
In the United States Bankruptcy Court
for the
Southern District of Georgia
Brunswick Division

In the matter of:)
) Chapter 11 Cases
FIRST AMERICAN HEALTH)
CARE OF GEORGIA, INC.) Numbers 96-20188
and its wholly owned subsidiaries) through 96-20218
listed on Exhibit "A")
)
Debtors)

**ORDER ON APPLICATION AUTHORIZING EMPLOYMENT OF
ALSTON & BIRD AS SPECIAL COUNSEL**

The Debtors' Chapter 11 cases were filed on February 21, 1996.¹ On March 1, 1996, Debtors filed an application seeking authorization to employ the law firm of Alston & Bird as special counsel to perform legal services enumerated as follows:

- (1) providing continuing and ongoing representation to the Parent with respect to the criminal proceedings;
- (2) representing Debtors in matters relating to Medicare and private pay reimbursement issues, including the Complaint for Turnover filed on the petition Date; and
- (3) matters related to the foregoing as they relate to Debtors obligations under the Bankruptcy Code, the

¹ Debtors consist of First American Health Care of Georgia, Inc., and its twenty-one wholly owned subsidiaries. Debtors operate in twenty-two states, employ approximately 16,000 individuals, and provide home health care to about 32,000 patients. During February 1996, Debtors' parent corporation and CEO were convicted of fraud stemming from Debtors' Medicare billing practices. Debtors' liabilities include the reimbursement of the Medicare overpayments and any criminal fines imposed at sentencing.

merger agreement with Integrated Health Services, Inc., and the plan of reorganization that the Debtors intend to file, and similar bankruptcy related matters, as such may arise during the pendency of the bankruptcy case.

The Court scheduled a hearing for March 27, 1996 to consider the application and an objection was filed by the United States Trustee. Because Debtors' criminal sentencing hearing was scheduled for approximately three weeks after the March 27 hearing, by separate order this Court approved Alston & Bird's representation of Debtors in matters relating to the Debtors' criminal defense pursuant to Section 327(e). The Court now reviews Debtors' request to employ Alston & Bird as special litigation counsel for certain civil matters as enumerated in the application.

Debtors' application as supplemented by Alston & Bird's counsel, Mr. LaFiandra, reveals that Debtors retained Alston & Bird in the fall of 1995 to represent Debtors in regard to a multi-count indictment for alleged Medicare fraud. On November 29, 1995, Alston & Bird was paid a \$200,000.00 retainer for this representation. The agreement provided that Alston & Bird would bill the Debtors monthly, be paid on a current basis for fees incurred and expenses advanced, and hold the retainer to secure payment of those sums. In fact, on December 11, 1995, and January 11, 1996, Alston & Bird rendered bills to the Debtors which were paid in a period of thirty days or less and totaled \$44,648.00 and \$161,504.50 respectively. Notwithstanding these billings the application reveals that "Debtors owed Alston & Bird approximately \$474,286.00 as of the petition date for outstanding legal fees and expenses (before application of any retainer)." In other words,

Alston & Bird holds a net pre-petition claim of approximately \$274,286.00 for its criminal representation of the Debtors. The application also reveals that Debtors paid an additional retainer of \$140,000.00 to Alston & Bird in consideration of its agreement to handle certain civil litigation against the United States Department of Health and Human Services.

The objection of the United States Trustee asserts that 11 U.S.C. Section 327(a) of the Bankruptcy Code prohibits Debtors from employing professionals who are not "disinterested" and that Alston & Bird is not "disinterested" under the definition set out in 11 U.S.C. Section 101(14) of the Bankruptcy Code because the firm is a creditor in this Chapter 11 case. 11 U.S.C. Section 327(a) provides as follows:

(a) Except as otherwise provided in this section, 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, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

The requirement that general counsel be "disinterested" incorporates 11 U.S.C. Section 101(14) which defines disinterestedness so as to exclude a creditor of the debtor. As a result, Alston & Bird cannot be employed under Section 327(a), at least in the absence of a waiver of all pre-petition fees.² In response, however, the applicant contends that the

² See United States Trustee v. Price Waterhouse, 19 F.3d 138, 141 (3rd Cir.1994)(sections 101(14) and 101(10) when read together "unambiguously forbid a debtor in possession from retaining a pre-petition creditor to assist in the execution of its title 11 duties"); In re Prince, 40 F.3d 356, 361 (11th Cir.1994)(law firm which was a creditor and held interest adverse is not a "disinterested person" under 327(a)); In re Federated Department Stores,

employment for which it seeks appointment falls under 11 U.S.C. Section 327(e) which reads as follows:

