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# RECOVERY OF CREDITORS' COSTS FROM THE BANKRUPTCY ESTATE: REASONABLE, NECESSARY, AND . . . UNCERTAIN?

*Judy Simmons Henry\**

## I. INTRODUCTION

For a creditor, the level of participation in a bankruptcy proceeding may hinge on the anticipated payment or reimbursement for costs, including attorney fees and expenses, from bankruptcy estate funds. Common areas of creditor intervention in chapter 11 or 7 cases include discharge complaints, exemption objections, first meetings, confirmation objections, and motions to convert or to appoint a trustee. These services conceivably benefit the creditor body as a whole. The available avenues in the Bankruptcy Code for recovery of creditor fees and expenses from the bankruptcy estate<sup>1</sup> are minimal, and the case law interpreting the Code's sections is, at best, conflicting. So can a creditor be made whole for time, effort, and cost expended in performing tasks beneficial to all creditors?

## II. ADMINISTRATIVE CLAIMS IN BANKRUPTCY

### A. What Avenues Are Available?—Request for Administrative Claim

Short of becoming counsel for a chapter 7 trustee<sup>2</sup> (which is often not an available option) or being satisfied with a general unsecured claim, for a creditor to recoup or have any real expectancy of payment for incurred fees and expenses, compliance with the technical requirements of 11 U.S.C. § 503 is necessary.<sup>3</sup> A creditor must request an administrative claim

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1. Upon the filing of a case, voluntary or involuntary, an estate is created and comprised of all interests of the debtor in property, with certain minimal exceptions. See 11 U.S.C. § 541(a)(1)-(2), (b), (c)(2) (1994). The estate may expand depending upon additional recoveries during the case. *Id.* § 541(a)(3).

2. Under 11 U.S.C. § 327, a trustee is authorized to hire attorneys and other professionals with the court's approval. In reality, trustees who are licensed attorneys typically hire themselves, or their law firms, to represent them in chapter 7 cases. 11 U.S.C. § 327(d) (1994). Prior representation of a creditor may not disqualify creditor's counsel from becoming trustee's counsel. *Id.* § 327(a). Compensation is awarded under 11 U.S.C. § 330(a)(1) for those professionals. Approved compensation under § 330(a) is automatically an allowed administrative expense of highest priority. See *id.* §§ 503(b)(2), 507(a)(1).

3. Compliance with the requirements for filing a proof of claim under 11 U.S.C. § 503 is not necessary in order for creditor's counsel to be entitled to assert an administrative expense. *In re Parker*, 21 B.R. 692, 693-94 (E.D. Tenn. 1982).

allowance for reimbursement of fees and out-of-pocket expenses under 11 U.S.C. § 503 of the Bankruptcy Code.<sup>4</sup>

Subsection 503(a) requires the timely filing of a request, or the tardily filing of a request, if cause exists,<sup>5</sup> to allow a creditor's claim as an administrative expense.<sup>6</sup> The request must be made by motion to the bankruptcy court for an order allowing the administrative claim<sup>7</sup> with proper service on the trustee or debtor in possession.<sup>8</sup> An application itemizing, in detail, services rendered, time spent, expenses incurred, amounts requested, and details regarding prior compensation in connection with the case must

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4. Section 503's origin dates back to § 64 of the Bankruptcy Act of 1898. Section 64(a)(1) provided for full, priority payment of certain debts in advance of any distributions to creditors. Priority debts included (1) a creditor's costs and expenses for recovering property of the debtor transferred or concealed either pre- or postpetition; (2) reasonable attorneys' and professionals' fees for involuntary petitioning creditors; (3) costs and expenses in successfully challenging the debtor's discharge; and (4) costs and expenses of adducing evidence resulting in certain criminal convictions. Bankruptcy Act of 1898 § 64(a)(1)-(3) (repealed 1978).

5. The 1994 amendments, effective October 22, 1994, added the timely and tardily request language to § 503(a). Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended at 11 U.S.C. § 503(a) (1994)).

6. The benefit of an administrative claim over other generally filed claims in a case is in the priority it holds. Subsection 507(a)(1) places administrative claims of § 503(b) first in line for distribution from funds available to unsecured creditors. The claims of secured creditors are not considered in § 507, nor are general unsecured, nonpriority claims considered. See *Larsen v. Carter (In re Larsen)*, 59 F.3d 783, 786 (8th Cir. 1995) (recognizing administrative expense as an exception to the general policy of equalizing distribution in bankruptcy).

7. FED. R. BANKR. P. 9013 requires that a request for an order be made by motion unless an "application" is otherwise authorized by the FEDERAL RULES OF BANKRUPTCY PROCEDURE. Although Rules 2002(a)(7) and (k) refer to "applications" for compensation, they do not appear to authorize the filing of a request for an administrative claim by "application" as opposed to "motion." FED. R. BANKR. P. 2002(a)(7) and (k).

8. Rules 2002(a)(7) and (k) require 20 days notice to parties in interest and to the U.S. Trustee, respectively, of a hearing on all fee applications for compensation or reimbursement totalling in excess of \$500. FED. R. BANKR. P. 2002(a)(7) and (k). Technically, the request for an administrative expense (the allocation of payment priority) is not a request for compensation. However, if the request is coupled with a plea that the trustee be required to distribute estate monies already on deposit, the request is for compensation and may be subject to broader notice requirements. Section 503(a) appears to contemplate available monies to pay an expense because it allows a creditor to "file a request for payment of an administrative expense." 11 U.S.C. § 503(a) (1994). However, unless there are clearly sufficient estate funds to pay all allowed administrative claims in a case, distribution may not occur until the end of the case. See *In re MS Freight Distrib., Inc.*, 172 B.R. 976, 979-80 (Bankr. W.D. Wash. 1994) (holding that treatment of administrative expense claims must be equal). Pro rata distribution to administrative expenses of funds occurs where estate monies are insufficient to pay all allowed expenses. See *In re Specialty Plywood, Inc.*, 137 B.R. 960, 963 (Bankr. C.D. Cal. 1992) (allowing estate's auctioneer to be paid as professional administrative claim under § 507(b)(1)(A)).

be submitted with the motion for administrative expense.<sup>9</sup> A hearing<sup>10</sup> will be conducted before the bankruptcy judge with the burden of proof on the moving party to establish by a preponderance of the evidence the entitlement to the allowance of the administrative expense.<sup>11</sup>

## B. What Fees and Expenses Are Required Administrative Claims?

The laundry list of subsection 503(b) is a noninclusive list<sup>12</sup> of expenses and services that "shall" be treated as allowed administrative claims.<sup>13</sup> Several of these required administrative expenses are restricted to specific kinds of allowed claims and result-oriented tasks not readily helpful to a creditor's recovery—certain taxes;<sup>14</sup> fines, penalties, and reductions related

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9. FED. R. BANKR. P. 2016.

10. "After notice and hearing" generally means whatever hearing the bankruptcy court determines is appropriate under the circumstances. 11 U.S.C. § 102(1)(A) (1994). To avoid any hearing, the creditor could seek an ex parte order of the court requiring a party in interest to request a hearing in a timely manner. If no objection is filed and no hearing requested, the Bankruptcy Code allows the creditor to submit an order authorizing the administrative claim. See 11 U.S.C. § 102(1)(B)(i) (1994). *But see In re Holthoff*, 55 B.R. 36, 39 (Bankr. E.D. Ark. 1985) (holding that bankruptcy court has an independent duty to review all requests for compensation from estate funds even if no party in interest objects); *In re Kentucky Threaded Prods., Inc.*, 49 B.R. 118, 120 (Bankr. W.D. Ky. 1985) (finding that lack of objections to administrative fee request does not prohibit court from exercising independent duty). If an objection is filed, the motion becomes a contested matter governed by Rule 9014 and certain rules governing adversary proceedings. FED. R. BANKR. P. 9014 and 7001-7087.

