

No. 03-6248
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**UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT**

In re GERALD ANTHONY SMITH, Debtor.)	
)	
J. BAXTER SCHILLING, Trustee, <i>et al.</i> ,)	
)	
Appellants,)	ON APPEAL FROM THE
)	UNITED STATES DISTRICT
v.)	COURT FOR THE WESTERN
)	DISTRICT OF KENTUCKY
GERALD ANTHONY SMITH, Debtor;)	
RICHARD CLIPPARD, United States Trustee,)	
)	
Appellees.)	

Before: **NELSON** and **BATCHELDER**, Circuit Judges, and **COLLIER**, District Judge.*

DAVID A. NELSON, Circuit Judge. This is an appeal from an order affirming a bankruptcy court's denial of compensation to the attorney for a trustee in bankruptcy. We are not persuaded that the bankruptcy court committed clear error in finding, as it did, that the attorney took certain actions out of self-interest, breaching the duties he owed to the parties who had an interest in the bankruptcy estate. Nor do we think the court abused its discretion by denying compensation to the attorney. The challenged order will be affirmed.

*The Honorable Curtis L. Collier, United States District Judge for the Eastern District of Tennessee, sitting by designation.

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I

The debtor, Gerald Anthony Smith, filed a voluntary petition under Chapter 7 of the Bankruptcy Code in February of 2001. Mr. Smith's petition listed assets totaling \$786,195, of which \$710,545 was claimed to be exempt. The listed liabilities came to a total of \$175,057; there were three secured claims aggregating \$92,929 and eight unsecured nonpriority claims aggregating \$82,128. The petition stated that Mr. Smith did not anticipate that there would be any funds available for distribution to unsecured creditors after the exclusion of exempt property and the payment of administrative expenses.

This was not Mr. Smith's first bankruptcy filing. He filed a petition under Chapter 13 of the Code in 1999. The Chapter 13 petition, which listed the same eight unsecured claims later listed in the Chapter 7 petition, was ultimately dismissed.

J. Baxter Schilling was appointed bankruptcy trustee in the Chapter 7 case. Mr. Schilling informed the bankruptcy court that the estate had assets to be distributed to unsecured creditors, and the court issued a "Notice of Last Day to File Claims" to all creditors named in the petition. The notice indicated that claims were to be filed by June 11, 2001. Only one unsecured claim, for about \$25,000, was filed by that deadline.

With the bankruptcy court's approval, Mr. Schilling engaged himself as counsel for the trustee. Wearing his counsel's hat, Mr. Schilling conducted discovery which indicated that Mr. Smith had attempted to conceal certain assets. On the strength of this information Mr. Schilling filed a complaint objecting to Mr. Smith's discharge.

The objection was filed in October of 2001. Mr. Schilling subsequently moved for payment of attorney fees and expenses through November 8, 2001. These fees and expenses had been incurred primarily in the taking of discovery and the preparation of motions seeking inclusion of various assets in the bankruptcy estate. Mr. Smith objected to the fee motion on the ground that the amount requested (approximately \$17,000) appeared excessive. The bankruptcy court awarded Mr. Schilling the bulk of the requested fees and all of the requested expenses — about \$15,000 in total.

Through additional discovery Mr. Schilling determined that Mr. Smith had fraudulently conveyed a mortgage to his brother, Robert W. Smith. Schilling commenced an adversary proceeding against the brother to have the conveyance set aside.

In March of 2002 Mr. Schilling, Gerald Smith, and Robert Smith agreed to settle all of the trustee's claims against the Smiths. The settlement agreement, which was drafted by Mr. Schilling, required Gerald Smith to pay \$50,000 into the bankruptcy estate as non-exempt assets. The estate had already collected approximately \$22,500 from Mr. Smith, and the parties agreed that those funds were also non-exempt assets, to be used for payment of administrative expenses and unsecured claims.

The settlement agreement obligated the Smiths not to object to the allowance of any claim filed against the estate. In addition, the agreement required Mr. Smith to support an application by Mr. Schilling for "final compensation," including the fees that had been disallowed following Schilling's initial motion for attorney fees. This last provision was not

negotiated between the parties; Mr. Schilling inserted it into the settlement agreement without discussing the matter with Mr. Smith or his lawyer. The bankruptcy court approved the settlement agreement in April of 2002.

Mr. Schilling filed a second and final motion for payment of attorney fees and expenses in May of 2002. Schilling sought about \$8600 in new fees, \$1700 in fees disallowed initially, and expenses of about \$135. The motion emphasized that through Mr. Schilling's efforts the estate had recovered over \$72,500 from Mr. Smith and that "the distribution to creditors, after payment of all costs of administration, will be 100% of the allowed timely filed claims, and a substantial percentage to all tardily filed claims."

