UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK
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LAWRENCE MORRISON, P.C.,

Plaintiff/Appellant,

-against-

UNITED STATES TRUSTEES,

Defendant/Appellee.
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MEMORANDUM & ORDER

09-CV-3565 (CBA)

AMON, United States District Judge.

Appellant Lawrence Morrison, P.C. ("Morrison"), counsel to Chapter 11 debtor Larry Bresnick ("Bresnick" or "Debtor"), appeals an order of the United States Bankruptcy Court for the Eastern District of New York, Brooklyn Division (the "bankruptcy court"), entered on June 23, 2009 (the "Order"). The Order denied Morrison's fee application (the "Fee Application") to the extent that it sought an award of fees incurred after the appointment of a Chapter 11 trustee in Bresnick's case.

The bankruptcy court's Order relied on Lamie v. United States Trustee, 540 U.S. 526 (2004), in which the Supreme Court unanimously ruled that federal bankruptcy law prohibits the use of bankruptcy estate funds to pay a debtor's attorney for work that the attorney performs after the appointment of a Chapter 7 trustee, unless the trustee specifically re-employs the attorney under 11 U.S.C. § 327(a). The issue on appeal is whether the bankruptcy court erred when it denied the Fee Application. For the reasons set forth below, the decision of the bankruptcy court is affirmed.

I. Procedural History

On March 30, 2007, Bresnick filed a Chapter 11 petition in the Bankruptcy Court for the Eastern District of New York, Brooklyn Division. Among his listed personal property, Bresnick

disclosed that he held a fifty percent interest in Block 7094, LLC ("Block 7094") and Tower Hill at Springville, LLC ("Tower Hill"). Tower Hill, a non-debtor, owns an undeveloped parcel of real property in Staten Island, New York (the "Tower Hill Property"). As managing member of Block 7094, Bresnick also filed a Chapter 11 petition on behalf of Block 7094.

On April 24, 2007, Bresnick filed an application to retain Lawrence Morrison as debtor's bankruptcy counsel pursuant to 11 U.S.C. § 327(a). On May 15, 2007, the bankruptcy court approved Morrison's retention effective as of March 30, 2007. The United States Trustee appointed official committees of unsecured creditors for both the debtor's case and the Block 7094 matter. The bankruptcy court also approved the retention of Pick & Zabicki LLP as counsel to both creditors' committees.

On June 25, 2007, the bankruptcy court granted the United States Trustee's motion for the appointment of a Chapter 11 trustee for cause pursuant to 11 U.S.C. § 1104(a)(1). After consulting with parties in interest, the United States Trustee filed a notice of appointment of Gregory Messer, Esq. as Chapter 11 trustee (the "Trustee"), and the bankruptcy court approved the appointment on June 28, 2007.

On July 3, 2007, the Trustee filed an application to employ the firm of LaMonica, Herbst & Maniscalco, LLP ("LH&M") as bankruptcy counsel under 11 U.S.C. § 327(a). The bankruptcy court approved LH&M's retention on July 20, 2007. The Trustee did not retain any other bankruptcy counsel.

On April 4, 2008, the bankruptcy court entered an order authorizing the sale of the Block 7094 property for $7.1 million and the sale of the Tower Hill Property for $1 million.

On March 13, 2009, the bankruptcy court approved a stipulation of settlement (the "Stipulation") resolving all claims against Bresnick's estate and dismissing the case. Under the Stipulation, estate funds in the Trustee's possession would be used to pay professional fees and expenses approved by the court, and the proceeds of the Tower Hill Property sale would be paid to the estate to satisfy any shortfall with respect to fee awards. Bresnick's case was dismissed pursuant to the Stipulation on June 29, 2009. It is undisputed that Morrison, as debtor's counsel, played an instrumental role in achieving a global settlement.

On April 23, 2009, Morrison filed the Fee Application with the bankruptcy court, seeking $11,455.00 in fees for time incurred prior to the appointment of the Trustee and $103,792.83 for work performed after the appointment of the Trustee. The United States Trustee objected to the request for fees incurred after the appointment of the Trustee on the grounds that, under the decision of the Supreme Court in Lamie, Morrison was not entitled to compensation from estate funds after appointment of the Trustee. On June 23, 2009, the bankruptcy court denied the Fee Application with respect to any work performed after the appointment of the Trustee. The court held that "§ 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized under § 327(a)." The court reasoned that, because the appointment of the Trustee terminated Bresnick's status as debtor in possession, Morrison's appointment as counsel for the estate also terminated. The court accordingly denied Morrison's fee application in the amount of $103,792.83. Subsequently, Morrison filed a timely notice of appeal.