11. *First Brandon Nat'l Bank v. Kerwin-White*, 109 B.R. 626, 633 (D. Vt. 1990) (holding that burden of proof is on Chapter 12 administrative claimant for appraisal cost as administrative claim); *In re Finevest Foods, Inc.*, 159 B.R. 972, 975 (Bankr. M.D. Fla. 1993) (holding that standard of proof on administrative claimant was by preponderance of evidence); see also *In re Cardinal Indus., Inc.*, 151 B.R. 833, 836 (Bankr. S.D. Ohio 1992) (holding that a filed proof of claim has prima facie presumption of validity and amount, the presumption does not extend to "status" of the filed administrative claim, and filing creditor must show entitlement to priority created by § 503(b) by preponderance of the evidence).

12. Section 503(b) provides for administrative claims "including" six specific expenses. 11 U.S.C. § 503(b) (1994). The rules of construction and interpretation specifically provide that "including" is not limiting language. See *id.* § 102(3); *Alabama Surface Mining Comm'n v. N.P. Mining Co. (In re N.P. Mining Co.)*, 963 F.2d 1449, 1453 (11th Cir. 1992) (holding that expenses not explicit in § 503(b) can receive administrative priority).

13. Section 503(b) states that "after notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under Section 502(f) of this title." 11 U.S.C. § 503(b) (1994). "Shall" has been generally accepted as mandatory and without discretion when interpreting the Bankruptcy Code. Although the language of § 503(b) requires the bankruptcy court to allow claims covered under the subsections of § 503(b), it does not restrict the bankruptcy court from allowing other claims as administrative expenses.

14. 11 U.S.C. § 503(b)(1)(B) (1994).

to the tax;<sup>15</sup> compensation of noncreditor professionals;<sup>16</sup> expenses for a custodian of debtor's property, including a reasonable attorney and accountant fee;<sup>17</sup> and indenture trustee fees in chapter 9 or 11.<sup>18</sup>

Other subsections of 503 require administrative expenses related to creditor participation. These expenses arise from service on a creditor's or an equity holder's committee and reasonable attorney and accountant fees attendant thereto;<sup>19</sup> attorney and creditor fees incurred in filing an involuntary petition;<sup>20</sup> and certain chapter 9 or 11 "substantial contribution" creditor expenses, including reasonable attorney and accountant fees,<sup>21</sup> certain witness fees, and mileage.<sup>22</sup>

The remaining four required administrative expenses of § 503 offer other avenues of possible recovery from the estate for a creditor who chooses to participate in the bankruptcy case. These subsections are less clear, lend themselves to ranging interpretations, and harbor the bulk of case law discussion.<sup>23</sup>

15. 11 U.S.C. § 503(b)(1)(C) (1994).

16. Subsection 503(b)(2) requires administrative expenses for reasonable services and expenses allowed under § 330(a) and incurred by debtor's counsels, accountants, appraisers, and auctioneers. 11 U.S.C. §§ 330(a), 503(b)(2) (1994). Subsection 503(b)(2) also requires administrative expenses for other professionals employed by the debtor under § 327 or 1103, including professionals of a trustee, but not professionals hired by a creditor. 11 U.S.C. §§ 330(a), 503(b)(2) (1994).

17. 11 U.S.C. §§ 503(b)(3)(E), 503(b)(4), 543 (1994).

18. 11 U.S.C. § 503(b)(5) (1994).

19. 11 U.S.C. §§ 503(b)(3)(F), 503(b)(4), 1102 (1994).

20. 11 U.S.C. § 503(b)(3)(A) (1994).

21. 11 U.S.C. § 503(b)(3)(D), (b)(4) (1994). Recovery by a creditor for making a "substantial contribution" is limited by statute to services performed in a chapter 9 or chapter 11 case. The services must have conferred a significant and demonstrable benefit to creditors and the estate. *In re Washington Lane Assocs.*, 79 B.R. 241, 244 (Bankr. E.D. Pa. 1987) (allowing creditor to recover costs and attorney fees in chapter 11 for installing individual utility meters in apartment building). *See also In re Romano*, 52 B.R. 590, 594 (Bankr. M.D. Fla. 1985) (requiring a substantial contribution to a successful result). A creditor's expenses for service on a chapter 11 creditors' committee are excepted under § 503(b)(3)(D). These expenses are specifically covered by § 503(b)(3)(F). *In re Marquam Inv. Corp.*, 176 B.R. 34, 37-38 (Bankr. D. Or. 1994) (allowing attorney fees under § 503(b)(3)-(4) as a substantial contribution to estate even though some fees exceeded recovery to estate).

22. 11 U.S.C. § 503(b)(6) (1994); 28 U.S.C. § 1821 (1994). Subsection 503(b)(6) references chapter 119 of title 28 to certain allowed fees and mileage as administrative claims. Chapter 119 covers not only witness fees but also costs to be taxed as part of a judgment (28 U.S.C. § 1920 (1994)); marshal fees (28 U.S.C. § 1921 (1994)); and bankruptcy filing fees as well as U.S. trustee quarterly fees (28 U.S.C. § 1930 (1994)). *See In re Office Prods. of America*, 136 B.R. 675, 689 (Bankr. W.D. Tex. 1992) (instructing creditors that their costs for testifying and traveling to hearing might be compensable under § 503(b)(6) upon proper application).

23. The United States Supreme Court has consistently mandated that when statutes are clear and unambiguous, resort to legislative history and other sources of interpretation is not

The following is a discussion of the relevant 503(b) subsections that mandate administrative allowance for:

- (1) the actual, necessary costs and expenses of preserving the estate;<sup>24</sup>
- (2) actual, necessary creditor's expenses incurred to recover, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor;<sup>25</sup>
- (3) actual, necessary creditor's expenses incurred with the prosecution of a criminal offense relating to the case, or to the business or property of the debtor;<sup>26</sup>
- (4) reasonable professional compensation for an attorney or accountant for (2) or (3) above.<sup>27</sup>

These subsections elevate the claim of a creditor or creditor's professional to administrative priority for taking actions that either benefit the debtor's estate as a whole (usually increasing distribution to creditors) or further an express public policy interest. Whether these parts of section 503 are helpful to a participating creditor seeking estate reimbursement requires an intensive factual and statutory requirement analysis. Many typical acts of participation by a creditor or its attorney are not specifically covered by these subsections; reimbursement for those efforts is not certain in most jurisdictions and is within the discretion of the bankruptcy judge to allow. A closer examination of these subsections is necessary to understand what expenses are specifically covered and whether creditor recovery for nonspecific services and costs thereunder is even possible.

1. *11 U.S.C. § 503(b)(1)(A) - Actual Necessary Costs and Expenses of Preserving the Estate*

A two-pronged test for allowance under subsection 503(b)(1)(A) is often used in evaluating facts.<sup>28</sup> First, the expense must arise out of a postpetition transaction between the creditor and trustee or debtor in

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proper. See *Pennsylvania Dept. of Welfare v. Davenport*, 495 U.S. 552, 559 (1990); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). However, many § 503 cases rely on prior versions of the Act and legislative discussions to interpret the statutes because of the lack of clarity and the discretion allowed within the statutory language.

24. 11 U.S.C. § 503(b)(1)(A) (1994). These expenses include wages, salaries, or commissions for postpetition services.

25. 11 U.S.C. § 503(b)(3)(B) (1994).

26. 11 U.S.C. § 503(b)(3)(C) (1994).

27. 11 U.S.C. § 503(b)(4) (1994).

