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PALM DRIVE HEALTH CARE DISTRICT  
7

8 UNITED STATES BANKRUPTCY COURT  
9 NORTHERN DISTRICT OF CALIFORNIA  
10 SANTA ROSA DIVISION

11 In re  
12 PALM DRIVE HEALTH CARE DISTRICT,  
a California local health care district,  
13 Debtor.  
14

Case No.: 14-10510-AJ

Chapter 9

**DEBTOR'S LIMITED OBJECTION TO  
COMMITTEE'S APPLICATION FOR  
EMPLOYMENT OF COUNSEL**

15 Date: [Not Set]  
16 Time: [Not Set]

17 Judge: The Hon. Alan Jaroslovsky  
18

19  
20 Palm Drive Health Care District (the "Debtor") hereby submits this limited objection to the  
21 Application Of The Official Committee Of Unsecured Creditors For Order Approving Employment  
22 Of Pachulski Stang Ziehl & Jones LLP As Committee Counsel (the "Application") submitted by the  
23 Official Committee of Unsecured Creditors (the "Committee"), which seeks approval of the  
24 Committee's employment of Pachulski Stang Ziehl & Jones LLP ("PSZ&J") as it counsel and  
25 compensation of PSZ&J as an administrative expense of this Chapter 9 case under Bankruptcy Code  
26 § 503(b). (All references to the "Code" herein are to Title 11, United States Code, unless otherwise  
27 indicated.) The Debtor's objection is to the proposed basis of compensation for PSZ&J, which  
28 contemplates compensation from the Debtor's funds without the Debtor's consent, contrary to

1 applicable Chapter 9 law. The Debtor requests that any order on the Application expressly provide  
2 that compensation for Committee counsel from funds of the Debtor may not in any event exceed  
3 such amount as the Debtor expressly consents to. As the basis for its objection to this key  
4 compensation element of the Application, the Debtor respectfully submits:

5 Chapter 9 Limitation on Committee Counsel Compensation

- 6 1. There is no statutory or constitutional basis for compensation for Committee counsel in a  
7 Chapter 9 bankruptcy case absent the consent of the debtor. The Committee glosses over  
8 this fundamental defect of the Application with cursory references: “PSZ&J will be paid  
9 by the Debtor” (Appl., ¶ 11); seeking “compensation to be paid as an administrative  
10 expense . . . pursuant to section 503(b)” (Appl., prayer paragraph); “the Committee has  
11 agreed that PSZ&J will be paid by the Debtor” (Kevane Declaration, ¶ 6); and “[t]he  
12 Committee agrees that the Firm shall be compensated by or through the Debtor as an  
13 administrative expense in the Chapter 9 Case” Appl. Exh. B, Engagement Letter, ¶2, 2<sup>nd</sup>  
14 para. Nowhere does the Application reference or acknowledge that consent of the Debtor  
15 is a precondition to payment of any compensation for Committee counsel from funds of  
16 the Debtor in Chapter 9.
- 17 2. Bankruptcy Code § 904 provides in relevant part: “Notwithstanding any power of the  
18 court, unless the debtor consents or the plan so provides, the court may not, by any stay,  
19 order, or decree, in the case or otherwise, interfere with — . . . (2) any of the property or  
20 revenues of the debtor; or (3) the debtor’s use or enjoyment of any income-producing  
21 property.” Further, only the debtor may propose a plan in a Chapter 9 case. *See* Code  
22 § 941; *In re Richmond Unified School Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Cal. 1991).  
23 The provisions of § 904 reflect the constitutional limitations inherent in a federal court  
24 presiding over the bankruptcy case of a public entity formed under the sovereignty of a  
25 state. “The entire structure of chapter 9 has been influenced by this pervasive concern to  
26 preserve the niceties of the state-federal relationship.” *In re City of Stockton*, 478 B.R. 8,  
27 20 (Bankr. E.D. Cal. 2012). This structure rests on and requires action by consent of the  
28 debtor in many ways. *Id.*