(e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

It is important to note that if an attorney's services qualify under Section 327(e), counsel may be employed for "a specified special purpose" even if that attorney has previously represented the debtor (1) if it is in the best interest of the estate and (2) if such attorney does not represent or hold any interest adverse to the debtor or the estate with respect to the matter on which such attorney is to be employed. There is no additional requirement,

Inc., 44 F.3d 1310, 1318 (6th Cir.1994)(debtor-in-possession does not have more latitude than the trustee in the retention of professionals and may not circumvent requirements of 327(a)); In re Eagle-Picher Industries, Inc., 999 F.2d 969, 972 (6th Cir.1993)(to be employed by a trustee, a professional can have neither an "adverse interest" nor be an "interested person," regardless of the professional's familiarity with the debtors' business operations); In re Middleton Arms, Ltd., 934 F.2d 723, 725 (6th Cir.1991)("section 327 prevents individual bankruptcy courts from having to make [equitable] determinations as to the best interest of the debtors in these situations"); In re CIC Investment Corp., 175 B.R. 52, 56 (9th Cir.B.A.P.1994)(pursuant to 327(a) and 101(14), the court cannot approve employment of counsel holding a pre-petition secured claim against the debtor); In re Brennan, 187 B.R. 135, 152 (D.N.J. 1995)(counsel's waiver of pre-petition debt precludes his disqualification under 327(a)); In re Fulgham Enterprises, Inc., 181 B.R. 139, 142 (Bankr.N.D.A la. 1995)(unless C.P.A. waives his pre-petition claim, he may not be employed by the debtor); In re Eastern Charter Tours, Inc., 167 B.R. 995, 998 (Bankr.M.D.Ga. 1994)(accountant holding pre-petition claim against debtor for routine services is disqualified from employment unless claim is waived); In re Jaimalito's Cantina Associates, Ltd., 114 B.R. 1, 2 (Bankr.D.C. 1990)(counsel who held pre-petition claim of unspecified amount did not qualify as "disinterested person" who could be employed to generally represent debtor); In re Watervliet Paper Co., Inc., 96 B.R. 768, 775 (Bankr.W.D.Mich. 1989)(debtor-in-possession may not retain firm as general counsel unless firm waives its pre-petition claim); Matter of Boro Recycling, Inc., 67 B.R. 3, 4 (Bankr.E.D.N.Y. 1986)(law firm that was "creditor," and, therefore, not a "disinterested person," could not be retained by debtor); Compare In re Martin, 817 F.2d 175 (1st Cir.1987)(counsel with pre-petition claims may only represent debtor-in-possession if the pre-petition claim was incurred in the direct relation to the filing of the petition).

however, that the attorney be disinterested as there is under Section 327(a) which governs the appointment of debtor's general counsel and other professionals.

The focus of this order is the scope of representation permitted by section 327(e) and whether Alston & Bird's application for employment satisfies the statute.

Debtors' initial application sought approval of the employment of Alston & Bird to perform broad, general, and far-flung services. At the hearing held on March 27, 1996, counsel from Alston & Bird stated to the Court that Debtors intentionally submitted an application with a broad scope of representation in the interest of including all potential matters for which Alston & Bird might be employed, but that in reality its employment would be more limited. After the hearing, an amended application outlining narrower services to be performed by Alston & Bird as special counsel was filed and reads as follows:

(3) . . . Debtors seek to employ . . . Alston & Bird. Debtors . . . request . . . Alston & Bird to perform the following legal services . . . (2) representing Debtors in complex and specific bankruptcy litigation matters relating to Medicare and private payors, including any litigation related to (a) the suspension or reduction of payments due to Debtors under Medicare, (b) the exclusion of any of the Debtors from participation in the Medicare program or similar program, (c) the assumption of the various Medicare-related provider agreements and the related cure and reinstatement issues thereunder and (d) the claim of the government against any Debtors in respect of any Medicare overpayments.

Mr. Frank Chamberlain, Debtors' CEO testified in support of Debtors' prospective employment of Alston & Bird. Chamberlain acknowledged that he viewed Alston & Bird

as "the litigators," but limited to "special counsel only, restricted to litigation." He considered it necessary to employ a firm of Alston & Bird's size to handle the complexity and magnitude of Debtors' anticipated litigation. When asked a series of questions to elicit the division of labor between Debtors' general bankruptcy counsel, Lamberth, Bonapfel, Cifelli, Willson & Stokes, P.A., and Alston & Bird, he stated that he would address such problems as they arose. Chamberlain anticipated that when those questions arose, he would meet with counsel from both the Lamberth firm and Alston & Bird to determine the appropriate course of action.

