuant to Section 1107, with limited exceptions, a Chapter 11 debtor has all of the rights and powers of a Chapter 11 trustee and is obligated to perform the duties of such a trustee. For this reason, many of the Code provisions that refer to a trustee's rights and duties apply to a Chapter 11 debtor.[8]

[8] The law on the qualification and role of professionals, the disclosure requirements, and the conflict of interest rules that apply Chapter11 debtor's counsel has been addressed extensively in case law and treatises. The author's goal is simply to alert the reader to some, but

Because a trustee is a fiduciary for creditors of the estate, an agent of the trustee must also serve as a fiduciary to the estate. See In re JLM, Inc., 210 B.R. 19 (2d Cir. BAP 1997) ("Both management and its counsel have fiduciary duties to an estate in bankruptcy.") (citations omitted). For this reason, a Chapter11 debtor's counsel must comply with an extensive list of requirements in order to represent the debtor and receive compensation for the services rendered. The failure to comply with the applicable statutory and decisional law may result in the full denial of fees.

B. The Court Must Approve the Attorney's Retention

One may not represent a Chapter 11 debtor unless the bankruptcy court approves such retention by the debtor. The court can not approve a firm's retention unless that firm is free from any disqualifying conflicts of interest or, in some cases, even the appearance of impropriety. Specifically, Section 327(a) provides in relevant part that the trustee, with the court's approval, may employ an attorney that does not hold or represent an interest adverse to the bankruptcy estate and that is disinterested. The term "disinterested" is defined in Section 101(14); the term "adverse interest" is not.

In order to seek the court's approval of a firm's retention, an application or motion seeking such retention must be submitted to the court as soon as possible. Fed. Rule of Bankr. Proc. 2014(a) sets forth the requirements of such an application. A copy of the application must be transmitted by the applicant to the UST. The application must include, among other things, the professional services to be rendered and any proposed arrangement for compensation. Any fact that could impact upon the firm's impartiality must be disclosed in the application.

C. Full Disclosure of All Connections to the Debtor is Mandatory

A firm should be fully versed in the applicable statutory and procedural requirements of the Bankruptcy Code, Rules, and local rules and orders regarding retention and compensation before representing a Chapter11 debtor. In addition to the aforementioned Section 327 and Rule 2014, proposed counsel's retention application and supporting documents must comply with the terms of Sections 328 and 329 and Rules 2016 and 2017. In addition, many of the bankruptcy courts have local rules that apply to attorney retention.

The rules governing a firm's disclosure of all of the information pertinent to the firm's qualification to serve as a Chapter 11 debtor's counsel directly impact the issue of compensation because violation of the rules can result in the full denial of compensation. "Failure to disclose direct or indirect relations to, connections with, or interests in the debtor violate Bankruptcy Code Section 327(a) and Bankruptcy Rule 2014." In re Balco Equities Ltd., Inc., 345 B.R. 87, 112 (Bankr. S.D.NY. 2006) (Law firm denied all compensation and required to disgorge all fees paid to date because of failure to disclose numerous connections with parties in interest in case).

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not all, of these issues since they can directly impact attorney compensation.

"The requirements of section 327 ...'serve the important policy of ensuring that all professionals appointed pursuant to [section 327] tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities.' " In re Source Enterprises, Inc., 2008 WL 850229 * 8 (Bankr.S.D.N.Y. 2008) (quoting In re Leslie Fay Cos., 175 B.R. 525, 532 (Bankr.S.D.N.Y.1994).

D. Full Disclosure of the Fee Agreement and Prior Compensation is Required

Section 329(a) requires counsel to disclose the compensation paid to the firm, or agreed to be paid to the firm, and the source of the compensation, in the one year period the precedes the Petition Date. Rule 2016(b) requires a debtor's counsel to file with the court a statement that contains the information required by Section 329 within 15 days of the Petition Date. This rule imposes an ongoing duty to disclose: if the fee agreement is amended, or an additional payment is made to counsel, a supplemental Rule 2016 statement must be filed with the court and provided to the UST.

It behooves counsel to clearly set forth the type of fee arrangement agreed to by the debtor. Section 328(a) does not proscribe any particular fee arrangement for counsel. In fact, it permits a Chapter 11 debtor to employ counsel, with the court's approval, on any reasonable terms and conditions, including on retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. But if the terms of counsel's retention and pre-petition fee agreement are not clearly set forth in the fee application and related documents, the failure to fully disclose this information may serve as a basis for an objection when counsel seeks the court's approval of its fees.

The author also suggests that the type of pre-petition retainer paid by the debtor should be disclosed at the outset of the case. For example, if the fee agreement provides for the payment of a classic retainer, in which the debtor and counsel intend title to the fees to pass to counsel immediately upon payment, the court and any party in interest will have an opportunity to address the reasonableness and propriety of the fee arrangement at the outset of the case: before substantial legal services have been provided to the debtor. It is not uncommon for a Chapter11 debtor to fail in its effort to reorganize its business and confirm a plan of reorganization. If there are inadequate funds available to pay in the claims of creditors and counsel, counsel may find itself competing with other creditors for a limited source of funds. In this scenario, the terms of the fee agreement can be crucial to ensuring that counsel can rely on payment from its retainer to the exclusion of the claims of other creditors.

E. Available Source of Funds to Pay Legal Fees

Because of the extensive legal services required in a Chapter11 case, counsel undertaking the representation of a small business or individual debtor will, under ideal circumstances, receive a pre-petition retainer that is large enough to ensure that the counsel's fees will be paid for all of the services required in the case. But, more often than not, a debtor will not possess

sufficient cash on hand to pay its counsel such a retainer prior to the Petition Date, and counsel will be required to seek additional payment for fees from the debtor or bankruptcy estate after the case is filed. Any such request must be approved by the court.