28. *First Sec. Bank v. Gillman*, 158 B.R. 498, 504 n.3 (D. Utah 1995).

possession.<sup>29</sup> Second, the expense must have been necessary to preserve the estate.<sup>30</sup>

Subsection 503(b)(1)(A) offers examples of expenses incurred in preserving the estate, such as postpetition wages, salaries, and commissions. Additionally, courts have recognized other expenses as necessary preservation costs, including EPA response costs,<sup>31</sup> unsecured credit for chapter 11 debtor,<sup>32</sup> lease rental for farmland property,<sup>33</sup> payments to cure defaults under an assumed lease,<sup>34</sup> civil fines for injunction violation in a chapter 11 case,<sup>35</sup> postpetition financing,<sup>36</sup> postpetition tort injury incurred in a chapter 11 catering business,<sup>37</sup> and expenses and liabilities incurred for a debtor in possession's assumption of an executory contract.<sup>38</sup> Failed adequate protection payments, which may include payment for attorney fees and expenses due a secured creditor, accrued during a chapter 11 or operating 7 case, may also qualify as a subsection 503(b)(1)(A) administrative expense.<sup>39</sup>

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29. *In re Jartran*, 732 F.2d 584, 588 (7th Cir. 1984) (disallowing amounts owed for prepetition contract with debtor to place ads in telephone directory postpetition as administrative claim because irrevocable contract was made before bankruptcy filing). *But see* *Lastra v. Esteves (In re Bay Broadcasting, Inc.)*, 182 B.R. 369, 374 (D.P.R. 1995) (holding that expense need not arise from a transaction with a debtor in possession but rather requirement of § 503(b)(1)(A) is that expense be incurred after there is a debtor in possession).

30. *Fazio v. Growth Dev. Corp. (In re Growth Dev. Corp.)*, 168 B.R. 1009, 1019 (Bankr. N.D. Ga. 1994) (holding that § 503(b)(1)(A) applies to postpetition claims for actual, necessary costs to benefit estate as interpreted by the courts).

31. *Juniper Dev. Group v. Kahn (In re Hemingway Transp., Inc.)*, 993 F.2d 915, 929 (1st Cir. 1993).

32. *In re Photo Promotion Assocs.*, 881 F.2d 6, 9 (2d Cir. 1989).

33. *In re Hilligoss*, 849 F.2d 280, 281 (7th Cir. 1988).

34. *Nostas Assocs. v. Costich (In re Klein Sleep Prods., Inc.)*, 173 B.R. 296, 299 (S.D.N.Y. 1994) (holding that measure of benefit to estate is not whether the assumption of lease benefitted the estate but whether the expenses related to the lease for which priority treatment is sought benefitted the estate); *LJC Corp. v. Boyle*, 768 F.2d 1489 (D.C. Cir. 1985) (holding that cure payments and post assumption lease payments qualified as expenses of administration although rent due after rejection of lease was held not recoverable under § 503(b)(1)(A)).

35. *Spunt v. Charlesbank Laundry, Inc. (In re Charlesbank Laundry, Inc.)*, 755 F.2d 200, 202 (1st Cir. 1988) (allowing administrative expense for fine imposed during chapter 11 where laundry was enjoined from operating yet failed to comply with court order).

36. *Lastra v. Estevez (In re Bay Broadcasting, Inc.)*, 182 B.R. 369, 374 (D.P.R. 1995).

37. *In re B. Cohen & Sons Caterers, Inc.*, 143 B.R. 27 (E.D. Pa. 1992).

38. *Stewart Foods, Inc. v. Broecker (In re Stewart Foods, Inc.)*, 64 F.3d 141 (4th Cir. 1995).

39. *See* 11 U.S.C. § 507(b) (1994) (awarding claim from failed adequate protection payment as top priority distribution if the "creditor has a claim allowable under subsection (a)(1)" of § 507). Subsection (a)(1) refers to priority of payment of administrative expenses allowed under § 503(b), without further reference to a specific subsection of (b). 11 U.S.C.

Two courts have analyzed and accorded administrative status to creditor's expenses, including attorney fees under subsection 503(b)(1)(A).<sup>40</sup> In *Ferro Alloys*, the debtor had a contractual obligation to pay a lender's legal fees in connection with the loan the debtor was seeking during its chapter 11 case. The loan agreement had been orally approved by the bankruptcy court, but the debtor notified the potential lender that it decided to enter into another loan relationship and withdrew its motion for authority to borrow from the potential lender before the written order approving the loan was entered by the court. The bankruptcy court determined that the legal fees incurred by the potential lender were significant in allowing the debtor to obtain more favorable financing terms from a second lender, and therefore, the fees incurred in the initial loan application process were necessary and reasonable. The court allowed the attorney's fees under subsection 503(b)(1)(A), finding that the potential lender's role in the case had the "effect of preserving the debtor's estate."<sup>41</sup>

In *Custom Millwork*, the bankruptcy court likewise authorized payment for the creditor's court cost expense incurred by the attorney. Pursuant to the terms of a collective bargaining agreement, the debtor was required to submit monthly reports which, if late, subjected the debtor to certain damages and payment of all court costs and collection if it became necessary for the creditor to take legal action in order to enforce the terms of the agreement. Although the court denied an administrative expense for the contractual liquidated damages as a penalty rather than an actual projection of the losses incurred by the debtor's breach, it allowed the cost of \$74.00 as the actual and necessary costs to creditors for taking the legal action to enforce the contract terms.<sup>42</sup> These costs were determined to be actual and necessary to preserve the estate.

In both *Ferro Alloy* and *Custom Millwork*, there was no discussion of whether a creditor's attorney's fees and costs were actually covered or contemplated under subsection 503(b)(1)(A). These cases represent a

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§ 507(a)(1) (1994). See also *In re MS Freight Distrib., Inc.*, 172 B.R. 976, 980 (Bankr. W.D. Wash. 1994).

40. *In re Ohio Ferro-Alloys Corp.*, 96 B.R. 795, 797-98 (Bankr. N.D. Ohio 1989) (authorizing administrative expense under § 503(b)(1)(A) for creditor's costs and attorney fees incurred in loan transaction); *In re Custom Millwork, Inc.*, 35 B.R. 171, 174 (Bankr. D. Haw. 1983) (allowing as § 503(b)(1)(A) expense a claim for legal court costs of \$74.00 in suing debtor on collective bargaining agreement).

41. *In re Ohio Ferro-Alloys*, 96 B.R. at 798.

42. *In re Custom Millwork*, 35 B.R. at 174. It is not clear from the facts presented why the creditors did not seek their attorney fees for time spent attempting to enforce the collective bargaining agreement. Presumably, there were either no attorney's fees or the creditor expected the liquidated damages clause to cover the attorney's fees incurred in the chapter 11 case and therefore, did not file a separate request for fee recovery.



willingness of courts to allow recovery for fees and expenses of creditors under subsection 503(b)(1)(A) if the requirements of a postpetition relationship and estate preservation are met.

Conversely, other courts have declined to approve creditor expenses as actual, necessary costs to preserve the estate.<sup>43</sup> In the *Kerwin-White*, *Williams*, and *TRI-L* cases, bankruptcy courts declined to approve the creditor's attorney fees under subsection 503(b)(1)(A) because of failure to comply with one or both of the requirements for allowance. In *Kerwin-White*, the district court cited the creditor's failure to meet its burden of proof as the reason for denying the appraisal cost as an administrative expense incurred as a benefit to the estate. In *Williams*, services were rendered prepetition rather than postpetition, as required before allowance under subsection 503(b)(1)(A). Also, the services benefitted only the creditor and not the estate, even after the creation of the estate by the filing of the petition. In *TRI-L*, the fact that the fees were incurred postconfirmation restricted the use of subsection 503(b)(1)(A). These courts, however, did not decline to allow subsection 503(b)(1)(A) to be utilized by creditors altogether. Arguably, these courts recognized that subsection 503(b)(1)(A) could have provided an opportunity for creditor's claims, including attorney fees and costs, given the proper set of facts.

No cases analyzing subsection 503(b)(1)(A) have concluded that professional compensation incurred by a creditor is not recoverable under that section if the two-pronged test is met.<sup>44</sup> However, there are no reported cases where courts have approved an administrative expense to a creditor under this subsection in a chapter 7 case. All the decisions allowing a creditor's attorney fees and costs arise from services rendered in a chapter 11 case.