DISCUSSION

On appeal, a district court reviews a bankruptcy court's conclusions of law de novo. Asbestosis Claimants v. U.S. Lines Reorganization Trust (In re U.S. Lines, Inc.), 318 F.3d 432, 435 (2d Cir. 2003). The sole issue on appeal is whether the bankruptcy court properly applied the United States Supreme Court decision of Lamie v. U.S. Trustee, 540 U.S. 526 (2004), to the circumstances of this case when it denied Morrison compensation from estate funds for all work done after the appointment of the Trustee. In order to answer this question, it is helpful to review the relevant provisions of the bankruptcy code.

When an entity initiates bankruptcy proceedings, all of its assets are transferred by operation of law into a bankruptcy estate. 11 U.S.C. § 541(1) (The commencement of a bankruptcy action "creates an estate . . . comprised [with various exceptions] of all legal or equitable interests of the debtor in property as of the commencement of the case"). Chapter 11 debtors retain control of the bankruptcy estate and business operations as "debtors in possession." See 11 U.S.C. §§ 1101(1) and 1108. Debtors in possession are required to undertake various duties, including accounting for estate property, disclosing assets, liabilities and financial affairs, timely filing tax returns, preparing and filing periodic financial reports, and proposing plans of reorganization. 11 U.S.C. §§ 521, 704(a)(2), (7) and (8), 1106(a)(5) and (6), and 1107(a).

Pursuant to 11 U.S.C. § 1104, the bankruptcy court may order the appointment of a trustee. That section provides as follows:

> (a) at any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, the court shall order the appointment of a trustee –
>
> > (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current

> management, either before or after the commencement of the case, or similar cause . . .
>
> (2) if such appointment is in the best interests of creditors, any equity security holders, and other interests in the estate . . . ; or
>
> (3) if grounds exist to convert or dismiss the case under § 1112, but the court determines that the appointment of a trustee . . . is in the best interests of creditors and the estate.

11 U.S.C. § 1104(a).

After the bankruptcy court has entered an order directing the appointment of a Chapter 11 trustee, the United States Trustee appoints the trustee after consultation with parties in interest. 11 U.S.C. § 1104(d). Once the trustee is appointed, the trustee becomes the estate's sole representative. 11 U.S.C. § 323(a) ("The trustee in a case under this title is the representative of the estate.").

Once appointed, the trustee is entitled to retain professionals to assist the trustee in carrying out his responsibilities on behalf of the estate. 11 U.S.C. § 327 governs the retention of professionals in Chapter 11 cases, and provides, in pertinent part, that:

> (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.

11 U.S.C. § 327(a). In the absence of a trustee, debtors in possession may, subject to court approval, retain professionals such as lawyers and accountants pursuant to § 327.

Retained professionals must apply to the bankruptcy court for the award of reasonable compensation and the reimbursement of actual and necessary expenses under 11 U.S.C. § 330(a), which provides, in part, that:

> (1) After notice to parties in interest and the United States trustee, the court may award a trustee, examiner, . . . or a professional person employed under section 327 . . .
>
> > (A) reasonable compensation for actual, necessary services rendered by the . . . professional person or attorney . . .; and
> >
> > (B) reimbursement for actual, necessary expenses.

Only professionals retained under 11 U.S.C. § 327 are entitled to receive compensation from estate funds 11 U.S.C. § 330. Lamie, 540 U.S. at 538-39.

In Lamie, the Supreme Court held that 11 U.S.C. § 330(a)(1) prohibits compensation awards to debtors' attorneys from estate funds after the appointment of a trustee in a Chapter 7 case, unless the attorney is employed by the trustee and approved by the court. 540 U.S. at 538-39. The facts of Lamie are nearly identical to the instant case in all material respects. The petitioner in Lamie was hired by a debtor company to prepare, file and prosecute a Chapter 11 bankruptcy proceeding, which he did. Id. at 531-32. Three months into the Lamie Chapter 11 reorganization, the United States Trustee filed a motion to convert the action into a Chapter 7 liquidation proceeding. The motion was granted and the court appointed an estate trustee pursuant to 11 U.S.C. § 701(a). The Supreme Court noted that the appointment of the trustee "terminated [the debtor's] status as debtor-in-possession and so terminated petitioner's service under § 327 as an attorney for the debtor-in-possession." Id. at 532. Petitioner nonetheless continued to provide legal services to the debtor in the absence of authorization from the trustee to do so, and sought compensation for his efforts under § 330(a)(1). Id.

