Toward A More Reasoned Approach To The Priority of Attorneys' Fees in Bankruptcy

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TOWARD A MORE REASONED APPROACH TO THE PRIORITY OF ATTORNEYS' FEES IN BANKRUPTCY

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I. INTRODUCTION

2006 and 2007 saw an unprecedented rise in the number of home mortgage foreclosures across the country, and this trend is likely to continue for some time. These massive foreclosures, brought on largely by the failure of the sub-prime mortgage market, have had a crippling effect on the United States economy. One significant outcome of this economic disaster is its crushing impact on the country's bankruptcy system. In fact, experts predict that the housing crisis will force consumers to file for bankruptcy protection in greater numbers than ever before. Some commentators have even suggested that recent changes in bankruptcy law may have played a role in precipitating the mortgage loan crisis.

In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection

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Act, which was designed to reduce abuse of the bankruptcy process and force more debtors to pay their debts rather than having them discharged in bankruptcy. Yet despite this sweeping bankruptcy reform legislation, more debtors are filing bankruptcy each year. In April, 2008, for example, consumer bankruptcy filings had increased by more than forty-seven percent over the same time in 2007. Similarly, 2007 saw a thirty-eight percent increase in consumer bankruptcy filings over 2006, while business bankruptcies increased forty-four percent during the same period. It is no surprise, then, that bankruptcy courts face an ever increasing caseload burden, which results in decreased efficiency and skyrocketing administrative costs. With such a burden facing the country's bankruptcy courts, it is imperative that Congress step in to resolve many of the complex issues of statutory interpretation in the Bankruptcy Code with which the courts are grappling.


WILLIAM HOUSTON BROWN & LAWRENCE R. AHERN III, 2005 BANKRUPTCY REFORM LEGISLATION WITH ANALYSIS 2D, § 8:1 (Thomson/West 2006); see also Press Release, White House Press Office, President Signs Bankruptcy Abuse Prevention, Consumer Protection Act (Apr. 20, 2005), available at http://www.whitehouse.gov/news/releases/2005/04/20050420-5.html. (“In recent years, too many people have abused the bankruptcy laws. They’ve walked away from debts even when they had the ability to repay them . . . Under the new law, Americans who have the ability to pay will be required to pay back at least a portion of their debts.”).

Appleson, supra note 5.


Business Filings Up 44% in 2007, BANKR. CT. DECISIONS, Apr. 29, 2008, at 1,4-5.

See, e.g., Matt Evans, Bankruptcy Reform May Hinder Court, Pro Bono Work, THE BUS. J. OF THE GREATER TRIAD AREA, July 31, 2005, available at http://msnbc.msn.com/id/8783273/ ("[N]o additional funds have been allocated to the courts to help absorb the increased demands."). In addition to skyrocketing court costs, BAPCPA has been predicted to nearly double the fees that attorneys charge to file a bankruptcy petition on behalf of a debtor. See Lorene Yue, Bankruptcy Reform Bill to Toughen Consumers’ Climb Out of Debt, CHI. TRIB., Mar. 27, 2005, available at http://www.chicagotribune.com/business/yourmoney/sns-yourmoney-0327onhemenoney.0,6472494.story.

One issue of major significance is how debtors' attorneys are compensated in bankruptcy. Over the past four years, the Supreme Court has twice had occasion to visit the issue of attorneys' fees in bankruptcy. In *Travelers Casualty & Surety Co. Of America v. Pacific Gas & Electric Co.*, the Supreme Court overruled the Ninth Circuit's decision in *Fobian v. W. Farm Credit Bank (In re Fobian)*, in which the Ninth Circuit had held that unsecured creditors could not collect post-petition attorneys' fees incurred in litigating issues of federal bankruptcy law, even though they could collect fees for litigating issues of state statutory law or contract law. The Supreme Court held that the Bankruptcy Code provided no statutory basis for such a distinction and struck down the longstanding *Fobian* rule.

In its second case addressing the treatment of attorneys' fees in bankruptcy, the Supreme Court handed down its decision in *Lamie v. United States Trustee* on January 26, 2004. In *Lamie* the Court resolved a conflict among the circuits on the proper priority to be granted to debtors' attorneys' fees in bankruptcy. In reaching its decision, the Court was forced to grapple with whether a 1994 Congressional amendment to section 330 of the Code was intentional, or instead was merely a scrivener's error. The amendment eliminated priority treatment for

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16 *Id.* at 1153.

17 *Travelers*, 127 S. Ct. at 1206. The Supreme Court refused, however, to address whether other principles of bankruptcy law disallowed unsecured creditors’ post-petition attorneys’ fees to be added to the creditors’ unsecured claim against the bankruptcy estate. *Id.* at 1207-08; *see also* Mark S. Scarberry, *Interpreting Bankruptcy Code Sections 502 and 506: Post-Petition Attorneys’ Fees in a Post-Travelers World*, 15 Am. Bankr. Inst. Law Rev. 611, 612 (2007).


19 *See infra* notes 108-28 and accompanying text.

20 *Lamie*, 540 U.S. at 530-39; *see also infra* notes 111-26 and accompanying text.
debtors' attorneys' fees in Chapter 7 and 11 bankruptcy proceedings, but not in Chapter 12 or 13 proceedings. The Supreme Court held that the attorneys' fees were not entitled to administrative priority treatment under the Bankruptcy Code. The Lamie decision had a significant impact on how debtors' attorneys would be compensated in bankruptcy.

Much has been written about the post-petition attorneys' fees issue that the Court addressed in Travelers, yet there is a void in the academic literature regarding the priority granted attorneys' fees in the aftermath of Lamie, despite the fact that it was decided three years before Travelers. This Article seeks to fill that void. Part II details the statutory provisions governing the administrative priority, with special emphasis on the amendments made to section 330 of the Bankruptcy Code in 1994. Part III then addresses the conflicting case law on the priority issue, examining the three courts of appeals cases that held that the 1994 amendments to the Code were the result of a scrivener's error, and the three courts of appeals cases that enforced the statutory changes as drafted. Part IV of the Article examines the Supreme Court's decision in Lamie from a statutory interpretation standpoint. Part V traces the history of the administrative priority, as well as the policy justifications for the Bankruptcy Code's priority rules. Arguing that debtors' attorneys' fees fall outside the policy underpinnings of the administrative priority, the Article proposes a statutory amendment to the Bankruptcy Code to clarify the treatment of attorneys' fees in bankruptcy and resolve this thorny issue of statutory interpretation. The Article

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22 Lamie, 540 U.S. at 538-39; see also infra notes 127-28 and accompanying text.

concludes that Congressional adoption of this amendment will be a small step toward easing the burden on the country's bankruptcy courts so that they can operate more efficiently during these difficult economic times.

II. A STATUTORY FRAMEWORK FOR THE PRIORITY AFFORDED ATTORNEYS' FEES IN BANKRUPTCY

When a debtor files for bankruptcy protection under the Bankruptcy Code, an estate is created by operation of law.24 The estate is composed of all of the debtor's pre-petition property, with certain very limited exceptions.25 This property, which is referred to as property of the estate, is sold in a chapter 7 bankruptcy proceeding, and the proceeds are distributed to creditors in a specified order. In chapter 11 and 13 bankruptcy proceedings, the debtor generally retains property of the estate and uses post-petition assets to pay its creditors, again in similar order. The debts of unsecured creditors are paid pro rata, unless those creditors hold claims entitled to priority under section 507 of the Bankruptcy Code. Creditors holding priority claims are paid before general unsecured creditors, in accordance with their specified order of priority. Thus, unsecured creditors holding first priority claims are entitled to full payment of their claims before unsecured creditors holding lower priority claims receive payment. If there are insufficient assets to pay a class of priority claimants in full, they are entitled to payment pro rata based on the amount of their claims. Because debtors rarely have enough assets to pay all of their creditors in full, it is very important that a creditor be able to establish that it holds a claim entitled to priority under the Bankruptcy Code.

25 See id. § 541(b), (c)(2).
The Code establishes ten classes of priority claims.\textsuperscript{26} This Article will focus on the second category of priority claims, which includes “administrative expenses allowed under section 503(b) of this title.”\textsuperscript{27} The policy justification for allowing administrative expenses high priority is because the bankruptcy estate must pull its own weight, and granting administrative expenses second priority will ensure that the trustee is able to expend sums to administer the estate in a manner that maximizes its value for the benefit of all creditors.\textsuperscript{28} Thus, administrative expenses enumerated in section 503(b) of the Bankruptcy Code include wages to employees for services that they render to the debtor after the bankruptcy proceeding is filed, taxes incurred by the estate, including penalties on such taxes, expenses incurred by creditors in recovering assets hidden by the debtor, and “compensation and reimbursement awarded under section 330(a) of this title.”\textsuperscript{29}

It is section 330(a) that is the subject of this Article. As originally enacted in 1978, section 330(a)(1) provided that “the court may award to a trustee, to an examiner, or to a

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\item \textsuperscript{26} 11 U.S.C. § 507(a)(1)-(10) (West Supp. 2007). The first category of priority claims includes domestic support obligations. Second priority is granted to administrative expenses of the bankruptcy estate. Creditors holding claims for debts arising after a debtor is forced into an involuntary bankruptcy proceeding but before the case is determined to have been properly filed are entitled to third priority. Fourth priority is granted to certain employee wages earned within 180 days before an employer's bankruptcy filing. Certain contributions to employee benefit plans are accorded fifth priority, and claims of farmers and fishermen, up to a specified statutory maximum, are granted sixth priority. Individuals holding unsecured claims of up to $2225 (indexed for inflation) on certain types of security deposits are entitled to seventh priority. Eighth priority claims include a wide variety of tax claims, including income taxes, property taxes, excise taxes, and trust fund taxes. Ninth priority is granted to certain claims of federal depository institutions, and personal injury and wrongful death claims arising out of a debtor's use of a motor vehicle or boat while the debtor was intoxicated from alcohol or drugs are entitled to tenth priority. \textit{Id.}
\item \textsuperscript{27} 11 U.S.C. § 507(a)(2) (West Supp. 2007). Second priority administrative expenses also include “charges assessed against the estate under chapter 123 of title 28.” \textit{Id.} Expenses falling within this category are not the subject of this Article.
\item \textsuperscript{28} See, e.g., VI \textsc{James M. Henderson}, \textsc{A Treatise On The Bankruptcy Law Of The United States} 165 (5\textsuperscript{th} Ed. Lawyers Co-Operative Publishing 1952); \textit{In re Cochise Coll. Park}, 703 F.2d 1339, 1355 (9\textsuperscript{th} Cir. 1983); \textit{In re Tebo}, 101 F. 419, 420 (D.W. Va. 1900).
\item \textsuperscript{29} 11 U.S.C. § 503(b)(1)-(8) (West. Supp. 2007). Section 503(b)(4) provides for administrative priority treatment for compensation of attorneys, but only those who render services to creditors who act in a manner that benefits the bankruptcy estate, such as prosecuting a criminal offense with respect to the debtor's business or property, because such actions benefit all creditors, and not merely the creditor incurring the costs of prosecution. Accordingly, attorneys' fees awarded under section 503(b)(4) do not encompass the attorneys' fees for the debtor.
\end{itemize}
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 . . . and (2) reimbursement for actual, necessary expenses.”