For appointment under Section 327(e) of the Bankruptcy Code Debtors must show that (1) the scope of Alston & Bird's representation be for "a specified special purpose," (2) that their retention of counsel be in the best interests of the debtor, and (3) that counsel does not hold an "interest adverse." The threshold issue is whether Alston & Bird's employment, as now defined, falls within the meaning of "a specified special purpose."

It is clear that Congress intended for Section 327(e) to apply to a narrow set of circumstances. The phrase, "specified special purpose," is in the singular, suggesting that it may be limited to cases involving a single lawsuit or a discrete and specialized advisory role (i.e., tax, securities, antitrust, etc.). The legislative history supports this interpretation. "This subsection does not authorize the employment of the debtor's attorney to represent the estate generally or represent the trustee in the conduct of the bankruptcy case. The subsection will most likely be used when the debtor is involved in complex litigation, and

changing attorneys in the middle of the case after the bankruptcy case has commenced would be detrimental to the progress of that other litigation." H.R. Rep. No. 595, 95th Cong., 1st Sess. at 328 (1977); S.Rep. No. 989 95th Cong., 2nd Sess. at 38-39 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 5824-5825, 6284-6285. "This provision thus recognizes the long-standing general rule that the trustee should not ordinarily employ an attorney who represents or has represented the bankrupt debtor, because the trustee should have an adviser impartial as between creditors [citation omitted]. Moreover, the 'specified special purpose' requirement serves the important policy of avoiding an unnecessary duplication of services at the expense of the estate." See In re Interstate Distribution Center Associates, Ltd., 137 B.R. 826, 833 (Bankr.D.Colo. 1992) (holding that the contemplated "special services" were tantamount to conducting the case and Section 327(e) was being used as a "vehicle" to permit counsel to remain vitally active in the conduct of the case) quoting In re NRG Resources, Inc., 64 B.R. 643, 647 (W.D.La. 1986). Accordingly, when analyzing the prospective employment of counsel pursuant to Section 327(e), the bankruptcy court should consider not only the "special" purpose specified in the application, but all relevant facts surrounding the debtor's bankruptcy, such as the nature of the debtor's business, all foreseeable employment of "special" counsel, the history and relationship between the debtor and proposed firm, the progress of any ongoing litigation, the expense of replacement counsel, potential conflicts of interest, and the role of general counsel.

The interplay between Sections 327(a) and (e) is important. Section 327(a) sets a stringent no-creditor status requirement for professionals hired by trustees or debtors-

in-possession. *See* cases cited *supra* note 2. Section 327(e) creates an exception, yet one which must be narrowly construed to avoid evisceration of the general rule. Certainly the rule has had its critics. *See In re Eastern Charter Tours*, 167 B.R. at 997 ("this Court is not free to ignore legislative enactments just because it may appear that another result might better serve the interest of the estate"); *In re Watervliet Paper*, 96 B.R. at 774 ("the Court's proverbial hands are tied"); *Matter of Boro Recycling, Inc.*, 67 B.R. at 4-5 ("[t]his Court is unhappy in having to deny the debtor . . . the expertise and experience of the firm . . . which the court believes the debtor needs . . ."). Yet the clear weight of authority is that these considerations must be addressed by Congress. *See Price Waterhouse*, 19 F.3d at 142 ("If it is thought that 327(a) should allow trustees and debtors in possession under some circumstances to employ professionals who are not "disinterested," an amendment of that provision should be sought from Congress).

I construe Section 327(a) and (e) together as generally discouraging the employment of a creditor and as resolving any doubt in favor of denial of the application. Ultimately, the bankruptcy court, when considering the application of prospective counsel pursuant to Section 327(e) must guard against the retention of a creditor whose role as "special counsel" has the potential of placing the professional in a *de facto* role which is impermissibly broad and general. To do otherwise would circumvent the "no creditor" rule of Section 327(a) by which Congress clearly intended to eliminate from the bankruptcy process the reality, or the appearance, of a conflict of interest on the part of professionals. *See In re Federated Department Stores, Inc.*, 44 F.3d at 1319 ("Congress sought to disqualify

professionals with the appearance of a conflict of interest as well as those who have an actual conflict of interest").