It is important to note that any payment of bankruptcy estates assets after the petition is filed must be paid from assets available for distribution. For example, if a debtor is a rental property owner, and its income is derived from rents, and all of the rents are subject to the liens of the debtor's mortgage-holders, there may be restrictions upon the debtor's use of those funds to pay legal fees without the consent of the mortgage-holders. Moreover, if a debtor is not paying the debts it incurs post-petition, such as monies due for post-petition taxes or for the fees incurred by other court-approved professionals, the court may not permit the payment of debtor's counsel's fees unless the claims of other post-petition administrative creditors are similarly satisfied. Counsel must anticipate the many impediments to receiving payment for legal fees that can arise in a Chapter 11 case before undertaking such representation. For these reasons, in many small cases, a firm may be required to forego payment of additional fees until the case is concluded. In such cases, representing a Chapter11 debtor can pose a financial hardship if the firm is not prepared to wait for its compensation.

F. The Fee Application Process

A court-approved counsel for a debtor may seek approval of its fees in two manners: either pursuant to Sections 330 and 331 or pursuant to Section 328. Section 331 provides in relevant part that a debtor's attorney may apply to the court for an award of interim compensation not more than once every 120 days after the Petition Date, or more frequently if the court so orders. It is not uncommon in larger Chapter 11 cases for a court to enter an order permitting the monthly payment of fees, or more frequent requests for interim fees. Such orders are not common in small Chapter11 cases.

Section 330 provides a mechanism for seeking final compensation in a case. Section 330 provides in relevant part that a court may award reasonable compensation for actual and necessary services rendered by debtor's counsel and reimbursement of actual and necessary expenses. Section 330 also provides that the court may award less than the amount requested. An award of fees pursuant to this section must be made on notice to all creditors, pursuant to Rule 2002, and after a hearing.

In determining the reasonable and necessary nature of a fee request, the court must consider the facts set forth in Section 330(a)(3) (recited above in Section 3). As described by the court in In re Korea Chosun Daily Times, Inc., 337 B.R. 758 (Bankr. E.D.N.Y. 2005),

> The prevailing method for weighing these factors is the "lodestar" approach. The lodestar amount represents the number of hours reasonably worked on a case multiplied by the reasonable hourly rate. Indeed, ... [i]t is now settled that the 'lodestar' method of fee calculation ... is *the* method to be used to determine a 'reasonable'

> attorney fee in all the federal courts, including the bankruptcy courts.

Id. at 766 (citations and quotations omitted).

Since there is no trustee appointed in Chapter11 cases, the UST customarily reviews all fees applications in Chapter11 cases. As a result, the UST has promulgated guidelines ("Guidelines") for the preparation of fee applications. See 28 C.F.R. Part 58 (Appendix). A copy of the Guidelines is annexed is Appendix D. The courts have, in some instances, adopted and amended the Guidelines. For example, in the Southern District of New York, the court has entered orders amending the Guidelines. The Southern District has also created forms to be used in Chapter11 fee applications. Those forms and orders can be found on the courts website at www.nysb.uscourts.gov. The failure to comply with the Guidelines and any applicable local rule or order will most likely result in an objection to the fee requested by the UST.

Under Section 330, it is the fee applicant's burden to provide establish the reasonable and necessary nature of the fees requested. This is most commonly accomplished through the fee applicant's time records. The time records should specify, for each attorney, the date, the hours expended, and the nature of the work done. See Korea Chosun, Id (citing New York State Ass'n for Retarded Children, Inc. v. Carey, 711 F.2d 1136, 1148 (2d Cir.1983).

Debtor's counsel may also seek fees pursuant to Section 328. The Second Circuit recently described the distinction between seeking approval of fees pursuant to Sections 330 and 328 as follows:

> Sections 328 and 330 establish a two-tiered system for judicial review and approval of the terms of the professional's retention. Section 330 authorizes the bankruptcy court to award the retained professional "reasonable compensation" based on an after-the-fact consideration of "the nature, the extent, and the value of such services, taking into account all relevant factors." 11 U.S.C. § 330(a). However, section 328(a) permits a bankruptcy court to forgo a full post-hoc reasonableness inquiry if it pre-approves the "employment of a professional person under section 327 ... on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis." *Id.* § 328(a). Where the court pre-approves the terms and conditions of the retention under section 328(a), its power to amend those terms is severely constrained. It may only "allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." *Id.* These two inquiries are mutually exclusive, as "[t]here is no question that a bankruptcy court may not conduct a § 330 inquiry into the reasonableness

> of the fees and their benefit to the estate if the court already has approved the professional's employment under 11 U.S.C. § 328

In re Smart World Technologies, LLC, 552 F.3d 228, 232-3 (2d Cir. 2009).

Although most requests for fees in Chapter11 cases are brought primarily under Sections 330 and 331, counsel should be aware of this additional source of statutory authority for a fee award.

6. Conversion: When Things Don't Go As Planned

A discussion about a Chapter11 debtor's counsel's compensation is not complete without mentioning the risk to counsel of a failed reorganization. If a case is not successful, and the case is converted to a Chapter7 case, the fees and administrative expenses incurred in the Chapter7 case supercede, or take priority over the fees incurred previously in the Chapter11 case. See Section 348. The same result occurs if a Chapter13 case is converted to a Chapter7 case. See, e.g., In re Resource Technology Corp., 356 B.R. 435 (Bankr. N.D. Ill. 2006) for a discussion of the effects of conversion on legal fees and the potential effects of administrative insolvency: when there are inadequate funds to pay all post-petition creditors, including the debtor's professionals. Once again, counsel's fee arrangement could be instrumental in ensuring the payment of its fees under such a circumstance.