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43. *First Brandon Nat'l Bank v. Kerwin-White*, 109 B.R. 626, 633 (D. Vt. 1990) (denying the creditor bank's claim for its cost of appraisal in a chapter 11 failed reorganization case under § 503(b)(1)(A) because the bank failed to show the appraisal benefitted the estate, but noting that with appropriate proof, the bank's claim could have been awarded under § 503(b)(1)(A)); *In re Williams*, 165 B.R. 840 (Bankr. M.D. Tenn. 1993) (disallowing creditor's attorney fees because they were incurred prepetition and because they benefitted only the creditor and not the estate); *In re TRI-L Corp.*, 65 B.R. 774, 777 (Bankr. D. Utah 1986) (disallowing postconfirmation attorney fees under § 503(b)(1)(A), but stating fees may be recoverable under § 503(b)(2)).

44. *In re Office Prods. of America*, 136 B.R. 675, 687 (Bankr. W.D. Tex. 1992) (holding that § 503(b)(1)(A) does not apply to compensation for professionals who are covered by § 503(b)(2)). The only professionals covered by subsection (b)(2) are those hired under § 330(a), which does not apply to a creditor's professionals. Therefore, *Office Products* should not be read to limit recovery under § 503(b)(1)(A) to a creditor for its costs, including professional costs, as an administrative claim.

An argument exists that when applying a strict construction of subsection 503(b), a creditor's attorney's time and expense in investigating, litigating, or participating in a case should not be compensable under subsection 503(b)(1)(A) because the same expenses are specifically covered by subsection 503(b)(4). Subsection 503(b)(4), allowing a creditor's reasonable attorney's fees and expenses, references *only* the incurred fees and expenses related to tasks in the prior subsection 503(b)(3), not the expenses in subsection 503(b)(1).<sup>45</sup> Arguably, to allow a creditor's professional to recover under subsection 503(b)(1)(A) would negate the application and limitation of subsection 503(b)(4) and the technical requirements of subsection 503(b)(3).

Another case supporting the award of professional fees to noncreditor entities under subsection 503(b)(1)(A) is *In re Gherman*.<sup>46</sup> The allowance of fees in *Gherman* does not award compensation for or reimbursement to a creditor, but does allow professional fees for a trustee's accountant in chapter 7. Although it did not, the court could have applied the strict construction approach that the fees were not recoverable under subsection 503(b)(1)(A) because they were covered under another subsection, 503(b)(2), as the trustee's professional. The fact that courts are allowing administrative expenses under subsection 503(b)(1)(A) for professionals of other parties in interest lends support to the claim of allowance of a creditor's expense under this same subsection.

Subsection 503(b)(1)(A), as interpreted by the majority of courts, does not prohibit recovery of a creditor's costs as administrative expenses. Likewise, attorney and professional fees are covered as allowed expenses, assuming the two-pronged test is met. Recovery under subsection 503(b)(1)(A) for creditor participation in a chapter 11 case may be easier than recovery for services rendered in connection with chapters 7 and 13 cases. However, recovery for the latter is not prohibited by the specific language of the statute or the cases interpreting this subsection.

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45. See *F/S Airlease II, Inc. v. Simon (In re F/S Airlease II, Inc.)*, 844 F.2d 99 (3d Cir.) (holding that because § 503(b)(2) provides for recovery of attorney compensation for professionals employed by debtor or trustee, § 503(b)(1)(A) should not be read to apply to attorney's fees and cost at all), *cert. denied*, 488 U.S. 852 (1988); *but see In re Weibel, Inc.*, 161 B.R. 479, 481 (Bankr. N.D. Cal. 1993) (rejecting the theory that attorneys for debtor who do not qualify for compensation under §§ 330 and 503(b)(2) because of failure to be properly hired based on disinterestedness requirement can likewise seek no compensation or administrative claims under § 503(b)(1)(A)), *aff'd sub nom. McCutchen, Doyle, Brown & Emerson v. Official Comm. of Unsecured Creditors (In re Weibel, Inc.)*, 176 B.R. 209 (Bankr. 9th Cir. 1994).

46. *In re Gherman*, 114 B.R. 305 (Bankr. S.D. Fla. 1990) (allowing trustee's accountant's fees as a professional expense under § 503(b)(1)(A) even though fees could have been recovered under a more specific subsection).

2. *11 U.S.C. § 503(b)(3)(B) and (b)(4)—Administrative Allowance for Creditor's Recovery of Concealed or Transferred Property*

a. *Can a Creditor Ever Recover Concealed or Transferred Property?*

Subsection 503(b)(3)(B) mandates court approval of an administrative expense for a "creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor."<sup>47</sup> Professional attorney and accountant fees incurred in connection with this type of recovery are required administrative expenses under subsection 503(b)(4).<sup>48</sup>

At first reading, this subsection appears to cover services rendered by a creditor in recovering a fraudulent conveyance. Pursuant to 11 U.S.C. §§ 548 and 544(b),<sup>49</sup> only a trustee or the debtor in possession has standing in bankruptcy to pursue a fraudulent conveyance action arising under federal or state law.

Additionally, a preferential transfer under 11 U.S.C. § 547 or an unauthorized postpetition transfer pursuant to 11 U.S.C. § 549 can be included within subsection 503(b)(3)(B) as property transferred or concealed in connection with a bankruptcy case. Unlike other typical creditor activity in discharge litigation, exemption objections, and claims litigation, preferences and unauthorized postpetition transfer actions are solely vested in the trustee or debtor in possession and not a creditor.

Despite the lack of standing under the substantive statutes, subsection 503(b)(3)(B) appears to offer a creditor a basis to substitute as trustee, with the court's approval, in order to pursue actions under § 547, 548, or 549.<sup>50</sup> This apparent authority creates several problems. The Bankruptcy Code does not contemplate "partial" removal of a trustee.<sup>51</sup> No procedure is set forth in the Federal Rules of Bankruptcy Procedure for a creditor to remove a trustee in order to assert an action under § 547, 548, or 549. Likewise, no procedure exists to allow a creditor to substitute or

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47. 11 U.S.C. § 503(b)(3)(B) (1994).

48. *Id.* § 503(b)(4).

49. *Id.* §§ 544(b), 548. The trustee is vested with the power to avoid fraudulent conveyances under state law pursuant to § 544(b) if any unsecured claimant has standing to pursue this action outside of bankruptcy court.

50. *See* 11 U.S.C. § 503(b)(3)(B) (1994).

51. Removal "for cause" is allowed under § 324(a), but the subsection also requires removal of the same trustee in all other cases in which the trustee serves under § 324(b), unless the court orders otherwise. Removal of one trustee causes the appointment of another. Section 325 contemplates appointment of a successor trustee upon a vacancy in the position.

replace a trustee in the case for a limited purpose. Therefore, subsection 503(b)(3)(B), while appearing to offer a creditor hope for recovery, really is too narrowly drawn to afford much relief.

As a practical matter, courts sometimes allow a creditor to *ex rel* the trustee for a limited purpose. Failure of the trustee to take actions because of a lack of estate funds or because of a difference in opinion as to the validity of the action may be cause for the creditor to assume certain trustee functions. Because there is no Bankruptcy Code section nor Bankruptcy Rule authorizing or implementing this action, knowledge of each court's custom or local rules is critical to *ex rel* removal practice.<sup>52</sup>

A creditor expecting recovery for expenses under subsection 503(b)(3)(B) for administering trustee functions must be willing to concede any recovery in the action to the estate. The creditor can recover the administrative expenses for taking the action as priority expenses, although the creditor's claim will share in the available estate proceeds pro rata with other like administrative creditors.

At least two cases have held that subsection 503(b)(3)(B) does not confer standing to a creditor to pursue trustee causes of action.<sup>53</sup> In *Munoz*, the district court affirmed the bankruptcy court's ruling that a creditor had no standing to pursue a fraudulent conveyance action with standing vested solely in the chapter 7 trustee, except "[i]n some very limited circumstances."<sup>54</sup> The creditor asserted that standing was vested in her pursuant to 11 U.S.C. § 503(b)(3)(B), but the court rejected this argument.<sup>55</sup>

In *SRJ*, a junior creditor in a chapter 11 case filed a preferential transfer complaint against a senior creditor and also requested subordination of the senior creditor's lien. The court determined that 11 U.S.C. §§ 503(b)(3)(B) and 547 do not confer derivative or implied standing in a creditor.<sup>56</sup>

Other creditor activity is not plagued by the "standing" issue of subsection 503(b)(3)(B). Creditors, along with a trustee,<sup>57</sup> have dual-

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52. See *Larsen v. Munoz (In re Munoz)*, 111 B.R. 928, 932 (D. Colo. 1990) (holding that where chapter 7 trustee fails to pursue fraudulent conveyance, signs a written declaration that he will not proceed, and there is a meaningful potential recovery, creditor who obtains prior court approval to proceed can pursue action).