After interpreting the "plain meaning" of § 330(a)(1) and finding it to be unambiguous, the Supreme Court held that the petitioner was not entitled to compensation under the statute. The Court first observed that, prior to a 1994 Congressional amendment to the Bankruptcy Code,

bankruptcy courts could award compensation to a debtor's attorney.[1] The Supreme Court analyzed the present statute and found that, though awkward and perhaps ungrammatical, it unambiguously authorizes an award of compensation to only three types of persons: "trustees, examiners, and § 327 professional persons." Lamie, 540 U.S. at 534. "A debtor's attorney not engaged as provided by § 327 is simply not included within the class of persons eligible for compensation." Id. Thus, after Lamie, debtor's attorneys seeking compensation in a Chapter 7 case will only be entitled to compensation for work conducted after the appointment of a trustee if the trustee engages debtor's counsel as a professional person pursuant to § 327.

In the bankruptcy court, Morrison argued that Lamie did not prevent him from recovering compensation in this case because Lamie addressed only Chapter 7 bankruptcies, not Chapter 11. He further argued that Lamie should not preclude payment of fees from estate funds where, as here, the parties contemplated that debtor's counsel would be paid by the estate and agreed that he should receive such payment. (See U.S. Trustee's Excerpts from Record on Appeal ("Record"), Ex. E at 9.) Morrison argued below that Chapter 7 and Chapter 11 bankruptcies should be treated differently, but provided little elaboration beyond the fact that Lamie did not

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[1] Prior to the 1994 Act, § 330(a) provided as follows:

> "(a) After notice to any parties in interest and to the United States trustee and a hearing . . . the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney. . . (1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney . . . ."

11 U.S.C. § 330(a) (1988) (emphasis added). The 1994 amendment deleted the words "or to the debtor's attorney" at the end of § 330(a) in what is now § 330(a)(1). Confusingly, however, § 330(a)(1)(A) still includes the word "attorney," stating that reasonable compensation may be paid for services rendered by "the trustee, examiner, professional person, or attorney . . . ."

specifically address Chapter 11. For the first time on this appeal, Morrison contends that (1) Lamie should not apply to the facts of this case because the case was not converted to Chapter 7 and therefore no "order for relief" under 11 U.S.C. § 348(a) relieved Morrison of his obligations to the debtor, (2) Lamie should not be applied to individual debtors in light of subsequent amendments to the Bankruptcy Code under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and (3) that, even if Lamie does apply, Morrison should be permitted to recover proceeds from the Tower Hill sale because that money should be considered "non-Estate Funds". Finally, Morrison argues here, as he did below, that he should be able to recover on fairness grounds because all parties treated him as a professional person and assumed he would be able to receive compensation from estate funds.

Morrison first contends that the appointment of a Chapter 11 trustee does not terminate the employment of debtor's counsel under § 327. According to Morrison, the conversion of a Chapter 11 case to Chapter 7 constitutes an "order for relief" pursuant to 11 U.S.C. § 348(a). (See Reply Br. of Appellant ("Reply Br.") at 3.) He argues that, unlike in Lamie, this case was not converted and therefore no such "order for relief" issued. Accordingly, Morrison argues that he remained employed under § 327(a) and remained obligated to continue representing Bresnick. Id. at 3-4. As noted earlier, this argument was not brought to the attention of the bankruptcy court. "[I]t is a well established general rule that an appellate court will not consider an issue raised for the first time on appeal." See Allianz Ins. Co. v. Lerner, 416 F.3d 109, 114 (2d Cir. 2005) (quoting Greene v. United States, 13 F.3d 577, 586 (2d Cir. 1994)). Although this rule is a prudential limitation and therefore discretionary, courts generally exercise the discretion to hear new arguments only "where necessary to avoid a manifest injustice or where the argument

presents a question of law and there is no need for additional fact-finding." Id. at 114 (citing Sniado v. Bank of Austria AG, 378 F.3d 210, 213 (2d Cir. 2004) (per curiam). "[T]he circumstances normally do not militate in favor of an exercise of discretion to address new arguments on appeal where those arguments were available to the parties below and they proffer no reason for their failure to raise the arguments below." Kendall v. Employees Retirement Plan of Avon Products, 561 F.3d 112, 123 (2d Cir. 2009) (quoting In re Nortel Networks Corp. Sec. Litig., 539 F.3d 129, 133 (2d Cir. 2008) (internal quotation marks and alterations omitted)). Morrison offers no such explanation for the failure to raise this statutory argument below, and the Court sees no basis to consider it for the first time on appeal.

