AMERICAN BANKRUPTCY INSTITUTE

2018 New York City Bankruptcy Conference

Engaging and Paying Contingency Counsel in Bankruptcy

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Hon. Alan S. Trust
U.S. Bankruptcy Court (E.D.N.Y.)

CONCURRENT SESSION

2018

American Bankruptcy Institute NYC Conference

Engaging and Paying Contingency Counsel in Bankruptcy

2:45-4:00 p.m.

Ilana Volkov – Moderator
Hon. Alan S. Trust, U.S.B.J. (E.D.N.Y.)
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4:15-5:30 p.m.

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I. Introduction and Overview

A. General Standards for Any Fee Arrangements

Rule 1.5 of New York Rules of Professional Conduct –Fees and Division of Fees

(a) A lawyer shall not make an agreement for, charge, or collect an excessive or illegal fee or expense. A fee is excessive when, after a review of the facts, a reasonable lawyer would be left with a definite and firm conviction that the fee is excessive. The factors to be considered in determining whether a fee is excessive may include the following: (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly; (2) the likelihood, if apparent or made known to the client, that the acceptance of the particular employment will preclude other employment by the lawyer; (3) the fee customarily charged in the locality for similar legal services; (4) the amount involved and the results obtained; (5) the time limitations imposed by the client or by circumstances; (6) the nature and length of the professional relationship with the client; (7) the experience, reputation and ability of the lawyer or lawyers performing the services; and (8) *whether the fee is fixed or contingent*.

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(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. Promptly after a lawyer has been employed in a contingent fee matter, the lawyer shall provide the client with a writing stating the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or, if not prohibited by statute or court rule, after the contingent fee is calculated. The writing must clearly notify the client of any expenses for which the client will be liable regardless of whether the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a writing stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

B. Kinds of cases that may be ripe for retaining contingency counsel

Note: Section 327(e) says pre-petition lawyers can be retained post-petition

Retaining and Paying Contingency Counsel and Other Professionals in Bankruptcy

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I. Standard for Retaining Contingency Counsel and Other Professionals in Bankruptcy

A. Section 328(a) Retention

Congress empowered trustees and creditors' committees to retain professionals pursuant to various sections of the Bankruptcy Code, including sections 327, 328 and 1103. However, the terms of compensation for professionals will vary depending on the section utilized for retention. Under section 328 of the Bankruptcy Code, the trustee or a creditors committee may seek court approval to retain a professional on "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or *on a contingent fee basis*." 11 U.S.C. § 328(a) (emphasis added).

Under the prior Bankruptcy Act, compensation agreements, including contingency fee arrangements, were not authorized, and courts were required to approve fees only if reasonable taking consideration of conservation of the estate. *Official Committee of Fox Markets, Inc. v. Ely*, 337 F.2d 461, 468 (9th Cir. 1964). When the Bankruptcy Code was enacted in 1978, Congress sought to facilitate retention of competent professionals by estate fiduciaries by incentivizing professionals to work on bankruptcy cases. Congress furthered this goal with section 328(a), which authorizes the approval of compensation agreements, a significant departure from pre-Code practice.

Pursuant to section 328(a), the reasonableness of a professional's compensation is decided on a prospective, rather than retrospective, basis. *See Riker, Danzig, Scherer, Hyland & Perretti v. Official Comm. of Unsecured Creditors (In re Smart World Techs., LLC)*, 552 F.3d 228, 232 (2d Cir. 2009) ("*Smart World*") ("[S]ection 328(a) permits a bankruptcy court to forgo a full post-hoc reasonableness inquiry …."); *In re High Voltage Eng'g Corp.*, 311 B.R. 320, 333 (Bankr. D. Mass 2004) (holding that bankruptcy court must determine reasonableness of professional's compensation before authorizing employment of professional). Once the terms of the professional's retention are approved by the court, the professional will be paid pursuant to the terms of the retention order unless "such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a). A bankruptcy court may approve retention of a professional on terms different from those proposed by the professional in its application in order to satisfy the requirement of reasonableness under section 328(a). *See In re Fed. Mogul-Global, Inc.*, 348 F.3d 390, 397-98 (3d Cir. 2003).

A professional may be compensated either under section 328 or section 330. The sections are mutually exclusive to one another, and a court "may not conduct a [section] 330

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inquiry into the reasonableness of the fees and their benefit to the estate if the court already has approved the professional's employment under [section] 328." *See Friedman Enters. v. B.U.M Int'I Inc. (In re B.U.M. Int'l, Inc.)*, 229 F.3d 824, 829 (9th Cir. 2000); *see also In re Iron Horse Bicycle Co., LLC*, No. 809-71324-ast, 2010 Bankr. LEXIS 378, at *13-14 (Bankr. E.D.N.Y. Feb. 4, 2010) (noting that Second Circuit has deemed sections 328 and 330 to be "mutually exclusive") (citations omitted).

Section 330 of the Bankruptcy Code governs a professional's compensation if engagement not approved under section 328(a). *See Owens v. United States Tr. (In re Owens)*, No. CC-13-1252, 2014 Bankr. LEXIS 3346, at *6-7 (B.A.P. 9th Cir. Aug. 6, 2014). Section 330 provides that professionals may be compensated for "actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person," and may be reimbursed for "actual, necessary expenses." *See* 11 U.S.C. § 330(a)(1)(A)-(B). The bankruptcy court may, on its own motion or by motion of a party in interest, award less compensation to the professional that it requested, so long as that compensation is reasonable. 11 U.S.C. § 330(a)(2). Reasonableness is measured by weighing "all relevant factors," including time spent performing services and the amount to be charged for those services. 11 U.S.C. § 330(a)(3).