- 1           3. Congress has implemented the constitutional limitations on Chapter 9 through an explicit  
2           statutory framework that precludes the compensation arrangement for its counsel that the  
3           Committee seeks to obtain without the Debtor's consent. The only provisions of the  
4           Bankruptcy Code that apply in a Chapter 9 case are those in Chapters 1 and 9 of the  
5           Code, except as otherwise explicitly provided in § 901. Code § 103(f). Sections 327 –  
6           331 of the Code, which provide the framework and authorization for compensation of  
7           professionals in bankruptcy cases generally, are explicitly not applicable in Chapter 9  
8           cases. Code § 901(a).
- 9           4. Confirmation of a plan of adjustment of debts requires that a Chapter 9 debtor commit to  
10          payment of all allowed claims under Code § 507(a)(2). § 943(b)(5). Claims under  
11          § 507(a)(2) are administrative expenses allowed under § 503(b) as well as “any fees and  
12          charges assessed against the estate under chapter 123 of title 28.” § 507(a)(2). Notably,  
13          however, a variety of administrative expenses that are allowable under § 507(a)(2) in  
14          bankruptcy cases generally have no application in Chapter 9 cases. For example, in  
15          Chapter 11 cases *only*, a quarterly fee on a sliding scale of disbursements is payable to  
16          the United States Trustee, pursuant to 28 U.S.C. § 1930(a)(6). Since § 1930(a)(6)  
17          payments are included within the kinds of claims payable under § 507(a)(2), they are in  
18          the abstract payable as a confirmation condition under § 943(b). However, no such  
19          payments are required from a Chapter 9 debtor for plan confirmation. The mere presence  
20          of “fees and charges assessed against the estate under chapter 123 of title 28” as a  
21          category cross-referenced in § 507(a)(2) does not make U.S. Trustee quarterly fees  
22          payable by a Chapter 9 debtor.
- 23          5. Code § 503(b) administrative expenses are also referenced in § 507(a)(2). For another  
24          notable example of the limitations of such cross-referencing, § 503(b)(3)(A) makes  
25          expenses incurred by a creditor that files an involuntary petition under § 303 an allowed  
26          administrative expense claim. Here again, in the abstract expenses of a petitioning  
27          creditor commencing an involuntary case against the debtor are payable as a confirmation  
28          condition under § 943(b). But § 303(a) specifies that an involuntary petition may be

1 commenced only under Chapter 7 or Chapter 11 of the Code. Thus, no such payments  
2 could be required from a Chapter 9 debtor for plan confirmation. The mere presence of  
3 expenses of a petitioning creditor in an involuntary case as a category cross-referenced  
4 via § 507(a)(2) and § 503(b)(3)(A) does not make such expenses allowable in Chapter 9,  
5 nor does it incorporate § 303 into Chapter 9 despite the explicit non-incorporation of  
6 § 303 in § 901(a). Such “back door” incorporation of an excluded section of the Code in  
7 the face of explicit non-incorporation in § 901(a) is untenable.

8 6. Section 503(b)(2) requires payment of “compensation and reimbursement awarded under  
9 section 330(a)” to professionals. But neither § 330, nor any of the compensation  
10 provisions of §§ 328-331, are applicable in Chapter 9, per § 901(a). Thus, there can be  
11 no “compensation . . . awarded under section 330(a)” in a Chapter 9 case. The mere  
12 presence of expenses of compensation awarded under § 330 as a category cross-  
13 referenced via § 507(a)(2) and § 503(b)(2) does not make such expenses allowable in  
14 Chapter 9, nor does it incorporate § 330 into Chapter 9 despite the explicit non-  
15 incorporation of § 330 in § 901(a). Here too such “back door” incorporation of an  
16 excluded section of the Code in the face of explicit non-incorporation in § 901(a) is  
17 untenable.

18 7. The above explication of the interaction between Code § 901(a), § 507(a)(2), § 503(b)(2),  
19 and § 330(a) is the plain reading of the statutory framework. When statutory language “is  
20 plain, the sole function of the courts – at least where the disposition required by the text is  
21 not absurd – is to enforce it according to its terms.” *Hartford Underwriters Ins. Co. v.*  
22 *Union Planters Bank.*, 530 U.S. 1, 6 (2000) (internal quotations and citations omitted.)

23 8. There is no Ninth Circuit precedent construing the statutory framework discussed above.  
24 There is lower-court case law consistent with the position that a Chapter 9 debtor cannot  
25 be compelled to fund compensation for counsel for a creditors’ committee without its  
26 consent. *In re County of Orange*, 241 B.R. 212, 216 (C.D. Cal. 1999) (§ 330 does not  
27 apply in Chapter 9 cases because not included via § 901(a)); see *In re East Shoshone*  
28 *Hosp. Dist.*, 226 B.R. 430, 431 & n.2 (Bankr. D. Idaho 1998) (§ 330 is not incorporated

1 via § 901; disagreeing with alternate analysis of *In re Castle Pines* [discussed *infra* paras.  
2 13-14]).

