Employment of Special Counsel by a Chapter 13 Debtor

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Northern District of Alabama
Western Division

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For additional reading on this subject, please see Hon. Clifton R. Jessup, Jr., *Getting Paid (Or Not): Select Issues Pertaining to the Retention and Compensation of Special Counsel* (Oct. 2016) (attached). Judge Jessup graciously granted permission to use and distribute his paper, originally prepared for the October 2016 Bankruptcy Law Update at Cumberland School of Law, Samford University.
EMPLOYMENT OF SPECIAL COUNSEL BY A CHAPTER 13 DEBTOR

I. Overview

Chapter 13 debtors routinely employ special counsel to pursue pre-petition and post-petition causes of action that constitute property of the bankruptcy estate. In such capacity, attorneys are usually entitled to reasonable compensation from the bankruptcy estate for actual and necessary services, as well as reimbursement of actual and necessary expenses. Special counsel who fail to meet the Bankruptcy Code's requirements for employment and compensation risk having fees reduced, denied, or even disgorged. This paper will address the first inquiry that special counsel should make before performing work for a chapter 13 debtor—does the Bankruptcy Code require court approval of special counsel's employment?

In many courts, the filing of applications to employ special counsel is so routine that a resounding "yes" seems the obvious answer. However, the text of Bankruptcy Code § 327 has led some courts to hold otherwise. Subsections (a) and (e) of § 327 provide as follows:

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

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

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1 Contributing authors: Joshua Johnson, Law Clerk to Hon. Jennifer H. Henderson, United States Bankruptcy Judge, Northern District of Alabama, Western Division; and Judge Henderson. Prepared October 2016. Karin Wolfe, Law Clerk to Judge Henderson, assisted in updating the paper in October 2017.

2 11 U.S.C. § 330(a)(1) ("After notice…and a hearing…the court may award to…a professional employed under section 327…reasonable compensation for actual, necessary services rendered by the…professional person, or attorney.

3 11 U.S.C. § 330(a)(4)(B) ("In a…chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.")
does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327(a), (e) (emphasis added).

Although § 327 expressly requires court approval for a chapter 13 trustee to employ special counsel, it is unclear whether this requirement extends to special counsel retained by a chapter 13 debtor. Unlike a chapter 11 debtor-in-possession, who is given the powers and duties of a chapter 11 trustee by statute, there is no parallel provision for chapter 13 debtors. Further, courts routinely permit chapter 13 debtors' bankruptcy counsel to file applications for compensation under Bankruptcy Code § 330(a)(4)(B), without first applying for court approval of counsel's retention by the debtor. It may seem incongruous to impose a burden on a debtor's special counsel that is not imposed on the debtor's bankruptcy counsel, particularly if special counsel seeks an award of compensation under § 330(a)(4)(B), as opposed to § 330(a)(1).

Because § 327 does not expressly require a chapter 13 debtor to seek court approval of the retention of special counsel, a split has developed among the courts. An apparent majority of courts have held that "[a] chapter 13 debtor does not need court authorization to employ an attorney," finding that "[n]othing in the Bankruptcy Code suggests that the term 'trustee' used in

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3 Notably, courts disagree as to who has standing to prosecute a cause of action belonging to a chapter 13 estate—the trustee, the debtor, or both. See generally In re Bowker, 245 B.R. 192, 194-200 (Bankr. D.N.J. 2000) (Judge Lyons) (holding that the chapter 13 debtor, alone, has the authority to retain special counsel and pursue causes of action that are property of the bankruptcy estate); In re Griner, 240 B.R. 432, 435-38 (Bankr. S.D. Ala. 1999) (Judge Mahoney) (holding that the chapter 13 trustee and the chapter 13 debtor have concurrent authority to proceed with causes of action that are estate property); Richardson v. United Parcel Service, 195 B.R. 737, 739 (E.D. Mo. 1996) (Judge Gunn) (holding that the chapter 13 trustee has exclusive standing to sue on behalf of the bankruptcy estate).

4 See 11 U.S.C. § 1107(a). Bankruptcy Code § 1303 does, however, give chapter 13 debtors certain powers exclusive of the chapter 13 trustee, including the power to "use, sell, or lease" estate property, other than in the ordinary course of business, after notice and a hearing.

5 In the United States Bankruptcy Court for the Northern District of Alabama, as in many jurisdictions, bankruptcy attorneys for chapter 13 debtors routinely request a "no look fee" authorized by local rule or general order, rather than applying for court approval of a fee. See Bankr. N.D. Ala. L.R. 2016-1(I).

6 In re Powell, 314 B.R. 567, 569 (Bankr. N.D. Tex. 2004) (Chief Judge Felsenthal); see also In re Roberts, 556 B.R. 266, 280-81 (Bankr. S.D. Miss. 2016) (Judge Ellington); In re Scott, 531 B.R. 640, 644-45 (Bankr. N.D. Miss. 2015)
[§] 327(e) is intended to include a chapter 13 debtor.⁷ Other courts, however, have interpreted the reference to "trustee" in § 327(e) to include a chapter 13 debtor and held that special counsel for a chapter 13 debtor must be employed pursuant to § 327(e) to be compensated.⁸

II. The "No Approval Necessary" View

As noted above, a number of courts do not require court approval of a chapter 13 debtor's retention of special counsel.⁹ These courts typically focus on the use of the word "trustee" in § 327(e).¹⁰ For example, Judge Olack "began his analysis of § 327(e) by noting that 'Congress says in a statute what it means and means in a statute what is says there ... [and that] when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.'"¹¹ Judge Olack concluded that § 327 applies only to a trustee, finding "nothing in the Bankruptcy Code suggests that the term 'trustee' used in § 327(e) is intended to include a chapter 13 debtor."¹²