B. <u>Improvidence Under Section 328</u>

Section 328(a)'s improvidence exception is a narrow one. *See Asarco, L.L.C. v. Barclays Capital, Inc. (In re Asarco, L.L.C.)*, 702 F.3d 250, 259 (5th Cir. 2012); *Smart World*, 552 F.3d at 234. "A court may not award a fee different from one that it has approved in a retention order unless it finds that the terms in the retention order were 'improvident in light of developments not capable of being anticipated at the time . . . .'" *Houlihan Lokey Howard & Zukin Capital v. High River Ltd. P'ship*, 369 B.R. 111, 117 fn.8 (S.D.N.Y. 2007) (quoting 11 U.S.C. § 328(a)). "This is a difficult requirement to meet, and courts rarely alter a fee award on these grounds." *Id.* (quoting *In re Yablon*, 136 B.R. 88, 92 (Bankr. S.D.N.Y. 1992)). "Congress enacted § 328(a) to eliminate the previous uncertainty associated with professional compensation in bankruptcy proceedings, even at the risk of potentially underpaying, or, conversely, providing a windfall to, professionals retained by the estate under § 328(a)." *ASARCO,* 702 F.3d at 258.

Few cases uphold the reduction on improvidence grounds of a professional's fee previously approved under section 328(a). *See e.g., In re Black Diamond Mining Co., LLC*, 2009 Bankr. LEXIS 3926, at *7-9 (Bankr. E.D. Ky. Dec. 11, 2009) (collapse of market for coal was not unforseeabale); *In re ARGOSE, Inc.*, 372 B.R. 705, 710 (Bankr. D. Del. 2007). "[T]he fact that contingency fees may appear excessive in retrospect is not a ground to reduce them because 'early success by counsel is always a possibility of capable of being anticipated.'" *Smart World*, 552 F.3d at 235 (quotation omitted.)

Improvidence requires a finding that terms of a professional's section 328(a) retention were incapable of anticipation at the time of retention. *See Official Comm. of Unsecured Creditors v. Perseus Partners VII, L.P. (In re Distributed Energy Sys. Corp.)*, 2009 Bankr. LEXIS 1284, at *9-10 (Bankr. D. Del. May 18, 2009) (collapse of American economy after professional's retention under section 328(a) was incapable of anticipation); *Gibbs & Bruns LLP v. Coho Energy, Inc. (In re Coho Energy, Inc.)*, 395 F.3d 198, 205 (5th Cir. 2004) ("That the arbitration panel would be kept so ill-informed as to use figures two and a half times in excess of the actual amount qualifies as an unanticipatable development within the discretion of a bankruptcy court's findings of fact.")

C. <u>Improvidence Based on Mutual Mistake? *In re Washinton Mutual, Inc.*</u>

Recently, in *In re Wash. Mut., Inc.*, 2018 Bankr. LEXIS 291 (Bankr. D. Del. Feb. 2, 2018), the Delaware Bankruptcy Court was asked to determine whether an alleged mutual mistake in the terms of Grant Thornton's engagement in the Washington Mutual chapter 11 cases was a sufficient basis to deny Grant Thornton's contingency fees on improvidence grounds.

In Washington Mutual, Grant Thornton was retained to pursue the estates' claims related to certain California overcharges related to bond interest payments, pursuant to a post-petition engagement agreement approved under section 328(a). *Id.* at *8. The retention agreement, which was incorporated into the debtor's application to retain Grant Thornton filed in June 2009, provided for a contingency fee of 10% of any "Economic Value" recovered from the California Franchise Tax Board ("FTB"). Economic Value was defined as any "tax, interest, and penalty offsets, whether received by check, deposit, overpayment applied, credit, audit offset, or any other means," and included "any reduction of other assessments that are received pursuant to an agreement with the FTB to not file or to withdraw any refund claims." *Id.*

During the chapter 11 case, Grant Thornton professionals assisted the debtors on tax issues and participated in negotiations with the FTB. The debtors also retained Alvarez & Marsal as restructuring advisor during their cases and Alvarez's services included dealing with all the debtors' tax issues. In February 2012, the debtors' chapter 11 plan was confirmed, approving the formation of a liquidating trust to review and make distributions on claims. In connection with confirmation, the court approved final fees of all professionals retained in the cases, including Grant Thornton's contingency fee.

After confirmation of the plan, Grant Thornton professionals assisted the liquidating trustee in objecting to the FTB's proof of claim. A few months after the objection to FTB's proof of claim was filed, the liquidating trustee and FTB agreed to a settlement of FTB's claim and payment to the debtors' estates of approximately $225 million. Alvarez professionals led the negotiations with FTB on behalf of the estates; Grant Thornton was not involved in the negotiations and only became aware of the settlement after reviewing the court docket. After the liquidating trustee refused to pay the contingency fee, Grant Thornton filed a motion to compel payment and for sanctions against the trust for failing to pay its fee.

The liquidating trust argued that the parties intended Grant Thornton's contingency fee for Economic Value that was derived solely from recovery on the interest overcharge issues. The parties, however, mistakenly entered into an engagement agreement that gave Grant Thornton a contingency fee on all FTB recoveries. This mutual mistake made it impossible to foresee that the Court would approve such a large contingency fee in favor of Grant Thornton. In other words, the liquidating trust argued that enforcing the plain terms of the engagement agreement makes it improvident. After trial, the court found that the parties intended the fee to apply to all economic value received from the FTB and rejected the liquidating trust's argument. *Id.* at *24.

The court further noted that even if the debtors were mistaken, such unilateral mistake does not support a finding of improvidence as it was foreseeable that a court would enforce the agreement as written. *Id.* Accordingly, there was no basis to find improvidence under section 328(a).

Perhaps the most important aspect of the decision is the court's granting of Grant Thornton's request for sanctions. While the liquidating trust argued sanctions were improper given the good faith dispute over the fee, the court noted that the trust's "conduct demonstrated an inexcusable disregard for the Court's [prior fee] order and cannot be remedied by a pleading of good faith. Because Grant Thornton had to file a motion to recover its contingency fee, the Court concludes that sanctions are appropriate in the amount of the costs associated with the filing and prosecution of its motion." *Id.* at **26-27.

D. Circumventing *Baker Botts v. ASARCO* With Section 328(a)?

In *Baker Botts L.L.P. v. ASARCO LLC*, 135 S.Ct. 2158, 2169 (2015), the Supreme Court held that professionals retained in bankruptcy cases are not entitled to fees for time spent on defending their fee applications.

