

ABI ANNUAL SPRING MEETING, April 19-22, 2001, Washington, D.C.

**GREAT DEBATES: THE ROLE OF THE UNITED STATES TRUSTEE-
FRIEND OR FOE?**

Russell L. Munsch, Esq., Munsch Hardt Kopf & Harr, P.C., Dallas, TX
Eric J. Spett, Esq., Munsch Hardt Kopf & Harr, P.C., Dallas, TX

Barbara G. Stuart, Esq., United States Trustee Region 12
Paul W. Bridenhagen, Esq., Trial Attorney, Executive Office for United States Trustees

ABI ANNUAL SPRING MEETING, April 19-22, 2001, Washington, D.C.

**GREAT DEBATES: THE ROLE OF THE UNITED STATES TRUSTEE-
FRIEND OR FOE?**

Russell L. Munsch, Esq., Munsch Hardt Kopf & Harr, P.C., Dallas, TX
Eric J. Spett, Esq., Munsch Hardt Kopf & Harr, P.C., Dallas, TX

Barbara G. Stuart, Esq., United States Trustee Region 12
Paul W. Bridenhagen, Esq.¹, Trial Attorney, Executive Office for United States Trustees

Introduction

The following is an introduction into various issues faced by bankruptcy lawyers, accountants and other professionals who must consistently interact with the Office of the United States Trustee. These materials address several issues that professionals must face and precautions that must be taken to avoid disqualification, or worse, disgorgement of fees. These materials also address the issue of post-confirmation U.S. Trustee fees and whether such fees are appropriate or simply a further tax imposed upon successful debtors as a cost to utilize the Chapter 11 process.

I. RETENTION OF PROFESSIONALS

A. Disinterestedness

Under the Bankruptcy Code, only "attorneys, accountants, appraisers, auctioneers, or other professional persons" are required to seek formal retention through the court. 11 U.S.C. § 327(a). The phrase "other professional persons" has been construed by the courts to include only those who play "a central role in the administration of the debtor's estate."²

¹ The views set forth in Part III of these materials are the representations of Ms. Stuart and Mr. Bridenhagen and do not necessarily represent the positions of the United States Trustee Program.

² Michael Cook and Stephen Lubben, Retention, Payment, Ethical and Other Obstacles for Non-Legal Professionals in Chapter 11 Reorganizations, 796 PLI/Comm 549, 560 (November-December, 1999).

Section 327(a) of the Bankruptcy Code sets forth two requirements for employment of a professional. First, the professional must not "hold or represent an interest adverse to the estate"; and second, the professional must be a "disinterested person."

Section 327(a) provides:

"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 disinterestedness persons, to represent or assist the trustee in carrying out the trustee's duties under this title."

Section 101(14) defines "disinterested person" as follows:

"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 the subparagraph (B) or (C) of this paragraph, or for any other reason.

Pre-bankruptcy counsel often find themselves in a classic "Catch 22" situation when evaluating how to handle unpaid invoices for prepetition services: disqualified if paid and disqualified if not paid.³ If counsel is paid, then the lawyer may have a received a preference, holds an interest adverse to the estate and is therefore disqualified.⁴ On the other hand, if counsel has not been paid for his services prepetition,

³ Jay Lawrence Westbrook, Fees and Inherent Conflicts of Interest, 1 Am. Bankr. Inst. L. Rev. 287, 300 (Winter, 1993).

⁴ Westbrook, *supra* note 3, at 300.

then the lawyer has a prepetition claim against the estate and is by definition a "creditor" and thus not "disinterested."⁵

1. Prior Representation

Most courts have found that a professional holding an unpaid claim for prepetition fees is a creditor of the estate, and thus, not disinterested.⁶ Therefore, a professional whose fees are not fully paid prior to bankruptcy has a choice: he or she can either waive the claim or forgo retention. In *United States Trustee v. Price Waterhouse, et al. (In re Sharon Steel Corp.)*,⁷ the Third Circuit considered the issue of whether Price Waterhouse, who had provided accounting, auditing and consulting services to a debtor prepetition, and held a pre-petition claim of \$875,894.15 against the debtor on account of such services, could nonetheless be employed by the debtor post-petition as the debtor's accountant and financial advisor. The bankruptcy court acknowledged that Price Waterhouse was one of the twenty largest creditors of the estate and that, if the relevant provisions of the Bankruptcy Code were read and interpreted literally, Price Waterhouse would be barred from serving as the accountant for the debtor, as creditors are *per se* interested.⁸ The bankruptcy court nevertheless declined to interpret § 327(a) literally, and instead took a more practical view which required that the court consider the "economic realities" of the case and the "overriding purposes of Chapter 11."⁹ Taking this approach, the bankruptcy court reasoned that Price Waterhouse's employment was imperative, as no harm to any other party had been alleged, Price Waterhouse agreed to not participate in the bankruptcy case or vote its unsecured claim and

⁵ Westbrook, *supra* note 3, at 300.

⁶ Susan P. Sonderby and Kathleen M. McGuire, [A Gray Area in the Law? Recent Developments Relating to Conflicts of Interest and the Retention of Attorneys in Bankruptcy Cases](#), 105 Com. L.J. 237, 247 (Fall 2000). See *e.g.*, [United States Trustee v. Price Waterhouse](#), 19 F.3d 138, 141 (3rd Cir. 1994).

⁷ 19 F.3d 138 (3rd Cir. 1994).

⁸ [Id.](#), at 140.