7 In re Scott, 531 B.R. at 645 (citations omitted).
9 See supra note 6.
10 See, e.g., In re Powell, 314 B.R. at 569-70; In re Scott, 531 B.R. at 645; In re Atkins, 2005 WL 4980279, at *3.
11 In re Scott, 531 B.R. at 644 (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) (internal quotation marks omitted)).
12 Id. at 645.
The "no approval necessary" courts also highlight the absence in chapter 13 of the statutory equivalent to Bankruptcy Code § 1107 and § 1203, which give chapter 11 and chapter 12 debtors many of the rights and duties of a trustee.\textsuperscript{13} Finding such omission intentional and indicative of legislative intent, these courts conclude that § 327 is inapplicable to a chapter 13 debtor’s special counsel.\textsuperscript{14}

Notably, "no approval necessary" courts consistently require special counsel to disclose the compensation paid (or agreed to be paid) pursuant to Bankruptcy Code § 329\textsuperscript{15} and also look to Bankruptcy Code § 330(a)(4)(B) for the statutory authority to award compensation to special counsel, not § 330(a)(1).\textsuperscript{16} Section 330(a)(4)(B) incorporates, by reference, the "factors" set forth in Bankruptcy Code § 330(a)(1), but court-approved employment under Bankruptcy Code § 327 is not a prerequisite to awarding fees under § 330(a)(4)(B).\textsuperscript{17} Though court approval of special

\textsuperscript{13} See, e.g., \textit{In re Jones}, 505 B.R. at 232.

\textsuperscript{14} See, e.g., \textit{In re Cahill}, 478 B.R. at 176; \textit{In re Gorski}, 519 B.R. at 71; see also \textit{In re French}, 111 B.R. 391 (Bankr. N.D.N.Y. 1989) (Judge Gerling); \textit{In re Butts}, 2010 WL 3369138, at *1 (Bankr. D. Mass. 2010) (Judge Hoffman) ("Nothing in the Bankruptcy Code...precludes a Chapter 13 debtor from retaining successor counsel, special counsel, or even co-counsel, with the fees of such counsel, which are paid out of property of the estate, being subject to review and approval by the court.").

\textsuperscript{15} 11 U.S.C. § 329 (a) provides:

Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.


\textsuperscript{17} 11 U.S.C. § 330(a).
counsel's retention is not required by such courts, court approval of any compensation to be paid to special counsel from estate property is required.\textsuperscript{18}

\textsuperscript{18} In some instances, special counsel may be compensated from non-estate assets, such as when a non-debtor agrees to pay special counsel's fee. In such cases, court approval of compensation may not be necessary, but disclosure is likely still required. Judge Wedoff's decision in \textit{In re McDonald Bros. Construction, Inc.}, 114 B.R. 990, 994-95 (Bankr. N.D. Ill. 1990), is instructive:

Any professional seeking compensation from the estate must comply with the fee application process. Rule 2016(a) so provides: "An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file with the court an application ..." (emphasis added). Moreover, if a professional in possession of estate funds takes the funds as compensation without a court order, that professional would violate the automatic stay. 11 U.S.C. § 362(a)(3) (prohibiting "any act ... to exercise control over property of the estate"). Similarly, a debtor in possession who transferred estate funds to a professional without court order would violate Section 363(b), which requires court approval, after notice and hearing, before estate property is used outside of the ordinary course of the debtor's business (and the employment of bankruptcy professionals would presumably not be in the ordinary course of business).

... Counsel for a debtor who is compensated from a source other than the estate must comply with the monitoring procedure of Section 329, but this procedure does not require court approval of a fee application. Most of the professionals retained by a debtor in bankruptcy may receive compensation without court scrutiny as long as they are paid entirely from sources other than the estate. Legal counsel for the debtor, however, must submit all of their compensation, regardless of source, to court scrutiny, pursuant to Section 329 of the Code....

... The disclosure requirement is broad in its sweep. Section 329(a) applies to all payments as well as agreements to pay compensation, whether made after the case is filed or any time during the year before filing, and it applies regardless of whether the services to be compensated are directly connected with the bankruptcy case or merely in contemplation of the bankruptcy filing. Moreover, this disclosure is required "whether or not such attorney applies for compensation under this title." Thus, even if a debtor's attorney intends to receive no compensation whatever from the estate, Section 329(a) assures that the court and other interested parties will be informed of the source and amount of the attorney's compensation for bankruptcy services.

Consider the following fact scenario: The proceeds of the subject cause of action have been exempted by the debtor in their entirety (or are otherwise excluded from the estate). Given the broad interpretation given to § 329 by courts, disclosure would still be required if the litigation would have any impact on the bankruptcy case (\textit{i.e.}, the debtor needs the exempt proceeds to fund the plan), even if § 330 approval is unnecessary. Of course, if special counsel's retention agreement was executed pre-bankruptcy, collection thereunder from property of the debtor might implicate the automatic stay, thus necessitating court approval under Bankruptcy Code § 362.
III. The "Approval Required" View

Disagreeing with the above line of cases, some courts have held that a debtor is required to obtain court approval pursuant to § 327 in order to employ special counsel.19 In In re Goines, Judge Sacca—after finding that a chapter 13 debtor has standing to pursue estate causes of action—concluded that a chapter 13 debtor must be permitted to retain counsel pursuant to § 327 for the statutory scheme to make sense and, thus, determined that the reference to "trustee" in § 327 necessarily includes a "chapter 13 debtor in possession."20

Similarly, in In re Price, Judge Mitchell read the reference to "trustee" in § 327(e) to include chapter 13 debtors.21 After first noting that Bankruptcy Code § 103(a) makes chapter 3 of the Bankruptcy Code applicable in chapter 13 cases, Judge Mitchell reasoned:22

Although there is no reference to chapter 13 in section 327, the section refers to duties of a trustee who seeks to employ other professionals. A chapter 13 trustee serves in all chapter 13 cases and if he or she seeks to retain special counsel, clearly the applicable section is section 327(e). The legislative history of section 327(e) provides: "The subsection will most likely be used when the debtor is involved in complex litigation, and changing attorneys in the middle of the case after the bankruptcy case has commenced would be detrimental to the progress of that other litigation." S. REP. NO. 95–989, at 38–39 (1978). The legislative history speaks of a debtor in general terms and makes no exclusion for chapter 13 debtors. Surely if Congress intended section 327 to apply only to non-chapter 13 cases the section would clearly mandate that. Is the absence of or failure to mention chapter 13 in section 327 because it is not necessary to mention it?23

Judge Mitchell went on to address the limited case law on the issue, finding that the practice of chapter 13 debtors applying to employ special counsel under § 327(e) is "so basic, blatant and

19 See supra note 8.
20 In re Goines, 465 B.R. at 706-08.
22 Id.
23 Id.
Finally, Judge Mitchell found that not requiring a debtor to get approval for special counsel "would produce some absurd results," such as not requiring disinterestedness, and concluded that it was prudent to "require special counsel to chapter 13 debtors to seek and obtain court approval of their employment as a prerequisite to awarding any fees."