Can a professional seek section 328(a) approval of an engagement agreement containing a provision awarding attorney fees to the professional for defending its fee application?

In *In re Boomerang Tube, Inc.*, 548 B.R. 69, 72 (Bankr. D. Del. 2016), the court held that committee counsel may not rely on section 328(a) retention for approval of fee defense provisions. *But see In re Joan & David Halpern, Inc.*, 248 B.R. 43 (Bankr. S.D.N.Y. 2000) (approving retention of financial advisory firm containing provision obligating debtor to indemnify firm based on applicable state law).

II. Hybrid Orders: Blackstone Protocol vs. *Relativity* Decision

Although sections 328 and 330 have been said to be mutually exclusive, the United States Trustee has objected to retention applications under section 328(a), requesting that hybrid approach be utilized, frequently in connection with the retention of investment bankers and financial advisors. This hybrid approach is colloquially known as the "Blackstone Protocol". However, the future of the Blackstone Protocol is in question in the Second Circuit after recent decisions by courts in the circuit.

A. The Blackstone Protocol

The Blackstone Protocol, which is utilized mostly for investment bankers and financial advisors, gives the United States Trustee the right to object to a professional firm's fee application on all grounds including but not limited to the reasonableness standard provided for in section 330 of the Bankruptcy Code, even if the firm's retention is approved pursuant to section 328(a). *See In re Global Crossing, Ltd., et al.*, Case No. 02-40187 (REG), Interim Order Pursuant to §§ 327(a) and 328(a) Authorizing the Employment and Retention of the Blackstone Group, L.P. as Financial Advisor to the Debtors and Debtors-in-possession.

The United States Trustee has also sought to apply the Blackstone Protocol to counsel retained on a contingency fee basis. *See e.g.*, *In re Aereo, Inc.*, Case No. 14-13200 (SHL), Dkt. No. 107 (order retaining Brown Rudnick LLP as Debtor's counsel at ¶ 5); *In re James G.*

Kennedy, Inc., Case No. 12-13669 (SMB), Dkt. No. 86 (order retaining special litigation counsel for trustee on contingency fee basis).

Before the development of the Blackstone Protocol, the United States Trustees would frequently object to professional retention applications that sought approval under section 328. These objections were mainly due to indemnification provisions in the retention applications. *Id*. However, over time an arrangement with the United States Trustees and professionals developed where the United States Trustee would not object to the retention applications if the United States Trustee would be permitted to review compensation under section 330.

B. Blackstone Protocol Questioned in the SDNY

Although the Blackstone Protocol developed as a solution to frequent objections to retention applications under section 328, it is not entirely clear that this arrangement is permissible under both section 328 and Second Circuit case law. The Bankruptcy Court for the Southern District of New York questioned whether the Blackstone Protocol is permissible. *See In re Relativity Fashion, LLC*, No. 15-11989 (MEW), 2016 Bankr. LEXIS 4339 (Bankr. S.D.N.Y. Dec. 16, 2016).

In *Relativity*, a fee examiner objected to a transaction success fee provided for in the retention agreements of two investment banking firms. *Id*. at *2-3. The firms were retained pursuant to section 328(a). *Id*. at *21. Both retention orders contained Blackstone Protocol language enabling certain parties to object to the reasonableness of any proposed fees under section 330 of the Bankruptcy Code. *Id*. After the retention orders were entered, the court also partially approved a stipulation to hire a fee examiner. *Id.* at *22. The docketed application purported to give the fee examiner the right to object to proposed fees provided for in the retention order. *Id*.

Before addressing the fee examiner's right to object, the court discussed the Blackstone Protocol, stating that it was "not at all clear that Congress contemplated this kind of hybrid approach when it enacted Section 328(a)." *Id*. at *17. The court also cited the Second Circuit's *Smart World* decision that stated sections 328 and 330 were "mutually exclusive," and a retention under section 328 foreclosed any fee analysis under section 330. *Id*. (citations omitted). The "best justification" for the Blackstone Protocol was that it could be considered "one of the approved terms of employment that is approved under Section 328(a)," and thus it is possible that allowing the United States Trustee to object would be permissible. *Id.* at *17-18. Because the Blackstone Protocol itself was not at issue in the case, the court did not rule whether its use was appropriate.

The court ultimately held that it did not have the authority to alter the retention agreements to give another party the right to object, and denied the objections to the transaction fees. *Id*. at *25, 34 ("Under the terms of Section 328(a) and under [existing precedent], I had no power to give anyone else the right to assert objections based on Section 330 standards.")

III. Does Section 328(a) Apply to Your Bankruptcy Court Retention?

Application of section 328(a) and whether it applies to a professional's retention is not uniform. Some circuit courts set strict requirements as to what retention agreements, retainer applications, and retainer orders need to contain for section 328(a) to apply. *See, e.g., Zolfo,* *Cooper & Co. v. Sunbeam-Oster Co.*, 50 F.3d 253 (3rd Cir. 1995). Others favor a more flexible, totality of the circumstances test. *See, e.g., Nischwitz v. Miskovic (In re Airspect Air, Inc.)*, 385 F.3d 915 (6th Cir. 2004). The differences in approach among the circuit courts can lead to different results on the same or similar sets of facts, and must be accounted for when drafting retainer agreements, retainer applications, and proposed retainer orders.

A. Second Circuit: *Smart World*

The Second Circuit is one of the last circuit courts to discuss retention requirements under section 328(a), doing so after the Sixth, Fifth, Third, and Ninth Circuits. After discussing the different tests employed by the other circuits, the Second Circuit held that the Sixth Circuit's totality of the circumstance approach is the better test to determine whether a retention and fee arrangement was approved under section 328(a).

In *Smart World*, the debtor sought to retain Riker Danzig on a contingency fee basis to maximize sale proceeds from the purchaser of the debtor's assets under a section 363 sale approved by the Bankruptcy Court. *Smart World*, 552 F.3d at 230. One of the debtor's largest creditors objected to the retention because it and other creditors were already involved in negotiations with the purchaser and any settlement could result in a windfall to Riker Danzig. After agreeing to modify the terms of its retention to address the objections, the bankruptcy court approved the retention, including the contingency fee. *Id*. at 230-31. The retention order, however, failed to mention that approval was pursuant to section 328(a). *Id*. at 231.