Alston & Bird represented Debtors during the months prior to the filing of the petition and continues to represent Debtors in all post-petition criminal matters. In this application, Debtors request the employment of Alston & Bird for "complex and specific bankruptcy litigation matters relating to Medicare and private payors, including any litigation related to (a) the suspension or reduction of payments due to Debtors under Medicare, (b) the exclusion of any of the Debtors from participation in the Medicare program or similar program, (c) the assumption of the various Medicare-related provider agreements and the related cure and reinstatement issues thereunder and (d) the claim of the government against many Debtors in respect of any Medicare overpayments." Besides the maintenance of its normal business, Debtors' primary financial objectives include the completion of a merger agreement with Integrated Health Services, a settlement of all Medicare-related overpayments due to the United States, and the minimizing of its criminal fine. In furtherance of these goals, Alston & Bird filed an adversary proceeding seeking a temporary restraining order together with interlocutory and permanent injunctive relief to compel the United States to continue forwarding Medicare PIP payments of \$22 million every two weeks.³ Although the pending litigation is specific and narrow, the scope of

³ See First American Health Care of Georgia, Inc. v. United States Department of Health and Human Services, Adv. Proc. 96-2007, Ch. 11 Case No. 89-40074, slip op. (Bankr.S.D.Ga., Feb. 1, 1996)(Davis, J.). Briefly, the PIP's are the primary source of the Debtors' income. Debtors, the largest private home health care provider in the U.S., receives approximately \$22 million on a bi-weekly basis from the government which represents estimated Medicare reimbursements. These payments are roughly ninety percent of the Debtors' revenue. After the Debtors'

potential representation is quite broad. Indeed, the Debtors propose to retain Alston & Bird for all future litigation "relating to Medicare and private payors."

Courts construing Section 327(e) have yet to articulate a clear test for what services fit the "specified special purpose" language of the statute. Most fact patterns, however, have limited this exception to cases where the litigation was pending either pre-petition, or at the time of the application, or where, in fact, only a single lawsuit was involved. See In re American Avia Associates-Sea, 150 B.R. 24 (Bankr.S.D.Tex. 1992) (debtor-in-possession may represent law firm as special counsel in complex and ongoing state court litigation); In re Milford Group, Inc., 164 B.R. 899 (Bankr.M.D.Pa. 1993) (trustee permitted to retain firm as special counsel in state court lender liability action); In re RPC Corp., 114 B.R. 116 (M.D.N.C. 1990) (firm permitted to act as special counsel in lender liability claim). No court appears to have approved an open ended appointment for multiple instances of *future* litigation. At least one case where "special counsel" was appointed for a laundry list of services illustrates the risk inherent in a liberal interpretation of 327(e).⁴ Most instances have involved litigation not central to a debtor's business or the

criminal conviction, the government withheld the delivery of these payments. Debtors filed for bankruptcy protection and retained the firm of Lamberth, Bonapfel, Cifelli, Willson & Stokes, P.A. as general counsel and Alston & Bird as special counsel for the purpose of obtaining a temporary restraining order prohibiting the suspension of these payments. This Court subsequently granted the temporary restraining order.

⁴ See In re Imperial Corporation of America, 181 B.R. 501, 506 (Bankr.S.D.Cal. 1995)(in regard to the approval of counsel for future employment, the bankruptcy court stated that if it had been presented with all of the material facts at the time of the application, "the Court never would have approved carte blanche [counsel's] request to be employed on 'all other general corporate and business law matters and commercial litigation arising in the course of applicant's operation of its business'"); see also In re D.L. Enterprises, 89 B.R. 107, 113 (Bankr.C.D.Cal. 1988)(bankruptcy court terminated special counsel's employment "effective immediately" when the evidence revealed that although counsel technically satisfied the elements of § 327(e) the application lacked complete and full disclosure).

success of the case. *See In re RPC Corp.*, at 120. Clearly there is no bright-line test generally agreed upon by the Courts which have been called upon to resolve these questions. Rather, the dividing line is a matter of degree. The continuum of possible levels of representation ranges from a single pending case, ancillary to the debtor's business on one extreme, which is permitted, to representation that amounts to conducting the Chapter 11 case on the other, which is clearly prohibited. *See In re Johnson*, 1994 WL 163911, 2 (N.D.Cal.) ("this provision does not permit the trustee to hire debtor's counsel for general assistance in conducting the case. Instead, the provision is meant solely to provide the trustee with the option of employing debtor's counsel for a special, clearly-delineated, and court-approved purpose"); *see also* 2 King *Collier On Bankruptcy*, ¶327.03, p. 327-88 (15th ed. 1996) (suggesting that the "special purpose" of Section 327(e) must not be related to the debtor's reorganization and the order authorizing counsel must "specify" the "special purpose") *citing In re McGrath Mfg. Co.*, 95 F.Supp. 825 (D.Neb. 1951). It is for the Court to determine where representation strays too far from a specified special purpose toward the general representation of the debtor.