⁹ [Id.](#)

the failure to appoint Price Waterhouse would jeopardize any hope the debtor had of presenting a viable business plan.¹⁰

The United States Trustee then appealed to the district court. The district court noted, like the bankruptcy court, that if read and interpreted literally, section 327(a) would bar Price Waterhouse from being appointed, because as a creditor of the estate it is *per se* "interested."¹¹ However, the district court interpreted the Third Circuit's holding in *In re BH&P, Inc.*¹² as adopting "a flexible approach to disqualification of professional employees." Using that approach, the district court affirmed the decision of the bankruptcy court.

The United States Trustee then appealed to the Third Circuit. Noting that when statutory language is clear and unambiguous it ordinarily must be followed, the Third Circuit attempted to synthesize Bankruptcy Code sections 1107(a), 101(14) and 101(10)(A).¹³ The Court concluded that "[t]hese provisions, taken together, unambiguously forbid a debtor in possession from retaining a prepetition creditor to assist it in the execution of its Title 11 duties."¹⁴ The Court went on to conclude that "[n]either the bankruptcy court nor the district court made any attempt to reconcile its holding with the plain language of these statutory provisions."¹⁵ The appellees argued that the debtor has discretion to appoint a professional person who is not disinterested and that Section 327(a) is rendered ambiguous by 11 U.S.C. § 328(c), which states, in relevant part:

Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such

¹⁰ Id., at 140.

¹¹ Id.

¹² 949 F.2d 1300 (3rd Cir. 1991).

¹³ 19 F.3d at 141.

¹⁴ Id.; citing In re Eagle-Picher Indus., Inc., 999 F.2d 969, 972 (6th Cir. 1993); In re Middleton Arms, Ltd. Partnership, 934 F.2d 723, 725 (6th Cir. 1991); In re Pierce, 809 F.2d 1356, 1362-63 (8th Cir. 1987); In re Hub Business Forms, Inc., 146 B.R. 315, 320 (Bankr.D.Mass. 1992); In re Patterson, 53 B.R. 366, 371-73 (Bankr.D.Neb. 1985).

¹⁵ Sharon Steel, 19 F.3d at 141.

professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person¹⁶

The Court rejected this argument, interpreting Section 328(c) to mean that if a non-"disinterested" professional is improperly employed, or if a professional person ceases to be "disinterested" "at any time during such professional person's employment," the court may deny compensation and reimbursement.¹⁷ Thus, the Court found that Section 328(c) created no ambiguity concerning the meaning of Section 327(a).¹⁸

Finally, the Court explained that notwithstanding the practical benefits of employing Price Waterhouse in this case, as the Sixth Circuit observed in *In re Middleton Arms*,¹⁹ "bankruptcy courts cannot use equitable principles to disregard unambiguous statutory language."²⁰ If, as the appellees asserted, and the bankruptcy and district courts held, Section 327(a) should allow trustees and debtors in possession under some circumstances to employ professionals who are not "disinterested," an amendment of that provision should be sought from Congress.²¹ The Court reversed the decisions of the bankruptcy court and district court, and held that 11 U.S.C. § 327(a) prohibited the debtors from employing Price Waterhouse.

2. Preferential Payments

As noted above, courts have also found professionals to possess an interest adverse to the estate where they may have received a preferential transfer in payment of prepetition fees.²² To avoid this dilemma, the professional could attempt to argue that his or her services were rendered in contemplation of bankruptcy, in which case their reasonableness is reviewable under section 329(b) and the lawyer is

¹⁶ Id., at 142.

¹⁷ Id.

¹⁸ Id.

¹⁹ 934 F.2d 723, 725 (6th Cir. 1991).

²⁰ Sharon Steel, 19 F.3d at 142.

²¹ Id.

²² 105 Com. L.J. at 247; see e.g., In re First Jersey Securities, Inc., 180 F.3d 504 (3rd Cir. 1999); Halbert v. Yousif, 225 B.R. 336 (Bankr.E.D.Mich. 1998), appeal dismissed, 201 F.3d 774 (6th Cir. 2000).

immunized from disqualification on that ground.²³ Although there is no statutory authority for this interpretation, payments made for such services, because they are reviewable by the court, are not voidable as preferences.²⁴

In *In re First Jersey Securities, Inc.*,²⁵ the Third Circuit addressed the propriety of the appointment of counsel for a debtor-in-possession where the debtor transferred restricted securities to its counsel in payment for pre-petition services on the eve of its filing for bankruptcy.²⁶ The U.S. Trustee and the Securities and Exchange Commission (SEC) alleged that the law firm was disqualified from serving as counsel for the debtor because it held an interest adverse to the estate by virtue of the firm having received a transfer of the restricted securities.

In New Jersey, concurrent with the filing of its Chapter 11 petition, the debtor filed an application to retain the law firm of Robinson, St. John & Wayne (RSW) as its counsel. The debtor owed RSW approximately \$389,000 for legal services rendered prior to the bankruptcy, primarily for work performed on behalf of the debtor in a securities fraud litigation.²⁷ On the same day as the Chapter 11 filing, the debtor transferred 200,001 shares of unregistered restricted stock in a company called International Thoroughbred Breeders, Inc. (ITB) to RSW. The stock was to be liquidated by RSW and payments were to be made as follows: \$200,000 as a retainer for representation in the bankruptcy case; \$250,000 for payment on firm invoices for representation in the securities fraud litigation, with any excess to be returned to the debtor.²⁸ The \$250,000 was to be considered full payment for the approximately \$389,000 due for pre-petition services. RSW waived the remaining pre-petition balance thereby eliminating itself as

²³ Westbrook, *supra* note 3, at 301.