Case law under section 330(a) was nearly uniform in holding that a debtor's attorneys' fees were entitled to administrative priority under the Bankruptcy Code, so long as the fees either benefitted the bankruptcy estate or were necessary for the proper administration of the bankruptcy case.31

Congress amended section 330(a) dramatically in 1994, deleting the debtor's attorney from the list of professionals entitled to administrative priority treatment under the Code.32 As amended in 1994, section 330(a) stated, in pertinent part, that “the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103— (A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and (B) reimbursement for actual, necessary expenses.”

Although any reference to the debtor's attorney

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30 11 U.S.C. § 330(a) (2000) (repealed 2005) (emphasis added). Section 327 of the Bankruptcy Code provides that "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 . . . in carrying out a trustee's duties under this title." 11 U.S.C. § 527(a) (West Supp. 2007).


(a)(1) [T]he court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103—

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner,
was repealed from the general language of section 330(a)(1), notice that Congress retained a reference to an attorney in section 330(a)(1)(A). Moreover, there is a missing disjunction between examiner and professional person in section 330(a)(1). These disparities have provided debtors' attorneys ammunition for arguing that Congress's elimination of debtors' attorneys from the list of professionals entitled to administrative priority was inadvertent, as discussed in greater detail in the following section.

However, another provision added by the 1994 amendments works against attorneys' arguments that the elimination of the phrase “or the debtor's attorney” was inadvertent. As part of the 1994 changes, Congress significantly expanded section 330, providing that a bankruptcy court is not entitled to allow compensation for services not “reasonably likely to benefit the debtor's estate or necessary to the administration of the case.”

It carved out an exception to this rule, however, for reasonable compensation of an individual debtor's attorney in chapter 12 and chapter 13 cases. This provision suggests that Congress intended that only chapter 12 and 13 attorneys are entitled to administrative priority for their fees in representing a debtor in bankruptcy, and then only if the debtor is an individual.

Following the bankruptcy amendments of 1994, there have been two attempts to amend

ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

11 U.S.C. § 330(a)(1)(A)-(B) (West Supp. 2007). This amendment, however, does not affect the attorneys' fees issue discussed in this Article.


In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.
section 330 to include the debtor's attorney to the list of administrative priority claimants. In 1996 Senate Bill 1559, entitled the Bankruptcy Technical Corrections Act of 1996,\textsuperscript{36} passed the Senate on August 2, 1996 by a unanimous vote.\textsuperscript{37} It was then received into the House of Representatives, but no action was taken on the bill in the House.

The following year, two bills were introduced in the House, House Bill 120\textsuperscript{38} and House Bill 764.\textsuperscript{39} Both proposed that the language “or the debtor’s attorney” be added back into section 330(a)(1) of the Bankruptcy Code. In June of 1997, the House Subcommittee on Commercial and Administrative Law amended House Bill 764 to reconcile the differences between it and its sister bill, H.R. 120.\textsuperscript{40} House Bill 764 passed the House by voice vote,\textsuperscript{41} but died when it reached the Senate.

It is interesting to note, however, that later in 1997 Senator Grassley introduced Senate Bill 1301, which incorporated much of House Bill 764, but did not include the amendment to add debtors’ attorneys’ fees back into section 330. It appears from Senator Grassley’s remarks in introducing the bill that this omission was intentional:

“I believe that Congress needs to look long and hard at the way

\textsuperscript{36} S. 1559, 104\textsuperscript{th} Cong, 2d Sess. 4 (1996). Section 4 of the Act proposed that section 330 of the Bankruptcy Code be amended to insert the phrase “or the debtor's attorney” after “1103.”

\textsuperscript{37} 143 CONG. REC. D1272-01, 1997 WL 705065.

\textsuperscript{38} H.R. 120, 105\textsuperscript{th} Cong, 1\textsuperscript{st} Sess. 7 (1997). House Bill 120 was drafted by the minority party and was introduced and sponsored by Representative John Conyers. H.R. REP. NO. 845, 105\textsuperscript{th} Cong., 2d Sess. 116 (1999).

\textsuperscript{39} H.R. 764, 105\textsuperscript{th} Cong, 1\textsuperscript{st} Sess. 4 (1997). House Bill 764 was drafted by the House's majority party and was sponsored by Representatives Henry Hyde, George Gekas, and Bill McCollum. H.R. REP. NO. 845, 105\textsuperscript{th} Cong., 2d Sess. 116 (1999). The purpose of H.R. 764 was primarily to make “technical corrections which are intended to clarify original intent, correct drafting defects, and improve grammar and cross-references in the Bankruptcy Code.” 143 CONG. REC. H 10661 (Nov. 12, 1997) (remarks of Rep. Gekas).

\textsuperscript{40} H.R. REP. NO. 845, 105\textsuperscript{th} Cong, 2d Sess. 117 (1999).

\textsuperscript{41} Id.
attorneys are compensated in bankruptcy. It seems to me, from the reports I receive from around the country, that attorneys are using up the assets of the bankruptcy estate without really contributing very much. And attorney's fees are paid ahead of—and at the expense of—schools, workers, and children entitled to support. I think that's something we need to change.\footnote{143 CONG. REC. S9406 (Sept. 16, 1997) (remarks of Sen. Grassley).}

Thus, not only did the 1994 amendments to the Bankruptcy Code raise significant issues of statutory interpretation, but subsequent Congressional action (or inaction in this case) merely served to exacerbate the problems caused by these amendments. It is not surprising, then, that courts attempting to interpret section 330 after 1994 have reached conflicting conclusions, as discussed in greater detail below.

\section*{III. CONFLICTING CASE LAW ON THE ATTORNEYS' FEES ISSUE}

The issue of the priority of a debtor's attorneys' fees in bankruptcy has resulted in a classic split among the circuit courts of appeals. The Fourth, Fifth, and Eleventh Circuits have held that the 1994 amendments to the Bankruptcy Code preclude first priority treatment to a debtor's attorney in both Chapter 7 and 11 proceedings.\footnote{See United States Tr. v. Equip. Servs., Inc. (\textit{In re} Equip. Servs., Inc.), 290 F.3d 739, 745 (4th Cir. 2002), \textit{cert. granted}, Lamie v. United States Tr., 538 U.S. 905 (2003); In re Top Grade Sausage, Inc., 227 F.3d 123, 130 (3d Cir.2000), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004); United States Tr. v. Garvey, Schubert & Barer (\textit{In re} Century Cleaning Servs., Inc.), 195 F.3d 1053, 1061 (9th Cir. 1999), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004); \textit{In re} Ames Dep't Stores, Inc., 76 F.3d 66, 71-72 (2d Cir. 1996), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004).} Conversely, the Second, Third, and Ninth Circuits have treated debtor's attorneys' fees in Chapter 7 and 11 proceedings as first priority administrative expenses on the grounds that the 1994 amendments to the Bankruptcy Code, which excluded such attorneys' fees from priority treatment, were the result of a scrivener's error.\footnote{See \textit{In re} Top Grade Sausage, Inc., 227 F.3d 123, 130 (3d Cir.2000), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004); United States Tr. v. Garvey, Schubert & Barer (\textit{In re} Century Cleaning Servs., Inc.), 195 F.3d 1053, 1061 (9th Cir. 1999), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004); \textit{In re} Ames Dep't Stores, Inc., 76 F.3d 66, 71-72 (2d Cir. 1996), \textit{abrogated} by Lamie v. U.S. Tr., 540 U.S. 526 (2004).} Each of these positions will be examined in further detail below.
A. Cases Allowing Priority Treatment to Attorneys' Fees

The first court of appeals to reach the issue of whether attorneys' fees are entitled to first priority treatment in bankruptcy as administrative expenses was the Second Circuit in *In re Ames Department Stores, Inc.*\(^45\) The facts of *Ames* are somewhat complicated. In the course of representing Ames Department Stores in a Chapter 11 reorganization, the highly regarded firm of Skadden, Arps, Slate, Meagher & Flom sought to terminate the company's group life insurance plan.\(^46\) Although Ames possessed the contractual right to terminate the plan, Section 1114 of the Bankruptcy Code made it difficult to terminate such plans, establishing specific procedures for the modification of employee benefits in bankruptcy.\(^47\) Skadden filed the motion to terminate the plan without regard to Section 1114 and the bankruptcy court denied its motion, stating that there was no doubt that Section 1114 applied to the plan's termination.\(^48\) Skadden appealed the bankruptcy court's decision to the district court, which not only affirmed the ruling, but also stated further that Skadden should not receive any fees for its work on the appeal because the appeal was frivolous and was designed merely to artificially raise Skadden's fees in the bankruptcy proceeding.\(^49\)

After the reorganization plan for Ames was approved by the bankruptcy court, Skadden filed a fee application for its services rendered during the reorganization. Following the

\(^{45}\) *In re Ames Dep't Stores, Inc.*, 76 F.3d 66 (2d Cir. 1996).