As mentioned previously, Alston & Bird represents the Debtors in an adversary filed against the United States to ensure the bi-weekly remittance of "periodic interim payments," or "PIPs." That matter, which is the only litigation now pending, is intended to insure the continued post-petition cash flow of the business. After surveying the cases dealing with Section 327(e) I hold that Alston & Bird's employment in Adversary Proceeding 96-2007 et.al., is for "a specified special purpose." Because it is, the remainder

of the inquiry is whether its appointment is (1) in the interest of the estate; and (2) whether Alston & Bird holds or represents an interest adverse to the debtor or the estate in regard to this particular matter. First, it is in the interest of the estate to approve Alston & Bird's continued handling of the pending adversary proceeding. The firm already has formulated the original pleadings, filed the case, briefed the issues, and tried the merits of the temporary restraining order hearing. Alston & Bird is capable, knowledgeable and experienced. I find that the substitution of another firm would increase costs, delay any further prosecution of the matter, and not be in the interest of the estate. Second, the affidavit of John C. Weitnauer establishes that Alston & Bird holds a pre-petition claim for services to the Debtors and may represent other parties in this large and far-reaching case. However, it also establishes that Alston & Bird does not hold or represent any interest adverse to the Debtors or the estate with respect to the pending litigation. Accordingly, Alston & Bird is approved for employment for the specified special purpose of prosecuting the pending adversary proceeding.

As to all other matters, I hold that Debtors' application to retain the law firm of Alston & Bird is denied. First, these potential litigation matters have not been filed and/or the causes of action have yet to accrue. Second, if the litigation arises, it will strike at the very heart of or be central to the Debtors' conduct of this Chapter 11 case. I find that it would go beyond the scope of what Congress intended in Section 327(e) to approve multiple case representation by Alston & Bird in cases yet to be filed, the outcome of which will dictate the manner in which Debtors' bankruptcy counsel can conduct the case and

determine in large measure the success of this Chapter 11 case. To permit Alston & Bird to litigate all Medicare and private payor disputes, Medicare exclusion issues, assumption of provider agreements, and disputes over Medicare overpayment for a period of time spanning several years, would potentially grant the firm a position of influence and control which should only be reserved for general counsel. If much of the pertinent information needed by Debtors' general counsel for strategic planning emanates from special counsel, the role of general counsel diminishes significantly while "special counsel," a creditor, could substantially influence the course of Debtors' bankruptcy.

The amended application for employment, although not as broad as the initial application, still requests a broad approval for all "complex and specific bankruptcy litigation matters relating to Medicare and private payors." Remembering that over ninety percent of Debtors' income derives from Medicare contributions, approval of this application could conceivably include most or all of Debtors' future litigation. The opinion of the Court in In re Neuman, 138 B.R. 683 (S.D.N.Y. 1992), is persuasive. Similar to the present case, in Neuman, the trustee sought appointment of "special counsel" to assist trustee in determining the allowable amount of a Medicare overpayment claim by the government. The District Court reversed the appointment of "special counsel" and denied the application finding that investigating the government's claim was a large part of conducting the case. The Court stated,

. . . [O]n the one hand, the appointment was clearly for a

special purpose, in the sense that . . . services are being employed only with respect to one claimant (the United States) and one sort of claim (medically related). On the other hand, investigating the validity of the government's claims is a large part of conducting the case We think it is clear both from the language of §327(e) and from the framework of §327 more generally that, even if there is a special purpose, it is crucial that the appointment not be part of the trustee's general duty of conducting the case.

Id. at 686. In addition, the District Court focused on the relationship of the creditor's prospective employment which was to reduce the claim of another creditor, the government. The District Court noted that in typical Section 327(e) situations a creditor is employed to bring assets into estate for all creditors; whereas, permitting a creditor to litigate Medicare reimbursement claims against the government has the potential of increasing the return to some creditors at the expense of another. Id. at 686. This Court agrees. Alston & Bird's criminal representation of the Debtors benefits all creditors; preservation of the PIP payments for current services benefits all creditors; however, allowing Alston & Bird to litigate all future Medicare-type disputes potentially will pit one creditor against another.

Alston & Bird has already been approved to represent the Debtors' in post-petition criminal matters. I find that the continued employment of Alston & Bird in Adversary Proceeding 96-2007 et. al. qualifies as retention for "a specified special purpose." However, the remainder of the proposed representation does not qualify and, therefore, is denied.

IT IS SO ORDERED.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ___ day of April, 1996.