The adversary proceeding was eventually settled by the debtor's creditors over the debtor's objection, and a plan incorporating the settlement was confirmed. *Id*. After confirmation of the plan, Riker Danzig applied for its fee. *Id*. The bankruptcy court reduced the fee, holding that although Riker Danzig was retained pursuant to section 328(a), the court's approval was improvident given the facts of the case, and those facts were incapable of anticipation. *Id*. The bankruptcy court found four events that were incapable of being anticipated in support of reducing the contingency fee: (1) the divergence of positions between the debtor and its creditors; (2) counsel took instructions from the debtor's officers and majority shareholders; (3) the unusually prolonged litigation; and (4) that counsel was an obstacle to the ultimate settlement. *Id.* at 231-32.

Riker Danzig appealed and the district court reversed, finding that the firm was retained pursuant to section 328(a) and the facts of the case were not incapable of being anticipated at the time of retention. *Id*.

On further appeal, the Second Circuit first addressed whether Riker Danzig firm was retained pursuant to section 328(a). *Id.* at 233. The court noted the split of authority on the issue, with the Third and Ninth Circuits employing a stricter standard than the Sixth, and sided with the Sixth Circuit's totality of the circumstances test. *Id*. Under this test, the Second Circuit had "little difficulty finding that the bankruptcy court's Retention Order was a section 328(a) pre-approval." The court found it significant that the retention application specifically referred to section 328(a), the language in the application was incorporated in the retention order, and comments made by the court at the hearing on the retention application indicated that it did not intend to apply section 330 standards to the retention order. *Id*. at 233-34. Having determined Riker Danzig's retention was under section 328(a), the Second Circuit had no difficulty concluding there were no later developments in the case that rendered the retention improvident.

Id. at 235 ("We agree with the district court that none of the four developments cited by the bankruptcy court were *incapable* of being anticipated (as opposed to merely not actually anticipated) [at the time of retention.]").

B. Third Circuit: *Zolfo Cooper*

The Third Circuit in *Zolfo* was the first circuit court to examine what was required for the provisions of section 328 to apply to a professional retention. In *Zolfo Cooper*, the debtor received approval from the court to retain 17 professionals, including Zolfo Cooper. 50 F.3d at 255-56. Zolfo Cooper's approved retention order stated only that "debtors in possession[] be and hereby are authorized to retain the firm of [Zolfo, Cooper & Co.] to perform the services as set forth in the foregoing Motion and Affidavit of Frank John Zolfo." *Id*. at 262.

The bankruptcy court was concerned with the rates being charged in the case, and admonished various law firms for trying to "reinvent the wheel". *Id*. at 256. When Zolfo Cooper filed its final application seeking payment for fees and expenses, the bankruptcy court denied it. *Id*. A subsequent order issued by the bankruptcy court explained that Zolfo Cooper's fees were to be capped at a rate of $225 per hour due to vague fee petitions and its excessive use of high-paid personnel on the case. *Id*. Zolfo Cooper moved for reconsideration of its application, which was denied. *Id*. at 256-57. The district court affirmed. *Id*. at 257.

On appeal to the Third Circuit, Zolfo Cooper argued, in part, that it was retained under section 328(a), and altering the firm's compensation under section 330 for reasonableness was impermissible. *Id*. at 261. The court disagreed, adopting the language used in a California bankruptcy court decision that stated the bankruptcy court's retention order must "expressly and unambiguously" state the specific terms and conditions of employment to constitute court approval under section 328(a). *Id*. at 261-62 (citing *In re C & P Auto Transp., Inc.*, 94 B.R. 682, 685 n.5 (Bankr. E.D. Cal. 1988)). Zolfo Cooper's retention order only set forth the "nature and range of services to be provided," not the terms of its compensation. Accordingly, the Third Circuit affirmed the bankruptcy court's decision.

E. Sixth Circuit: *Airspect*

The Sixth Circuit addressed retentions under section 328 after the Third and Ninth Circuits, but took a different view of the law. In *Airspect*, the debtor retained a law firm to pursue a cause of action against the city of Akron, Ohio. 385 F.3d at 918. After retaining a law firm, the debtor filed a chapter 11 bankruptcy petition and applied for approval of the law firm as special counsel. The retention application provided for a $7,000 retainer, plus a contingency fee which varied based on the outcome of the case. *Id*. The bankruptcy court's retention order only provided that the law firm be paid its retainer, and required the firm to submit its fees to the court for approval. *Id*. Ultimately, the case settled. *Id*. at 918-19.

The law firm submitted a fee application and the bankruptcy court reduced the award for reasonableness under section 330. The Sixth Circuit Bankruptcy Appellate Panel reversed, holding that the law firm was retained under section 328(a). *Id*. On remand, the bankruptcy court held that the approval was improvidently granted and awarded the law firm the same fee as in its prior order. *Id*. The Sixth Circuit Bankruptcy Appellate Panel again reversed, and the United States Trustee appealed.

In its analysis of section 328(a), the Sixth Circuit noted the Third and Ninth Circuits prior holdings, but concluded that the standards in *Zolf Cooper* and *Circle K* were "too constrictive." *Id.* at 921. In rejecting those decisions, the Sixth Circuit stated that "[n]owhere does the Bankruptcy Code mandate that the application specifically mention § 328 or that the court's approval order expressly and unambiguously state specific terms and conditions." *Id*. However, the Sixth Circuit also stated that "[a] standard inferring § 328 pre-approval from the simple mention of a fee agreement in the debtor's motion for appointment, however, would undermine the statutory scheme." *Id*. Instead, the Sixth Circuit held that a totality of the circumstances test was most appropriate. *Id*.

