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Feature

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Court's Broad Power to Approve Appointment of Estate Professionals

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Pursuant to § 327(a) of the Bankruptcy Code, bankruptcy trustees and debtors in possession (DIPs)[1] must obtain court approval to employ estate professionals, such as attorneys, accountants, appraisers or auctioneers, to represent or assist them in carrying out their duties.[2] The requirement that a party must obtain court approval in order to employ professionals is unusual; in most other areas of law, a party has total freedom to choose its professionals and court approval is not required.[3] One reason for this unique requirement is that in contrast to most areas of law in which only the interests of the party employing the professional are at stake, the interests of parties other than the trustee or DIP employing the professional, such as creditors and sometimes shareholders, are also at stake in a bankruptcy proceeding.[4]

Trustees and DIPs are fiduciaries to the bankruptcy estate and are obligated to act not in their own best interest, but rather in the best interests of the estate, including its creditors.[5] Furthermore, estate professionals are compensated from the bankruptcy estate,[6] and the court must ensure that estate funds are administered appropriately.[7] Therefore, § 327 "gives the Court the ability to perform a screening process, verify the necessity of employment, ensure the neutrality of the person employed, and control and limit estate expenses, thereby promoting efficient administration of the bankruptcy estate."[8]

Section 327(a) details only two standards for employment of an estate professional by a trustee or DIP: the professional must be disinterested[9] and may not hold or represent an interest adverse to the estate.[10] If these standards are satisfied, the court must then exercise its discretion in determining whether to approve a professional's employment. The court should consider "the protection of the interests of the bankruptcy estate and its creditors, and the efficient, expeditious, and economical resolution of the bankruptcy proceeding."[11] Despite the court's broad discretion over the appointment of estate professionals,[12] the court should interfere with the trustee or DIP's choice of professionals in only the rarest of circumstances.[13]

A recent decision by the Judicial Council of the Ninth Circuit highlights the bankruptcy court's broad discretion to review and consider the retention of pro-

1 Section 327 refers only to a trustee. However, a debtor in possession has the rights, powers and duties of a chapter 11 trustee. *See* 11 U.S.C. § 1107(a). Therefore, § 327 applies to the employment of professionals by a debtor in possession. *See In re Congoleum Corp.*, 426 F.3d 675, 688 n.13 (3d Cir. 2005) (citing *United States Trustee v. Price Waterhouse*, 19 F.3d 138 (3d Cir. 1994)); *In re Living Hope Se. LLC*, 509 B.R. 629, 646 n.21 (Bankr. E.D. Ark. 2014).

2 *See* 11 U.S.C. § 327.

3 *See In re Doors & More Inc.*, 126 B.R. 43, 44 (Bankr. E.D. Mich. 1991).

4 *Id.* at 45.

5 *See Antioch Litig. Trust v. McDermott Will & Emery LLP*, 500 B.R. 755, 764 n.16 (S.D. Ohio 2013) ("A bankruptcy trustee and a debtor-in-possession owe fiduciary duties to all of the creditors of the bankruptcy.") (citing *Natco Indus. Inc. v. Fed. Ins. Co.*, 69 B.R. 418 (S.D.N.Y. 1987)); *Doors & More*, 126 B.R. at 45.

6 *See* 11 U.S.C. § 330.

7 *See In re Prod. Assocs.*, 264 B.R. 180, 185 (Bankr. N.D. Ill. 2001) ("[T]he court has an independent duty to assure that the funds [in a bankruptcy estate] are administered in a way that is consistent with the intent of the Bankruptcy Code.... Thus, any professional seeking compensation from the estate must first obtain approval from the court.") (citing *In re McDonald Bros. Constr. Inc.*, 114 B.R. 989, 994 (Bankr. N.D. Ill. 1990)).

8 *In re McKenzie*, 449 B.R. 306, 318 (Bankr. E.D. Tenn. 2011).

9 A "disinterested person" for purposes of § 327 means a person who:
(A) is not a creditor, an equity security holder, or an insider;
(B) is not and was not, within [two] years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.
11 U.S.C. § 101(14).