²⁴ Id.

²⁵ 180 F.3d 504 (3rd Cir. 1999).

²⁶ Id., at 506.

²⁷ Id.

²⁸ Id.

a creditor of the debtor.²⁹ The transfer of stock was noted in both the debtor's bankruptcy petition as well as RSW's retention application; however, neither party disclosed that the payment was made within 90 days of bankruptcy.³⁰

The bankruptcy court held that the SEC did not present a prima facie case that RSW received a voidable preference under 11 U.S.C. § 547(b).³¹ In the alternative, the bankruptcy court found that the transfer of stock, even if a preference, was not a voidable preference because it was a payment made in the ordinary course of business under § 547(c). As such, if the transfer was made in the ordinary course of business between the parties and according to ordinary business terms, the court held, the transfer could not be avoided by the debtor's estate.³²

On appeal, the district court agreed with the bankruptcy court that the transfer of stock did not constitute a preference and therefore RSW should not be disqualified.³³ The district court also concluded that the stock transfer was not made on account of an antecedent debt owed by the debtor before the transfer was made and that RSW's disclosures regarding the stock transfer payments were sufficient under § 327(a).³⁴

The Third Circuit disagreed with the lower courts, and held that the payment was not made in the ordinary course of business.³⁵ The Court found the timing of the transfer to RSW "clearly suspect," noting that the transfer of stock occurred on the day the debtor filed its bankruptcy petition.³⁶ The Court acknowledged that law firms have begun to accept equity positions as payment from "start-up" companies with strong growth potential, but contrasted such practice with what occurred in this case: the stock

²⁹ Id.

³⁰ Id., at 506-07.

³¹ Id., at 507.

³² Id., at 508.

³³ Id.

³⁴ Id.

³⁵ Id., at 513.

³⁶ Id.

transferred to RSW was not stock of a client with growth potential, but rather, stock of a third party.³⁷

The Court concluded that "[v]iewed in its totality, it is clear this payment was not made in the ordinary course of business," and "[a]ccordingly, the preferential payment was a preference, creating an actual conflict of interest, and thus, disqualifying RSW as counsel for the debtor."³⁸

B. Penalties for Non-Compliance with Section 327

The penalties for attorneys who fail to meet the disinterested standard, who hold an interest adverse to the estate or fail to make adequate and timely disclosures, can be severe. Penalties for any of the foregoing can range from disqualification to disgorgement of fees.

Bankruptcy Code section 328(c) provides a penalty for professionals who fail to satisfy the requirements of section 327(a). Section 328(c) provides:

Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

The Bankruptcy Code also provides the procedural mechanism to enforce these requirements. Under Fed. R. Bankr. P. 2014, any applying professional must set forth "to the best of the applicant's knowledge" all known connections of the applicant with the "debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee" in both the application for employment and an accompanying verified statement.³⁹ Counsel who fail to disclose timely and completely their connections proceed at their own

³⁷ Id.

³⁸ Id., at 514.

³⁹ Kravit, Gass & Weber, S.C. v. Michel (In re Crivello), 134 F.3d 831, 836 (7th Cir. 1998); Fed. R. Bankr. P. 2014(a); see also 3 Collier on Bankruptcy ¶ 327.01[1] (15th rev. ed. 2000).

risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation.⁴⁰

1. Disqualification

Disqualification can occur at the beginning of a case upon disclosure and before services have been rendered, but it can also occur during the case after substantial services have been rendered and expenses incurred.⁴¹ Courts can, and often do, deny conflicted counsel fees and expense reimbursements and, at times, order attorneys to disgorge fees already received.⁴² The Ninth Circuit has stated that the court has discretion to deny all fees even where the professional's failure to fully disclose relevant information is negligent or inadvertent, as opposed to willful.⁴³ One court has noted, "[s]o important is the duty to disclose that the failure to disclose relevant connections is an independent basis for the disallowance of fees or even disqualification."⁴⁴

In *In re Park-Helena Corp.*,⁴⁵ the president of the Debtor, Gerald Meyer, paid a \$150,000 retainer out of his personal funds to Starrett, a partner of the law-firm being retained by the Debtor in contemplation of its chapter 11 bankruptcy filing.⁴⁶ The firm completed an Application for Employment pursuant to Fed. R. Bankr. P. 2014, in which the firm stated that it received a retainer from Park-Helena and did not have any connections with Park-Helena's creditors.⁴⁷ The Court thereafter approved the firm's employment.

⁴⁰ In re Crivello, 134 F.3d at 836; see Rome v. Braunstein, 19 F.3d 54,59-60 (1st Cir. 1994) (denying \$62,000 in fees to sole practitioner); In re Martin, 817 F.2d 175, 182 (1st Cir. 1987); In re Guard Force Management, Inc., 185 B.R. 656, 664 (Bankr.D.Mass. 1995); In re Roger J. Au & Son, Inc., 71 B.R. 238, 242 (Bankr.N.D.Ohio 1986).

⁴¹ Edwin E. Smith and Peter C.L. Roth, Ethical Standards in Bankruptcy Contexts: Disinterestedness, 791 PLI/Comm 261, 266 (April, 1999).

⁴² Smith and Roth, *supra* note 41, 791 PLI/Comm at 266.

⁴³ See Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d 877, 882 (9th Cir. 1995), cert. denied, 516 U.S. 1049 (1996).

⁴⁴ In re Leslie Fay Cos, Inc., 175 B.R. 525, 533 (Bankr.S.D.N.Y. 1994).