\(^{46}\) *Id.* at 68.


\(^{48}\) *Ames*, 76 F.3d at 69. The bankruptcy court issues its ruling from the bench, and the ruling was not published.

\(^{49}\) *Id.* The district court's ruling was also unpublished.
instructions of the district court, the bankruptcy court disallowed $35,000 in fees associated with the earlier appeal. Skadden appealed the bankruptcy court's order to the district court, which, again, affirmed the order.\(^5\) Skadden then appealed the issue to the Second Circuit Court of Appeals regarding the propriety of the district court's refusal to grant its attorneys' fees. The Second Circuit found that the district court failed to specify any authority for imposition of sanctions on Skadden or to provide due process by way of notice and opportunity to be heard.\(^5\) The Second Circuit also found that Skadden's conduct was not sanctionable because the applicability of Section 1114 of the Bankruptcy Code to the company's group life insurance plan was “a wide open question.”\(^5\)

The Second Circuit next addressed Skadden's request that its fees be granted first priority as administrative expenses under Section 330 of the Code. The court acknowledged that “debtors' attorneys were not specifically included in the coverage of amended Section 330,” but then agreed with Collier on Bankruptcy that the omission was inadvertent.\(^5\) The Second Circuit ultimately held, however, that its decision did not turn on whether the omission of debtors' attorneys from Section 330 was inadvertent, because if the facts of the case before it indicated that Skadden's services benefitted the bankruptcy estate, they would have been compensable as administrative priority expenses under Section 330 of the Bankruptcy Code even if the omission were not inadvertent.\(^5\)


\(^5\) Ames, 76 F.3d at 70.

\(^5\) Id. at 71.

\(^5\) Id. (citing 2 Collier on Bankruptcy ¶ 330.01, at 330-8-9; ¶ 330.04, at 330-41-43).

\(^5\) Id. at 71 (citing In re Taxman Clothing Co., 49 F.3d 310, 315 (7th Cir. 1995)).
Three years after the Second Circuit's decision in *Ames*, the Ninth Circuit had occasion to revisit the issue in *United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Services, Inc.)*. In the case, Century Cleaning Services filed a Chapter 11 bankruptcy petition and hired the law firm of Garvey, Schubert & Barer to represent it in the proceeding. Garvey petitioned the bankruptcy court to serve as counsel for Century as debtor-in-possession, and its application was granted. At the time of the Chapter 11 filing, Garvey had already been compensated fully for its pre-petition services. The case was then converted to a Chapter 7 proceeding and the bankruptcy court appointed a trustee to administer the debtor's bankruptcy estate, but Garvey continued to provide legal services for its client, Century, “including filing the conversion petition, preparing schedules, amended reports, a statement of affairs, and a Rule 2015 report, communicating with creditors, and participating in 2004 examinations.” Garvey failed to apply to the court for reappointment in Century's Chapter 7 proceeding.

When Garvey filed its fee application for services performed during the pendency of the Chapter 7 proceeding, the trustee objected to its application, and the bankruptcy court ruled in favor of the trustee, holding that the plain language of the statute did not authorize payment. The Bankruptcy Appellate Panel affirmed the bankruptcy court's decision, and Garvey appealed the decision to the Ninth Circuit.

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55 *U.S. Tr. v. Garvey, Schubert & Barer (In re Century Cleaning Servs., Inc.),* 195 F.3d 1053 (9th Cir. 1999).

56 *Id.* at 1054.


58 *Century Cleaning Servs.,* 195 F.3d at 1055.

59 *Century Cleaning Servs.,* 202 B.R. at 151.

After reviewing the 1994 amendments to Section 330 of the Bankruptcy Code, the Ninth Circuit overturned the decisions of the lower courts, holding that Garvey was eligible for compensation as an administrative priority under the Bankruptcy Code. The court determined that the statute was ambiguous because there was an internal conflict between Section 330(a)(1), which excluded the phrase “or to the debtor's attorney” and Section 330(a)(1)(A), which included the debtor's attorney within the ambit of compensable administrative priority expenses. This ambiguity, according to the court, allowed it to examine the statute's legislative history. The court concluded that the legislative history supported the proposition that the omission of a debtor's attorney fees in Section 330(a)(1) was a drafting error. The court noted that, before the amendment, the sentence was not ambiguous and both portions of the provision included reference to the debtor's attorney, as was true with the original version of the 1994 amendments when they were first introduced in Congress. After examining the history of the amendment to Section 330(a)(1), the court noted that the section was amended by Senator Metzenbaum to consolidate the new subsection that provided for objections by the United States Trustee with another similar provision, and not to eliminate a debtor's attorney from the list of compensable professionals. The court observed that the material that was moved was directly before the words “or to the debtor's attorney” and that the deletion of that phrase when the words preceding it were moved was most likely an “unintended slip of the pen" and not a deliberate omission.

61 Century Cleaning Servs., 195 F.3d at 1054.
62 Id. at 1057 (citing In re Miller, 211 B.R. 399, 401-02 (Bankr. D. Kan. 1997)).
63 Id. at 1058.
64 Id. at 1059; see also 140 CONG. REC. S4741-01(1994); 140 CONG. REC. S4405-06 (1994).
65 Century Cleaning Servs., 195 F.3d at 1060.
The Ninth Circuit also noted that, as a policy matter, eliminating a debtor's attorney from the list of compensable officers would make it more difficult for Chapter 7 debtors to obtain counsel. Moreover, the court concluded that such a significant change in the bankruptcy law would not have occurred without a mention of the change during the enactment of the 1994 amendments. Accordingly, the Ninth Circuit allowed Garvey to receive its fees as an administrative priority under Section 330 of the Bankruptcy Code.

The final circuit to address the priority issue was the Third Circuit in *In re Top Grade Sausage, Inc.* Top Grade Sausage, Inc. and Forist Distributors, Inc. were both New Jersey businesses owned and managed by the Lipari family. When the family patriarch amassed considerable debt defending himself from criminal prosecution, Top Grade and Forist voluntarily filed separate Chapter 11 petitions. The bankruptcy court administered the cases together, primarily because of the commonality of the parties involved and because the issues were substantially the same in both cases. The bankruptcy court granted the debtors' application for retention of Hellring, Lindeman, Goldstein & Siegal as their counsel. Because there was significant acrimony during the reorganization, Hellring was required to address many conflicts that arose. When the reorganization was unsuccessful, the bankruptcy court converted both cases to Chapter 7 proceedings. Hellring later filed an application for over $80,000 of attorneys’

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66 *Id.*

67 *Id.* at 1061. Judge Thomas dissented, arguing that the statute's plain language indicated that Congress intended to eliminate debtors' attorneys from the list of compensable officers under section 330 of the Bankruptcy Code. *Id.* at 1060-62.


69 *Id.* at 125-26.

70 *Id.* at 126.
fees as an administrative priority, and the bankruptcy trustee objected to the motion.\textsuperscript{71} After a hearing, the bankruptcy court disallowed the payment of fees or expenses by the estate to Hellring for services rendered during the attempted reorganizations, but did allow compensation for services rendered after the cases were converted to Chapter 7.\textsuperscript{72} The bankruptcy court reasoned that Hellring's services in the Chapter 11 proceeding duplicated the services rendered by the bankruptcy trustee.

After the district court affirmed the bankruptcy court's decision,\textsuperscript{73} Hellring appealed the decision to the Third Circuit, which examined Section 330 of the Bankruptcy Code in great detail, noting that the 1994 amendments were remarkable for two reasons. First, the debtor's attorney was removed from the list of officers eligible to receive compensation as an administrative priority.\textsuperscript{74} Second, the list of compensable officers was separated not by the term "or," but merely by a comma. The court stated that "[t]his omission renders the section grammatically unsound."\textsuperscript{75} The court found that the omission of the phrase "or the debtor's attorney" from Section 330 was ambiguous and inconsistent with other provisions within the same section of the Bankruptcy Code. It noted that the "most striking effect caused by the omission is on the internal consistency of § 330 itself . . . . As § 330 now reads then, the second half of the sentence seems to partially permit what the first half prohibits."\textsuperscript{76}

\textsuperscript{71} Id.

\textsuperscript{72} Id. at 126. The bankruptcy court issued its ruling from the bench, and the ruling was not published.

\textsuperscript{73} Id. at 127. The district court's ruling was also unpublished.

\textsuperscript{74} Id. at 127.

\textsuperscript{75} Id.

\textsuperscript{76} Id. at 128-29.
The Third Circuit also noted that section 330(a)(4)(B) allows for attorneys' fees for debtors in Chapter 12 and Chapter 13 proceedings if the debtor is an individual, and it discussed whether that provision limited the compensation of attorneys in Chapter 7 and Chapter 11 proceedings. The court held that the provision allowing attorneys' fees in Chapter 12 and Chapter 13 proceedings merely set forth a different standard for determining whether attorneys were entitled to reimbursement in those cases and did not suggest that other attorneys were not entitled to reimbursement. The court ultimately concluded that debtors' attorneys were entitled to receive their fees as a first priority administrative expense, but only if the attorneys' services were “reasonably likely to benefit the debtor's estate.” The court concluded that Hellring's services could have been performed by the trustee instead, and therefore were not compensable.