10 Holding or representing an interest adverse to the estate means "(1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or (2) to possess a predisposition under circumstances that render such a bias against the estate." *In re Rental Sys. LLC*, 511 B.R. 882, 897 (Bankr. N.D. Ill. 2014).

11 *See In re Vouzianas*, 259 F.3d 103, 107 (2d Cir. 2001) (citing *In re AroChem Corp.*, 176 F.3d 610, 621 (2d Cir. 1999)); *In re Gordon Props. LLC*, 504 B.R. 807, 810 (Bankr. E.D. Va. 2013) (citing *In re Harold & Williams Dev. Co.*, 977 F.2d 906, 910 (4th Cir. 1992)). *See also In re Vettori*, 217 B.R. 242, 245 (Bankr. N.D. Ill. 1998) (articulating similar standard, namely, that in determining whether to approve employment of professional, court should consider whether employment is in estate's best interests and whether it will aid in administration of case); *In re Doors & More Inc.*, 126 B.R. 43, 45 (Bankr. E.D. Mich. 1991) (same).

12 *See In re LTHM Houston-Operations LLC*, No. 14-33899, 2014 Bankr. LEXIS 4495, at *11 (Bankr. S.D. Tex. Oct. 24, 2014) ("The Bankruptcy Code provides the Court with broad discretion regarding the employment of professionals to work on behalf of the estate.") (citing *In re Harold & Williams Dev. Co.*, 977 F.2d at 909).

13 *See In re Hash*, 472 B.R. 866, 868 (Bankr. W.D. Ky. 2012) ("The trustee should be deprived of his or her choice of professionals in 'only the rarest cases.'") (quoting *In re Smith*, 507 F.3d 64 (2d Cir. 2007)). *See also In re Great Lakes Factors Inc.*, 337 B.R. 657, 660 (Bankr. N.D. Ohio 2005) ("[A] bankruptcy trustee is to be afforded wide latitude in their decision[s] on how to best manage the estate, including the propriety of employing a professional.").

fessionals, as well as deny the requested retention if the court does not believe, based on the professional's performance in previous cases, that the professional's employment will serve the best interests of the estate. In *In re Complaint of Judicial Misconduct*,[14] a principal owner of a financial advisory firm (the "complainant"), whose retention had been denied, brought a complaint against a bankruptcy judge, alleging that the judge refused to appoint the firm as an advisor to the bankruptcy estate in two cases due to personal *animus*.

The complainant claimed that the *animus* arose out of a previous case in which the firm, serving as a financial advisor to an estate, repeatedly exceeded the monthly fee caps that were included in the orders approving the firm's retention. The bankruptcy judge denied fees in excess of the caps, but the fee order was reversed on appeal on the grounds that the judge relied on the wrong statutory provision in denying the fees. In two subsequent cases, the same judge denied the firm's retention based on its failure to comply with the fee caps in the previous case. In one of those cases, the judge stated, "Find me somebody else.... There's no question in my mind that they violated [my] order [in a previous case] regardless of what the [Bankruptcy Appellate Panel] did.... I don't have confidence in them."[15] In the other case, he said, "I've had a history with them of them not following my court orders in my opinion and I'm not going to appoint [them].... They violated [my order in a previous case]. For technical reasons I got reversed, but I'm not hiring them in this case. I have no confidence in their abilities."[16] The complainant asserted that the reversal of the judge's fee order in the previous case evidenced that the judge improperly imposed the fee caps, and therefore, the judge's denial of their retention in the subsequent cases was unreasonable and constituted personal *animus*.

Chief Judge Alex Kozinski, writing for the Judicial Council of the Ninth Circuit, explained that the bankruptcy judge's comments did not reflect an impermissible motive because "[i]n making a discretionary appointment to a position of trust, a judge may rely on his own prior experience with the applicants for the appointment. The judge's refusal to appoint the financial group in subsequent cases was consistent with his observation that it had disregarded his orders in the past and could therefore not trust them to perform faithfully in the future."[17] Although the judge's fee order in the previous case was reversed, the appeals court left open the possibility that the financial group's fees could have been limited pursuant to a different statutory provision. Therefore, the judge was justified in believing that the fee caps that he had imposed were substantively sound and should have been complied with by the financial advisory firm. For these reasons, "[i]t was not misconduct, or even wrong, for the judge to consider the group's repeated refusal to abide by the financial limits [that] he set in a past case in making future appointments. Indeed, it would have been irresponsible to disregard the group's prior record."[18] Therefore, the Judicial Council of the Ninth Circuit dismissed the complainant's allegations of misconduct.