IV. Other Considerations

Notably, even among the "no approval necessary" courts, several express a preference that debtors seek court approval to employ special counsel in order to avoid future challenges to fees, including challenges based on conflicts of interest.

Some courts may require a chapter 13 debtor to obtain approval of special counsel by local rule. For example, the United States Bankruptcy Court for the Northern District of Alabama has made Local Rule 2016-1 applicable to all applications for compensation made pursuant to § 330 and § 331 by an attorney for a debtor. This Local Rule requires those seeking compensation to file an application cover sheet that states, among other things, "the date the application for employment was filed" and "the date the order authorizing employment was entered." Although a chapter 13 debtor's bankruptcy attorney may elect to receive a "no look fee" in lieu of applying for compensation (thus avoiding the requirements of subsection (b) of Local Rule 2016-1), no

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24 Id. (footnote omitted).

25 Id.

26 See In re Smith, 536 B.R. 478, 483 (Bankr. M.D. Ala. 2015) (Judge Sawyer) (noting that approval of employment of special counsel is not required, but it is preferred).

27 See Bank. N.B. Ala. L.R. 2016-1(a).

28 See id. at 2016-1(b)(2), (3).

29 Id. at 2016-1(b)(2), (l).
such exception exists for special counsel to a chapter 13 debtor.\footnote{Id. at 2016-1, passim.} In fact, among the services an attorney for a chapter 13 debtor must provide to receive the "no look fee" is "assisting the debtor in petitioning the Court to employ special counsel."\footnote{Id. at 2016-1(l).} As such, Local Rule 2016-1 arguably makes court approval of special counsel's retention a prerequisite to compensation.

V. Conclusion

Special counsel often plays a crucial role in chapter 13 proceedings. It is important for any counsel to communicate with their clients about bankruptcy filings so that counsel may comply with the procedures for employment, disclosure, and compensation under the Bankruptcy Code. In practice, seeking and receiving approval as special counsel is simple and straightforward. Even if § 327 does not require a chapter 13 debtor to obtain court approval of his or her retention of special counsel, local rule or precedent may require such approval.
Getting Paid (or Not):
Select Issues Pertaining to the Retention
and Compensation of Special Counsel

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¹ Presentation materials prepared with the assistance of Melissa H. Brown, law clerk to the Honorable Clifton R. Jessup, Jr.
I. HISTORICAL EXAMINATION OF FEE SHARING IN THE BANKRUPTCY CONTEXT

While the legislative history of fee sharing under 11 U.S.C. § 504 is limited, an examination of the treatment of fee sharing in bankruptcy reveals that “Congress’s pre-Code attitude toward the sharing of compensation, as codified in section 62 of The Bankruptcy Act of 1898 (‘the Act’) was significantly more permissive than under section 504.” Fee sharing agreements were generally permitted between professionals who rendered services in a bankruptcy proceeding pursuant to § 62(c) of the Act which provided as follows:

A custodian, receiver, or trustee or the attorney for any of them, or any other attorney, rendering services in a proceeding under this Act or in connection with such proceeding, shall not in any form or guise share or agree to share his compensation for such services with any person not contributing thereto, or share or agree to share in the compensation of any person rendering services in a proceeding under this Act or in connection with such proceeding, to which services he has not contributed: Provided, however, That an attorney-at-law may share such compensation with a law partner or a forwarding attorney-at-law, and may share in the compensation of a law partner.

Accordingly, fee sharing was permitted under the Act between professionals, without regard to whether they were members or regular associates in a professional association, as long as each contributed to the services for which the compensation was allowed. However, the final sentence of subsection (c) created an exception which also permitted referral-based fee sharing between an “attorney-at-law” and a “partner or a forwarding attorney-at-law’ who presumably contributed no services to the bankrupt.”

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3 § 62(c) of the Bankruptcy Act (emphasis in the original).
The Rules of Bankruptcy Procedure promulgated in 1973, effective between 1973 and 1983, imposed stricter procedures for fee sharing by removing the exception for referral-based fee sharing between an attorney and a forwarding attorney. Rule 219(d) provided as follows:

*Restriction on Sharing of Compensation.* Except as herein provided, a person rendering services in a bankruptcy case or in connection with such a case shall not in any form or guise share or agree to share the compensation paid or allowed him from the estate for such services with any other person, nor shall he share or agree to share in the compensation of any other person rendering services in a case under the Act or in connection with such a case. This rule does not prohibit an attorney or accountant from sharing his compensation as trustee, receiver, attorney or accountant with a member or regular associate thereof, and does not prohibit an attorney for a bankrupt or for a petitioning creditor from sharing his compensation for services rendered with any other attorney contributing thereto. If a person violates this subdivision, the court may deny him compensation, may hold invalid any transaction subject to examination under Rule 220 to which he is a party, or may enter such other order as may be appropriate.5

Rule 219(d) continued to permit fee sharing “between attorneys regardless of whether they practiced in the same ‘professional association, corporation, or partnership,’ provided all attorneys receiving compensation contributed services to the debtor.”6 However, Rule 219(d) “wholly prohibited fee sharing based on a pure referral relationship” between an attorney and a forwarding attorney.7 “The Advisory Committee note to Rule 219(d) made clear that the sharing of compensation allowed between an attorney and a forwarding attorney under Section 62c of the 1898 Act was no longer to be permitted unless the attorneys sharing had both contributed to the services for which the compensation was allowed.”8

7 Id.
Rule 219(d) also eliminated the provision under § 62(d) of the Bankruptcy Act which mandated that bankruptcy courts withhold all compensation from professionals who violated the restrictions on fee sharing under the Act. However, “the principle purpose for the revision of the rule was not to dilute its underlying policy but to make available additional discretionary sanctions such as removal from office or dismissal from employment.”