B. Cases Disallowing Priority Treatment to Attorneys' Fees

The Fifth Circuit was the first court of appeals to hold that a debtor's attorneys' fees were not entitled to first priority administrative treatment under the Bankruptcy Code after it was amended in 1994. In *Andrews & Kurth L.L.P. v. Family Snacks Inc. (In re Pro-Snax Distributors, Inc.)*, creditors of Pro-Snax Distributors forced the company into an involuntary

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77 *Id.* at 129-30. The Third Circuit suggested that other courts have concluded, based on section 330(a)(4)(B), that Chapter 7 and 11 attorneys are precluded from administrative priority treatment based on the statutory construction canon, *expressio unius est exclusio alterius*. *Id.* at 130 (citing *Century Cleaning*, 195 F.3d at 1057 n.3).

78 *Id.* at 130.

79 *Id.* at 132.

80 *Id.*

Chapter 7 bankruptcy proceeding on August 10, 1995. The court appointed an interim Chapter 7 trustee on August 31, 1995. Shortly thereafter, Pro-Snax Distributors converted the case to Chapter 11, and on October 16, 1995 the court appointed a permanent Chapter 11 bankruptcy trustee to oversee administration of the case. The debtor filed a plan of reorganization with the court; however, the court refused to confirm the reorganization plan based upon the objections of certain creditors. Thereafter, the creditors petitioned successfully to have the case reconverted to a Chapter 7 bankruptcy proceeding. The debtor's attorneys, Andrews & Kurth, filed a fee application with the bankruptcy court seeking payment of over $55,000 in fees and expenses for its representation of the debtor after the filing of the involuntary bankruptcy petition against it. The creditors maintained that the fees paid to the law firm should not be granted first priority as administrative expenses because such preferential treatment was barred by statute. The bankruptcy court ruled in favor of Andrews & Kurth on its fee application and awarded the firm its fees for the entire period that the case was in Chapter 11, including the time billed after the trustee was appointed, and for the time after the case was reconverted to a Chapter 7 proceeding. The creditors then filed an appeal in the United States District Court for the Northern District for Texas, which reversed the bankruptcy court's decision, holding that fees could not be awarded for the time after the Chapter 11 trustee had been appointed by the court. The district court held that the statute expressly precluded compensation of attorneys after the

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82 Id. at 416. Involuntary bankruptcy proceedings are governed by section 303 of the Bankruptcy Code. See 11 U.S.C. § 303 (2000).

83 Family Snacks, 157 F.3d at 417.

84 Id.


appointment of a trustee, and remanded the case to the bankruptcy court to determine whether
the fees awarded to Andrews & Kurth before the appointment of the Chapter 11 trustee resulted
in a material and tangible benefit to the bankruptcy estate.87

The Fifth Circuit affirmed the district court's decision.88 It first addressed Andrews &
Kurth's argument that the 1994 Act's removal of “the debtor's attorney” from the list of
professionals entitled to compensation from the bankruptcy estate was inadvertent because such
a sweeping amendment to the Bankruptcy Code would have been discussed in the Act's
legislative history, and in fact the legislative history was silent on the issue.89 Andrews & Kurth
cited both the Second Circuit's decision in In re Ames Department Stores, Inc.90 and the
preeminent bankruptcy treatise, Collier on Bankruptcy,91 in support of its position.92

The Fifth Circuit refused to examine the legislative history, however, stating that the
statute was clear on its face and excluded attorneys from its catalog of compensable officers.93

“Although the legislative history and, indeed, a brief syntactical evaluation of the closet issue
suggests that Congress inadvertently neglected to include attorneys, our canons of construction
do not require – nay, do not permit – us to consider these exogenous sources when the statute is

87 Id. at 839.
89 Id. at 421.
90 In re Ames Dep't Stores, Inc., 76 F.3d 66 (2d Cir. 1996).
91 Collier on Bankruptcy ¶ 330.LH[5] at 330-77 (“Because the change is inconsistent with current case law and the
legislative history of § 330 does not support such drastic change, courts should construe the deletion as unintended.” [Get proper
cite]
92 Family Snacks, supra note 88, at 421.
93 Id. at 425.
clear textually on its face. Accordingly, the Fifth Circuit affirmed the district court's decision and precluded Andrews & Kurth's application for attorneys' fees as a first priority administrative expense from the debtor's bankruptcy estate.

The following year, the Eleventh Circuit followed the Fifth Circuit in holding that a debtor's attorneys' fees were not entitled to priority treatment under the Bankruptcy Code. In Inglesby, Falligant, Horne, Courington & Nash, P.C. v. Moore (In re American Steel Product Inc.), the debtor, American Steel Product, Inc., was forced into an involuntary Chapter 7 bankruptcy proceeding. The case was then converted to a Chapter 11 proceeding and later reconverted to a Chapter 7. Originally, American Steel Product acted as debtor-in-possession, but when the case was converted to a Chapter 11 proceeding, a trustee was appointed and remained as trustee after the case was converted back to a Chapter 7. The Inglesby firm submitted its fee application to the bankruptcy court upon the conclusion of the proceedings, and the court refused to pay the firm's fees out of the bankruptcy estate, holding that Section 330 of the Bankruptcy Code precluded a debtor's attorney from being granted an administrative priority for its fees in a Chapter 7 or Chapter 11 proceeding. The district court affirmed the

94 Id.

95 Id. at 426. The Fifth Circuit also decided the standard to be applied in determining whether Andrews & Kurth's fees for services rendered before the trustee was appointed. Andrews & Kurth had argued that the standard should be whether the services were "objectively beneficial toward the completion of the case at the time they were performed." Id. Conversely, the creditors argued that the appropriate standard to be used was whether the services "resulted in an identifiable, tangible, and material benefit to the bankruptcy estate." Id. (citing In re Melp, Ltd., 179 B.R. 636 (E.D. Mo. 1995)). The court determined that the stricter "material benefit" test was the appropriate measure to be used. Id. at 426.


97 Id. at 1355.

bankruptcy court's decision, and the case was appealed to the Eleventh Circuit. The Court refused to follow the Inglesby firm's suggestion that Section 330 contained a drafting error because it allowed for attorneys' fees as a first priority administrative expense only in Chapter 12 and Chapter 13 proceedings.\(^9\) “Where the statute's language is plain, as here, our sole function is to enforce it according to its terms.”\(^10\) Accordingly, the Eleventh Circuit denied the Inglesby firm's petition to have its fees paid as a first priority administrative expense.\(^1\)

The final court of appeals case holding that debtors' attorneys' fees are not entitled to administrative priority is the Fourth Circuit's decision in *United States Trustee v. Equipment Services, Inc. (In re Equipment Services, Inc.)*.\(^10\) In the case, Equipment Services filed a Chapter 11 bankruptcy proceeding and retained John Lamie, an attorney, to prepare its bankruptcy petition and represent the company during its Chapter 11 proceedings.\(^10\) Lamie received a retainer and represented Equipment Services as debtor-in-possession. Approximately three months later, upon the motion of the United States trustee, the bankruptcy court converted the Chapter 11 proceeding to a Chapter 7 proceeding, and an administrator was appointed by the Court. Lamie continue to represent Equipment Services after the conversion.\(^10\) Upon the conclusion of the bankruptcy proceeding, Lamie filed a fee application for his work both while the case was in Chapter 11 and after it was converted to Chapter 7. The trustee objected to the

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\(^9\) *Steel Prod.*, 197 F.3d at 1356.

\(^10\) *Id.* at 1357 (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989)).

\(^1\) *Id.* at 1357.


\(^10\) *Id.* at 742.

\(^10\) Lamie's services after the case was converted to a Chapter 7 proceeding included amending the debtor's asset schedules, appearing at hearings on adversary matters, and monitoring the debtor's post-petition assets and debts. *Id.* at 743.
fees earned while the case was in Chapter 7 because the application for fees did not specify that the bankruptcy estate benefitted from Lamie's services.105

Like the Fifth and Eleventh Circuits before it, the Fourth Circuit found that the plain language of Section 330(a) of the Bankruptcy Code clearly omits a debtor's attorney from the ambit of that section, and therefore any consideration of the amendment's legislative history would be inappropriate.106 The Court stated that, if the statute was a result of a scrivener's error, it was up to Congress to correct it. “Because the plain language of §330(a) as it is now written is unambiguous and is reasonable in application we are constrained to enforce the language as written.”107

After the Fourth Circuit handed down its decision in Equipment Services, the corporation's attorney, John Lamie, appealed the decision to the United States Supreme Court. The Court granted certiorari to resolve the growing conflict among the circuits.

IV. THE SUPREME COURT'S DECISION IN LAMIE

In Lamie v. United States Trustee,108 the Supreme Court resolved the issue of whether a debtor's attorney can receive compensation from the debtor's Chapter 7 estate as a first priority administrative expense under section 330 of the Bankruptcy Code.109 The Court held

105 Id. at 742-43. The trustee did not object to Lamie's fees for the period that he represented Equipment Services as debtor-in-possession, because those fees were authorized by the court under section 327 of the Bankruptcy Code. Id. at 742. For a more in-depth discussion of section 327, see supra notes 30-33 and accompanying text; see also infra notes 117-28 and accompanying text.

106 Id. at 745.

107 Id. at 745-46. It should be noted that the Fourth Circuit allowed Lamie's fees while the case was in Chapter 11 to be paid out of the bankruptcy estate because he served as attorney for the debtor-in-possession, which benefitted the bankruptcy estate. Id. at 747.