⁴⁵ 63 F.3d 877 (9th Cir. 1995).

⁴⁶ Id., at 879.

⁴⁷ Id.

Several months later, the firm filed an Application for Compensation requesting that a total of \$74,497.30 be offset against the \$140,900.75 that remained of the previously received retainer.⁴⁸ Once again, the firm indicated that it had received a retainer from "the Debtor."⁴⁹ The Debtor's major creditor, Chartwell Financial Corp. objected to the fee request, alleging that the Debtor violated 11 U.S.C. § 329 and Fed. R. Bankr. P. 2014 and 2016 by failing to disclose that Meyer, and not the Debtor, had actually paid the retainer to Starrett out of his personal account.⁵⁰ The firm argued that Meyer's payment was, in effect, a payment from the Debtor inasmuch as Meyer had previously received a \$1.35 million "loan" from the Debtor and his \$150,000 payment to the firm was credited toward his debt.⁵¹

The bankruptcy court sustained Chartwell's objection, concluding that the firm had violated section 329 of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure 2014 and 2016 by failing to disclose (1) the true source of the retainer, and (2) the firm's connections to Meyer.⁵² The bankruptcy court also found that the firm may have been aware of an attempt by the Debtor to deplete the assets of the bankruptcy estate and accordingly, the court found that the firm's failure to disclose was willful.⁵³ The bankruptcy court thus denied the firm's entire fee request.⁵⁴ On appeal, the district court affirmed.

The Ninth Circuit rejected the firm's argument that the funds used to pay the retainer were, in some sense, the Debtor's funds. Instead, the Court explained that "the question ... is whether Neben & Starrett's failure to provide the details of the payment constitutes a violation of the section 329 and Rule 2016 disclosure requirements. We hold that it does."⁵⁵ The Court went on to explain that the disclosure

⁴⁸ Id.

⁴⁹ Id.

⁵⁰ Id.

⁵¹ Id., at 880.

⁵² Id.

⁵³ Id.

⁵⁴ Id.

⁵⁵ Id., at 881.

rules are applied literally, even if the results are sometimes harsh.⁵⁶ "Negligent or inadvertent omissions 'do not vitiate the failure to disclose.'"⁵⁷

The Court concluded that the finding by the bankruptcy court that the firm's failure to disclose fully the circumstances surrounding payment of the retainer was not negligent or inadvertent, but willful, and was not clearly erroneous.⁵⁸ As such, the Court held that the bankruptcy court's denial of all fees was within its discretion.⁵⁹

2. Disgorgement

When a court finds that a professional is not disinterested or possesses an interest adverse to the estate, the court may call for the total or partial disgorgement of compensation.⁶⁰ In *In re Southmark Corp.*,⁶¹ the debtor contended that the accounting firm employed by the examiner to do accounting investigatory work, Coopers & Lybrand, held an interest materially adverse to the estate.⁶² The debtor contended that Coopers, which had performed accounting and auditing work for Drexel Burnham Lambert, failed to disclose that during its engagement by the examiner, it had discontinued an investigation of certain issues pertaining to Drexel's transactions with the debtor. The debtor asserted that the Coopers' failure to disclose such information required relief from the compensation award and a disgorgement of compensation because Coopers held an interest materially adverse to the estate.⁶³

The bankruptcy court reviewed the facts of the case and concluded that Coopers' failure to "fully disclose connections and activities with and regarding Drexel prevented the court from fully performing its function under the Bankruptcy Code and thereby frustrated the purposes of the Code to assure that the

⁵⁶ Id.

⁵⁷ Id.; *In re Maui 14K, Ltd.*, 133 B.R. 657, 660 (Bankr.D.Haw. 1991).

⁵⁸ Park Helena Corp., 63 F.3d at 882.

⁵⁹ Id.

⁶⁰ Smith and Roth, *supra* note 41, at 267.

⁶¹ 181 B.R. 291 (Bankr.N.D.Tex. 1995).

⁶² Id., at 292.

⁶³ Id., at 293.

professional person employed by the examiner tenders undivided loyalty and provides untainted advice and assistance."⁶⁴

Recognizing that Coopers did provide valuable services on matters not involving Drexel, the bankruptcy court concluded that Coopers should be required to partially disgorge its compensation and limited disgorgement to compensation paid in connection with work regarding Drexel.⁶⁵ The total amount ordered to be disgorged by Coopers was \$220,000 in addition to the debtor's attorneys fees and expenses in prosecuting the motion.⁶⁶

C. Conflicts

Section 327(c) also addresses the situation where the professional is disqualified because the professional also represents a creditor of the estate.⁶⁷ The question raised is whether the professional's judgment and advocacy would be clouded by divided loyalty to two clients.⁶⁸

Section 327(c) provides as follows:

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.

Upon an objection by a creditor (or the U.S. trustee), the court must deny the employment if an actual conflict exists or the professional's engagement would be tainted with the appearance of a

⁶⁴ Id., at 296.

⁶⁵ Id., at 297.

⁶⁶ Id. Other decisions reach a different result, reasoning that a court does not have the authority to allow employment of a professional with a conflict of interest, and that such employment is void *ab initio*. Sonderby and McGuire, *supra* note 6 at 255. See e.g., Michel v. Federated Dep't Stores (In re Federated Dep't Stores), 44 F.3d 1310, 1319 (6th Cir. 1995) (request by financial advisors for payment of fees upon final reorganization denied where objection to financial advisor's appointment was valid and should have been sustained).

⁶⁷ Sonderby and McGuire, *supra* note 6, at 248.