The Rules also imposed “extensive disclosure requirements on professionals.” To receive compensation an attorney had to comply with Rule 215 which required attorneys to provide extensive disclosures relevant to their employment including: (1) the specific facts showing the necessity of employment; (2) the reason for the professional’s selection; (3) the services to be rendered; and (4) the professional’s connections with the debtor, creditors or any other party in interest.

Due to practices that existed prior to the enactment of the Bankruptcy Code in 1978, “§ 504 was drafted to protect the integrity of the bankruptcy process and to ensure that adequate attention is paid to bankruptcy matters . . . .” With the enactment of the Bankruptcy Code on November 6, 1978, Congress further strengthened the prohibition against fee sharing by exempting only partners, members and regular associates within the same professional association, corporation, or partnership from § 504(a)’s prohibition against fee sharing. As originally enacted, § 504 provided

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9 In re Futuronics Corp., 655 F.2d 463, 470 (2nd Cir. 1981).


11 Id.


13 The effective date of the Bankruptcy Reform Act of 1978 was October 1, 1979.

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as follows:

§ 504. Sharing of Compensation

(a) Except as provided in subsection (b) of this section, a person receiving compensation or reimbursement under section 503(b)(2) or 503(b)(4) of this title may not share or agree to share –

(1) any such compensation or reimbursement with another person; or

(2) any compensation or reimbursement received by another person under such sections.

(b)(1) A member, partner, or regular associate in a professional association, corporation, or partnership may share compensation or reimbursement received under section 503(b)(2) or 503(b)(4) of this title with another member, partner, or regular associate in such association, corporation, or partnership, and may share in any compensation or reimbursement received under such sections by another member, partner, or regular associate in such association, corporation, or partnership.

(2) An attorney for a creditor that files a petition under section 303 of this title may share compensation and reimbursement received under section 503(b)(4) of this title with any other attorney contributing to the services rendered or expenses incurred by such creditor’s attorney.\textsuperscript{14}

Recommendations of the Commercial Law League of America suggesting § 504 “should specifically provide for sharing of compensation among co-counsel” were rejected by Congress.\textsuperscript{15}

Instead, Congress essentially prohibited all fee sharing with individuals from outside a professional’s firm, providing only two exceptions:

Section 504 prohibits the sharing of compensation, or fee splitting among attorneys, other professionals, or trustees. The section provides only two exceptions: partners or associates in the same professional association, partnership, or corporation may share compensation inter se; attorneys for petitioning creditors that join in a petition


commencing an involuntary case may share compensation.\textsuperscript{16}

In 2005, BAPCPA amended § 504 to create a limited exception for referral fees for bona fide public service attorney referral programs. Subdivision (c) provides as follows:

(c) This section shall not apply with respect to sharing, or agreeing to share, compensation with a bona fide public service attorney referral program that operates in accordance with non-Federal law regulating attorney referral services and with rules of professional responsibility applicable to attorney acceptance of referrals.\textsuperscript{17}

The prohibition against fee sharing was not otherwise altered with the 2005 Amendments. Accordingly, the plain text of § 504 continues to suggest “a Congressional intent to protect the integrity of the bankruptcy process and ensure that professionals seeking compensation are motivated by a desire to preserve the bankruptcy estate more than fee maximization.”\textsuperscript{18} A leading treatise explains the reasoning for the special treatment of fee sharing agreements and the general prohibition in bankruptcy cases as follows:

Whenever fees or other compensation is shared among two or more professionals, there is incentive to adjust upward the compensation sought in order to offset any diminution to one’s own share. Consequently, sharing of compensation can inflate the cost of a bankruptcy case to the bankruptcy estate, and therefore to the creditors. Fee splitting also subjects the professional to outside influences over which the court has no control, which tends to transfer from the court some degree or power over expenditure and allowances. . . . The potential for harm makes such arrangements reprehensible as a matter of public policy as well as a violation of the attorney’s ethical obligations.\textsuperscript{19}

It is often noted that the restrictions under § 504 are meant to “ensure that lawyers preserve the

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\textsuperscript{17} 11 U.S.C. § 504(c).
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\textsuperscript{18} In re Fair, 2016 WL 3027264 *11 (Bankr. N.D. Tex. 2016).
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\textsuperscript{19} 4 COLLIER ON BANKRUPTCY § 504.01[2] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).
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integrity of the bankruptcy process and do not treat bankruptcy matters as matters of traffic.”

II. **Fee Sharing Under the Bankruptcy Code and Rules**

A. **When Does 11 U.S.C. § 504(a) Apply?**

For the prohibition against fee sharing under § 504(a) to apply, the following elements must be satisfied:

- A person must receive compensation or reimbursement pursuant to section 503(b)(2) or 503(b)(4) of the Bankruptcy Code as an administrative expense of the estate;

- Another person must share, or agree to share, in the awarded compensation; and

- The person that shared the compensation does not fit within one of the statutory exceptions.\(^{21}\)

The term “person” is defined under § 101(41) of the Bankruptcy Code to include individuals, partnerships, and corporations. Accordingly, § 504(a) applies to any person or entity receiving compensation pursuant to the administrative expense provisions of subsections 503(b)(2) or (b)(4) of the Bankruptcy Code who shares compensation with another person, subject to the limited exceptions set forth in § 504(b).

B. **Applicable Bankruptcy Code Provisions**

- **11 U.S.C. § 503(a):** Section 503(a) of the Bankruptcy Code permits an entity to file

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a request for payment of an administrative expense as described in section 503(b)(1) through (b)(9).