109 In Lamie, the Supreme Court noted that an attorney could be compensated for her legal work in a bankruptcy
that section 330 must be read plainly and that Congress's deletion of the phrase "or the debtor's attorney" from the statute must be enforced as written.\textsuperscript{110}

The Court began its analysis by identifying the differences between the wording of section 330 under the 1978 statute and its 1994 amendment.\textsuperscript{111} The Court noted that the phrase "or to the debtor's attorney" had been deleted in 1994 and that the provision as rewritten had grammatical issues stemming from the missing word "or" before "a professional person."\textsuperscript{112} "The deletion created an apparent drafting error. It left current § 330(a)(1) with a missing 'or' that infects its grammar."\textsuperscript{113} Moreover, the Court explained that "the inclusion of the word 'attorney' in § 330(a)(1)(A) defeats the neat parallelism that otherwise marks the relationship between §§ 330(a)(1) and 330(a)(1)(A)."\textsuperscript{114}

The court then established that under its general rule of statutory construction, if a statute is plain on its face, the sole purpose of the courts is to enforce the statute in accordance with its terms, unless enforcing the statute as written would lead to an absurd result.\textsuperscript{115} The Court explained that, even if the statute is "awkward, and even ungrammatical," so long as it does not

\textsuperscript{110} Id. at 538-39.

\textsuperscript{111} Id. at 530.

\textsuperscript{112} Id.; see also supra notes 32-35 and accompanying text.

\textsuperscript{113} Id.

\textsuperscript{114} Id. at 531; see also supra notes 32-35 and accompanying text.

\textsuperscript{115} Id. at 534 (citing Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000). The Court also noted that "the starting point in discerning congressional intent is the existing statutory text, and not the predecessor statutes." Id. (citing Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 438 (1999)).
affect that statute's meaning, the statute must still be read in accordance with the plain meaning rule.\textsuperscript{116}

Addressing the substance of Lamie’s claim, the Court held that a debtor’s attorney was simply not listed in section 330(a) as a party who could receive compensation from a Chapter 7 bankruptcy estate as a priority claimant, unless that attorney’s fees fell within the ambit of section 327.\textsuperscript{117} The Court also explained that the missing conjunction “or” would make a difference only if it affected the substance of the act or obscured its meaning.\textsuperscript{118} Because the missing conjunction merely rendered the statute awkward, without changing its underlying meaning, the grammatical error was irrelevant to the outcome of the case.\textsuperscript{119}

The Court added that enforcing the statute as written would not produce absurd results because a debtor's attorney has other avenues to receive compensation for her services.\textsuperscript{120} For example, attorneys for a debtor in Chapter 12 and Chapter 13 proceedings would continue to receive their fees as administrative priority expenses under section 330(a)(4)(B) of the Code, which was added as part of the 1994 amendments.\textsuperscript{121} In addition, attorneys for Chapter 7 debtors could receive administrative priority treatment if they are appointed by the trustee under section

\begin{footnotesize}
\textsuperscript{116} Id.

\textsuperscript{117} Id. The Court reasoned that it was irrelevant whether a debtor’s attorney was listed in section 330(a)(1)(a) because the Court’s analysis did not reach that section until it was established that the debtor’s attorney was in the class of persons set forth in section 330(a)(1). Id.

\textsuperscript{118} Id. at 534-35.

\textsuperscript{119} Id. The Court conceded that the reference to an attorney in section 330(a)(1)(A) was surplusage under its interpretation of the statute. It noted, however, that while canons of statutory construction suggest that statutes should be construed to avoid surplusage, those canons were not absolute. Id. at 536 (citing Chickasaw Nation v. United States, 534 U.S. 84, 94 (2001)).

\textsuperscript{120} Id. at 537.

\textsuperscript{121} Id. at 537 (“In a Chapter 12 or Chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor’s attorney.”); see also supra notes 34-35 and accompanying text.
\end{footnotesize}
It concluded that, even though the interpretation of the statute might lead to a harsh outcome, such a reading was necessary to give proper deference to the legislative process.\textsuperscript{123}

Although the Court stated that it was not necessary to look to the statute's legislative history because the statute was plain on its face, it nevertheless examined it, concluding that although it was plausible that the deletion of the debtor's attorney phrase was a mistake,\textsuperscript{124} it was equally plausible that it was intentional.\textsuperscript{125} Accordingly, the Court determined that the statute's legislative history was not helpful in resolving the issue before it.\textsuperscript{126}

Finding that Lamie was not entitled to administrative priority treatment for his attorneys' fees in Equipment Services' chapter 7 proceeding, the Court held that “section 330(a) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorize by Section 327. If the attorney is to be paid from estate funds under Section 330(a)(1) in a Chapter 7 case, he must be employed by the trustee and approved by the court.”\textsuperscript{127}

\textsuperscript{122} Id.

\textsuperscript{123} Id. at 538 (citing United States v. Locke, 471 U.S. 84, 95 (1985)).

\textsuperscript{124} The Court explained that in the legislative history of section 330(a)(1)(A), it is clear that the primary reason for deleting language from that section was because the provision granting the government's right to object to a fee application was moved to new section 330(a)(2). Id. at 539 (citing S. Rep. No. 103-168 (1993)). Thus, it was possible that Congress may have deleted too many words from that section during the courts of moving the objection provisions. In such a case, the deletion of “or to the debtor's attorney” from section 330(a)(1)(A) could have been a mistake. Id. at 540.

\textsuperscript{125} The Court suggested that the amendment that deleted a portion of section 330(a)(1)(A) and added section 330(a)(2) was part of an attempt by Congress to curb abuses in awarding professional fees. See 140 Cong. Rec. 28753 (stmt. of Sen. Metzenbaum). Therefore, deleting the debtor's attorney from the list of administrative priority claimants could advance that purpose. Lamie, 540 U.S. at 540. Moreover, at the same time that Congress deleted “or to the debtor's attorney” from section 330(a)(1), it added language in section 330(a)(4)(B) that provided administrative priority to a debtor's attorneys' fees in a Chapter 12 or Chapter 13 bankruptcy proceeding. Thus, the Court concluded, Congress could have intended to continue priority treatment to attorneys in Chapter 12 and Chapter 13 proceedings despite the statute's broad exclusion of debtors' attorneys from the list of compensable professionals in section 330(a)(1). Id. at 541.

\textsuperscript{126} Id. at 540-41. “There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted.” Id. at 538.

\textsuperscript{127} Id. at 538-39. The Supreme Court concluded its opinion by stating that, although the National Association of Consumer Bankruptcy Attorneys brought the 1994 change to the attention of Congress during its deliberations, the Association did not object to the change. Congress went on to pass the statute unchanged.
The Court suggested that, if Congress intended a different result, it was up to Congress to amend the statute to conform it to legislative intent.\textsuperscript{128}

\section*{V. THE ADMINISTRATIVE PRIORITY: A PROPOSAL FOR CHANGE}

Whether the Supreme Court reached the correct result in \textit{Lamie} and, indeed, whether the Bankruptcy Code itself is flawed in its treatment of priority claims turns on the proper scope and purpose of the administrative priority. This section examines the history of the priority rules, together with their underlying policy justifications. Concluding that section 330 of the Bankruptcy Code, as it is currently drafted, deviates from the historical purpose and policy behind the administrative priority, this Article offers a modest proposal for change.

\subsection*{A. The History and Policy Underlying First Priority Administrative Expenses}

Since 1841 courts have recognized the importance of granting special priority to expenses that directly benefit the bankruptcy estate.\textsuperscript{129} Both bankruptcy statutes and court decisions since that time have consistently allowed debtors' attorneys' fees as administrative priority expenses only if they provide an express benefit to the bankruptcy estate or to the debtor's unsecured creditors. Thus, in order to evaluate whether section 330 of the Bankruptcy Code properly defines the scope of the administrative priority, it is imperative to examine the history and policy underlying this priority.

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{128}] \textit{Id.} at 542 ("It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think... is the preferred result." \textit{Id.} (quoting United States v. Granderson, 511 U.S. 39, 68 (1994)).
\item[\textsuperscript{129}] See infra notes 134-74 and accompanying text.
\end{itemize}
\end{footnotesize}
1. The Bankruptcy Act of 1800

The first major bankruptcy act in the United States was the Bankruptcy Act of 1800.\(^{130}\) For the most part, it followed English bankruptcy law and provided only for involuntary bankruptcy.\(^{131}\) Under the Act, all creditors who duly proved their debts received a pro rata share of the debtor's assets, with no priority accorded to one creditor over another.\(^{132}\) Congress repealed the Act after three years because it was too difficult for the average person to bring his case and witnesses to the distant federal courts in the early 1800s.\(^{133}\)

2. The Bankruptcy Act of 1841

When Congress passed The Bankruptcy Act of 1841,\(^{134}\) it included both voluntary and involuntary bankruptcies\(^{135}\) and, for the first time, recognized “the justice of granting to the honest debtor . . . a discharge and release from his remaining debts.”\(^{136}\) It was repealed less than two years later for the same reason as the Bankruptcy Act of 1800: access to bankruptcy courts was extremely limited for the average person.\(^{137}\)


\(^{132}\) The Bankruptcy Act of 1800 §§ 29-30.


\(^{135}\) Loveland, *supra* note 131, at 10.

\(^{136}\) The Bankruptcy Act of 1841 § 9.

\(^{137}\) Loveland, *supra* note 131, at 12.
The Bankruptcy Act of 1841 again provided for a pro rata distribution of the debtor's assets to creditors with bona fide debts, but, for the first time, it granted priority to a small number of debts, including debts owed to the government, debts held by sureties, and wage claims up to twenty-five dollars.\footnote{Section 5 of the Act provides:}

\begin{quote}
And be it further enacted, That [sic] all creditors coming in and proving their debts under such bankruptcy, in the manner hereinafter prescribed, the same being bona fide debts, shall be entitled to share in the bankrupt's property and effects pro rata, without any priority or preference whatsoever, except only for debts due by such bankrupt to the United States, and for all debts due by him to person who, by the laws of the United States, have a preference, in consequence of having paid moneys as his sureties, which shall be first paid out of the assets; and any person who shall have performed any labor as an operative in the service of any bankrupt shall be entitled to receive the full amount of the wages due to him for such labor, not exceeding twenty-five dollars.
\end{quote}

The first case to address the issue of whether attorneys' fees were entitled to priority treatment in bankruptcy was \textit{In re Hale},\footnote{\textit{In re Hale}, 11 F. Cas. 178 (C.C.D.N.H. 1842).} which was decided under the Bankruptcy Act of 1841. In \textit{Hale}, the debtor's attorneys assisted the debtor in filing a voluntary bankruptcy petition and were able to secure a discharge of his debts as a result. At the conclusion of the bankruptcy proceeding, the attorneys sought to collect their fees from the assets of the estate as a priority claim.\footnote{\textit{Id.} at 179.}

The court rejected the attorneys' claim, holding that their labor benefitted only the debtor, and therefore he should be responsible for paying the fees.\footnote{\textit{Id.}}

I can perceive no ground, upon which payment can be decreed therefore out of the assets of the bankrupt. They were incurred for his sole personal benefit, and not for the benefit or at the instance of his creditors. He, and he only, therefore, ought to bear them.