53. See *In re Munoz*, 111 B.R. at 931; *NBD Park Ridge Bank v. SRJ Enters., Inc. (In re SRJ Enters., Inc.)*, 151 B.R. 189, 193 (Bankr. N.D. Ill. 1993).

54. *In re Munoz*, 111 B.R. at 932.

55. *Id.* at 931 n.2 (stating that § 503(b)(3)(B) could refer to allowance of costs and expenses incurred prior to bankruptcy proceeding or prior to trustee appointment (citing 3 COLLIER ON BANKRUPTCY ¶ 503.04(b) (Lawrence P. King ed., 15th ed. 1989))).

56. *In re SRJ Enters.*, 151 B.R. at 193 n.1 (holding that § 503(b)(3)(B) only authorizes recovery for creditor's expenses for one "who had standing in the first place").

57. Appointment of an interim and final trustee in a chapter 7 case is automatic. 11 U.S.C. §§ 701, 702 (1994). In a chapter 11 case, the debtor remains in possession of assets

standing to attend and participate in a case by examining assets, attending the first meeting of creditors, and pursuing actions,<sup>58</sup> including a complaint to deny discharge,<sup>59</sup> an objection to exemptions, and an objection to a claim.<sup>61</sup> Simply because the Bankruptcy Code and Bankruptcy Rules contemplate dual standing, administrative compensation to the creditor for those services and expenses is not mandated under § 503 unless they can be pigeon-holed in one of its subsections. Because these identified dual-standing services do not squarely fit within the statute—subsection 503(b)(3)(B) (or other subsections of 503(b))—some courts have consciously overlooked, ignored, or tortured the other statutory requirements of subsection 503(b)(3)(B) to compensate equitably and administratively dutiful creditors who either participate alongside a trustee or who exercise singular efforts beneficial to all creditors or the estate. Other courts, ignoring the standing issue altogether, have declined to allow the creditor claims as administrative expenses based on remaining strict statutory language requirements of subsection 503(b)(3)(B) for recovery of property and prior court approval.

b. Recovery of Concealed or Transferred Property—Is It Necessary?

The statutory language of subsection 503(b)(3)(B) requires recovery of property transferred or concealed by the debtor. The express language of only this subsection of 503(b) provides that recovery of property for the benefit of the estate is necessary.<sup>62</sup> However, it is somewhat confusing to determine what instances can constitute recovery of property.

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and in control of the case as a fiduciary for creditors. 11 U.S.C. § 1107 (1994).

58. Conversely, there are actions that only a trustee is vested with standing to pursue, including turnover actions (11 U.S.C. §§ 542, 543 (1994)); lien avoidance actions (11 U.S.C. § 545 (1994)); preference actions (11 U.S.C. § 547 (1994)); fraudulent transfer actions (11 U.S.C. § 548 (1994)); and postpetition transfer avoidance actions (11 U.S.C. § 549 (1994)). Creditor's counsel must not undertake to pursue these actions without first removing the trustee or becoming counsel to the trustee.

59. Section 727 and Bankruptcy Rules 7001-7087 allow both a trustee and creditor to file a complaint to deny the debtor's general discharge of debts for certain "bad acts."

60. Under § 522 and Bankruptcy Rule 4003 or under state laws, a debtor has a right to claim certain property free of claims of creditors. The exempt property becomes estate property and remains a part of the debtor's bankruptcy estate until and unless an objection is timely filed. If successful, a creditor/trustee objection provides additional property for liquidation by the trustee and distribution to unsecured creditors.

61. Section 502 allows "a party in interest" to object to claims. Both a trustee and creditor would, definitionally, have standing, although a creditor rarely objects to claims.

62. See 11 U.S.C. § 503(b)(3)(B) (1994).

Except possibly in objecting to exemptions, the other common "dual" standing tasks do not appear to fit the "recovery" requirement of subsection 503(b)(3)(B). Discharge complaints, claims objections, and first meeting participation do not technically allow the estate to "recover" any property. Additional litigation or trustee activity to take possession of the asset is necessary. In a successful exemption objection, property is arguably recovered because, but for the objection, the property would be removed (exempted) from the estate.

However, as with discharge and claims litigation, the property recovered, even as to an exemption objection, must have been "transferred or concealed." Because the debtor must schedule the asset to claim it exempt and thereby trigger the objection, an exemption objection should likewise not fit within the statutory allowance of a subsection 503(b)(3)(B) expense.

Despite standing issues, apparent requirements for recovery of property, and the requirement for property to have been concealed or transferred, courts have used subsection 503(b)(3)(B) to allow an administrative expense.<sup>63</sup> One situation commonly analyzed under subsection 503(b)(3)(B) involves whether a creditor can recover fees and expenses incurred in challenging the debtor's discharge.<sup>64</sup>

In *In re George*, a creditor's attorney sought to recover his services and his costs incurred in successfully blocking the chapter 7 debtor's discharge based on facts that the creditor had located concealed assets. The court analyzed the issue of whether recovery was allowable by comparing the administrative expense portions of the former Bankruptcy Act to the current Act.<sup>65</sup> The court pointed out that the prior Act expressly included creditors' reasonable costs and expenses in opposing or revoking a discharge as allowed expenses. While the Bankruptcy Act omitted this provision, the court found that "a creditor's reasonable expense incident to opposing a discharge or revoking a discharge, opposing claimed exemptions, resisting

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63. See *In re Zedda*, 169 B.R. 605 (Bankr. E.D. La. 1994) (allowing recovery under § 503(b)(3)(B) for attending a meeting of creditors, performing title work, negotiating, and strategizing with the trustee, although creditor did not recover property); *In re Antar*, 122 B.R. 788 (Bankr. S.D. Fla. 1990) (allowing attorney fees in discharge action even though trustee later joined in discharge complaint); *In re Rumpza*, 54 B.R. 107 (Bankr. D.S.D. 1985) (awarding fees in discharge action despite no recovery of property); *In re George*, 23 B.R. 686 (Bankr. S.D. Fla. 1982) (allowing fees and costs).

64. The denial of debtor's general discharge under § 727 causes the debtor to lose that pot of gold at the end of the bankruptcy rainbow. The debtor often loses all but exempt property and owes all his debts because of discharge denial. This result allegedly benefits all creditors, not simply the creditors in pursuit who expended personal resources to achieve this result.

65. *In re George*, 23 B.R. at 686-87 (case predates the 1984 Bankruptcy Code).

claims or performing other similar services benefitting the estate, may be allowed as an administrative expense."<sup>66</sup>

The court acknowledged that the omission of an express provision for the expenses incurred in connection with a challenge to the debtor's discharge could indicate a legislative intent to deny them, but the court rejected this theory, finding "no plausible reason why a creditor who benefits all other creditors by filing an involuntary petition, by recovering a fraudulent transfer, or by aiding a criminal prosecution must be reimbursed his expenses, but must be denied his expenses if he successfully opposes the debtor's discharge."<sup>67</sup> The court further provided that "[t]he omission of these items from section 503(b)(3) following the term 'including' merely deprives these related expenses of mandatory reimbursement."<sup>68</sup> The fact that the creditor did not ask the court to direct the trustee to perform these tasks or seek the trustee's replacement did not prevent reimbursement to the creditor for his fees and costs in blocking the discharge.

The court further concluded that the creditor's acts constituted a recovery of property.<sup>69</sup> Because the trustee was left only to sell the discovered property after the discharge adversary proceeding, the statutory recovery requirement was met.