Even if properly preserved, however, Morrison's argument fails on the merits. The triggering event that prevented the petitioner's recovery in Lamie was not conversion to a Chapter 7 proceeding – rather, it was the appointment of a trustee that "terminated [the debtor's] status as debtor-in-possession and so terminated petitioner's service under § 327 as an attorney for the debtor-in-possession." 540 U.S. at 532.[2] The statutory language construed in Lamie is

[2] Morrison contends that it is a "faulty premise" that once a Chapter 11 trustee is appointed, "the debtor and its counsel is no longer a fiduciary for the estate." (Reply Br. at 4.) In support, he cites to Rome v. Braunstein, 19 F.3d 54, 62 (1st Cir. 1994) for the proposition that "counsel to a Chapter 11 debtor owes continuing loyalty to the debtor throughout the Chapter 11 proceedings; appointment of a Chapter 11 trustee does not end counsel's obligation to the debtor entity." This authority contradicts the very proposition suggested by counsel: while Morrison may well have continued to owe a fiduciary obligation to the debtor, appointment of the trustee eliminated the debtor's status as "debtor-in-possession," a term of art under the Bankruptcy Code, and accordingly Morrison no longer owed a fiduciary duty to the bankruptcy estate. Morrison may, thus, recover from his client – the Debtor – but not from the estate.

not limited to Chapter 7, and there is no basis in law to presume that a different result would follow where a Chapter 11 trustee has been appointed.[3]

Other courts have come to similar conclusions. For instance, in In re Pro-Snax Distributors, Inc., 157 F.3d 414, 425 (5th Cir. 1998), cited with approval in Lamie, the Court of Appeals for the Fifth Circuit observed that "[§ 330(a)] is clear on its face" and "excludes attorneys from its catalog of professional officers of a bankruptcy estate who may be compensated for their work after the appointment of a Chapter 11 trustee." Similarly, in In re Bay Voltex Corp., No. 03-42684 EDJ, 2006 WL 3834300 (Bankr. N.D. Cal. Dec. 29, 2006), the bankruptcy court held that Lamie prohibited debtor's counsel from recovering any fees after the appointment of a Chapter 11 trustee. Noting that Lamie concerned a Chapter 7 debtor rather than a Chapter 11 debtor out of possession, the court observed that this was "tantamount to a distinction without a difference." 2006 WL 3834300, at *1. Morrison argues that this statement is dicta but, in fact, it is central to the holding of the case. The Bay Voltex court noted that the "distinction is irrelevant," reasoning that: "Under § 323(a), the trustee is the representative of the estate. Neither a Chapter 7 debtor not [sic] a Chapter 11 debtor out of possession is a trustee, and neither represents the estate. Section 330(a) makes no provision for compensation of

[3] This conclusion is further supported by a number of articles addressing developments in bankruptcy law that have identified the significant obstacles to payment from estate funds facing a Chapter 11 debtor's attorney after Lamie. See, e.g., Bruce A. Markell, The Sub Rosa Chapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. ILL. L. REV. 67, 83 (2007) ("The Chapter 11 debtor's lawyer would . . . presumably be covered by Lamie v. United States Trustee, and could not receive compensation from the estate." See also Dillon E. Jackson, Lamenting Lamie and the Appointment of the Chapter 11 Trustee, AM. BANKR. INST. J., Nov. 2004, at 11 ("Although Lamie specifically dealt with a Chapter 7 conversion, the decision also applies to Chapter 11 cases where a trustee has been appointed. The triggering event on which a loss of the right to compensation is based is not conversion; rather, it is the appointment of a trustee.") (emphasis in original).

professionals employed by a debtor that is not a trustee." Id.; see also In re Del Monico, No. 04 B 38235, 2006 WL 345013, at *2 (Bankr. N.D. Ill. Feb. 15, 2006) (holding that no compensation could be awarded to a debtor's attorney for services after the appointment of a Chapter 11 trustee prior to conversion to Chapter 7, and finding that it was the appointment of the Chapter 11 trustee, not the conversion, that prevented the debtor's attorney from recovering compensation).