⁶⁸ Id.

conflict.⁶⁹ However, something more than the mere fact of dual representation must be shown if the court is to deny employment.⁷⁰

Because of the various situations in which conflicts can arise, courts have been unable to formulate a universal standard to determine whether a specific conflict requires disqualification.⁷¹ As a result, courts differ as to whether attorneys should be disqualified only for "actual" conflicts rather than "potential" conflicts which may, in the future, become "actual" conflicts.

In the Third Circuit case of *In re Marvel Entertainment Group, Inc.*,⁷² the Third Circuit addressed the issue of whether a conflict existed with respect to prospective counsel for a Chapter 11 trustee who had previously represented the agent for certain of a debtor's secured creditors.

The U.S. Trustee recommended attorney Gibbons to serve as trustee.⁷³ Pursuant to this recommendation, Gibbons disclosed that his law firm was representing the agent for certain of the debtor's secured creditors.⁷⁴ The representation, however, did not involve litigation and was unrelated to the case at bar. Moreover, Gibbons disclosed that the other client had granted his firm an unconditional waiver of any conflicts that might arise from Gibbons' service as trustee.⁷⁵ The firm later terminated its representation of the other client. Thereafter Gibbons was appointed as trustee.

Gibbons subsequently moved for an order authorizing the employment of his law firm as trustee's counsel. In support of his employment motion, Gibbons submitted an affidavit from the law firm which

⁶⁹ 3 Collier on Bankruptcy, ¶ 327.04 [7][a] (15th ed. rev. 2000).

⁷⁰ 3 Collier on Bankruptcy, ¶ 327.04 [7][a] (15th ed. rev. 2000); see, e.g., *In re Kliegl Bros. Universal Elec. State Lighting Co., Inc.*, 189 B.R. 874 (Bankr.E.D.N.Y. 1995) (law firm which disclosed representation of a creditor on an unrelated matter in its application for appointment as debtor's counsel and which was appointed in the absence of an objection was not subject to later disallowance of fees on the U.S. Trustee's motion merely because of the existence of the disclosed creditor representation).

⁷¹ Alexander G. Benisatto and Alyson M. Fiedler, The Disinterested Standard of Section 327(a): Applying an Equitable Solution for Potential Conflicts in Small Bankruptcies, 7 Am. Bankr. Inst. L. Rev. 363, 372 (Spring, 1999).

⁷² 140 F.3d 463 (3rd Cir. 1998).

⁷³ Id., at 469.

⁷⁴ Id.

⁷⁵ Id.

was materially identical to Gibbons's prior disclosures. An objection to the employment of Gibbons' firm was filed questioning whether the firm was "disinterested" as required by 11 U.S.C. § 327(a). The substance of the objection was that while an "actual" conflict of interest may not have existed in light of the firm's termination of its relationship with the other client, there still existed the "appearance" that the firm would not act impartially.⁷⁶ The district court denied Gibbons's motion for an order authorizing the employment of his firm as trustee's counsel, reasoning that the firm's "representation of Chase taints the image of objectivity that the trustee and his counsel should possess."⁷⁷ Gibbons appealed the district court's decision.

The Third Circuit concluded that the district court applied an incorrect legal standard under §§ 327(a) and 101(14)(E) in considering the employment motion, and that, even under the proper standard, its denial of the employment motion was not a permissible exercise of discretion.⁷⁸ The Court expressly reiterated its holding in *BH&P*,⁷⁹ which prescribes a three-step analysis for determining whether disqualification is mandated or discretionary:

(1) Section 327(a), as well as § 327(c), imposes a per se disqualification as trustee's counsel of any attorney who has an actual conflict of interest; (2) the district court may within its discretion—pursuant to § 327(a) and consistent with § 327(c)—disqualify an attorney who has a potential conflict of interest and (3) the district court may not disqualify an attorney on the appearance of conflict alone.⁸⁰

The Court explained that the district court erred when it held that it could disqualify as disinterested any person who "in the slightest degree might have some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and the Bankruptcy Rules."⁸¹

⁷⁶ Id.

⁷⁷ Id.

⁷⁸ Id., at 476.

⁷⁹ 949 F.2d 1300 (3rd Cir. 1991).

⁸⁰ Marvel, 140 F.3d at 476.

⁸¹ Id., at 477.

"Even applying the proper standard," the Court concluded, "the district court's disqualification of the Firm would amount to an abuse of discretion" in light of the fact that the firm's conflict was neither actual nor potential.⁸² The Court explained that if it were to uphold the district court's order "under these circumstances, it is with the utmost difficulty that we could imagine how a law firm with any prior relationship to a secured creditor could ever serve as trustee's counsel. Such a result would be tantamount to a *per se* rule" which the Court refused to adopt in BH&P.⁸³ As such, the Court reversed the district court, holding that the trustee was within his rights and prerogative to select Gibbons's firm as his counsel.⁸⁴

While the Court in Marvel concluded that a professional could not be disqualified on the appearance of conflict alone, other courts have decided the issue differently. Some courts interpret section 327(a) to disqualify attorneys in certain cases where potential conflicts of interest exist, however, courts in favor of this approach have refused to adopt a *per se* disqualification rule for potential conflicts.⁸⁵ In *In re Martin*,⁸⁶ the Court declined to adopt a *per se* disqualification rule for potential conflicts, and instead adopted a "balancing test" which weighed various factors including: (1) whether the arrangement is "reasonable;" (2) whether the parties have acted in "good faith;" (3) whether the arrangement is necessary for retaining "competent counsel;" and (4) the likelihood that the potential conflict will become an actual conflict.⁸⁷

II. FEE GUIDELINES

⁸² Id.