- **11 U.S.C. § 503(b)(4):** Section 503(b)(4) provides administrative expense status for the reasonable compensation for professional services rendered by an attorney or accountant to an entity *other than the bankruptcy estate* whose expenses are allowed as an administrative expense under § 503(b)(3). Accordingly § 503(b)(4) is not applicable to the compensation of special counsel who is employed by the trustee to represent the bankruptcy estate.

- **11 U.S.C. § 503(b)(2):** Section 503(b)(2) provides that “compensation and reimbursement awarded under § 330(a)” is an allowed administrative expense.

- **11 U.S.C. § 330(a):** Section 330(a) provides that subject to the limits set out in sections 326, 328, and 329, the bankruptcy court may award reasonable compensation and expenses for actual, necessary services rendered by various types of professionals employed under §§ 327 or 1103. “Section 330(a) is the single vehicle by which *all* professional persons employed under section 327 are paid – regardless of what basis they are paid.”

- **11 U.S.C. § 327:** Section 327 of the Bankruptcy Code governs the employment of professionals by the trustee and “tells us who the trustee may hire to represent him in a case.”

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23 *Id.* at 795.
professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.”24 Section 327(e) further authorizes the trustee, with the court's approval, to “employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.”25

• 11 U.S.C. § 328: Section 328 of the Bankruptcy Code “tells us on what terms the trustee may hire professional persons to represent him in the case.”26 Compensation for professionals employed pursuant to § 327 may be set “on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or a fixed or percentage fee basis, or on a contingent fee basis. . . .”27 Section 328 allows, at the time of employment under § 327, the bankruptcy court to pre-approve the reasonableness of a professional’s compensation agreement. However, even if the bankruptcy court “pre-approves a professional’s compensation pursuant to § 328, the bankruptcy court ‘may 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.”’’

“[W]hile section 328 governs the terms and conditions under which a professional might be hired, it is section 330 itself that actually governs whether the professional person will get paid. . . . It is only pursuant to section 330(a), that any professional retained by the trustee gets paid, regardless on what terms and conditions the professional was retained.”’’

Thus, because all professionals retained by the trustee are compensated under § 330(a), their entitlement to payment arises under section 503(b)(2) and “because they receive their compensation, if any, ‘under section 503(b)(2) . . . all such professionals are subject to the restriction on fee sharing in section 504(a)(1).”’’

C. DISCLOSURE REQUIREMENTS

The Bankruptcy Code and Rules impose significant disclosure requirements for the employment of professionals. Rule 2014(a) of the Federal Rules of Bankruptcy Procedure requires full disclosure by professionals of all connections with parties in interest, providing that:

(a) Application for an order of employment

An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment,

28 Miller Buckfire & Co., LLC v. Citation Corp. (In re Citation Corp.), 493 F.3d 1313, 1318 (11th Cir. 2007).


30 Id. at 798.
the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections 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. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections 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.31

The final sentence of Rule 2014(a) provides that the Application for Employment must be accompanied by a Verified Statement from the proposed professional. As explained by the bankruptcy court in In re Toys, Inc.,

Disclosure ‘goes to the heart of the integrity of the bankruptcy system.’ Therefore, the duty to disclose under Bankruptcy Rule 2014 is considered sacrosanct because the complete and candid disclosure by an attorney seeking employment is indispensable to the court’s discharge of its duty to assure the attorney’s eligibility for employment under section 327(a) and to make an informed decision on whether the engagement is in the best interest of the estate.32

Rule 2016 of the Federal Bankruptcy Rules of Procedure imposes additional requirements upon an entity seeking compensation for services rendered and the reimbursement of expenses. Rule 2016 (a) and (b) provide:

(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 how 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.

(b) Disclosure of compensation paid or promised to attorney for debtor

Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney’s law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed.\footnote{Fed. R. Bankr. P. 2016 (a) and (b).}

In addition, some districts have special Local Rules imposing additional disclosure requirements with which professionals must comply. In the case of \textit{In re Palacios}, 2016 WL 361569 (Bankr. S.D. Tex. 2016), the bankruptcy court denied Special Counsel’s Application for Approval of Employment and struck the Application for Allowance of Trustee’s Special Counsel’s Fees and Expenses. The Local Rules for the Southern District of Texas require professionals seeking employment \textit{nunc pro tunc} to include the following explanations: “(A) An explanation why the application was not filed earlier; (B) An explanation why the order authorizing employment is required \textit{nunc pro tunc}; and (C) An explanation, to the best of the applicant’s knowledge, how

\footnote{Fed. R. Bankr. P. 2016 (a) and (b).}
approval of the application may prejudice any parties-in-interest.”

In *Palacios*, the debtors failed to disclose a pending class action products liability lawsuit in which they were claimants. More than a year after the debtors received their Chapter 7 discharge, the Chapter 7 trustee filed a Motion to Reopen the Case to pursue settlement of the debtors’ personal injury claim. After the bankruptcy court reopened the case, the Chapter 7 trustee filed an Application to Compromise which included a gross settlement amount of $87,968 less attorney’s fees of $35,187.20 and expenses for three law firms.

The bankruptcy court conditionally approved the settlement but reserved ruling on the issue of attorney’s fees to allow proposed special counsel to comply with the retention and disclosure requirements under § 327(e), § 328(a), Rule 2014, and the applicable Local Rules. Counsel filed a Fee Application but failed to include the disclosures required by the Local Rules regarding *nunc pro tunc* employment. The bankruptcy court denied counsel’s employment based on her “willful disregard of the Local Rules and this Court’s procedures, of which [counsel] was plainly cautioned.” As the bankruptcy court explained:

The Application to Employ does not contain one iota of explanation on the untimeliness or potential prejudice to parties-in-interest, and certainly does not give a hint as to why retroactive employment is warranted. Furthermore, BLR 2014-1 also requires notice to all creditors in the case, which the Application to Employ purports, on the one hand, to comply with but patently fails to deliver. Apparently, [counsel], on behalf of the estate, “respectfully” requests that this Court divine the facts necessary to determine which creditors she has purportedly noticed. This Court declines to inhale those vapors.