A similar result was reached in *In re Peterson*,<sup>70</sup> where the bankruptcy court provided that a creditor's attorney's claim for pursuing additional net disposable income in a chapter 12 case did not fail simply because it did not fit within one of the specific subsections of 503(b). Rather, the court explained that the use of the word "including" in conjunction with the Bankruptcy Code's statute regarding rules of construction, which states that "the words 'includes' and 'including' are not limiting," makes it clear that the list of compensable services and expenses in subsection 503(b) is not meant to be all-inclusive.<sup>71</sup> However, the district court reversed the bankruptcy decision, reasoning that subsection 503(b)(3)(D) did not authorize recovery for services rendering a substantial benefit to the case except in chapters 9 and 11. Because chapter 12 was not included (albeit

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66. *Id.*

67. *Id.*

68. *Id.* (emphasis added).

69. *Id.*

70. 145 B.R. 631, 636 (Bankr. D.S.D. 1992), *rev'd sub nom.* United States Trustee v. Farm Credit Bank (*In re Peterson*), 152 B.R. 612 (D.S.D. 1993).

71. *Id.* at 636-37. See also *In re Zedda*, 169 B.R. at 608 (stating that use of the term "including" indicates that the list of items in § 503(b) is illustrative); *In re Rumpza*, 54 B.R. at 109 (agreeing with *In re George* that recovery of expenses incurred in opposing a discharge is not prohibited, but is not mandatory and providing that such recovery "should not depend on a successful outcome").

chapter 12 did not exist when subsection 503(b)(3)(D) was enacted), to allow the recovery under subsection 503(b), generally and not specifically, would negate subsection 503(b)(3)(D).<sup>72</sup> Despite its reversal, the district court conceded that subsection 503(b) does not include the "only activities which may qualify as compensable administrative expenses."<sup>73</sup>

Several courts appear willing to compensate dutiful creditors for beneficial services despite the lack of recovery of property. However, compensation is awarded "outside" the specific laundry list of subsection 503(b), with reliance placed on the noninclusive language of subsection 503(b).

### c. Prior Court Approval—What Is It?

An additional requirement for recovery under subsection 503(b)(3)(B) is some necessity for "prior court approval." Little has been written about the nature of the necessary approval.<sup>74</sup> Notably, only subsection 503(b)(3)(B) requires any type of court approval. Actions and activities of a creditor's attorney other than recovery of property concealed or transferred by a debtor require no approval.<sup>75</sup>

The cases are inconsistent as to the requirements for prior court approval. Does the reference to approval mean authorization for hire of a creditor or its professional to represent the estate or to remove the trustee?<sup>76</sup> Is it approval to investigate or to attack certain transfers? Is the approval to recover fees? Additionally, when must the approval be sought and received?

If the required approval is reference to authority to pursue an action, arguably, this "requirement" should not reasonably be required for a creditor's attorney when the cause of action is not vested solely in the trustee (dual standing tasks). Standing of a creditor to pursue many actions is already authorized by the Bankruptcy Code or the Bankruptcy Rules. There is no need to "replace" a trustee in litigating actions not vested solely with a trustee. Even though a trustee *should* bring an action, such as

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72. United States Trustee v. Farm Credit Bank (*In re Peterson*), 152 B.R. 612, 614 (D.S.D. 1993).

73. *Id.*

74. For instance, *In re George* did not even consider the "prior court approval" requirement when authorizing fees and costs under § 503(b)(3)(B). See *In re George*, 23 B.R. 686 (Bankr. S.D. Fla. 1982).

75. See *In re Washington Lane Assocs.*, 79 B.R. 241, 243 (Bankr. E.D. Pa. 1987) (comparing subsection requiring court approval and other subsections of § 503).

76. See *In re Monahan*, 73 B.R. 543 (Bankr. S.D. Fla. 1987) (involving creditor's failure to get approval for "employment of attorney").



discharge or exemption objection, if he does not, a creditor is already vested with standing without further court approval.

Likewise, neither the Bankruptcy Code nor the Bankruptcy Rules require a creditor's attorney to apply for fees in representing the creditor. Although the Bankruptcy Rules contemplate a creditor's fee application and itemization before recovering under § 503, the filing cannot be prior to the rendering of services.<sup>77</sup>

As a practical matter, once the creditor seeks court approval to remove the trustee partially (or even to simply investigate or file the action), the element of surprise has disappeared. The requirement of prior court approval may often tip a dishonest debtor into further transferring or concealing assets. With cash, quickly transferable and easily commingled, this can be devastating to the ultimate recovery in the action, if allowed. Additionally, the delay and expense in obtaining prior court approval must be considered by the creditor.

To recover under subsection 503(b)(3)(B), however, it appears that some type of prior approval is necessary. Although the express statutory language requires "prior court approval," under subsection 503(b)(3)(B) there is strong dissention to adhere to the strict wording of the statute.<sup>78</sup>

Neither the Bankruptcy Code nor the Bankruptcy Rules require a creditor to seek approval for employment of professionals. Section 327 requires only that a trustee or debtor in possession seek approval for employment of professionals. Therefore, prior court approval for employment is not appropriate.

Courts reimbursing a creditor despite the lack of prior court approval have either totally disregarded the need for the prior approval or have approved the fees and expenses through retroactive authorization or the entry of a *nunc pro tunc* order. In *In re Rumpza*,<sup>79</sup> the court simply disregarded the need for a creditor to obtain prior court approval because of the inequities that would result and because the denial of fees and expenses would defeat creditor participation.<sup>80</sup>

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77. FED. R. BANKR. P. 2016.

78. See, e.g., *In re Zedda*, 169 B.R. 605, 607-08 (Bankr. E.D. La. 1994) (Creditor's attorney assisted trustee in uncovering fraudulent conveyance from debtor to her father. The court allowed recovery by creditors for fees without prior court approval because fees benefitted estate and assisted in asset recovery by trustee.); *In re Johnson*, 72 B.R. 115 (Bankr. E.D.N.C. 1987); *Carpenter v. Valley Wholesale Bldg. Prods. (In re Carpenter)*, 56 B.R. 704 (Bankr. D.R.I. 1986); *In re Rumpza*, 54 B.R. 107 (Bankr. D.S.D. 1985); *In re George*, 23 B.R. 686 (Bankr. S.D. Fla. 1982) (approving, retroactively, efforts of creditor and his attorney to recover property in the context of a discharge action).

79. 54 B.R. 107 (Bankr. D.S.D. 1985).

80. *Id.* at 109; see also *In re George*, 23 B.R. at 687.

In *Rumpza*, a creditor's attorney informed the chapter 7 trustee of various irregularities in the debtor's schedules. The creditor's attorney then examined the debtor under Bankruptcy Rule 2004, which caused the debtor to admit he had failed to list several assets.<sup>81</sup> The attorney filed a complaint objecting to the debtor's discharge, and the debtor amended his exempt property to include the assets disclosed by the creditor's attorney. The trustee objected to the debtor's amendment, and before trial on the attorney's objection to the debtor's discharge, the debtor and trustee entered a settlement with respect to the exemption objection, causing a recovery for the estate of approximately \$6500.<sup>82</sup>

The administrative expense was granted despite the attorney's failure to obtain prior court approval as "[a]lthough [the attorney] did not obtain prior court approval, efforts such as these by creditors on behalf of the estate and resulting in a benefit to all creditors should be encouraged, and the Court will not deny him compensation on that basis."<sup>83</sup> Although the creditor did not actually recover any property for the estate, the court allowed the creditor's attorney to recover his fees as an administrative expense because the attorney's actions had been "instrumental in the discovery of the assets for the estate."<sup>84</sup>

Rather than totally disregard the statutory language requiring prior court approval, several courts have awarded fees and expenses to a creditor's attorney through retroactive authorization or by entry of a *nunc pro tunc* order.<sup>85</sup>

In *Johnson*, a creditor's attorney successfully set aside the fraudulent transfer of the debtor's marital home after examining the debtor under Bankruptcy Rule 2004. Sale of the recovered property netted \$80,000 for the estate for the payment of administrative expenses and distribution to unsecured creditors.<sup>86</sup> The creditor's attorney then sought reimbursement under subsections 503(b)(3)(B) and 503(b)(4) for its expenses in bringing the fraudulent conveyance action (an action only the trustee had standing to pursue) although the attorney had not obtained prior court approval to either recover the property or be employed.