⁸³ Id., at 470.

⁸⁴ Id.

⁸⁵ Benisatto and Fiedler, *supra* note 71, at 375.

⁸⁶ 817 F.2d 175 (1st Cir. 1987).

⁸⁷ There is yet a third line of cases that disqualifies attorneys for both actual and potential conflicts in accordance with Canon Nine of the Model Code. Under this approach, courts hold that both types of conflicts require a *per se* rule in favor of disqualification based on the "appearance of impropriety." Benisatto and Fiedler, *supra* note 74 at 376. Model Code Canon 9 provides that "a lawyer should avoid even the appearance of professional impropriety." Benisatto and Fiedler, *supra* note 74 at 376. See, e.g., In re Roger J. Au & Son, Inc. v. Aetna Insurance Co., (In re Roger J. Au & Son, Inc.), 64 B.R. 600 (Bankr. N.D. Ohio 1986) (holding that attorney is disqualified based on potential conflict where the attorney represented both the corporate debtor and the debtor's shareholder and principal officer).

Interim compensation for professionals is governed generally by 11 U.S.C. § 331, which provides:

A trustee, an examiner, a debtor's attorney, or any professional person employed under section 327 or 1103 of this title may apply to the court not more than once every 120 days after an order for relief in a case under this title, or more often if the court permits, for such compensation for services rendered before the date of such an application or reimbursement for expenses incurred before such date as is provided under section 330 of this title. After notice and a hearing, the court may allow and disburse to such applicant such compensation or reimbursement.

11 U.S.C. § 331.

Compensation for services and reimbursement of expenses, both interim and final requests, are also governed by Rule 2016, Federal R. Bankr. P. Bankruptcy Rule 2016(a) provides as follows:

(a) Application for Compensation or Reimbursement. An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file an application setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested. An application for compensation shall include a statement as to what payments have theretofore been made or promised to the applicant for services rendered or to be rendered in any capacity whatsoever in connection with the case, the source of the compensation so paid or promised, whether any compensation previously received has been shared and whether an agreement or understanding exists between the applicant and any other entity for the sharing of compensation received or to be received for services rendered in or in connection with the case, and the particulars of any sharing of compensation or agreement or understanding therefor, except that details of any agreement by the applicant for the sharing of compensation as a member or regular associate of a firm of lawyers or accountants shall not be required. The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other entity. Unless the case is a chapter 9 municipality case, the applicant shall transmit to the United States trustee a copy of the application.

Rule 2016, Fed. R. Bankr. P.⁸⁸

Bankruptcy Code Section 331 allows professionals employed under Section 327 to apply for reimbursement of fees and expenses no more than once every 120 days, or more often if the court permits.

Courts routinely allow professionals employed under Section 327 to apply for fees and reimbursement of

⁸⁸ 28 C.F.R. § 58 sets forth the Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses filed under 11 U.S.C. § 330, promulgated by the Office of the United States Trustee. The Guidelines can also be located on-line at: <<http://www.usdoj.gov/ust/fee0206.htm>>.

expenses on a monthly, rather than a quarterly, basis. The Bankruptcy Courts in both Delaware and Dallas, for example, both permit such a practice. The problem, though, is that the rules regarding monthly fee applications are both inconsistent and nonuniform, and in some cases, nonexistent.

Some jurisdictions, including Dallas, have a specific rule dealing with interim compensation arrangements in complex cases.⁸⁹ In other jurisdictions, including Delaware, no specific rules or guidelines for requesting reimbursement of fees and costs on a monthly basis exist. That is not to say, however, that the bankruptcy courts in Delaware do not allow such a practice. The courts in Delaware simply have not promulgated any specific rules dealing with this issue. In effect, the bankruptcy courts in Delaware seem to author informal "guidelines" each time a professional is successful, or unsuccessful, in recovering his or her fees.

The lack of consistency among the jurisdictions will not be abated until such time as the Office of the United States Trustee promulgates guidelines that are identical for each jurisdiction. Until such time, professionals practicing in jurisdictions around the country must be mindful of the procedures, or lack thereof, for each jurisdiction when applying for interim fees.

III. POST-CONFIRMATION U.S. TRUSTEE FEESA. The Statute

The quarterly fees paid by Chapter 11 debtors are set forth in 28 U.S.C. § 1930(a)(6), which presently provides as follows:

In addition to the filing fees paid to the clerk, a quarterly fee shall be paid to the United States trustee in each case under chapter 11 of title 11 for each quarter (including any fraction thereof) until the case is converted or dismissed, whichever occurs first. . . . [10 graduated levels of disbursements ranging from \$250 per quarter (disbursements less than \$15,000) to maximum \$10,000 per quarter (disbursements of \$5,000,000 or more)].

⁸⁹ Pursuant to the Guidelines for Compensation and Expense Reimbursement of Professionals, promulgated for professionals practicing in the bankruptcy courts in the Northern District of Texas and effective January 1, 2001, the Court may, upon request in a complex case, consider at the outset of the case approval of an interim compensation mechanism for estate professionals that would enable professionals, on a monthly basis, to be paid up to 80% of their compensation for services rendered and reimbursed up to 100% of their actual and necessary out of pocket expenses. Under such procedure, if approved by the court, professionals are required to circulate monthly billing statements to the United States Trustee and other primary parties in interest. Thereafter, the debtor in possession or Trustee, as the case may be, will be authorized to pay the applicable percentage of the professional's bill that is not disputed or contested by a party in interest. Unfortunately, the Guidelines do not outline what information should or should not be included in the monthly fee application.