There were no tardily filed claims at that time. On June 10, 2002, however, Mr. Schilling filed claims on behalf of the seven unsecured creditors that had been named in the petition but had not filed claims.

There were no objections to the application for attorney fees. Before ruling on the application, however, the bankruptcy court ordered the United States Trustee to investigate and report on the propriety of the provision in the settlement agreement that required Mr. Smith to support the fee request.

The U.S. Trustee reported that "it is not unheard of for Chapter 7 trustee compensation to be included in a settlement agreement." But the Trustee also reported that Mr. Schilling had obtained more money from Mr. Smith than was necessary to pay the timely filed claims. The seven claims filed by Mr. Schilling in June of 2002, the Trustee stated, were unallowable

under Fed. R. Bankr. P. 3004. The Trustee concluded that Schilling had filed unallowable claims in order to justify his attorney fees and to maximize his trustee commission.¹

Mr. Schilling objected to the U.S. Trustee's report, arguing that he had acted properly in filing the tardy claims. Under 11 U.S.C. § 726(a)(3), Mr. Schilling pointed out, unsecured creditors may receive a distribution even if their claims are untimely. Schilling also said his review of the file from Mr. Smith's Chapter 13 case revealed that four of the unsecured claims listed in the Chapter 7 petition had been assigned to other entities before that petition was filed. The assignees were not named in Chapter 7 petition and had not received notice of the deadline for filing claims. Finally, Mr. Schilling noted that two of the unsecured creditors named in the Chapter 7 petition had filed claims in the Chapter 13 proceeding, and he expressed uncertainty as to whether those claims might be allowable in the Chapter 7 case. Schilling emphasized that the settlement agreement, which designated the \$72,500 paid by Mr. Smith as non-exempt assets of the estate, required him to distribute those assets to unsecured creditors.

On September 17, 2002, the bankruptcy court awarded Mr. Schilling less than one-fifth of the amount he requested in his May 2002 fee application. Finding that Schilling's hourly rates and the time he had spent on certain tasks were excessive, the court reduced the "lodestar" fee amount from \$8599.50 to \$4095. The court then reduced that amount by 50

¹Under 11 U.S.C. § 326(a), a trustee's maximum compensation is keyed to the amount of money disbursed to parties in interest other than the debtor.

percent to reflect its finding that Schilling had “acted in his own self-interest” in two ways: (1) by drafting the settlement agreement so as to “silence objections to his actions in execution of his duties as Trustee . . . , to garner support for his counsel fees,” and to “eliminate[] the Debtor as a potential beneficiary of the estate,” and (2) by filing tardy claims “in breach of his duty to the estate and the Debtor as a party in interest.” The court did not reconsider the fees it had previously disallowed. It awarded all of the expenses sought by Mr. Schilling.

The U.S. Trustee filed a motion to alter or amend the judgment on the ground that the bankruptcy court’s findings required denial of all compensation to Mr. Schilling. On December 6, 2002, the bankruptcy court granted the U.S. Trustee’s motion, denied all requested fees, and ordered Mr. Schilling to disgorge the fees he had been awarded previously.

The district court affirmed the bankruptcy court’s orders of September 17 and December 6, 2002, and Mr. Schilling filed a timely appeal.

II

This court reviews a bankruptcy court’s compensation orders for abuse of discretion. See *In re Federated Department Stores, Inc.*, 44 F.3d 1310, 1315 (6th Cir. 1995). We must accept the bankruptcy court’s factual findings unless they are clearly erroneous, but the court’s legal conclusions are not entitled to deference. See *id.*

A

Under 11 U.S.C. § 327(a), a trustee in bankruptcy may employ an attorney “that do[es] not hold or represent an interest adverse to the estate, and that [is a] disinterested person[], to represent or assist the trustee in carrying out the trustee’s duties.” The trustee may employ himself as the attorney if such an arrangement “is in the best interest of the estate.” 11 U.S.C. § 327(d).

Section 330(a)(1) provides for “reasonable compensation” of a trustee’s attorney “for actual, necessary services.” The bankruptcy court may award less than what the attorney has requested, however, and the court may deny compensation altogether if the attorney “is not a disinterested person, or represents or holds an interest adverse to the interest of the estate” *Id.* §§ 330(a)(2), 328(c).

“Disinterestedness,” in this context, must be analyzed “against the backdrop of the equitable duties that apply to positions of trust.” *In re Big Rivers Electric Corp.*, 355 F.3d 415, 431 (6th Cir. 2004). Accordingly, persons required by the Bankruptcy Code to be disinterested “must satisfy the unbending standards of fiduciary duty” to which trustees are held. *Id.* The statutory provision for “reasonable compensation” likewise “suggests that [trustees’ attorneys] must remain loyal to all relevant parties in the bankruptcy and must act as fiduciaries in doing so.” *Id.* at 432.

