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UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF GEORGIA  
ATLANTA DIVISION

IN RE: ) CHAPTER 11  
)  
DERRICK L. PATTERSON, ) CASE NO. 07-61961-MHM  
)  
Debtor. )

**ORDER ON APPLICATION FOR COMPENSATION OF DIANA MCDONALD**

This case commenced as a case under Chapter 11 February 5, 2007. At the time this case was filed, Debtor was represented by Diana McDonald ("Applicant"). Ms. McDonald effectively withdrew as attorney for Debtor by a Certificate of Consent filed July 27, 2007, which provided for Ms. McDonald's withdrawal and the substitution of K.A. Foreman as attorney for Debtor. A Chapter 11 Trustee had been appointed as a result of an order entered May 25, 2007. This case was converted to a Chapter 7 case July 23, 2007.

On August 27, 2007, Ms. McDonald filed an application for compensation (the "Application"). Objections to that application were filed by the Chapter 7 Trustee and the U.S. Trustee. Ms. McDonald seeks compensation in the amount of \$13,679.90. Debtor paid Ms. McDonald a prepetition retainer in the amount of \$7,500. Ms. McDonald seeks permission to apply that retainer in partial satisfaction of her fees, with the balance due to be paid by Debtor, if not paid pursuant to 11 U.S.C. §726(b) at the close of the case.<sup>1</sup>

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<sup>1</sup> As noted by the court in *Rus, Miliband & Smith, APC v. Yoo (In re Cepek)*, 339 B.R. 730 (9th Cir. BAP 2006):

Chapter 11 debtors' counsel are risk takers, just the same as other administrative creditors, whose awareness of possible disgorgement in the event of conversion merely encourages them to attain a fruitful reorganization.

*Cepek*, at 745, citing *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659, 664 (6th Cir.2004).

Hearing was held October 2, 2007. Present were Ms. McDonald; Debtor's attorney, K.A. Foreman; Neil Gordon, the Chapter 7 Trustee; and Jeneane Treace, attorney for the U.S. Trustee. In the objection by the Chapter 7 Trustee, he seeks turnover of the \$7,500 retainer, as the estate appears to be administratively insolvent.

The U.S. Trustee's objection also asserts that Ms. McDonald should be required to turn over the \$7,500 prepetition retainer. Additionally, the U.S. Trustee points out that the Application has 5.26 hours of time expended after Trustee, Neil Gordon, was appointed. The U.S. Trustee asserts that other hours expended by Ms. McDonald were excessive or did not benefit the estate. The U.S. Trustee argues that, while represented by Ms. McDonald, Debtor's tenure as debtor-in-possession was injurious to the estate.

As set forth in the State Bar of Georgia Formal Advisory Opinion No. 91-2 (1990), "retainers" which represent advance fee payments must be placed in the client's trust account, to be withdrawn only when earned. The majority position in bankruptcy case law is that such retainers are property of the estate and must remain in the trust account until entry of an order allowing payment of fees. *See, In re Printing Dimensions, Inc.*, 153 B.R. 715 (Bankr. D. Md. 1993), and cases cited therein. No definitive case law exists in this circuit on this issue but a decision from the Bankruptcy Court in the Middle District of Florida implies, in *dicta*, the court's recognition that a retainer is property of the estate until the fees are earned *and* approved by the bankruptcy court. *In re Bicoastal Corp.*, 118 B.R. 855 (Bankr. M.D. Fla. 1990) (J. Paskay).

As shown by the Chapter 7 Trustee and the U.S. Trustee, this case may be administratively insolvent, in which event, the Chapter 7 administrative expenses would

have priority over the Chapter 11 administrative expenses. Therefore, the objectors argue, the retainer paid to Ms. McDonald must be turned over to the Chapter 7 Trustee until it is determined whether liquidation of the estate will produce sufficient assets to pay all administrative expenses. In support of this position, the U.S. Trustee cites *Specker Motor Sales Co. v. Eisen*, 393 F. 3d 659 (6th Cir. 2004). See also 11 U.S.C. §727(b).

Ms. McDonald asserts that the prepetition retainer should be more accurately characterized as a security retainer, which is not subject to disgorgement, citing *Rus, Miliband & Smith, APC v. Yoo (In re Cepek)*, 339 B.R. 730 (9th Cir. BAP 2006). While espousing the principles enunciated in *Specker*, *Cepek* recognized an exception to the disgorgement rule applicable to security retainers:

[A]ll amounts secured by the lien created by the security retainer must be paid. Because these amounts must be paid before section 726 distributions commence, disgorgement solely on the basis of section 726(b) is impermissible....[T]he [bankruptcy] court may, in the exercise of its discretion, order disgorgement or turnover for other reasons, including (but not limited to) instances when a professional has not provided services commensurate with the retainer or has not properly disclosed the secured interest in the retainer.

