

The United States Bankruptcy Court for the District of Maryland disgorged attorneys' fees as a sanction against debtors' counsel pursuant to 11 U.S.C. § 329 and Bankruptcy Rule 2017.

***In re Kestner*, No. 12-32831-RAG and No. 12-32832-NVA (jointly administered) 2015 Bankr. LEXIS 1378 (Bankr. D. Md. April 20, 2015).**

Summary by Marissa K. Lilja, Tydings & Rosenberg LLP

In *In re Kestner*, the Honorable Robert A. Gordon of the U.S. Bankruptcy Court for the District of Maryland first denied a Motion to Reconsider the Court's Orders to Justify Fee and a subsequent Disgorgement Order filed by the Kestners' (the "Debtors") counsel, concluding that the Court had authority to enter the Orders under 11 U.S.C. § 329 and Bankruptcy Rule 2017. The Court then considered the Fee Application filed by Debtors' counsel, which already reflected a significant voluntary reduction of fees, and ultimately awarded \$81,432.18 to Debtors' counsel.¹

The Debtors initially filed two Chapter 13 bankruptcies, which were voluntarily converted to Chapter 11 after extensive litigation over eligibility. *Kestner* at *2-*15. In the Disclosures of Compensation, Debtors' counsel claimed that he accepted a flat fee in accordance with "Appendix F4B"², but he also received additional retainers in the amount of \$10,000 for each case. *Id.* at *12-*14. The Court was concerned with the "vague and confusing" information presented and issued an Order to Justify Fee. *Id.* at *14. After counsel failed to fully comply with the Order, the Court issued an Amended Order to Justify Fee and further warned counsel that a failure to comply would result in disgorgement of some or all of his fees. *Id.* at *17. After counsel again failed to respond, the Court entered the Disgorgement Order as a sanction, directing counsel to return the \$20,000 retainer. *Id.* at *18-*19.

The Court first addressed the Motion to Reconsider the Orders to Justify Fee and the Disgorgement Order. The Court explained that the duty to review attorneys' fees arose from the long history of widespread abuse prior to regulation. *Id.* at *29-*35. As its source of authority to review and subsequently disgorge the pre-petition fees, the Court relied on the plain language of § 329, which grants authority to review and possibly disgorge the compensation of *any* attorney representing a debtor. *Id.* at *27-*28. This is supported by Rule 2017(a) which specifically authorizes a *sua sponte* investigation of compensation by the Court. *Id.* at *28-*29. In addition to having the authority to issue the Orders to Justify Fee, the Court found it appropriate to do so because of the unexplained difference between the flat fee arrangement and the amount actually received by counsel pre-petition. *Id.* at *40-*41. This discrepancy was nearly six times the amount a married couple would typically pay for a Chapter 13, imposing a duty to review the fees. *Id.*

¹ The Court also addressed the application to employ special counsel for a state-court appeal. The Court granted his application and awarded his fees without legal analysis. Therefore, discussion of that retention is excluded.

² The three Chapter 13 flat fee arrangements cover work performed in the main bankruptcy case, but do not cover adversary proceedings, appeals, audits and fees that were not "reasonably expected and that are extraordinary."

The Court then clarified that the Disgorgement Order is a sanction issued under § 105(a) in response to the failure to comply with the Orders to Justify Fee, and that it was not a limit on fees which counsel could collect. *Id.* at *45-*46. The Court concluded that the Debtors' counsel was afforded due process since the Orders to Justify Fee were issued to ensure future compliance pursuant to the authority of the court, were explicit in their instructions, and Debtors' counsel received a clear warning that his fees could be disgorged. *Id.* at *46-*52.

Finally, the Court considered the Application for Compensation filed by Debtors' counsel, requesting fees of \$82,903.20, which reflected almost a 48% fee write down for all services in both cases. *Id.* at *43, *53. The Court individually analyzed each category of fees proposed in the application and justified any deductions by applying the loadstar analysis from *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974) and the §330 reasonableness standard.³ *Id.* at *53-*77. Overall, while recognizing that this was more difficult than an ordinary consumer case, the Court found that counsel's strategy of filing two chapter 13 cases doubled the filings and lead to unnecessary litigation, and accordingly slightly lowered the fees awarded to Debtors' counsel beyond the substantial write down already taken. *Id.* at *59-*61. The Court granted an overall award of \$81,432.18, plus costs, to Debtors' counsel. *Id.* at *77-*78.

³ The Court separately considered the fees claimed for the time in Chapter 13 proceedings and Chapter 11 proceedings, as in Chapter 13 counsel may be awarded fees for actions beneficial and necessary for the debtors, whereas in Chapter 11, fees may only be awarded for actions which benefit the estate. *Id.* at *57.