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35  *Id.* at *13.
36  *Id.*
Accordingly, the bankruptcy court denied the Application to Employ. Although bankruptcy courts have discretion in determining the employment of professionals, the bankruptcy court explained that counsel “should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtor’s estate or which might impair the high degree of impartiality and detached judgment expected of them during the course of administration.”

Finally, the bankruptcy court refused to consider the reasonableness of the fee request. Section 330(a) does not permit the award of compensation to attorneys that have not been properly employed. The Bankruptcy Code is “clear that the employment of a professional on behalf of a debtor-in-possession or the trustee is a matter that should be put before the court prior to the engagement beginning, and only ‘under rare or exceptional circumstances’ should retroactive employment be approved.”

III. WHAT DOES § 504'S PROHIBITION ON FEE SHARING MEAN FOR SPECIAL COUNSEL WHO ENTERED INTO A FEE SHARING AGREEMENT PREPETITION?

a. Goldberg v. Vilt (In re Smith), 397 B.R. 810 (Bankr. E.D. Tex. 2008): A prepetition referral fee agreement between debtor’s counsel and special counsel violated § 504(a). The Chapter 7 trustee filed a Complaint for Disgorgement of an Authorized Fee and for Negligence seeking the disgorgement of a $103,200 referral fee received postpetition by counsel for the debtor. The bankruptcy court determined that bankruptcy counsel violated § 504(a) by accepting a referral fee from special counsel pursuant to a prepetition fee sharing agreement and ordered disgorgement.

37 Id. at * 5 (quoting I.G. Petroleum, LLC v. Fenasci (In re W. Delta Oil Co.) 432 F.3d 347, 354-55 (5th Cir. 2005)).

38 Id. at *13.
It did not matter that the referral fee agreement predated the petition date or that such agreement might be permissible under the Texas Disciplinary Rules of Professional Conduct.

Debtor and debtor’s counsel were long-time friends. Prepetition, debtor’s counsel referred the debtor to a state court attorney to file a lawsuit related to the death of the debtor’s minor daughter. On July 8, 2003, the debtor executed a 40% contingent fee contract with state court counsel. While the state court action was pending, the debtor filed a Chapter 7 petition for relief in February of 2004. Debtor’s counsel filed a Rule 2016(b) Statement of Attorney Compensation in which he represented that within one year before the filing of the petition that he had agreed to accept no compensation for legal services render on behalf of the debtor in contemplation or in connection with the bankruptcy case.

At the first meeting of creditors, the Chapter 7 trustee learned of the undisclosed state court action and the role of state court counsel. Counsel for the debtor did not disclose to the trustee his entitlement to any funds arising from the pending lawsuit. Subsequently, the trustee filed an Application to Employ the debtor’s state court counsel as special counsel for the bankruptcy estate for the purpose of prosecuting the lawsuit with compensation to be based upon the prepetition contingent fee contract, and the bankruptcy court entered an Order Approving the Application.

In March of 2005, special counsel and debtor’s counsel settled the lawsuit through mediation for the sum of $630,000. Special counsel received a 40% contingency fee in the amount of $252,000 and from this amount paid debtor’s counsel $123,200. Neither attorney informed the Chapter 7 trustee of the settlement despite repeated inquiries by the trustee until October of 2006, nineteen months after the settlement had occurred. Even then, neither attorney informed the trustee about the referral fee.
When the trustee finally discovered the fee sharing arrangement, he filed action against debtor’s counsel seeking disgorgement pursuant to §§ 504, 327(e), 329 and Rule 2016(b) of the Federal Rules of Bankruptcy Procedure. Debtor’s counsel argued that § 504 was inapplicable and could not be used to deprive him of a referral fee that was enforceable under state law. The bankruptcy court explained that § 504 imposes a prohibition against fee sharing in “virtually all circumstances arising in a bankruptcy case” and is “designed to deter any expansion of the size of administrative expense claims which are granted priority under the Bankruptcy Code’s distribution scheme.” 39 It is the “potential for harm’ that supports an absolute prohibition.” 40

That the agreement was reached pursuant to the terms of a fee sharing agreement prepetition was irrelevant, as the bankruptcy court explained:

First of all, [special counsel] was never compensated with the Debtor’s funds on the basis of the pre-petition contingent fee agreement. [Special counsel] was compensated with the assets of the bankruptcy estate on the basis of a post-petition employment agreement that simply mirrored the terms of the pre-petition contingent fee agreement. Setting aside that ‘technicality,’ the reach of § 504 is comprehensive. It is not limited to the post-petition sharing of compensation. However, because [debtor’s counsel] ultimately shared in compensation awarded in the post-petition period under §§ 503(2) and 330(a), the sharing of that compensation undoubtedly violated § 504. 41

Further, it was not necessary for the court to examine whether the fee agreement actually increased the costs to or harmed the bankruptcy estate. A violation of “§ 504(a) is dependent only upon a finding that the prohibited conduct occurred.” 42


40 Id. at 817.

41 Id. at 817-18.

42 Id. at 819.
Finally, the court noted that the “policy considerations that led Congress to prohibit the allowance of virtually all referral fees in bankruptcy cases” necessarily superceded any state law authority to the contrary. Instead, attorneys from different firms representing a debtor must seek and obtain court approval of their retention and fees independently of each other.

b. **In re IHE, 2014 WL 4104204 (Bankr. S.D. Tex. 2014):** Debtor filed a Nunc Pro Tunc Application to Employ two attorneys as proposed special counsel in state court litigation regarding a personal injury sustained in an automobile accident. At the evidentiary hearing on the Application, the attorneys submitted a proposed contingent fee contract which provided that one attorney would retain the first $80,000 in attorney’s fees approved by the court and that all remaining fees would be split between the attorneys on a 50/50 basis.

The agreement further disclosed that one of the attorneys was originally an employee of a different law firm when his representation of the debtor began. Counsel retained the case when he opened his own practice with the agreement that he would share his portion of the fees with his prior law firm pursuant to the original terms of his employment agreement with the firm.