Morrison also argues that Lamie should not be applied to individual, as opposed to corporate, Chapter 11 debtors. (See Reply Br. at 11-17.) He notes that Lamie was decided prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which provides, inter alia, that, in the case of an individual debtor, all "[e]arnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under Chapter 7, 12, or 13 included as "property of the estate". 11 U.S.C. § 1115. Thus, he contends, after BAPCPA, an attorney to an individual debtor who continues to operate his business during a Chapter 11 reorganization would not be able to recover fees directly from the debtor after the appointment of a trustee. Morrison maintains that the Supreme Court could not possibly have intended or contemplated this result in Lamie. This argument was not raised before the bankruptcy court and Morrison has offered no explanation for his failure to raise this argument below. Indeed, although Morrison devoted the bulk of his reply brief and considerable time at oral argument to the claim that applying Lamie's rationale to individual debtors would result in an absurdity, Morrison's opening brief never mentions the BAPCPA or even identifies any reasons why corporate and individual debtors should be treated differently. Although the court, for the same reasons set forth above, does not consider this untimely argument, it notes in passing that the legislative branch is best suited to

remedy the alleged harshness resulting from the interplay of the BAPCPA and Lamie. Were the court to address Morrison's argument, it would be obligated to "assume that Congress passed [the] subsequent law with full knowledge of the existing legal landscape[.]" In re Northwest Airlines Corp., 484 F.3d 160, 169 (2d Cir. 2007) (citing Miles v. Apex Marine Corp., 498 U.S. 19, 32 (1990) ("We assume that Congress is aware of existing law when it passes legislation.")). Moreover, as noted at oral argument, even under the BAPCPA, an individual debtor would regain access to earnings once the estate emerges from bankruptcy, and counsel would presumably be able to seek payment from the debtor at that time. (See 4/16/2010 Tr. at 29-30.)

Morrison additionally claims that he should be able to receive compensation from the proceeds of the Tower Hill sale because that money should be considered "non-Estate Funds". (See Appellant Br. at 16.) As before, this argument was never raised before the bankruptcy judge and accordingly should not be considered for the first time on appeal. In any event, the terms of the Stipulation establish that the debtor's interest in the Tower Hill proceeds would be deposited with the Trustee and earmarked for the compensation of professionals. (See Record, Ex. H at ¶ 8 ("The shortfall of any court allowed and approved commissions and professional fees and expenses shall be paid from the [net proceeds of the Tower Hill sale]. All of the net proceeds, exclusive of any and all closing costs to be paid at closing, shall be deposited with Gregory Messer, Esq., as the Disbursing Agent.").) Such funds accordingly became estate property after approval of the Stipulation. See 11 U.S.C. 541(a)(7) (defining property of the estate to include "[a]ny interest in property that the estate acquires after the commencement of the case."). Finally, Morrison argues that he was "explicitly and implicitly" treated as the debtor-in- possession's attorney after the appointment of the Trustee. He notes that the

Stipulation identifies him as counsel to the debtor in possession, that he was instrumental in negotiating the Stipulation, and that no party ever objected to his involvement. (See Appellant Br. at 11-12.) This Court is not without sympathy for Morrison's position. It is clear from the record that Morrison worked diligently on his client's behalf and that he no doubt played an important role in achieving a global resolution of this case. Nonetheless, Morrison cannot recover compensation from the bankruptcy estate for his work conducted after the appointment of the Trustee. Morrison is not entitled to compensation merely because the parties continued to work with him – even if his work was appreciated and, in fact, welcomed. The fact remains that Morrison was not employed by the Trustee and therefore cannot recover compensation for services after the Trustee was appointed. See, e.g., In re Bartmann, 320 B.R. 725, 742 (Bankr. N.D. Okla. 2004) ("Professionals who render services to the estate without first obtaining an order authorizing their employment are effectively volunteers."). Accordingly, the decision of the bankruptcy court is affirmed.

SO ORDERED.

Dated: Brooklyn, New York
June 24, 2010

/s/ Hon. Carol Bagley Amon

Carol Bagley Amon
United States District Judge