B. Fees Payable Until Case is Converted, Dismissed or Closed

Pursuant to 28 U.S.C. § 1930(a)(6), every open case or every debtor in a case pending under chapter 11 must pay a fee each quarter to the United States Trustee.⁹⁰ The monies generated from quarterly fee payments represent a significant source of revenue for the United States Trustee System Fund.⁹¹ Consequently, the monitoring and collection of quarterly fees is an integral part of the United States Trustee's oversight of chapter 11 cases. Efforts to ensure the prompt payment of fees begin at the inception of the case and continue until the case is dismissed, closed or converted, and if fees are not paid at the time the case is dismissed, closed or converted, collection efforts will continue nonetheless.

C. Fee Calculated Based On All Post-Confirmation Disbursements

The United States Trustee Program adheres to the plain meaning of the word "disbursement," and the courts have agreed with the Program's position that the plain meaning of the term should be broadly construed to include "all payments", including normal operating expenses.⁹²

To construe the statute otherwise would contravene the intent of the statute and adversely affect the fiscal balance struck by Congress. Each time Congress has enacted legislation amending or clarifying §1930(a)(6) it has either increased the amount of quarterly fees chapter 11 debtors are required to pay or has broadened the group to whom the statute applies. On each such occasion Congress has emphasized an intent that the statute be a source of generating revenue to fund the United States Trustee System.⁹³

⁹⁰ See In re CF&I Fabricators of Utah, Inc., 150 F.3d 1233 (10th Cir. 1998).

⁹¹ See generally In re Prines, 867 F.2d 478 (8th Cir. 1989).

⁹² See, e.g. Tighe v. Celebrity Home Entertainment, Inc., 210 F.3d 995 (9th Cir. 2000); In re Jamko, Inc., — F.3d — , 2001 WL 94608 (11th Cir., 2001); In re Maruko, 219 B.R. 567, 572 (S.D.Cal. 1998); Vergos v. Uncle Bud's, Inc., 1998 WL 652542 (M.D. Tenn., August 17, 1998); In re: Postconfirmation Fees, 224 B.R. 793, 798 (Bankr E.D.Wash. 1998) (en banc); In re Campesinos Unidos, Inc., 218 B.R. 886 (Bankr. S.D.Cal. 1998); United States Trustee v. Wintersilks, Inc., Slip Op. (No. 00-C-0106-C, W.D. Wis. June 2, 2000) rev'g In re Wintersilks, Inc., 243 B.R. 351 (Bankr. W.D. Wis 1999); In re A.H. Robins Co., Inc., 219 B.R. 145, 151 (Bankr.E.D.Va. 1998); In re Hess' Sons, Inc., 218 B.R. 354, 360-61 (Bankr.D.Md., 1998); In re Boulders on the River, Inc., 218 B.R. 528, 536, 539 (D. Or. 1997); In re Roy Stanley, Inc., 217 B.R. 23 (Bankr.N.D.N.Y. 1997); In re Gates Community Chapel of Rochester, Inc., 212 B.R. 220, 225 (Bankr.W.D.N.Y.1997); In re Sedro-Woolley Lumber Co., Inc., 209 B.R. 987, 989 (Bankr.W.D.Wa. 1997); In re P.J. Keating Co., Inc., 205 B.R. 663, 666-67 (Bankr.D.Mass. 1997); In re Bushnell, 1997 WL 701318 (Bankr.D.Vt. 1997).

⁹³ See In re Jamko, Inc., — F.3d — , 2001 WL 94608 (11th Cir., 2001); In re N. Hess' Sons, Inc., 218 B.R. 354,360 (Bankr.D.Md.1998) and In re Gates Community Chapel of Rochester, Inc., 212 B.R. 220, 225 (Bankr.W.D.N.Y.1997).

Before embarking on a disbursement definition battle, the United States Trustee will first consider whether any potential dispute will actually affect the amount of fees owed. Since the disbursement categories set forth in 28 U.S.C. § 1930(a)(6) are quite large, differences in definition may have no practical consequence.

D. Cash Collateral/Financing Order Payments

Payments to secured creditors pursuant to cash collateral or financing orders are disbursements upon which the quarterly fee is calculated. Debtors and secured creditors often structure financing orders that are designed to permit the continued use of cash collateral. Pursuant to these arrangements, the debtor usually pays the creditor the cash collateral, which the creditor then loans back to the debtor. Regardless of how the parties may choose to characterize the debtor's payments, they are still considered disbursements for purposes of calculating quarterly fees.⁹⁴ Motions and proposed orders seeking relief in this regard should provide for the payment of quarterly fees, or they will be subject to an objection by the United States Trustee.

E. Payments Out of Escrow or By Third Parties

Disbursements include payments made on behalf of the debtor by an escrow company or other third party.⁹⁵ Where affiliated entities file bankruptcy, quarterly fees will be calculated for each entity separately. Therefore, if a parent corporation makes payments on behalf of subsidiaries or affiliates, those payments will be considered third-party payments and will be attributed to the total disbursements made by each subsidiary or affiliate. Thus, for example, parent corporations will not be allowed to claim all disbursements for the purpose of calculating quarterly fees and pay the maximum fee, while each subsidiary pays only the minimum fee.⁹⁶

⁹⁴ See In re Wernerstruck, Inc., 130 B.R. 86, 88-89 (S.D. 1991).