Under the totality of the circumstances, the Sixth Circuit determined that the law firm was not retained under section 328(a). The only fact in the law firm's favor was that the retainer agreement, which provided for a contingency fee. *Id*. at 922. Both the application and the order approving the law firms' retention failed to mention section 328(a). *Id*. Additionally, neither the bankruptcy court's order nor the retention agreement itself made any mention as to whether the contingency fee was reasonable in the case. *Id*. Even the briefs of the parties in the case failed to affirmatively bring up section 328(a). *Id*.

F. <u>Fifth Circuit: *National Gypsum*</u>

The Fifth Circuit employed a rule somewhere in between the Third and Ninth Circuits, on the one hand, and the Second and Sixth Circuits' rule, on the other. In *Donaldson Lufkin & Jenrette Sec. Corp. v. Nat'l Gypsum Co. (In re Nat'l Gypsum Co.)*, the debtor agreed to employ a professional in its Chapter 11 bankruptcy case. 123 F.3d 861, 862 (5th Cir. 1997). The professional was to receive a flat fee payment of $125,000 per month, as per its engagement letter. *Id*. The bankruptcy court issued an order approving retention of the professional at the rate stated in its engagement letter, but reserved the right to review the professional's fees. *Id*. The bankruptcy court also issued three subsequent orders extending the professional's employment in the case as per the terms of the engagement letter and the court's prior order. *Id*. However, the requested fee in the professional's final application was reduced by the bankruptcy court on reasonableness grounds. *Id*. The professional appealed, and the district court affirmed.

On appeal to the Fifth Circuit, the court observed that Congress enacted section 328(a) to give professionals greater certainty than under section 330 or the prior bankruptcy act. *Id*. The key distinction noted by the Fifth Circuit is that compensation is pre-approved under section 328(a), and can only be changed if the terms of compensation prove to be improvident. *Id*. This provides professionals both certainty of compensation, pursuant to the terms of its agreement with its client and a finding of reasonableness by the bankruptcy court at the time of the agreement's approval.

Turning to the facts of the case, the Fifth Circuit found that the bankruptcy court had "expressly approved the terms of the agreement," and found those terms to be reasonable. The court's reservation of the right to review fees was only a reservation of a right to review the terms of the agreement for improvidence. Accordingly, the court reversed the decisions of the bankruptcy court and the district court.

G. Ninth Circuit: *Circle K*

The Ninth Circuit took a similar view of section 328(a)'s requirements. In *Circle K Corp. v. Houlihan, Lokey, Howard & Zukin, Inc. (In re Circle K Corp.)*, 279 F.3d 669, 672 (9th Cir. 2001), the bondholder committee sought to retain a financial advisor. The retention agreement provided that the financial advisor would be paid $100,000 per month, plus reasonable out-of-pocket expenses. *Id*. The bankruptcy court entered a retention order approving the financial advisor's retention and used substantially the same language as the retention agreement, except that it also added that the fees were subject to the approval of the bankruptcy court. *Id*. Neither the retention agreement nor the retention order mentioned sections 328 or 330. *Id*. When the financial advisor submitted its final fee application, the bankruptcy court evaluated it under the reasonableness standard of section 330 and approved only half of the requested fees. *Id*. The financial advisor appealed to the district court, which affirmed. *Id*.

On appeal to the Ninth Circuit, the financial advisor argued that it was retained under section 328(a), and that its fees should not have been reduced. *Id.* at 673. The Ninth Circuit disagreed. It noted that the retention order court failed to mention section 328, and instead reserved the right to review proposed fees. *Id.* at 674. Based on this language, the Ninth Circuit concluded that the financial advisor's fees had only been conditionally approved. *Id*.

The court noted that for a professional to be retained under section 328(a), the retention agreement must "explicitly" invoke section 328(a), and that the bankruptcy court's retention order should specifically state that the bankruptcy court is authorizing the retention under section 328(a) as well. *Id*. Because the financial advisor failed to include this language, the Ninth Circuit affirmed the bankruptcy court's decision.[1]

IV. What Language Should Engagement Letters, Retainer Agreements, Retention Applications and Orders Contain?

Although the Second and Sixth Circuits employ a totality of the circumstances test when evaluating retentions under section 328(a), it would be wise for professionals to follow the requirements of the Third and Fifth Circuits. Recommended language in the retention application and order includes: (1) explicit invocation of section 328(a) as the law governing the retention; (2) the scope of employment in the case; (3) the compensation due to the professional; (4) when certain compensation may be due; and (5) that the fees due in the case are reasonable. By using this language, courts employing the totality of the circumstances test will likely find that the professional was retained under section 328(a). *See, e.g., Smart World*, 552 F.3d at 234 ("This language was incorporated into the Retention Order, authorizing payment in accordance with the debtor's application and the [letter to the court].") Courts requiring specific enumeration of certain terms will also be satisfied. *See National Gypsum*, 123 F.3d at 862 ("If prior approval is given to a certain compensation, § 328 controls and the court starts with that approved compensation, modifying it only for developments unforeseen when originally approved."); *Zolfo Cooper*, 50 F.3d at 262 (language used was "bind the court to particular terms and conditions of compensation"). This removes any uncertainty facing the retained professional.

[1] In another case addressing the application of section 328(a), the Ninth Circuit held that the retention order and pre-approval of the fees by the bankruptcy court must be final. *See B.U.M.*, 229 F.3d at 830.

Finally, in the event there is a dispute over whether a professional was retained under section 328(a), it would be wise of counsel to the professional to mention in its brief that the firm was retained under section 328(a). *See Airspect*, 385 F.3d at 922.