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81. *In re Rumpza*, 54 B.R. at 108.

82. *Id.* at 109.

83. *Id.*

84. *Id.*

85. See, e.g., *In re Zedda*, 169 B.R. 605 (Bankr. E.D. La. 1994); *In re Peterson*, 145 B.R. 631 (Bankr. D.S.D. 1992), *rev'd sub nom.* United States Trustee v. Farm Credit Bank (*In re Peterson*), 152 B.R. 612 (D.S.D. 1993); *In re Antar*, 122 B.R. 788 (Bankr. S.D. Fla. 1990); *In re Johnson*, 72 B.R. 115 (Bankr. E.D.N.C. 1987).

86. *In re Johnson*, 72 B.R. at 117.

The court explained that, under subsections 503(b)(3)(B) and 503(b)(4), a creditor can be reimbursed for its efforts to recover property if it obtains prior court approval "to undertake the activity for which compensation is sought."<sup>87</sup> However, the court recognized that many courts have allowed compensation through the entry of a *nunc pro tunc* order approving the activity for which compensation is sought.<sup>88</sup> After pointing out that this *nunc pro tunc* approval should be given only in extraordinary circumstances, the court found that the facts surrounding the fraudulent conveyance action constituted exceptional circumstances because the creditor recovered approximately \$80,000 for the estate.<sup>89</sup>

The *Johnson* court was also faced with the decision of whether to award in excess of \$4000 in attorney fees for successfully objecting to the debtor's discharge.<sup>90</sup> The creditor had not sought prior approval to pursue the discharge action. Reasoning that the complaint brought into the estate only a 1979 automobile, "not of significant value," the court declined to find "exceptional circumstances" warranting a retroactive order authorizing the discharge action.<sup>91</sup> Interestingly, the court in *Johnson* recognized that subsection 503(b)(3)(B) might not ever permit compensation to a creditor who obtains denial of discharge because there is no recovery of property.<sup>92</sup>

The *In re Antar*<sup>93</sup> court held that a creditor's attorney's fees and costs related to uncovering undisclosed assets of the debtor would be allowed despite the failure to obtain court authority to undertake the actions.<sup>94</sup> While the court pointed out the importance of insuring that a debtor receives the benefit of the Bankruptcy Code protections, the court reasoned:

[T]his Court also realizes that a viable alternative available to this Court and the Trustees is to welcome the assistance of creditors who are willing to undertake the burden, financially and otherwise, of investigating the financial affairs of the debtor for the purposes of uncovering undisclosed assets as well as prosecuting causes of action which maintain the integrity of this Court. To not allow, under the appropriate circumstances, creditors and their counsel to recover fees and costs incurred and paid with relation to this investigation and prosecution of action would

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87. *Id.* at 118.

88. *Id.*

89. *Id.*

90. *Id.*

91. *In re Johnson*, 72 B.R. at 118-19.

92. *Id.* at 119 n.1 (citing *In re Beck-Rumbaugh Assocs.*, 68 B.R. 882 (Bankr. E.D. Pa. 1987) and *In re George*, 23 B.R. 686 (Bankr. S.D. Fla. 1982)).

93. 122 B.R. 788 (Bankr. S.D. Fla. 1990).

94. *Id.* at 791.

have a chilling effect upon creditor participation within a bankruptcy proceeding.

This Court is aware that not every instance and circumstance should warrant a retroactive allowance and authorization for counsel fees for a creditor's counsel pursuant to 11 U.S.C. Section 503(b), but the appropriate circumstances exist in this proceeding for the allowance of same upon a retroactive basis.<sup>95</sup>

Another court permitted a creditor's attorney to recover reasonable fees despite the absence of prior employment authorization. The trustee in *In re Zedda*<sup>96</sup> agreed that a creditor's attorney's work led to the entry of a judgment in favor of the estate in the amount of \$54,383.57.<sup>97</sup> Because of the substantial benefit to the estate, the creditor's attorneys sought recovery of their expenses in association with the work performed. In making its decision allowing recovery, the court analyzed the issue of whether creditors should be compensated for services beneficial to the entire estate. The court examined both cases allowing creditor compensation for services without any sort of prior court authorization and cases denying fees under similar circumstances.<sup>98</sup> The *Zedda* court sided with courts allowing the creditor to recover as better reasoned. While the court acknowledged that retroactive authorization for attorney's fees for a creditor's attorney should not be granted in every instance, recovery in the *Zedda* case was justified because the attorney's services substantially benefitted the estate and assisted in the recovery of assets to the estate.<sup>99</sup>

One court has adopted a required approval approach for an altogether different reason. In *In re Marcus*,<sup>100</sup> the bankruptcy court declined to approve attorney's fees related to a successful discharge action because prior approval was not sought by the creditor. The basis stated for this rigid approach was that "creditors should be allowed to recover assets for the estate only if the trustee in bankruptcy is unwilling to act."<sup>101</sup> In *Marcus*, no proof was offered that the trustee failed to act (pursue a discharge action), and, therefore, allowance as administrative expense was denied.<sup>102</sup>

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95. *Id.*

96. 169 B.R. 605 (Bankr. E.D. La. 1994).

97. *Id.* at 607.

98. *Id.*

99. *Id.* at 608.

100. No. 84 B 20015, 1987 Bankr. LEXIS 2424 (Bankr. S.D.N.Y. Aug. 24, 1987).

101. *Id.* at \*4.

102. Presumably the bankruptcy court would have known whether the trustee filed, settled, or litigated a discharge complaint. Strangely, the case turned on a burden of proof issue that could have been the subject of judicial notice of this particular court.

Other courts have firmly denied compensation under subsection 503(b)(3)(B) because the mandate for prior court approval is clear.<sup>103</sup> In *Fall*, the court cited "early court control" as a basis for adhering to the statutory requirement for court approval.<sup>104</sup> Additionally, the court refused to grant *nunc pro tunc* approval to allow the expenses retroactively because "such orders are not appropriate even if rarely granted under other circumstances."<sup>105</sup>

In *Monahan*, an unsecured creditor's attorney succeeded in litigation objecting to a pension plan exemption. No prior court approval was sought by the creditor for employment of the attorney to pursue possible assets for the case. Citing cases both approving and denying similar requests, the *Monahan* court denied compensation based on the plain language requirement for prior approval.<sup>106</sup> Additionally, because the pension plan money was openly scheduled as an exempt asset, thus not concealed or transferred in the ordinary sense of those terms,<sup>107</sup> another statutory requirement was missing.

Rejecting the *George* decision, the *Romano* court examined pre-Code cases and compared the legislative changes in subsection 503(b)(3)(B) and its predecessor statutes. Reasoning that the predecessor statute, section 64 of the Act, did not require prior court approval, and that attorneys are charged with the knowledge that prior approval is necessary under the Code before embarking on tasks, the court denied recovery under subsection 503(b)(3)(B).<sup>108</sup>

While no reported Eighth Circuit or Arkansas decisions currently exist, several related cases might be somewhat instructive to creditors in this jurisdiction. The concept of retroactive authorization or the entry of a *nunc pro tunc* order has been discussed by Arkansas courts in the context of 11 U.S.C. § 327(a) for the employment of attorneys and professionals for noncreditor entities. This subsection is similar to subsection 503(b)(3)(B) in that it provides that "the trustee [or debtor in possession], with the court's approval, may employ one or more attorneys[.]" indicating prior approval must be obtained.<sup>109</sup> While court approval appears to be required under this

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103. See *In re Fall*, 93 B.R. 1003, 1012 (Bankr. D. Or. 1988); *In re Monahan*, 73 B.R. 543, 544 (Bankr. S.D. Fla. 1987); *In re Romano*, 52 B.R. 590, 593 (Bankr. M.D. Fla. 1985); *Lazar v. Casale (In re Casale)*, 27 B.R. 69, 70 (Bankr. E.D.N.Y. 1983) (denying fees but finding costs possibly allowed upon compliance with other statutes).