⁹⁵ St. Angelo v. Victoria Farms, Inc., 38 F.3d 1525, 1534-35 (9th Cir. 1994), modified, 46 F.3d 969 (9th Cir. 1995); In re Hays Builders, Inc., 144 B.R. 778, 779-80 (W.D. Tenn. 1992), rev'g 95 B.R. 79 (Bankr.W.D.Tenn. 1988) and 96 B.R. 142 (Bankr. W.D. Tenn. 1989); In re Central Copters, Inc., 226 B.R. 447 (Bankr. D. Mont. 1998).

⁹⁶ Cf. In re HSSI, Inc., 193 B.R. 851 (N.D. Ill. 1996) (reversing holding of bankruptcy court that transfers of proceeds of consignment sales from individual debtor accounts to concentration holding accounts were not disbursements).

F. Non-Cash Transactions

Disbursements are calculated upon cash transfers, not transfers in kind. For example, when estate assets are sold and the purchaser assumes an obligation of the debtor as part of the sale consideration, the amount assumed is not considered a disbursement for purposes of calculating the quarterly fee.

G. Fee Due Dates and Periods Covered

Quarterly fees are calculated on a calendar quarter basis. The fee for each quarter is payable on the last day of the month immediately following the end of the calendar quarter. 28 U.S.C. § 1930(a)(6). Every plan of reorganization must provide for payment of any unpaid fees on or before the effective date of the plan. 11 U.S.C. § 1129(a)(12). The filing of a voluntary petition commences a case. 11 U.S.C. § 301. The obligation to pay quarterly fees commences on the date the chapter 11 petition is filed.

H. Equitable Considerations

Equitable considerations do not allow a court to set aside applicable bankruptcy law.⁹⁷ Congress could not have been clearer in its mandate that quarterly fees are to be paid in all cases notwithstanding confirmation or consummation status. Indeed, as set forth above, Congress expressly enacted clarifying legislation concerning the scope of amended section 1930(a)(6) in the September 1996. That legislation stated, in relevant part, that "notwithstanding any other provision of law, the fees under 28 U.S.C. § 1930(a)(6) shall accrue and be payable from and after January 27, 1996 in all cases (including, without limitation, any cases pending as of that date), regardless of confirmation status of their plans."⁹⁸

The bankruptcy court may disagree with the policy decision reached by Congress in this regard, but it should not use the guise of equity to re-write a limitation that does not exist into the plain language of the statute. Congress has made a policy decision on the scope of amended section 1920(a)(6) and barring any constitutional infirmity, Congress' decision must be respected.⁹⁹ Most recently, the Eleventh

⁹⁷ Prisbrey v. Noble, 505 F.2d 170 (10th Cir. 1974).

⁹⁸ 110 Stat. 3009-19.

⁹⁹ Tennessee Valley Authority v. Hill, 437 U.S. 153 (1978)("Once Congress, exercising its delegated powers, has decided the order of priorities in a given area, it is for the Executive to administer the laws and for the courts to enforce them

Circuit rejected arguments sounding in equity, stating that Congress not the courts was the appropriate forum to resolve such complaints.¹⁰⁰

Thus, for example, courts may not close cases *nunc pro tunc* in order to excuse debtors from applicable fees.¹⁰¹ In the *Jr. Food Mart. of Arkansas* case, the bankruptcy court had re-opened a case on November 16, 1995 to allow filing of an adversary proceeding. On November 20, 1995 the adversary proceeding was suspended pending certain state court litigation. After section 1930(a)(6) was amended, debtor sought closure of the case *nunc pro tunc* to November 20, 1995 to avoid accrual of post-confirmation fees. Although the United States Trustee Program did not agree with the holding in the *Jr. Food Mart. of Arkansas* case, an appeal was not pursued. The facts in that case were unique, however, and no similar circumstances have arisen in any subsequent case. The reported decision in *In re Wintersilks, Inc.*,¹⁰² in which the bankruptcy court closed a case *nunc pro tunc* to excuse the debtor's obligation to pay quarterly fees was reversed by an unpublished decision.¹⁰³ Similarly the decision in *In re Uncle Bud's, Inc.*,¹⁰⁴ was reversed by the district court on appeal.¹⁰⁵

when enforcement is sought."); *In re Corporate Business Products, Inc.*, 209 B.R. 951, 955 (Bankr.C.D.Cal. 1997)(rejecting argument that post-confirmation quarterly fees constitute an unfair tax on a reorganized debtor who is out of bankruptcy) (quoting *Griffin v. Oceanic Contractors*, 458 U.S. 564, 576 (1982)("The remedy for any dissatisfaction with the results in particular cases lies with Congress and not with [the] Court. Congress may amend the statute; we may not.")).

¹⁰⁰ See *In re Jamko, Inc.*, — F.3d —, 2001 WL 94608, *3 n.6. (11th Cir., 2001).

¹⁰¹ *In re Rhead*, 232 B.R. 175, 181 (Bankr. Ariz. 1999). But see, *In re Jr. Food Mart. of Arkansas*, 201 B.R. 522(Bankr.E.D.Ark. 1996).

¹⁰² 243 B.R. 351 (Bankr.W.D.Wis. 1999).

¹⁰³ See *United States Trustee v. Wintersilks, Inc.*, Slip Op. (No. 00-C-0106-C, W.D. Wis. June 2, 2000).

¹⁰⁴ 206 B.R. 889 (Bankr.M.D.Tenn. 1997).

¹⁰⁵ See *Vergos v. Uncle Bud's, Inc.*, 1998 WL 652542 (M.D. Tenn., August 17, 1998).