V. Payment of Contingency Counsel and Other Professionals Retained Under Section 328(a)

While retention under section 328(a) gives a firm assurances that its fee is not subject to post-hoc reasonableness scrutiny, it does not create an automatic right of payment. In approving a fee arrangement under section 328(a), it has been held that "a court may not revisit the reasonableness" of the arrangement when approval of the fees eventually is sought. *In re XO Comm'ns, Inc.*, 323 B.R. 330, 339 (Bankr. S.D.N.Y. 2005). Bankruptcy Rule 2016(a), however, requires a "detailed statement" from an entity seeking professional compensation under the Bankruptcy Code. It provides:

> (a) APPLICATION FOR COMPENSATION OR REIMBURSEMENT. An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate ***shall file an application setting forth a detailed statement*** of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested. An application for compensation shall include a statement as to what payments have theretofore been made or promised to the applicant for services rendered or to be rendered in any capacity whatsoever in connection with the case, the source of the compensation so paid or promised, whether any compensation previously received has been shared and whether an agreement or understanding exists between the applicant and any other entity for the sharing of compensation received or to be received for services rendered in or in connection with the case, and the particulars of any sharing of compensation or agreement or understanding therefor, except that details of any agreement by the applicant for the sharing of compensation as a member or regular associate of a firm of lawyers or accountants shall not be required. The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other entity. Unless the case is a chapter 9 municipality case, the applicant shall transmit to the United States trustee a copy of the application.

Fed. R. Bankr. Proc. 2016(a).

Courts have held that Rule 2016(a) applies to professionals retained under section 328(a) pre-approved contingency fees. *See In re Acevedo*, 2010 Bankr. LEXIS 335 *5-6 (Bankr. E.D.N.Y. Jan. 26, 2010); *In re Lenworth Westbrooks*, 202 B.R. 520, 522 (Bankr. N.D. Alaska 1996).

Does contingency fee counsel need to maintain "detailed" time records in support of its final fee application? In *Smart World*, the Second Circuit described the fee application process of a professional retained under section 328(a) as a "relatively ministerial" act. *Smart World*, 552 F.3d at 234.

> The requirement that Riker Danzig 'further appl[y]' for payment was entirely *pro forma*, as the court had already fixed and approved the calculation of the amount to be paid. Unlike the orders in *B.U.M.* and *Circle K*, Riker Danzig's Retention Order did not provide for any additional layer of substantive approval prior to payment. In fact, Judge Blackshear specifically told the parties at the hearing that the court would not "review the time records of the individual . . . because of the fact that he agreed to a contingency fee." Thus, we agree with both courts below in concluding that the Retention Order was a pre-approval under section 328(a).

Id.

Key Issues When Litigation Finance is Used in Bankruptcy Cases

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I. Overview

Third party litigation funding has become prevalent in civil litigation generally and is an available tool in bankruptcy to assist estate representatives, including the debtor-in-possession, trustees and official committees, to realize the value of litigation claims for the bankruptcy estate, when the estate lacks cash to aggressively prosecute the claims. *See* Kenneth Epstein & Eric B. Fisher, *Litigation Funding: An Essential Tool for Maximizing the Value of the Debtor's Estate*, NEW YORK LAW JOURNAL (March 15, 2018).

Litigation funding may be used to finance any type of cause of action, ranging from the more typical preference and fraudulent transfer claims to claims for breach of fiduciary duty, insurance coverage, tax refunds and virtually any other claim that could enhance the value of the estate.

As just one example, in *In re Complete Retreats*, No. 06-50245, 2011 WL 1424579 (Bankr. D. Conn. 2011), litigation funding was used by a bankruptcy trustee to guarantee a minimum recovery to the estate and allow the trustee to pursue a litigation claim to further enhance that recovery. In this situation, the litigation funder paid the trustee an option premium, which ensured a minimum recovery, in exchange for the right to finance the trustee's fraudulent transfer litigation. The bankruptcy court approved this financing transaction over the objections of the fraudulent transfer defendants, who challenged the transaction as champertous and against public policy.

II. Ethical and Policy Considerations

A. Will the availability of funding make chapter 11 cases more litigious and more difficult to resolve?

As litigation funding becomes a more accepted part of bankruptcy practice, the overarching question is whether it will foster an even more litigious environment in chapter 11 cases than already exists.

We are not aware of any empirical studies of this question, but there are some built-in constraints in the bankruptcy context to suggest that litigation funding will not promote excessive litigation:

1. Estate representatives using litigation funding may only do so in a manner consistent with their fiduciary duty to maximize the value of the bankruptcy estate.

2. Most litigation funding arrangements are subject to some degree of bankruptcy court oversight and may be objected to by parties-in-interest in the bankruptcy proceeding. *See, e.g., In re Superior National Ins. GR*, 2014 WL 51128, at *3 (U.S. Bankr. Ct. C.D. Cal. Jan. 7, 2014) (bankruptcy court approved post-confirmation third-party funding of litigation trust); *In re*

Tropicana Entertainment, Case No. 08-10856 (KJC)(U.S. Bankr. Ct. D. Del. Jan. 20, 2017)(same).

3. Third party litigation funders are incentivized to fund only those claims that present a favorable risk/return ratio for the funder, *i.e*., claims that have merit.

B. Are litigation funding arrangements potentially champertous?

1. The ancient common law doctrines of champerty and maintenance prohibit third parties from acquiring interests in lawsuits in certain circumstances.

2. The expansion of third-party litigation financing has tested these doctrines over the past few years, and those states that have not eliminated champerty doctrines have narrowed them in a manner mostly hospitable to third-party litigation finance.

3. When entering into litigation finance arrangements, it is essential to consider the applicable state law on champerty. The doctrine still has some vitality.

In the 2016 decision of *Justinian Capital SPC v. WestLB*, the New York Court of Appeals ruled that a litigation financing arrangement was champertous. The Court of Appeals also noted that the transaction did not fall into the statutory safe harbor in New York's Judiciary Law, which exempts litigation finance transactions involving a *bona fide* investment of at least $500,000 from challenges based on champerty. The rationale for the $500,000 safe harbor is that funders are unlikely to invest substantial capital in frivolous claims.

In any event, although the case can be distinguished on its facts and likely does not apply to larger transactions, it indicates the need to research applicable champerty considerations carefully when considering a litigation finance transaction.

4. To comply with ethical responsibilities (and minimize champerty considerations), litigation funding arrangements should be explicit in providing that funder cannot control litigation strategy or settlement decisions. *See* ABA Model Rules 1.8 and 5.4.

C. Are attorney-client privilege and work-product protections compromised in third-party litigation funding arrangements?

