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Column
Last in Line

*22 TEXAS BANKRUPTCY COURT DENIES REIMBURSEMENT OF COMMITTEE MEMBER'S ATTORNEY'S FEES

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Last year, the Third Circuit Court of Appeals sparked a firestorm of controversy with its opinion in *In re First Merchants Acceptance Corp.*, 198 F. 3d. 394 (3d Cir. 1999). [2] In *First Merchants*, the chair of the creditors' committee hired its own attorney (in addition to the two law firms retained by the committee itself) to help fulfill its duties as a member and chair of the committee. After plan confirmation, this committee member sought reimbursement from the bankruptcy estate for the fees charged by its *own* attorney; the district court [3] denied the request.

In reversing the district court, the Third Circuit acknowledged that while reimbursement of a committee member's attorneys' fees is at odds with the policies of the Bankruptcy Code, the "plain meaning" of the Bankruptcy Code required a reversal of the district court's denial of the reimbursement request because a committee member is entitled to reimbursement of "expenses ... incurred in the performance of the duties of such committee" pursuant to 11 U.S.C. §503(b)(3)(F), and because 11 U.S.C. §503(b)(4) entitles the committee member (as an entity described in §503(b)(3)) to reimbursement for the fees of its *own* attorney as "reasonable compensation for professional services rendered by an attorney ... of an entity whose expense is allowable under" 11 U.S.C. §503(b)(3). The reimbursement request was remanded to the district court for further proceedings.

On Nov. 6, 2000, the U.S. Bankruptcy Court for the Northern District of Texas weighed in on the subject in its opinion in *In re Firstplus Financial Inc.*, 254 B. R. 888 (Bankr. N.D. Tex. 2000), and became the first court to revisit the issue since the *First Merchants* decision. The Texas bankruptcy court rejected the Third Circuit's analysis and denied a committee member's request for reimbursement of its attorney fees.

In *Firstplus Financial*, Turner Broadcasting Systems was appointed to serve on the committee and its representative was elected committee chair. Although the committee was represented by counsel, the Turner representative hired an attorney to represent Turner Broadcasting Systems and, once hired, delegated much of the responsibility of committee membership to him. Consequently, the attorney attended some committee meetings, interviewed experts, negotiated with the debtor and with other creditors, and participated in long plan negotiations. The court described Turner's lawyer as the "alter ego" of the Turner representative and, in fact, he was the "alter ego with an hourly billing rate," charging Turner for performing as a committee member.

Relying on the Third Circuit's opinion in *First Merchants*, Turner Broadcasting Systems filed an application for administrative fees, seeking reimbursement for the legal fees that it had paid its attorney. Thus, the court had before it the same issue as the one decided by the Third Circuit Court of Appeals in *First Merchants*, namely whether committee members may recover attorneys' fees from the estate under 11 U.S.C. §§503(b)(3)(F) and 503(b)(4) for attorneys hired by them (without court approval) to represent their individual interests as committee members in the bankruptcy case. In framing the issue, the bankruptcy court evidenced its desire to address the same issue the Third Circuit addressed in *First Merchants* because the court could have easily

denied Turner's reimbursement request based on its finding that the attorney's services were neither necessary nor justified, and that they failed to provide any benefit to the bankruptcy estate.

After framing the issue, the court laid out the rules of statutory construction that *it* considered applicable, and they were markedly different from the rules of construction that the Third Circuit employed in *First Merchants*. Relying on the Supreme Court's opinion in *In re Ron Pair Enterprises Inc.*, 489 U.S. 235, 241 (1989), the bankruptcy court noted that the "plain-meaning" rule of statutory construction that the Third Circuit used is not applicable in rare cases in which the literal application of a statute will produce a result that is demonstrably at odds with the intention of the drafters. In these circumstances, the intention of the drafters must control. Relying on *Dewsnup vs. Timm*, 502 U.S. 410, 419 (1992), the bankruptcy court also noted that Congress does not write on a "clean slate" when it amends the bankruptcy laws, and, consequently, courts should be reluctant to accept arguments that interpret the Bankruptcy Code provisions in such a way as to effect a major change in the practice without explicit legislative history or guidance.