3 The Committee's Proposed Compensation Arrangement  
4 Rests on the Flawed "Back-Door Incorporation" Theory

5 9. The Committee's proposed compensation arrangement implicitly relies on the "back-door  
6 incorporation" theory of the applicability of Code § 330 in Chapter 9 that has been shown  
7 above to be untenable. On that theory, § 303 would also apply in Chapter 9. On that  
8 theory, U.S. Trustee quarterly fees would also be payable by a Chapter 9 debtor. None of  
9 these points is sound. The methodology employed to make such a point is unsound. A  
10 section of the Code expressly and directly excluded from Chapter 9 by § 901(a) cannot  
11 become included indirectly via cross-references in § 507(a)(2) and § 503(b) of the Code.  
12 Such an approach would make important parts of § 901(a) superfluous, thus ignoring the  
13 express directive of Congress.

14 10. One case that is sometimes noted as supportive of requiring payment of fees of creditors'  
15 committee professionals as a plan confirmation requirement has a context that shows  
16 something quite different. In the Orange County Chapter 9 case, there was a compromise  
17 reached between the debtor and professionals for various committees early in the case  
18 that provided debtor consent to payment of fees *only according to debtor-agreed*  
19 *percentages*. *In re County of Orange*, 179 B.R. 195 (Bankr. C.D. Cal. 1995). Early in  
20 the case, "the County filed [a motion], which was represented to be a compromise of  
21 opposing positions regarding the County's obligation to pay Committee professionals. It  
22 sets forth the conditions under which the County will compensate professionals of the  
23 Subcommittees and members of the Committee." 179 B.R. at 198.

24 The *County decided* to pay 100% of the [general creditors'] Committee  
25 professional fees because the Committee has and will continue to play a  
26 pivotal role in the reorganization process. The County decided to pay half of  
27 the Vendor Subcommittee professional fees because, while some  
28 compensation was necessary to ensure that it could function and contribute to  
the reorganization effort, it was not clear that all of the Vendor  
Subcommittee's work would ultimately meet the substantial contribution  
standard."

179 B.R. at 198 n.6 (emphasis added).

- 1 11. The issue which then arose was whether some professionals could compel interim  
2 payment of compensation from the debtor. The court held that it had no authority to  
3 make such an order, because § 331 – providing for possible interim compensation  
4 arrangements in bankruptcy cases generally – expressly does not apply in Chapter 9  
5 because of its omission by Congress from § 901(a). 179 B.R. at 199
- 6 12. Under the County’s compromise arrangements with committee professionals, the  
7 compensation to which it had consented would for the most part be payable only at the  
8 end of the case, at plan confirmation. 179 B.R. at 199. Notably, under the terms of the  
9 compromise with the debtor professionals for several of the committees would even then  
10 receive payment in full of their fees from the debtor only if they could show that they had  
11 made a “substantial contribution” to the case. *Id.* at 198-99. The bankruptcy court then  
12 noted its view that § 943(b)(5) required payment of fees of committee professionals at  
13 plan confirmation time. *Id.* at 199-200 & notes. This is, however, at most dictum  
14 because the debtor’s consent to arrangements for payment of committee and  
15 subcommittee professionals had already been worked out in the compromise.
- 16 13. The Debtor has found one reported and one unpublished decision from bankruptcy courts  
17 that commit the specific analytical error on which the Committee’s proposal rests to  
18 reach incorrect results. The bankruptcy court in *In re Castle Pines North Metro. Dist.*,  
19 129 B.R. 233 (Bankr. D. Colo. 1991) applies the faulty back-door incorporation merely  
20 by cross-referencing reasoning refuted above. The argument runs: “Congress, by  
21 specifically referring to § 507(a)(1) [now § 507(a)(2) after intervening amendment] in  
22 § 943(a)(5) [now (b)(5)], has necessarily included § 503(b), which, in turn, includes  
23 § 330(a). The symmetry is complete by the specific inclusion of §§ 1102, 1103 and 503  
24 in § 901(a).” 129 B.R. at 234.
- 25 14. In tracing this supposed chain of Congressional intent through these many cross-  
26 references, the *Castle Pines* court expressly chooses to ignore Congress’s much more  
27 direct expression of its intent in declining to include § 330 in § 901(a). Congress has  
28 included more than 75 Code sections and subsections from other chapters via § 901(a).