1. Courts have consistently found that materials shared with third-party litigation funders are protected under the umbrella of work-product immunity provided that there was a confidentiality agreement in place when the information was exchanged. *See, e.g., Charge Injection Technologies, Inc. v. E.I. DuPont de Nemours & Co*., 2015 WL 1540520 (Del. Sup. Ct. 2015); *Miller UK Ltd. v. Caterpillar Inc*., 17 F. Supp. 3d 711 (N.D. Ill. 2014).

2. However, attorneys should be aware that the common interest doctrine may not shield privileged information shared with a third-party funder. To be cautious, attorneys should share work-product protected materials only and should not share privileged information.

3. Attorneys should be particularly cautious about any information shared with a third-party funder during the due diligence process leading up to a potential third-party funding transaction.

In *Acceleration Bay LLC v. Activision Blizzard*, No. 16-453-RGA, 2018 U.S. Dist. LEXIS 21506 (D. Del. Feb. 9, 2018), the court held, among other things, that information shared with a third-party funder when the parties were exploring a potential transaction was not protected by work-product immunity because the information was not being shared for the primary purpose of aiding the litigation, but rather for the purpose of seeking a loan.

AMERICAN BANKRUPTCY INSTITUTE—2018 NEW YORK CITY CONFERENCE

ECONOMIC TERMS OF CONTINGENT FEE ARRANGEMENTS IN BANKRUPTCY

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Section 328(a) of the Bankruptcy Code allows attorneys to utilize contingency fee arrangements to represent debtors and other estate parties in bankruptcy cases. 11 U.S.C. § 328(a); s*ee also In re Fed. Mogul-Glob., Inc.*, 348 F.3d 390, 401 (3d Cir. 2003) ("Accordingly, Section 328(a) is properly read to say that 'reasonable terms and conditions' include, but are not limited to, retention on a retainer, on an hourly basis, or on a *contingent fee* basis.") (emphasis added).

The terms of a contingency arrangement must be agreed upon between the counsel and the client in "unambiguous" terms to be approved at the outset of litigation by a bankruptcy court under Section 328. *See* 3 Collier on Bankruptcy § 328.02. Contingency fees approved under Section 328 will only be modified by a court after approval if "such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a).

I. Types of Fees

[1] The author would like to thank Caroline S. Burton and Kyle R. Hosmer, both associates at McGuireWoods LLP, for their contributions to the article.

Attorneys in bankruptcy cases have, like all attorneys, employed a number of different types of contingent fee arrangements in recent years.

A. Percentage Fees

The simplest arrangement provides that an attorney is entitled to a percentage of the client's recovery. In today's practice, contingent percentages in the range of one third of recovery (33.3%) are typical for cases that are not tried. *See, e.g, In re Celebrity Contractors, Inc.*, No. 12-10281, 2015 WL 602067, at *1 (Bankr. E.D. La. Feb. 9, 2015) (recognizing a "standard thirty-three and one-third percent (33 1/3%) contingency fee arrangement" in a Chapter 7 proceeding); *In re Barron*, 325 F.3d 690, 694 (5th Cir. 2003) (finding an attorney was "entitled to a one-third contingency fee approved by the bankruptcy court"). *Cf.* Litigation Management Handbook § 4:21 (noting that for contingency fees generally "[t]he percentage is a matter of negotiation between client and counsel, although figures around 33% are the norm"). Generally, the fee percentage is taken from a client's net recovery, i.e. the judgment after costs are deducted. *Id.*

Courts have approved fee agreements of forty (40%) or more of a client's recovery in the event an attorney is successful at trial. U.S. Bankruptcy Judge Mary Kay Vyskocil of the U.S. Bankruptcy Court for the Southern District of New York recently approved a 41% contingency fee for Beus Gilbert PLLC, which amounted to more than $88 million. The 41% rate was approved by the Bankruptcy Court at the outset under 11 U.S.C. § 328, and the fee was the result of litigation that spanned more than a decade in a suit stemming from Magnesium Corp. of America's 2001 bankruptcy. Judge Vyskocil approved the fee over objections from a group of noteholders, and after the Supreme Court refused to grant certiorari on the issue. *See* Cara Salvator, "Beus Gilbert Granted $88M Fee Request for RenCo Suit Win," Law360 (Jan. 31, 2018), available at *https://www.law360.com/articles/1007605/beus-gilbert-granted-88m-fee-request-for-renco-suit-win*. The Court rejected an argument that the 41% fee was excessive, and recognized the judgment itself was significant "due in no small part to the work of Beus Gilbert, the only firm willing, at the time, to be retained to pursue the action on a contingency fee basis." *In re Magnesium Corp. of Am., et. al.*, 01-14312, Doc. No. 976, at 10 (S.D. N.Y. Bankr. January 31, 2018). In light of Beus Gilbert's substantial work and investment, including bearing all expenses without payment for a decade, the Court found it would be "manifestly unfair to now allow the [n]oteholders to second guess the contingency fee approved . . . in 2003." *Id.* at 10-11.

Contingency fees in excess of 33% have also been approved where the legal work is particularly nuanced. In one memorable case, the U.S. Bankruptcy Court for the District of Maryland upheld a 40% contingency fee award to a firm that earned $71.2 million when the case settled on the eve of trial. *In-re Merry-Go-Round Ents. Inc.*, 244 B.R. 327 (Bankr. D. Md. 2000). The Court approved the final sum based on the fairly-negotiated terms of the original agreement, which anticipated "complex and unprecedented" litigation and "novel and substantial legal issues to overcome." *Id.* at 332. In short, the Court found a "deal" was still a "deal" when counsel "hit a home run" and achieved an "extraordinary recovery" for its client. *Id.* at 330.