\footnote{\textit{Id.} at 179.}
It would, or at least might, have been different, if the costs and expenses had been incurred by a creditor in prosecuting a petition against a bankrupt, in invitum, to have him decreed a bankrupt for then and in such a case the proceedings and decree might be said to be for the benefit of all the creditors. But, here, there is no ground upon which the court can say that the costs and expenses are to be a charged upon the assets in bankruptcy.\footnote{Id.}

Thus, \textit{Hale} is an important case because it represents the first instance in which a court would establish that a debtor's attorneys' fees were entitled to priority treatment only to the extent that they benefitted the bankruptcy estate.

\textbf{3. The Bankruptcy Act of 1867}

The Bankruptcy Act of 1867,\footnote{Act of Mar. 2, 1867, ch. 176, 14 Stat. 517, \textit{repealed by} Act of June 7, 1878, ch. 160, 20 Stat. 99 [hereinafter The Bankruptcy Act of 1867].} which lasted 11 years, was a pivotal piece of legislation because it was the first act to establish a full priority system for the distribution of a debtor's assets in bankruptcy.\footnote{\textsc{Loveland}, supra note 131, at 12.} The Act's priority scheme granted first priority status to the administrative expenses of the bankruptcy estate:

\begin{quote}
Debts entitled to priority. \textsc{Sec.} 5101. In the order for a dividend, the following claims shall be entitled to priority, and to be first paid in full in the following order:

\begin{enumerate}
  \item First. The fees, costs, and expenses of suits, and of the several proceedings in bankruptcy under this Title, and for the custody of property, as herein provided.
  \item Second. All debts due to the United States, and all taxes and assessments under the laws thereof.
\end{enumerate}
\end{quote}
Third. All debts due to the state in which the proceedings in bankruptcy are pending, and all taxes and assessments made under the laws thereof.

Fourth. Wages due to any operative, clerk, or house-servant, to an amount not exceeding fifty dollars, for labor performed within six months next preceding the first publication of the notice of the proceedings in bankruptcy.

All debts due to any person who, by the laws of the United States, are, or may be, entitled to a priority, in like manner as if the provisions of this Title had not been adopted. But nothing contained in this Title shall interfere with the assessment and collection of taxes by the authority of the United States or any State.\(^\text{145}\)

The Act suffered from three major structural problems. First, critics argued that it was too easy for creditors to force a debtor into bankruptcy involuntarily. Second, it was too difficult for the debtor to obtain a discharge of his debts after being forced into bankruptcy.\(^\text{146}\) Finally, the Act allowed bankruptcy attorneys and court officers to obtain excessive fees in debtors’ bankruptcy proceedings.\(^\text{147}\)

Courts did, however, draw a distinction between the attorneys for the debtor and the attorneys for the estate when examining whether their fees were entitled to priority under the

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\(^{145}\) The Bankruptcy Act of 1867 § 5101.


\(^{147}\) See, e.g., In re Oakland Lumber Co., 174 F. 634, 637 (2d Cir. 1909) (“Nothing contributed so much to bring about the repeal of the act of 1867 . . . as the large expense of administration, the small estates being entirely absorbed in fees.”); In re Wells, 114 F. 222, 224 (W.D. Mo. 1902) (“The act of 1867 carried with it many evils, real or supposed. One of such evils was its oppressive and expensive features. The estates were eaten up by a most vicious fee system. The litigation was all or practically all, in the federal courts, generally sitting at a great distance from the debtor, the claimants, and the witnesses. It was the purpose of the present statute [1898] to correct this, and limit the fees and expenses, and have the greater part of the litigation where the parties resided.”); see also In re Beck, 92 F. 889, 892 (S.D. Iowa 1899) (“One of the strongest objections urged against the bankruptcy statute of 1867 was what was claimed by many to be the excessive fees possible thereunder, in whose payment the estate was largely consumed, leaving to the creditors little, if any, desirable dividends.”).
statute. For example, in *In re Handell*, the court refused to grant administrative priority status to the debtor's attorneys' fees for the preparation and filing of his bankruptcy petition and schedules. The court concluded that the administrative priority provision “has been construed to include only the costs due the register, clerk, marshal, and assignee; and not any expenses incurred by the bankrupt, or for services rendered by attorneys for the bankrupt in preparing the petition and schedules of the bankrupt.”

In addition, some courts made a distinction between debtors’ attorneys’ fees incurred before the bankruptcy petition was filed, and those incurred after the filing of the petition. In general, courts held that the former fees were not entitled to administrative priority, but the latter could be granted administrative priority treatment if they benefitted the bankruptcy estate or unsecured creditors.148 “In order to justify an order that the assignee pay such claim [as an administrative priority], it must be clearly shown that the alleged services were properly and necessarily rendered for the purpose of benefiting or preserving the estate of the bankrupts, in the interest of the general creditors, and not in the interest of any creditor of class of creditors.”149

A small number of courts, however, granted administrative priority to the full amount of the debtor's attorneys' fees, even if those fees were incurred to prepare the debtor's bankruptcy petition. These courts reasoned that the debtor was entitled to keep very little property as exempt, and the exempt property that the debtor did retain was insufficient to cover his attorneys' fees.150

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148 *In re Jaycox*, 13 F.Cas. 398, 399 (N.D.N.Y. 1873).

149 Id.

150 In *In re Comstock*, 6 F.Cas. 239 (W.D. Mich. 1871), the court stated:
Under the Bankruptcy Act of 1867, courts had a difficult hurdle to overcome before even reaching the priority issue because of General Order No. 30. The Order stated that “no allowance shall be made against the estate of the bankrupt for fees of attorneys, solicitors, or counsel, except when necessarily employed by the assignee, when the same may be allowed as disbursements.” Accordingly, attorneys' fees incurred to prepare a debtor's bankruptcy petition and accompanying schedules were not entitled to an administrative priority under General Order No. 30, even if the services resulted in some benefit to the creditors of the bankruptcy estate. Thus, while some cases decided under the Bankruptcy Act of 1867 allowed reasonable compensation for a debtor's attorney, that practice was abrogated by the Supreme Court's pronouncement in General Order No. 30.

When a party is declared bankrupt in a proceeding in invitum, a warrant issues at once to the marshal to take possession of the bankrupt's property and effects; he is thereby deprived of all control over his estate, save such as is exempt; he is practically without means with which to pay his attorneys for services in defending against the petition. The amount which the bankrupt gets by exemption is, in most cases, trifling, and in no case is it so much but that he or his family are dependent for support on his personal efforts and earnings. . . . I will not believe, nor will I hold, that congress [sic] intended to deprive a party of the right to have enough of his own property appropriated to his use, to enable him to contest the doubtful questions which may be, and frequently are, involved as to the charge of acts of bankruptcy.

_Id._ at 240. _See also In re Olds_, 18 F. Cas. 644, 644 (W.D. Mich. 1870) (The estate should pay the debtors' costs from assets of the estate. “The bankrupts having, by force of law, surrendered all their property to be disposed of for the benefit of their creditors, it seems just and right that the avails of such property shall, so far as necessary, be used to give the bankrupts that relief when, upon conformity to the requirements of the law, they are entitled to claim, viz., a discharge from their debts.”).


152 “The principle adopted by the register is, that the services for which he thinks an allowance should be made were more or less beneficial to the creditors and the assignee, and were services proper and necessary to be rendered, on the procurement of the bankrupts. This would be a very proper consideration were it not for the express language of general order No. 30, which was manifestly intended to exclude the exercise of all discretion by the court in cases of this kind.” _In re Hamburger_, 11 F. Cas. 317 (S.D.N.Y. 1875).

153 In _In re Lloyd_, 7 F. 459 (W.D. Pa. 1881), the court stated:

It is a settled rule in this court never to allow counsel on either side to be paid out of the funds in dispute. . . . In the spirit of this rule, and to guard against abuses which threatened to creep into the administration of the bankrupt law, the supreme court, as I conceive, so amended the general orders in bankruptcy as to put an end to allowances out of the bankrupt's estate to the petitioning creditors attorneys, solicitors, or counsel.
4. The Bankruptcy Act of 1898

The precursor to current bankruptcy law was The Bankruptcy Act of 1898. Section 64 of the Act addressed the issue of priority, and granted first priority to the actual and necessary costs of preserving the estate after the bankruptcy filing. The main purpose of the 1898 Act was to allow for equitable distribution of the debtor's estate among creditors, with priority being given to one creditor over another only when the purpose of the priority was clear from the statute.