1 Had Congress meant § 330 to apply in Chapter 9, it could simply and directly have made  
2 the inclusion in § 901(a). That Congress did not do so is the plainest and therefore most  
3 accurate expression of Congressional intent. Reduced to its fundamental illogic, the  
4 “symmetry” considered compelling by the *Castle Pines* court is actually an argument that  
5 Congress has both excluded and included § 330 as to Chapter 9. This contradictory  
6 approach is an untenable interpretation of the statutory framework. Further caution  
7 against thus ignoring the plainest expression of Congressional intent – § 901(a) – is  
8 provided by the constitutional limitation embodied in § 904’s prohibition on interfering  
9 with the revenues and property of the Chapter 9 debtor.

10 15. In an unpublished decision, the bankruptcy court in *In re Pauls Valley Hosp. Auth.*, 2013  
11 Bankr. Lexis 5510 (Bankr. W.D. Okla. July 18, 2013), follows the *Castle Pines*  
12 argument. The *Pauls Valley* court follows the same chain-of-cross-references approach  
13 employed by *Castle Pines*. 2013 Bankr. Lexis at Sec. I.D. It adopts the *Castle Pines*  
14 reliance on “symmetry,” resulting in the same inherent contradiction between the plain  
15 language exclusion via § 901(a) and the supposed inclusion by “symmetry” of cross-  
16 references. *Pauls Valley*, *id.* Neither *Castle Pines* nor *Pauls Valley* are coherent or  
17 persuasive interpretations of the statutory framework. The debtor’s consent is a  
18 precondition to any compensation for creditors’ committee professionals in Chapter 9.

19 Debtor’s Conditional Consent to Capped Compensation for Committee Counsel

20 16. Although therefore not required to do so, the Debtor has taken a reasonable stance and is  
21 willing to consent to some compensation for counsel for the Committee. The Debtor’s  
22 Board of Directors has considered this topic, and concluded that it will consent to  
23 compensation for Committee counsel from Debtor funds to a maximum of \$50,000 and  
24 subject to this Court’s review of such compensation for reasonableness at plan time under  
25 Bankruptcy Code § 943(b)(3).

26 17. The Debtor made known to the Committee prior to the Committee’s solicitation and  
27 selection of counsel the extent to which the Debtor would consent to funding Committee  
28 counsel. The \$50,000 limit on such consent was made known to the Committee. The

Debtor is informed that the Committee made this known to attorneys who sought the engagement to represent the Committee in this case. Attorneys solicited by the Committee were free to decline the proposed engagement if these conditions were not acceptable.

18. It is not for the Debtor to tell the Committee who it should engage as counsel. On the other hand, the Committee and counsel it engages to represent it must live within the constraints of the Chapter 9 framework.

#### Further Consequences of This Compensation Issue

19. The harm to the Debtor from the Committee's proposal is potentially not limited to the Committee's fees. An additional committee – an official committee representing former employees ("Employee Committee") – is in the process of appointment, at the earlier direction of this Court. If the Committee's proposed compensation arrangement is allowed to stand without appropriate limitation, then it could very well happen that the Employee Committee would be encouraged (despite this Court's comment to the contrary at the hearing held on July 18, 2014) also to seek compensation payable by the Debtor without its consent on a § 503(b) administrative expense basis. This chain of falling dominoes should be stopped before it starts, by appropriately limiting an order on employment of counsel for the present Committee as here requested by the Debtor.

WHEREFORE, under the circumstances and in light of the applicable law, the Debtor urges that any order approving the Application specify that compensation for counsel for the Committee will be payable from funds of the Debtor only (i) within the limit of the amount consented to by the Debtor and (ii) upon subsequent review and approval by this Court under Code § 943(b)(3).

While a hearing is not required on professional employment applications, to the extent that the Court wishes to hear oral argument on this compensation arrangement dispute, the Debtor

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1 suggests that specially setting the matter for the date and time of the pending status conference in the  
2 case – September 15, 2014, at 2:00 p.m. – would be a potential convenience to all.

3 Dated: September 7, 2014

FOX ROTHSCHILD LLP

4 By: /s/ Dale L. Bratton

Dale L. Bratton

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6 Attorneys for Debtor  
Palm Drive Health Care District  
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