The court next analyzed the legislative history of 11 U.S.C. §503(b)(3)(F) (which was added to the Bankruptcy Code with the 1994 amendments) in order to ascertain the legislative intent. Initially, there were two proposed versions of the bill that ultimately became §503(b)(3)(F). The Senate version *would have* expressly allowed the estate to reimburse attorney or accountant fees incurred by a member of a committee under certain circumstances. The House version did not include such language. The Senate version of the bill was rejected. Unlike the Third Circuit Court in *First Merchants*, the *Firstplus Financial* court found that the rejection of the Senate language evidenced clear legislative intent that 11 U.S.C. §503(b)(3)(F) should not be used to reimburse committee members for their professional fees. Moreover, the legislative history does not contain *any* discussion regarding the allowance of fees for committee member's professionals. Obviously, allowing the scarce assets of a bankruptcy estate to be used to pay a committee member's professional fees would have been a significant change in bankruptcy practice that would warrant discussion in the legislative history.

The bankruptcy court was troubled by the inherent conflict of interest between the committee member's attorney (who is hired to represent the interest of that individual committee member) and the bankruptcy estate, and noted that it makes no sense to require a financially beleaguered debtor to pay the fees of an attorney with whom it has a conflict of interest. Indeed, the irony of the entire situation was not lost on the Texas bankruptcy court. After all, here was a committee member who had indicated a willingness to serve on the committee, and then promptly hired counsel and delegated ***38** many of its duties as a committee member to the attorney who performed them at an hourly rate plus travel expenses. Reasoning that the drafters of the 1994 amendments *never* intended to endorse this result, and that *Firstplus Financial* was one of those "rare cases" in which the literal application of the statute would yield a result demonstrably at odds with the clear legislative intent, the bankruptcy court denied Turner's reimbursement request.

Without acknowledging that a committee member's attorneys fees are eligible for reimbursement from the estate under the "reasonable and necessary" standard, the court denied the reimbursement request on that basis as well, finding that the attorney's services benefitted only Turner and its representative and were of no value to the estate.

Although *Firstplus Financial* stands in stark contrast to the Third Circuit's opinion in *First Merchants*, which used the "plain-meaning" rule of statutory construction, *Firstplus Financial* seems to reach the right result on the facts of that case because the attorney was acting as a "stand-in" for the committee member. However, the bankruptcy court might have gone too far. In *Firstplus Financial*, the bankruptcy court could have simply denied Turner's reimbursement request on the basis that committee members serve without a fee and should not be able to subvert this policy by hiring counsel as a "proxy." In its effort to "close the Pandora's Box" that some commentators believe the Third Circuit opened in its *First Merchants* decision, the bankruptcy court in *Firstplus Financial* sets an unsettling precedent for those complex or contentious cases in which committee members feel that they need to hire counsel to represent them in performing their duties. Indeed, in complex or contentious cases, reimbursement of committee members' attorneys fees does *not* seem to be at odds with the policy of the Bankruptcy Code or with the responsibility the Bankruptcy Code places on the committee in the reorganization process.

Both *First Merchants* and *Firstplus Financial* invite us to take a long, hard look at the practical realities of committee membership. Perhaps the more important question is this: *Why* did committee members in both cases feel the need to hire their own counsel? Perhaps *First Merchants* and *Firstplus Financial* are symptomatic of the tensions that are often inherent in committee membership today. Increasingly, committee membership is becoming a complex undertaking, especially when the committee consists of a heterogeneous group of unsecured creditors such as trade creditors, noteholders and banks. Although each such committee member has an unsecured claim, they often have widely different goals and views of the best course of action. These different views can fractionalize a creditors' committee, and meetings can become contentious. Perhaps a committee member's attorney fee should be reimbursable as "reasonable and necessary" in complex or contentious committee situations. Although 11 U.S.C. §1102 empowers the U.S. Trustee to appoint additional committees, U.S. Trustees often decline to do so because additional committees can be expensive and can complicate the reorganization process. The problem of a committee member's attorney fees is delicate, difficult and bound up with related fears of "hidden" administrative expenses and conflicts of interest.

First Merchants and *Firstplus Financial* probably represent the "tip of the iceberg" in attempting to resolve these complex issues. Because *Firstplus Financial* comes so quickly on the heels of the Third Circuit's decision in *First Merchants*, many will view it as an effort to firmly close the "Pandora's Box" that the Third Circuit is perceived to have opened. Hopefully, Congress will give us a timely and well-reasoned legislative solution.

Footnotes

1 The author gratefully acknowledges the assistance of her partner, Joel Applebaum.

2 Indeed, the case sparked Tom Salerno's article in the March 2000 issue of the *ABI Journal* entitled, "Third Circuit Creates the 'Hidden Administrative Claim' in Chapter 11 Cases." Joel Applebaum's article in the April 2000 issue entitled, "Reimbursement of Committee Member Expenses," and Larry Ahern's letter to the editor supporting the Third Circuit's opinion.

3 In *First Merchants*, the district court did not refer the chapter 11 case to the bankruptcy court.

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