In re Complaint of Judicial Misconduct demonstrates the bankruptcy court's broad discretion and power to deny employment of an estate professional based on the court's experience with the professional in prior cases, even if the professional otherwise satisfies the statutory requirements of § 327(a). It also serves as a warning to professionals that if they fail to abide by fee caps or similar provisions, not only can the court limit their fees in the instant case, but a court may also consider such a failure in determining whether to approve their employment in subsequent cases.

Several bankruptcy courts have similarly denied employment of an estate professional based on a professional's unsatisfactory performance in previous cases. For example, in *In re Slack*,[19] the bankruptcy court denied an application to employ counsel for the debtors because, among other things, counsel had repeatedly failed to attend hearings and to make timely and sufficient filings of reorganization plans and other documents in several prior cases, resulting in prejudice to his clients and other interested parties. The court found that "these derelictions of duty not only permit an inference that applicant should not be appointed as counsel in these chapter 12 proceedings, but in fact compel the court to conclude that applicant counsel's appointment in this case would not, in view of past experience, aid in its administration."[20]

Other bankruptcy courts have cited attorneys' flawed records as a reason for denying or limiting their employments.[21] In each of these cases, the proposed attorneys' shoddy work in previous cases demonstrated to the court a lack of ability to competently represent a debtor. The courts explained that "[o]ne of the most efficient methods for determining whether an attorney has competence to be appointed chapter 11 counsel is to look at the attorney's performance in previous cases."[22] Therefore, "[i]t is entirely proper to consider counsel's performance in previous cases in determining whether his appointment in this present case" should be approved.[23]

These cases serve as a reminder to estate professionals that their conduct and the quality of their work might have repercussions well beyond those for the case in which they are currently employed. Aside from the potential consequence that the court may reduce their fees in the instant case,[24] poor performance might result in a court denying their retention in subsequent cases in which they seek employment. Therefore, it is essential that estate professionals work diligently, because doing so serves the interests of not only the estate, but themselves as well. abi

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14 761 F.3d 1097 (9th Cir. 2014).
15 *Id.* at 1099 (alteration in original).
16 *Id.* (alteration in original).
17 *Id.*
18 *Id.*
19 73 B.R. 382 (Bankr. W.D. Mo. 1987).
20 *Id.* at 387.
21 *See In re Wiley Brown & Assocs. LLC*, No. 06-50886, 2006 WL 2390290, at *1 (Bankr. M.D.N.C. Aug. 14, 2006) (denying DIP's application to employ attorney because, in addition to representing interest adverse to estate, attorney's deficient performance in instant case and previous cases demonstrated that he did not have "the necessary experience and proficiency to represent the Debtor"); *In re Vettori*, 217 B.R. at 246 (Bankr. N.D. Ill. 1998) (although attorney's "difficulty with some intricacies of the law and also with maintaining records, keeping schedules, and meeting deadlines" were "sufficient reasons to warrant denial" of attorney's retention, court-approved retention on condition that attorney associate with another attorney as a mentor); *In re Doors & More Inc.*, 126 B.R. at 46 and n.9 (denying attorney's application to be retained by debtor because attorney's multiple failures in instant case, as well as failure in previous case, demonstrated that his employment "would not be in the best interest of this estate").
22 *Wiley Brown & Assocs.*, 2006 WL 2390290, at *18; *Vettori*, 217 B.R. at 245.
23 *Wiley Brown & Assocs.* at *18-19; *Vettori* at 245; *Doors & More*, 126 B.R. at 46 n.9.
24 *See* 11 U.S.C. § 330(a)(2).