104. *In re Fall*, 93 B.R. at 1012.

105. *Id.* at 1012 n.8.

106. *In re Monahan*, 73 B.R. at 544.

107. *Id.*

108. *In re Romano*, 52 B.R. 590, 593 (Bankr. M.D. Fla. 1985).

109. 11 U.S.C. § 327(a) (1994) (emphasis added).

statute, at least one Arkansas court has recognized that “[u]nder certain circumstances, the bankruptcy court has discretion within its equity powers to enter an order *nunc pro tunc* authorizing employment of a professional under section 327.”<sup>110</sup> Also, in *In re Westside Creek Ltd. Partnership*,<sup>111</sup> an Arkansas bankruptcy court noted its power “to relieve an attorney from the harsh result of the rule by the entry of a *nunc pro tunc* order if no order was originally obtained.”<sup>112</sup> While these cases do not address subsection 503(b)(3)(B) specifically, they do provide support for obtaining retroactive authorization for employment.

The cases regarding prior court approval are not consistent. Some adhere to the necessity for employment authorization, while others require approval to bring actions or recover fees. Other courts equitably award compensation under the “do right” rule by ignoring the statutory language and awarding *nunc pro tunc* approval of employment, compensation, or actions taken.

### 3. 11 U.S.C. § 503(b)(3)(C) and (b)(4)—*Administrative Payments for Prosecuting a Criminal Offense*

Subsections 503(b)(3)(C) and 503(b)(4) of the Bankruptcy Code allow a creditor to recover “actual, necessary expenses,” including reasonable compensation paid to an attorney, in “connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor.”<sup>113</sup> Under the prior Bankruptcy Act, subsection 64(a)(3) gave priority status to the “reasonable cost and expenses” of creditors through whose efforts and expense “evidence shall have been adduced resulting in the conviction of any person of an offense.” By its clear language, the prior Act authorized reimbursement only if a conviction resulted from the creditor’s efforts. Subsection 503(b)(3)(C) is broader than the prior Act in that it does not expressly require a conviction in order for the creditor to be reim-bursed.<sup>114</sup>

In the only reported decision under subsection 503(b)(3)(C), the bankruptcy court in *In re Fall*<sup>115</sup> addressed recovery of a creditor’s attorney’s fees under that subsection. Initially, the court provided that the

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110. *Merchants & Farmers Bank v. Hill*, 122 B.R. 539, 544 (E.D. Ark. 1990).

111. 93 B.R. 177 (Bankr. E.D. Ark. 1988).

112. *Id.* at 179 n.2.

113. 11 U.S.C. § 503(b)(3)-(4) (1994).

114. *In re Fall*, 93 B.R. 1003, 1012 (Bankr. D. Or. 1988).

115. 93 B.R. 1003 (Bankr. D. Or. 1988).

extent to which a creditor's actions must directly contribute to the prosecution of a criminal offense was unclear from the language of the Code.

The phrase "in connection" could encompass a wide variety of activities. Its use suggests a legislative intent that a creditor whose activities can be shown to have contributed in any direct way to the results which led to prosecution of a criminal offense, whether or not resulting in conviction, may have its expenses allowed.<sup>116</sup>

In *Fall*, as a result of the creditor's and the trustee's investigations, a report was submitted to the U.S. Attorney's office, which then planned to convene a grand jury to review alleged bankruptcy crimes by the debtor.<sup>117</sup> The court authorized recovery in *Fall* under subsection 503(b)(3)(C) for certain expenses by finding that the creditor's attorney had incurred fees and expenses in connection with the prosecution of a criminal offense as required by subsections 503(b)(3)(C) and 503(b)(4). The court stated that "[a]ll investigations made, information revealed, litigation filed and prosecution pursued were the result of [the creditor's] early and forceful intervention and its willingness to fund continued inquiry."<sup>118</sup>

Under *Fall*, actions of a creditor and counsel involving actual fraudulent transfers,<sup>119</sup> bad faith discharge and dischargeability complaints,<sup>120</sup> or false oaths discovered at first meetings or at Rule 2004 examinations, could all be reimbursed as allowed expenses under subsections 503(b)(3)(C) and 503(b)(4). The necessity for a criminal prosecution of *anyone* in connection with the case or with the debtor's property is largely out of the creditor's control. However, bankruptcy judges, receivers, or trustees having reasonable belief that the bankruptcy laws have been violated, or that an investigation should start, are required to refer the matter to the U.S. Attorney.<sup>121</sup> The U.S. Attorney is likewise required to inquire about the facts and report to the bankruptcy judge. A grand jury must be convened if it is "probable" that an offense has been committed.<sup>122</sup> These statutes may facilitate a creditor's recovery for fees and costs for investigations and

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116. *Id.* at 1012.

117. *Id.* at 1007.

118. *Id.* at 1013.

119. Section 548 provides for both actual and constructive fraud, as do most state fraudulent conveyance statutes made applicable through incorporation under § 544(b). Fraud under 11 U.S.C. § 548(a)(1) requires actual intent to hinder, delay, or defraud a creditor that may serve as a basis for investigation for indictment under one of the bankruptcy crimes statutes (18 U.S.C. § 152 (1994)) or other state or federal criminal statutes. 11 U.S.C. § 548 (1994).

120. *See* 11 U.S.C. §§ 523, 727 (1994).

121. 18 U.S.C. § 3057(a) (1994).

122. *Id.*

possibly litigation related to possible crimes under subsections 503(b)(3)(C) and 503(b)(4), but they do not guarantee payment.

### III. CONCLUSION

For a creditor to maximize chances of recovery of anticipated fees and costs or already-expended funds, a few practical suggestions follow. If there is a trustee in the case, the creditor's counsel must explore the possibility of becoming counsel to the trustee so that recovery can be sought under 11 U.S.C. §§ 503(b)(2) and 330(a) as compensation for a professional employed by the trustee. The standard for recovery then becomes one of reasonableness of the actual and necessary fees and expenses incurred.

If becoming counsel to the trustee is not applicable or impractical, before one ever undertakes to engage in the representation, counsel should become familiar with the applicable jurisdiction's tests for administrative expense allowance and discover whether the literal language of the 503 subsections is followed by the circuit or lower courts. The goal is to try to pigeonhole the services into one or more of the articulated subsections requiring administrative expense allowance as interpreted by each court. Alternatively, counsel should analyze whether the applicable jurisdiction grants administrative expenses outside the mandated expense provided under § 503.

In jurisdictions where little or no case law exists, counsel should file something, anything, to secure a ruling on whether there is a necessity for "prior court approval" and, if so, the scope of the approval. This pleading may be related to becoming "forced" counsel to the trustee or simply requesting declaratory relief. The objective is to apprise the bankruptcy judge of the problem and the triangle in which the creditor finds itself—torn between the vague statute, the perceived necessity to act, and the desire for reimbursement for taking action.

In addition, solicitation of support from the U.S. Trustee and the appointed panel trustee, if applicable, for a creditor's legal position and the activity being undertaken may prove helpful. A creditor's attorney may estop these interested parties from later objecting to administrative allowance of fees and costs if the creditor's actions are fully disclosed to both the U.S. Trustee and the panel trustee, before the actions are taken. The same disclosure of creditor activity may be made to other creditors to prevent or estop an objection to an administrative claim for fees and costs.<sup>123</sup> However,

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123. Caution should be exercised not to violate an attorney-client or work product privilege when communicating with third parties about strategy or discovered information.



nothing prevents the bankruptcy judge from *sua sponte* objecting to an administrative expense request even if no other party in interest objects. Therefore, the creditor must be prepared to defend its request against an objection by the court.

Attorneys should place themselves in a position to advise creditor clients of the process, procedure, and chances of recovery under § 503. Full disclosure of the possible obstacles for recovery of an administrative expense at the outset of representation can prevent false expectations by the creditor for recoupment of fees and costs expended. This will also allow the creditor to project more accurately the estimated costs of its participation in the bankruptcy proceeding and decide whether it desires to participate.