The Act granted third priority to attorneys' fees in involuntary bankruptcies, but provided that, in voluntary bankruptcies, the court should use its discretion in whether to grant

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Id. at 460-61 (quoting Hauenstien v. Lynham, 100 U.S. 483 (1879)). Some lower courts, however, carved out an exception to General Order 30 for services rendered by the debtor's attorney that clearly benefited the bankruptcy estate. In re Beck, 92 F. 889, 892 (S.D. Iowa 1899). In Beck, the court stated:

If, meanwhile, legal services are actually needed for preservation of the property, pending the appointment of the trustee, and such necessity clearly appears, and as well, that such services were rendered which were beneficial to the general creditors . . . the court is authorized to allow a reasonable fee therefor. In other words, fees for legal services rendered for the bankrupt . . . in proceedings instituted by the bankrupt for his own benefit, will not be allowed as a debt having the priority given under the clause under consideration. Such fee, if allowable at all, must be presented as a claim against the estate, and take its place with other general claims. But, if legal services are rendered under circumstances and of a nature which constitute a special benefit to the estate generally . . . the court may allow therefor, when such necessity and benefit clearly appear.

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Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978) [hereinafter The Bankruptcy Act of 1898].

Section 64 stated, in pertinent part:

(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

(b) The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be

(1) the actual and necessary cost of preserving the estate subsequent to filing the petition

third priority for the fees of the debtor's attorney.\textsuperscript{157} The rationale for this distinction appeared to be twofold: first, the debtor did not choose to file for bankruptcy protection, and therefore had no control over whether to incur attorneys' fees; and second, if the debtor's property was sold by the trustee for the benefit of creditors, the debtor would have no assets remaining with which to pay his attorney.\textsuperscript{158}

Under the 1898 Act, administrative expenses were granted first priority because the estate was required to pull its own weight. “The costs of the administration of an estate are always chargeable against the assets of the estate.”\textsuperscript{159} Bankruptcy law “expressly provides for the cost of administration as a prior lien upon the assets of the bankrupt's estate before there is any distribution of it to creditors.”\textsuperscript{160}

The leading case discussing the priority afforded attorneys' fees under the 1898 Act was \textit{In re Erie Lumber Company}.\textsuperscript{161} \textit{Erie} involved an attorney who represented a debtor in an involuntary bankruptcy proceeding. The court held that the attorney's fees were part of the

\begin{itemize}
\item \textsuperscript{157} Section 64 provided for third priority in the following situations:
\begin{itemize}
\item (3) The cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary cases, as the court may allow.
\end{itemize}
\end{itemize}

\textsuperscript{158} \textit{Id.} at 890-91.

\textsuperscript{159} \textit{In re Tebo}, 101 F. 419, 420 (D.W. Va. 1900).

\textsuperscript{160} \textit{Id. Tebo} directly addressed the issue of compensation to the attorney of a debtor out of the property of the estate, even though that issue was never appealed. “The court is of opinion that the allowance to counsel [for the debtor] rests largely in the discretion of the referee in bankruptcy, and, there being no evidence filed before the judge of this court that the allowance made by the referee was unjust, excessive, and exorbitant, I am of opinion not to disturb it.” \textit{Id.} at 421. State bankruptcy law was also greatly affected by The Bankruptcy Act of 1898. John Deere Plow Co. v. McDavid, 137 F. 802, 812 (8th Cir. 1905), established the principle that state preferences could not interfere with federal preferences.

\textsuperscript{161} \textit{In re Erie Lumber Co.}, 150 F. 817 (S.D. Ga. 1906).
cost of administering the estate. “[T]he professional services of attorneys are essential to the proper administration of a bankrupt's estate, and are second only in dignity to the wages of labor exerted in its creation.”

5. The Chandler Act Amendments

The Chandler Act amended the priority section of the Bankruptcy Code significantly, specifically allowing trustees to recover their fees in opposing the bankruptcy discharge as an administrative priority. One of the most significant changes, however, allowed attorneys for debtors in voluntary bankruptcy proceedings to recover their fees as administrative priority expenses as well. In order to receive priority, the fees had to arise during the administration of the bankruptcy estate. Accordingly, generally only post-petition expenses were granted administrative priority treatment. The attorneys seeking priority had the burden of

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162 Id. at 825.

163 Chandler Act (Bankruptcy Act, Amendments of 1938), ch. 575, 52 Stat. 840 (1938) (repealed 1978) [hereinafter The Chandler Act]. The amendments provided, in pertinent part:

(b) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be

(1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; for fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estates of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow.

Id. § 64 (emphasis added).

establishing that their fees fell within the intended class of priority claimants and benefitted the bankruptcy estate.  

6. The Bankruptcy Reform Act of 1978

Beginning in 1978, the claims that were entitled to priority treatment were enumerated much more clearly in the Bankruptcy Code. First priority claims included primarily administrative expenses specified in section 503(b). As established in Part II of this Article, section 503(b) included compensation and reimbursemens that were awarded under section 330 of the Code. For the first time, debtors' attorneys' fees were granted first priority treatment irrespective of whether their services conferred any specific benefit on the bankruptcy estate. “The debtor's attorney is included among the professionals compensated under section 330 on the theory that his services, while not performed for the direct benefit of the estate, may be helpful to the bankruptcy process because they facilitate orderly administration of the estate.”

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165 REA Express, 442 F. Supp. at 73. It is also important to note that, in pre-1978 cases, although the priority section was included in what is now the Chapter 7 provisions of the Bankruptcy Code, they have been held equally applicable in Chapter 11 proceedings. Id. (“The purpose of according first priority to administrative expenses in a Chapter XI proceeding is to encourage current employees and current suppliers to deal with the debtor while it is attempting to survive and arrive at an arrangement as provided by law.”). Id. at 74.


168 11 U.S.C. § 507(a)(1) (date) (amended 2005). “Section 330 is designed to secure for the estate the services of competent professional persons, including a trustee, an attorney for the trustee, accountants, appraisers, and others who may be needed in order best to operate, reorganize, or liquidate the estate.” In re Yermakov, 718 F.2d 1465, 1469-70 (9th Cir. 1983) (citing S.Rep. No. 989, 95th Cong., 2d Sess. 40-41 (1978)). See also supra notes 27-29 and accompanying text.

169 Yermakov, 718 F.2d at 1470 (“Because ‘economy in administration is the basic objective’. . . Section 330 limits the compensation payable to the debtor's attorney as well as other professionals to a reasonable amount for ‘actual’ services that are ‘necessary’ in connection with the bankruptcy process.”). Id.
Yet despite this radical change in the treatment of attorneys' fees in bankruptcy, some remnants of pre-1978 policy still remained. For example, courts facing the issue of whether contingent attorneys' fees could be treated as administrative expenses were reluctant to allow them because they did not benefit the bankruptcy estate. One court stated that “such a result would flatly contradict the policy reason for granting administrative expense priorities, which is that the estate as a whole is benefitted if general creditors subordinate their pre-bankruptcy claims in order to secure goods and services necessary to an orderly and economical administration of the estate after the petition is filed.”

7. The 1994 Amendments

As discussed in part II, the 1994 amendments to the Bankruptcy Code significantly altered the priority granted to a debtor's attorneys' fees in bankruptcy. The amendments deleted the debtor's attorney from the list of parties entitled to administrative priority treatment under section 330(a)(1). Although the amendments made to the Code in 1994 amended section 330 dramatically, the purpose of the administrative priority remained the same – to allow parties whose services benefitted the bankruptcy estate to be paid ahead of other creditors. Moreover, because every priority claim decreases the assets that are available to the debtor's general unsecured creditors, courts have continued the tradition of strictly construing priority claims in bankruptcy.

170 Id. at 1471 (citing In re Chochise Coll. Park, 703 F.2d 1339, 1355-56 (9th Cir. 1983).


172 See supra notes 32-33 and accompanying text.

173 See In re Morad, 328 B.R. 264, 271 (B.A.P. 1st Cir. 2005).

174 In re Hutchison, 223 B.R. 586, 588 (Bankr. M.D. Fla. 1998). Attorneys have continued to attempt to squeeze their claims within the ambit of section 507(a)(3) as wage claims if they are denied first priority treatment as administrative expenses,
B. Policy Justifications Underlying Priority Claims

When paying creditors' claims in bankruptcy, the Code starts with a general presumption "favoring equality in distribution such that 'if one claimant is to be preferred over others, the purpose should be clear from the statute." All of the priority rules in the Bankruptcy Code can be justified on one of two policy grounds. Either the priority debts increase the value of the bankruptcy estate for the benefit of all creditors, or they preserve the social safety net provided by the government and, thus, benefit society as a whole. A brief examination of the debts afforded priority treatment under the Code serves to illustrate this point.

Domestic support obligations, such as child support, are granted first priority treatment under the Bankruptcy Code. This provision was added in 2005 because Congress recognized that spouses and dependent children often did not receive payments necessary for their survival when the payor filed for bankruptcy protection. As a result, they were often forced to file for bankruptcy themselves. Thus, the purpose behind affording domestic


176 For a more complete discussion of the priority rules generally, see supra notes 25-29 and accompanying text.


support obligations first priority is to prevent this domino effect, thereby easing the
government's burden of providing for the welfare of spouses and children of debtors.

Administrative expenses are granted second priority in bankruptcy. As the previous
discussion of the history of the administrative priority demonstrates, this priority category is
designed to encourage the trustee and other professionals to work diligently to preserve and
enhance the value of the bankruptcy estate for all creditors. In addition, it recognizes the need
for the bankruptcy estate to pull its own weight. For example, insurance needed to preserve
estate assets is an administrative priority expense, as are the fees for the trustee and other
professionals working with the trustee, such as appraisers and accountants for the estate.
Thus, the primary policy justification for the administrative priority is that the expenses
incurred thereunder enhance the value of the bankruptcy estate for the benefit of all creditors.
Courts have consistently held that administrative priority expenses should be narrowly
construed “to honor ‘the traditional presumption favoring ratable distribution among all
holders of unsecured claims.’”

Third priority expenses include claims made by so-called involuntary gap creditors. When a debtor is forced into bankruptcy involuntarily by the debtor's creditors, there is a
period of time between the filing of the involuntary petition and the hearing by the bankruptcy
court to determine whether the debtor properly belongs in bankruptcy court. The intervening

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180 In re Morad, 328 B.R. 264, 271 (B.A.P. 1st Cir. 2005) (“[T]he very essence of an administrative expense under § 503(b)(1)(A) is that it arises during the administration of the estate.”).