The bankruptcy court examined the exception under § 504(b)(1) and concluded that the Application should be denied. “Courts interpret the Section 504(b)(1) exception to the general rule prohibiting fee sharing in Section 504(a) very narrowly, and only apply it to fee sharing between attorneys that are members of the same law firm.” Accordingly, although the Chapter 13 trustee did not oppose the Application, the bankruptcy court determined that the fee sharing provisions in

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43 *Id.* at 819.
44 *Id.* at 817.
45 *In re IHE, 2014 WL 4104204* *2 (Bankr. S.D. Tex. 2014).*
the contract violated § 504(a) and denied the Application.

c.  **In re Carter, 2008 WL 5255801 (Bankr. M.D. N.C. 2008):** Motion to Employ Special Counsel denied where a referring law firm received a 20% finders fee and the second firm received the remaining 80% of any fee collected. Prepetition, the debtors entered into an agreement to employ two law firms to prosecute the wife’s Social Security disability claim. One firm performed “client intake” services and opened a file on the second firm’s computer system. The second firm then performed the remaining legal work for the client. The bankruptcy court denied the Motion to Employ explaining that the firms’ agreement was a prohibited fee sharing agreement under § 504. The bankruptcy court denied the Motion without prejudice for the debtors to employ only one of the law firms if they so wished.

d.  **In re Hepner, 2007 WL 161003 (Bankr. S.D. Tex. 2007):** Chapter 7 Trustee moved to reopen two discharged cases to administer the estates’ interests in the debtors’ claims related to the Fen-Phen diet drug. Prepetition, the debtors in each case had contracted with a law firm which referred the litigation to another firm in exchange for a referral fee. The Chapter 7 trustee sought to employ the law firm performing the work to pursue the estates’ interests. The trustee indicated that any referral fee would be deducted from the attorneys fees to be paid to special counsel, and no estate funds would be used to pay the referral fees. The bankruptcy court found such distinction to be “meaningless where the estates pay the fee in full, and the attorney to whom the matter is referred then pays the referral fee.”

Bankruptcy matters should not be treated “as matters of traffic.”

46 **In re Hepner, 2007 WL 161003 * 2 (Bankr. S.D. Tex. 2007).**

47 **Id.**
IV. MISCELLANEOUS ISSUES RELATED TO THE RETENTION AND COMPENSATION OF SPECIAL COUNSEL

A. Prepetition Contingent Fee Agreement Constitutes an Executory Contract

_In re Hall_, 415 B.R. 911 (Bankr. M.D. Ga. 2009): A prepetition contingent fee agreement was deemed rejected as an executory contract pursuant to 11 U.S.C. § 365(a). Prepetition, the debtor entered into a 45% contingent fee agreement with lead counsel and co-counsel to prosecute malpractice claims related to the death of the debtor’s son. Lead counsel agreed to split the contingent fee on a 60% - 40% basis with co-counsel. Approximately eight months later, the debtor filed a Chapter 7 petition and did not inform co-counsel. The Chapter 7 trustee filed an Application to Employ and hired lead counsel to represent the estate’s interest in the pending lawsuits. For several years, the debtor continued to talk to co-counsel about his case, but neither the debtor nor lead counsel mentioned the debtor’s pending bankruptcy. After the case settled, co-counsel sought to be employed _nunc pro tunc_ and filed a Potential Administrative Fee Claim and a Motion to Disgorge attorney’s fees in the amount of $340,000 paid to lead counsel.

Initially, the bankruptcy court determined that co-counsel’s contingent fee contract was rejected 60 days after the debtor filed bankruptcy because the Chapter 7 trustee did not assume the contract. A contingent fee contract is an executory contract if further legal services must be performed before the matter is brought to conclusion. Here the contingency, the recovery in the malpractice actions, did not occur prepetition. Accordingly, the contingent fee contract was deemed rejected pursuant to § 365(a) sixty days after the debtor filed a Chapter 7 petition for relief. The rejection gave rise to a prepetition claim for damages based on _quantum meruit_ which the bankruptcy court could not award without some proof of value.
Further, the bankruptcy court refused to approve co-counsel’s employment *nunc pro tunc* as there was no evidence his services benefitted the estate. Finally, co-counsel’s Motion to Disgorge constituted a fee sharing dispute best resolved in state court.

**B. Hedge Agreements**

*In re Winstar Communications, 378 B.R. 756 (Bankr. D. Del. 2007):* The bankruptcy court could not approve a “hedge” agreement between special counsel and a lender pursuant to which the lender agreed to make an undisclosed fixed payment to special counsel and its special litigation consultant in exchange for an assignment of their interests, up to $10 million, for the prosecution of debtor’s claims to a $300 million judgment on appeal. Special counsel described the proposal as a “risk mitigating hedge involving trade claims.”

The bankruptcy court agreed that the hedge agreement did not appear to offend any of the policies underlying § 504 where there was no incentive to inflate fees that were already earned and the lender agreed that it would have no right to object to any proposed settlement. Nevertheless, the bankruptcy court could not approve the agreement in light of the clear statutory prohibition against fee sharing and where the agreement indisputably apportioned fees awarded to special counsel with the lender.