*Cepak*, at 737. Ms. McDonald asserts the retainer she received from Debtor was such a security retainer. The evidence, however, does not support her assertion. The application to approve her employment as Debtor's attorney did not characterize the retainer as a security retainer; and, indeed, if the application had done so, it would not have been approved. The Retainer Agreement between Debtor and Ms. McDonald was not attached to her employment application, but Ms. McDonald did produce it at the hearing on her compensation application. That agreement does not clearly state the retainer was a security

retainer. Additionally, Georgia law does not recognize a security retainer. *See* Georgia Formal Advisory Opinion No. 91-2 (1990), which describes two types of "retainers": the classic retainer, which is earned when paid, by the attorney's agreement to be "on call" for the client. The more usual type of retainer, such as the type paid in this case, represents advance fee payments that must be placed in the trust account, to be withdrawn only when earned. Prepaid fees do not constitute a security retainer, especially when not clearly and unambiguously identified as such to the client and the court.

Additionally, even if the retainer paid to Ms. McDonald were a security retainer, the value of Ms. McDonald's services rendered in this case do not exceed the amount of the retainer. In the instant case, Ms. McDonald seeks to charge an excessive amount for many of the services provided. For example, she charges 4.67 hours for preparation of a skeletal petition; 4.33 hours to gather documents; 2.5 hours to prepare and file a motion to withdraw (that was denied). The recitation in the Retainer Agreement of services to be provided evidences a less than full understanding of the services that an attorney for a Chapter 11 Debtor must undertake. Ms. McDonald filed only one, apparently incomplete, operating report for her client. She failed to adequately monitor her client's stewardship of the rental properties' income and expenses, with the result that rents were collected but not used to pay the expenses associated with the properties. When Debtor finally filed his Statement of Financial Affairs and other schedules<sup>2</sup> and Statement of Financial Affairs, it was apparent that monthly expenses exceeded income and that the estate was illiquid and

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<sup>2</sup> Section §521 and Bankruptcy Rule 1007(b) require a debtor to file schedules of assets and liabilities, a schedule of current income and expenditures, a schedule of executory contracts and unexpired leases, and a statement of financial affairs (the "Schedules"). Section 1116 requires a small business debtor to file the most recent balance sheet, statement of operations, cash flow statement and Federal income tax return.

not likely capable of successful reorganization. The brief period prior to appointment of the Chapter 11 Trustee that Debtor acted as debtor-in-possession resulted in severe erosion in the estate's financial condition.

The services sought to be compensated were evaluated pursuant to the principles set forth in *Norman v. Housing Authority of City of Montgomery*, 836 F. 2d 1292 (11th Cir. 1988) and *Miller Buckfire & Co. LLC, v. Citation Corporation*, 493 F. 3d 1313, (11th Cir. 2007). The value of a professional's services can be determined by multiplying the number of hours reasonably expended by a reasonable hourly rate. That calculation results in the lodestar. The initial consideration in calculating the lodestar is that of a reasonable hourly rate, which is determined using the subjective factors set forth in *Johnson v. Georgia Highway Express, Inc.*, 488 F. 2d 714 (5th Cir. 1974).<sup>3</sup> The other consideration in calculating the lodestar is hours reasonably expended. Hours which would be unreasonable to bill to a client irrespective of the skill of counsel must be excluded. *Norman*, 836 F. 2d 1292. In the instant case, the lodestar, for the services rendered to file the skeletal petition and to file the Schedules, Statement of Financial Affairs and one incomplete monthly report, is \$1,500. Accordingly, it is hereby

**ORDERED** that the Applicant is allowed compensation in the amount of \$1,000. It is further

**ORDERED** that, within 10 days of the date of entry of this order, Ms. McDonald shall remit to the Chapter 7 Trustee the full amount of the prepetition retainer, \$7,500. Her

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<sup>3</sup> *Bonner v. City of Prichard*, 661 F. 2d 1206 (11th Cir. 1981), renders decisions of the Fifth Circuit issued prior to September 30, 1981, binding precedent for the Eleventh Circuit.

Chapter 11 administrative expense claim of \$1,500 shall stand allowed and will be paid in accordance with the Chapter 7 priorities.

The Clerk, U.S. Bankruptcy Court, is directed to serve a copy of this order upon Debtor, Debtor's current and former attorneys, the Chapter 7 Trustee, and the U.S. Trustee.

IT IS SO ORDERED, this the 14<sup>th</sup> day of January, 2008.



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MARGARET H. MORPHY  
UNITED STATES BANKRUPTCY JUDGE