181 See, e.g., In re Amarex, 853 F.2d 1526, 1530 (10th Cir. 1988); In re Pre Press Graphics, 287 B.R. 726, 730 (Bankr. N.D. Ill. 2003).

period is called the involuntary gap period. If creditors are unwilling to loan the debtor money or provide goods and services to the debtor during that period, the debtor will surely be ready for bankruptcy at the end of the involuntary gap period. Therefore, the Bankruptcy Code seeks to encourage creditors to deal with the debtor during this period by affording them third priority treatment should the debtor ultimately stay in bankruptcy. Thus, the policy justification for providing priority treatment to involuntary gap creditors is to enhance the value of the bankruptcy estate by allowing the debtor to continue its business operations during the gap period.

The fourth priority is reserved for employees of a debtor who provide services within the 180 day period before the bankruptcy petition is filed. If employees’ wages are protected should their employer be forced to file for bankruptcy protection, they have more incentive to continue working for a shaky company, thereby increasing the possibility that the debtor will not need bankruptcy protection. In addition, employees are dependent on their employer to provide their livelihood and support their families. If the employer eventually files a bankruptcy petition, there is a greater chance that employees might lose their jobs and be forced to rely on welfare or the bankruptcy system to survive. Therefore, granting

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183 For a comprehensive discussion of the respective rights of creditors and debtors during the involuntary gap period, see Joseph Mullin, Comment, Bridging the Gap: Defining the Debtor’s Status During the Involuntary Gap Period, 61 U. CHI. L. REV. 1091 (1994).

184 11 U.S.C. § 507(a)(4) (West Supp. 2007). These claims are capped at $10,950 per creditor.

185 See, e.g., In re Northwest Eng’g Co., 863 F.2d, 1313, 13154 (7th Cir. 1988).


187 See Elizabeth Warren, Bankruptcy Policy, 54 U. CHI. L. REV. 775, 790 (1987) (“Employees are among the creditors least likely to have spread the risks of default.”).
employees' wages fourth priority in bankruptcy reduces the burden on the government's social safety net.

The Bankruptcy Code provides fifth priority to claims for contributions to employee benefit plans. This priority protects retirement benefits in bankruptcy, again reducing the obligation of the government to provide support to individuals during their retirement. Unsecured claims of certain farmers and fishermen are granted sixth priority treatment in bankruptcy. Protecting the debts of those who supply food to the country helps to insure that farmers and fishermen will continue their businesses, thereby relieving the government of the burden to feed its citizens.

Seventh priority treatment is provided to individuals for deposits made for purchasing, leasing, or renting property that has not yet been received as of the time that the debtor files for bankruptcy, or for personal services that have not yet been provided. Because most of the debts falling within this category are for security deposits for apartment rental, it is likely that this priority protects the government against having to provide a safety net for individuals who cannot afford to rent an apartment when their landlord files for bankruptcy.

One of the largest categories of priority claims is for taxes owed to governmental units. These claims include income taxes, property taxes, trust fund taxes, and penalties incurred before the bankruptcy filing. It is no surprise that the purpose behind this priority is


189 See, e.g., Employers Ins. of Wausau v. Plaid Pantries, Inc., 10 F.3d 605, 607 (9th Cir. 1993).


to assist the government in collecting funds with which to provide welfare and other social services to those in need throughout the country.

Ninth priority treatment is granted to claims by FDIC regulatory agencies to maintain the capital of FDIC insured banks and financial institutions.\textsuperscript{192} This priority category, which was recently added to the Bankruptcy Code, allows FDIC agencies to collect their claims ahead of general unsecured creditors because, in the absence of priority treatment, the claims would likely remain unpaid, putting a burden on the government to satisfy the claims, thereby reducing the funds available to provide welfare and other social service benefits.

Tenth priority is afforded to death or personal injury claims that arise because the debtor operated a motor vehicle or boat unlawfully while intoxicated due to alcohol or drugs.\textsuperscript{193} This priority category does not fit within either of the two general policy justifications for priority claims generally. Presumably the intent behind granting priority treatment to these claims is either to punish the debtor for illegal behavior or to serve as a deterrent to such behavior. In either case, however, it can be argued that these claims should not be granted priority treatment, but such an argument is beyond the scope of this Article.

The following section examines whether debtors’ attorneys’ fees fall within either of the generally accepted policy justifications for priority claims generally. Concluding that they do not, it offers a modest proposal for change.


C. A Proposal For Amending The Administrative Priority Rules

For over 150 years, United States bankruptcy laws have consistently provided that attorneys representing debtors in bankruptcy proceedings are entitled to have their fees paid as administrative priority expenses only if they can demonstrate a clear and substantial benefit to the bankruptcy estate. The Bankruptcy Reform Act of 1978 sharply deviated from that longstanding practice, however, by treating debtors' attorneys' fees as administrative priority expenses without a showing that the services benefitted the estate. The Act offered no legislative history to support such a dramatic change. Although some courts sought to narrow this broad grant of priority for attorneys' fees, they were constrained by the statute's express language. While both the 1994 Amendments and the Supreme Court's decision in Lamie took important steps toward narrowing the ability of debtors' attorneys to have their fees treated as administrative priority expenses, many loopholes and difficult issues of statutory interpretation remain.

Debtors' attorneys' fees generally do not enhance the value of the bankruptcy estate for the benefit of all creditors. Certainly there might be instances in which the attorneys' services indirectly benefit the estate, such as when attorneys bring actions against creditors for violations of the automatic stay. In these instances, however, the attorneys' services primarily benefit debtors, with only an indirect and incidental benefit to the estate. Moreover, debtors' attorneys' fees do not fall within the second policy justification for priority treatment, because they do not preserve the government's social safety net. Although it can be argued that the

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194 See supra notes 129-74 and accompanying text.
195 See supra notes 169-70 and accompanying text.
attorneys' services in filing bankruptcy petitions keep debtors off the public dole, thus preserving the safety net for others, the bankruptcy process is, at its core, part of the social safety net provided by the government.

Accordingly, because debtors' attorneys' fees do not fit within either of the two generally accepted policy justifications for priority treatment in bankruptcy, Congress should amend the Bankruptcy Code to eliminate their priority status generally. However, Congress should provide an exception to this general prohibition if the attorneys' fees offer a clear and substantial benefit to the bankruptcy estate, such as when the trustee hires the debtor's attorney to perform legal services on behalf of the estate. Following is a draft of the statutory language that Congress might use to implement the changes proposed by this Article.

Section 330 of Title 11 U.S.C. should be amended as follows:

1. Delete the phrase “or the debtor’s attorney” from section 330(a)(1)(A) of Title 11 U.S.C.

2. Delete section 330(a)(4)(B) of Title 11 U.S.C. and replace it with the following:

The fees of a debtor’s attorney are governed by this section only to the extent that the attorney is appointed by the trustee pursuant to section 327 and the services of such attorney are approved by the Court.

The first amendment removes any ambiguities regarding the application of Lamie to the priority afforded debtors’ attorneys’ fees, while the second amendment eliminates the disparity between chapter 7 and 11 cases, on the one hand, and chapter 12 and 13 cases, on the other. It also expands the reasoning of Lamie to cases filed under chapter 12 and 13 of the Bankruptcy Code.
D. Potential Criticisms of The Proposed Statutory Amendment

Critics might argue that while the statutory amendment proposed in this Article unifies the policy underpinnings of the priority rules, it does so at the expense of debtors because they will be the parties who bear the financial burden of paying their attorneys' fees if the fees are not afforded administrative priority treatment. The response to this criticism requires an understanding of the policies underlying the bankruptcy system in the United States. The system is founded on the dual policy justifications of ensuring the debtor's fresh start while providing for a fair and equitable distribution of assets to creditors. The current treatment of affording debtors' attorneys' fees administrative priority treatment favors the fresh start policy over an equitable distribution to creditors. There are many problems inherent in the Bankruptcy Code. Some provisions unjustly favor debtors over creditors, and others unduly burden the debtor's fresh start. The purpose of academic discourse is to approach each issue from a consistent theoretical perspective in an attempt to harmonize the competing policy justifications at the base of the Bankruptcy Code. As this Article has attempted to demonstrate, the treatment of attorneys' fees in bankruptcy unjustly favors debtors at the expense of a fair and equitable distribution of the estate's assets to creditors.

196 See, e.g., H.R. REP. No. 95-595, at 125 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6086 (noting that the fresh start allows debtors “to get out from under the debilitating effect of too much debt” and that the “two most important aspects of the fresh start available under the Bankruptcy laws are the provision of adequate property for a return to a normal life, and the discharge, with the release from creditor collection attempts.”).

197 See, e.g., Burlingham v. Crouse, 228 U.S. 459, 473 (1913); IRS v. Luongo (In re Luongo), 259 F.3d 323, 330 (5th Cir. 2001).
VI. CONCLUSION

With the troubling economic times facing this country today, it is imperative that the nation's bankruptcy system operate efficiently to provide a safety net for those who have lost their homes to foreclosure or who find themselves in difficult economic situations as a result of the loss of a job or a health crisis. Yet the Bankruptcy Code has so many unanswered issues of statutory interpretation that courts' attention is diverted from assisting honest but unfortunate debtors to attempting to resolve these thorny issues. It is time that Congress step in to amend the Bankruptcy Code and eliminate many of these unresolved statutory interpretation dilemmas, such as the treatment of debtors' attorneys' fees in bankruptcy.

This Article proposes a statutory amendment to the Bankruptcy Code that establishes clear guidelines for when debtors' attorneys are entitled to have their fees treated as administrative priority expenses in a bankruptcy proceeding. It calls on Congress to adopt the proposal in order to bring the bankruptcy system one step closer to operating efficiently and effectively during these difficult economic times.