An attorney for a bankruptcy trustee must thus eschew “all opportunities to advance self-interest,” and he owes a fiduciary duty of loyalty to those parties with an interest in the bankruptcy estate. *Id.* at 433-34 (internal quotation marks omitted). If the attorney fails in these duties, the bankruptcy court must deny all compensation unless “peculiar and unique circumstances” are present. *Id.* at 436 (internal quotation marks omitted).

B

We are not persuaded that the bankruptcy court committed clear error in its finding that Mr. Schilling acted in his own interest, rather than in the interest of the bankruptcy estate. The insertion of the provision in the settlement agreement under which Mr. Smith was required to support Mr. Schilling’s request for attorney fees had no purpose, it seems to us, other than to minimize (or attempt to minimize) judicial scrutiny of that request.² Insulation of the trustee’s attorney’s fee motion from scrutiny is obviously not to the benefit of parties with an interest in the bankruptcy estate.

At first blush, the provision of the settlement agreement prohibiting the Smiths from objecting to the allowance of any claim does not seem to promote Mr. Schilling’s self-interest. The same can be said of the provision requiring the estate’s assets to be used “to pay administrative [expenses] and unsecured claims.” But in the light of later events — *i.e.*,

²In reliance on this provision of the settlement agreement, Schilling’s May 2002 fee motion suggested that the previously disallowed fees should be awarded simply because Smith no longer objected to them.

Schilling's filing of unallowable claims, a matter to which we shall turn next — these provisions can reasonably be viewed as part of an effort to justify higher fees. Under 11 U.S.C. § 726(a), any surplus that remains after the payment of creditors' claims must be distributed to the debtor. Ordinarily, therefore, a debtor will have an incentive to object to unallowable claims. The settlement agreement effectively eliminates that incentive, both by prohibiting objections to claims and by barring (or purporting to bar) any distribution to Mr. Smith. As a result of these provisions, Schilling could file tardy claims — thereby bolstering his request for fees — with the assurance that Mr. Smith would not interfere.

Turning to Mr. Schilling's filing of claims, we do not think the bankruptcy court committed clear error in finding that Schilling acted out of self-interest. These claims were eleven months late. See Rule 3004, Fed. R. Bankr. P. (allowing bankruptcy trustees to file claims "within 30 days after expiration of the time" for creditors to file).³ And claims filed late by a trustee — even claims filed on behalf of creditors without notice — are not eligible for distributions from the bankruptcy estate. See 11 U.S.C. §§ 726(a)(2)(C) and (a)(3) (allowing payment of tardy claims that are filed by a creditor under § 501(a)); *In re Drew*, 256 B.R. 799, 804-05 (10th Cir. BAP 2001) ("No provision is made for the payment of claims

³Mr. Schilling argues that the claims were not late because the "Notice of Last Day to File Claims" was without legal effect. We are not persuaded that the notice was a nullity. The notice misstated the law by saying that tardy claims "will be barred from receiving any distribution of assets." (As Mr. Schilling has pointed out, tardy claims may be paid after payment of all timely claims. See 11 U.S.C. § 726(a)(3).) But we can conceive of no reason why this misstatement should invalidate the notice or the deadline that it established.

filed tardily [by a trustee] under § 501(c).”). It can fairly be inferred, we believe, that the purpose of Mr. Schilling’s filings was not to maximize distributions to unsecured creditors, but to justify Schilling’s request for fees — the total of which exceeded the amount of the single timely unsecured claim.⁴

In short, the record permits a finding that Mr. Schilling filed unallowable claims to bolster his fee request and used the settlement agreement to ensure Mr. Smith’s acquiescence in that course of conduct. Regardless of whether we would make such a finding ourselves, we cannot say that the bankruptcy court was precluded from doing so.

⁴Mr. Schilling objects that he filed the tardy claims in his capacity as trustee, and that the compensation for his legal services should not be affected by that action. We rejected a similar objection in *Big Rivers Electric*:

“What is true of Schilling is also true of ‘The Law Firm of J. Baxter Schilling,’ the sole member of which is J. Baxter Schilling. . . . The district court did not abuse its discretion in concluding that, for these purposes, Schilling and his counsel (Schilling) were one and the same” *Big Rivers Electric*, 355 F.3d at 437.

C

Mr. Schilling's actions, as found by the bankruptcy court, violated his fiduciary duties. Instead of displaying "single-minded devotion to the interests of those on whose behalf [he] act[ed]," Schilling embraced "opportunities to advance self-interest." *Big Rivers Electric*, 355 F.3d at 434 (internal quotation marks omitted). Absent "peculiar and unique circumstances," therefore, the bankruptcy court was required to "deny all compensation." *Id.* at 436 (internal quotation marks omitted). We are aware of no unusual circumstances suggesting that the denial of compensation in this case was an abuse of discretion.

AFFIRMED.