**C. Substitution of Counsel**

*McElrath v. Winnecour (In re Mazzei), 522 B.R. 113 (Bankr. W.D. Pa. 2014):* After the “sale” of a law practice to another attorney, including the assignment of 1,841 clients and accounts receivable, the bankruptcy court had to determine whether the payment of fees earned by the old law

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48 *In re Winstar Communications, 378 B.R. 756, 759 (Bankr. D. Del. 2007).*

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firm to the new law firm constituted impermissible fee sharing.\(^{49}\)

As counsel for various Chapter 13 debtors, the fees of the old firm were allowed as administrative expenses under § 503(b)(2). Further, neither firm fit within the § 504(b)(1) exceptions as the firms were not affiliated and the two entities were not members, partners, or associates in a professional association, corporation, or partnership. Because the court never authorized the distribution of the old firm’s compensation to the new firm, “the channeling of funds” between the firms appeared “to be the type of phantom compensation and fee sharing that section 504 was designed to prevent.”\(^{50}\)

Fee sharing consists of taking an “existing fee and splitting it among two or more professionals with each having a present and concurrent right to payment.”\(^{51}\) On its face, the agreement between the firms appeared to constitute fee sharing where payments from Chapter 13 plan distributions owed to the old firm would be collected by the new firm. However, the distinguishing factor that excepted the arrangement from the definition of fee sharing was that the firms did not have “simultaneous claims to the same fee.”\(^{52}\) Through the assumption and assignment of the respective fee agreements, the new firm stood in the shoes of the old firm for the transferred cases, and the old firm’s claim to the funds was extinguished. The date of sale bifurcated the fees so that there was no concurrent right to payment.

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\(^{49}\) Although the attorneys presented conflicting testimony regarding a sale of the law firm had occurred because consideration did not change hands, the bankruptcy court held a sale of the practice did in fact occur because a buyer’s assumption of a seller’s liabilities may qualify as consideration.


\(^{51}\) Id. at 133.

\(^{52}\) Id.
However, to the extent the old law firm continued to file fee applications in transferred cases, the bankruptcy court explained that “[t]here is no clearer example of fee sharing than when one attorney sells his practice (including all accounts receivable) to another attorney and then files a fee application seeking payment from clients he no longer represents.”53

D. Regular Associate

*In re Ferguson, 445 B.R. 744 (Bankr. N.D. Tex. 2011):* An attorney who shared office space with special counsel employed by the Chapter 13 trustee was not a “regular associate” for purposes of § 504(b)(1). After a state court action settled for $1 million, special counsel retained by the Chapter 13 trustee filed fee applications seeking either a one-third contingency fee or fees of $48,628,67 plus an enhancement of not less than two or three times the fees. The issues before the bankruptcy court were whether special counsel was entitled to a one-third contingency fee and whether his arrangement with another attorney with whom he shared office space violated § 504(a).

Special counsel was not entitled to the contingency fee because: (1) although the bankruptcy court approved his employment, the court made it clear during the hearing that the court was not pre-approving the contingent fee request pursuant to § 328; (2) the Application to Employ was filed on an expedited basis without sufficient notice to debtors and debtors’ state court counsel; and (3) had the court known that the unsecured debt in the case totaled $11,556,04 it would have never considered retention on a basis that could result in an award of a large contingency fee at debtors’ expense.

Before deciding on the amount that should be awarded to special counsel, the bankruptcy

53 *Id.* at 135.
court had to consider whether special counsel’s fee request which included fees charged by another attorney violated § 504(a). The attorneys shared office space, but special counsel had a separate law practice. The attorney regularly provided assistance to special counsel for which special counsel would bill $250 per hour and then pay the attorney $166 per hour. Special counsel did not disclose the arrangement to the bankruptcy court.

Special counsel argued that fixed contingency fees pre-approved under § 328 do not fall within the scope of § 504(a) because fixed contingency fees are not subject to review under § 330(a) and are, thus, not the type of fees described by § 503(b)(2) for purposes of § 504(a). The bankruptcy court rejected this argument, explaining as follows:

[S]ection 330(a)(1) does not except from its scope any compensation awarded to ‘a professional person employed under section 327.’ While section 330(a)(1) makes an award of compensation ‘subject to sections 326, 328, and 329,’ sections 330 and 331 are the only provisions of the Code which authorize the payment of professionals such as [special counsel]. Indeed, if [special counsel] were not entitled to compensation under section 330, its compensation would not be allowable as an administrative expense, since section 503(b)(2) is the only statutory basis for according that status to compensation awarded to persons employed under section 327 (and 1103).

Moreover, that section 330(a)(1) is ‘subject to’ not only section 328 but also section 326 demonstrates that Congress did not intend by the qualifier to make an exception to 330. Section 326 limits compensation of trustees. Congress clearly meant to clarify that any award of compensation to a trustee must fall within section 326’s limits. The reference to section 328 in section 330(a)(1) must be read similarly, to simply constrain a court awarding compensation to do so in accordance with the terms of retention applicable pursuant to section 328, which like section 326, provides ‘[l]imitation[s] on compensation.’ 54

Accordingly, the bankruptcy court had to consider whether the attorneys were regular associates for purposes of § 504(b)(1). Although Rule 9001(10) broadly defines the term ‘regular

associate” to mean “any attorney regularly employed by, associated with, or counsel to an individual or firm,” the bankruptcy court determined that § 504(b) is not so broad. “Rather, it provides that a ‘regular associate in a professional association, corporation, or partnership (emphasis added) may share compensation.” Accordingly, pursuant to the plain language of § 504(b)(1) an attorney may only share fees with a member, partner, or associate in the same professional association, corporation, or partnership.

Although a finding of improper fee sharing generally results in denial of compensation or disgorgement, given the circumstances of the case the bankruptcy court allowed the trustee to file an Application to Employ Co-Special Counsel for his services rendered. However, in order to give full meaning to § 504(a), special counsel could not profit from co-counsel’s employment.

V. CONCLUSIONS

Section 327 permits the employment of multiple attorneys as special counsel for services rendered to the estate and for each to be compensated pursuant to § 330. However, each attorney must be compensated separately as there is nothing in §§ 327 and 330 which permit sharing of compensation in violation of § 504(a). If special counsel have been employed prepetition pursuant to a fee sharing agreement, the agreement should be clearly repudiated in writing and in fact. Once a bankruptcy estate is created, the cause of action becomes property of the estate and to be compensated special counsel must be employed by the estate. If multiple attorneys are required to prosecute a cause of action on behalf of the estate and seek compensation on a contingent fee basis, the percentage of fees to be paid to each and duties to be performed by each must be set forth

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55 Id. at 752.
separately in their respective Applications for Employment, not in a fee sharing agreement which the bankruptcy court is improperly requested to approve.