B. Hybrid Fees

"Hybrid" contingency fee arrangements have also been used in bankruptcy litigation. In a typical such arrangement, attorneys negotiate to receive some portion of recovery less than 33%, in addition to hourly payment at a reduced rate. The hourly fee and the portion of recovery are inversely related – i.e. the higher the hourly rate, the lower the portion of recovery, and vice-versa. *See, e.g., Gelfuso and Lachut, Inc. v. Mary's Italian Restaurant, Inc.*, 896 A.2d 721 (R.I. 2006) (hourly rate and 25% contingency). The hallmark of hybrid fees is their flexibility, and practitioners determine the proportionality between the hourly fee and the portion of recovery in myriad ways. *See* Litigation Management Handbook § 4:21 (listing twelve variations of contingency fee models). The reduction in hourly fees can be structured on a scale between lawyers of differing seniority, or unilaterally across all counsel.

In some situations, monthly retainers or flat fees may be used in lieu of, or in addition to, hourly fees and a portion of recovery. *See, e.g., Kasowitz, Benson, Torres & Friedman, LLP v. Reade*, 98 A.D.3d 403, 950 N.Y.S.2d 8 (1st Dep't 2012), *order aff'd*, 20 N.Y.3d 1082, 965 N.Y.S.2d 71, 987 N.E.2d 631 (2013) (flat fee of $1 million plus 20% of recovery above a specified base). Some firms have attempted to borrow the terms of fees typically used for investment banking financial advisors in several cases, albeit with mixed success. In the bankruptcies of the Finova Group Inc., and Comdisco, Inc., for example, counsel for the official committee of unsecured creditors sought to be retained on a monthly flat fee plus "contingent fee" basis. *See* Laurie Selber Silverstein, "The Financial Adviser Model for Attorney Compensation in

Bankruptcy Cases" in *The American Bar Association Journal*, available at https://corporate.findlaw.com/finance/the-financial-adviser-model-for-attorney-compensation-in.html. The fee structure proposed in *Finova* sought to compensate the law firm $50,000 per month (plus reimbursement of actual and necessary expenses) plus a contingent fee ranging from $1.0 to $3.95 million based on the value of distributions paid to unsecured creditors. *Id.* A similar arrangement was sought in *Comdisco*. *Id.* The firm supported its fees with affidavits describing its expertise, and represented that the monthly fee would be less than, or equal to, the cost of the case with hourly rates. *Id.* Courts did not consider the firm's applications in published opinions, as both were modified before being approved by the court. *See id.* (describing alterations to fee arrangements agreed upon in *Finova* and *Comdisco*). The firm was ultimately compensated on an hourly basis in both cases, and earned a success fee of $800,000 in *Finova*.[2] *Id.* at n. 57 & 58.

C. Reverse Contingency Fees

Attorneys defending clients in bankruptcy proceedings can also link their fees to their success. A so-called "reverse contingency fee[] . . .depends in whole or in part on how much money the lawyer saves the client, given the client's potential liability — so that the lower the settlement or judgment, the higher the lawyer's fee." Black's Law Dictionary, CONTINGENT FEE, (10th ed. 2014). The purpose of these arrangements is to "base counsel's monetary reward on its performance and, at the

[2] Success fees for attorneys in bankruptcy cases are discussed in more detail below, see *infra*.

same time, peg clients' fees to the value of the services they receive." Litigation Management Handbook § 4:21. Reverse contingency fees are relatively unusual. *See id.* at n. 27 (citing a 2011 survey of law firms which found that reverse contingency fees were the least used of ten alternate fee arrangements).

A "potential weakness in a 'reduction of liability' contingent fee arrangement" is the potential difficult of "determin[ing] of the amount of the savings to the client." *In re Adam Aircraft Indus., Inc.*, 532 B.R. 814, 825 (D. Colo. 2015). Courts have therefore required fee applications based on a reduction of a client's liability to include a "specific method of calculating the amount of the savings to the estate." *Id.* at 826.

II. Fee Enhancements

A. Overview

One consequence of clients' increased demand for alternative fee arrangements is that "success fees" or other risk-sharing arrangements find greater occurrence in compensation structures.

The "success fee" is one such risk-sharing arrangement. Under this model, an attorney (or other advisor, as discussed below), receives a pre-determined fee for achieving a desired outcome in a matter. *See, e.g.*, Alternative Fee Arrangements—Success-Based Fees, N.Y. Practice Series § 67:29 (Sept. 2017). The success fee arrangement is thus a close cousin of the contingency fee, with three differences.

First, it generally does not represent the entire compensation structure for a firm, but is a supplement to a fixed-fee or hourly-rate agreement. *But see* Goldman

Ismail Tomaselli Brennan & Baum LLP, *Success-Based Fee Arrangements*, http://www.goldmanismail.com/firm-fees.html (last accessed Apr. 13, 2018). Second, it may take the form of a pre-determined lump sum—as opposed to a percentage of recovery—that increases or decreases depending on the particular outcome obtained. And third, it usually includes specific performance metrics—e.g., winning an early dispositive motion, finding funding for a project, or obtaining approval from a regulatory agency—rather than depending on general victory at trial.

Variations on the arrangement exist, such as a "holdback/success fee" under which "a portion of . . . fees [are paid] up front, [with] a portion withheld contingent upon success in the matter. If the matter is concluded successfully, [the firm] receives a multiple of the holdback or an agreed upon success fee." *Alternative Fee Arrangements*, *supra*. These arrangements can be employed in such matters as "patent cases where the outcome sought is a finding of validity of a patent, or in litigation defense cases where the result sought is summary judgment or limiting damages below a certain quantum." *Id.*

Success fees are not limited to use by law firms: other advisors use them too, such as chief restructuring officers and financial advisors in the bankruptcy context. As noted in the *In re Residential Capital, LLC* decision, a survey of more than thirty bankruptcy cases since 2005 where the debtor retained restructuring professionals as a chief restructuring officer revealed that 66% of those professionals received compensation of both time-based pay and a success fee. 504 B.R. 358, 363 (Bankr. S.D.N.Y. 2014). The median value of the success fee was $2 million. *Id.*

A recent opinion from the Fifth Circuit, as another example, considered a success fee paid to KPMG Corporate Finance, LLC and Roth Capital Partners, LLC "to arrange for a potential private placement" of a debtor's equity. *In re Valence Tech., Inc.*, 647 F. App'x 438 (5th Cir. 2016). Under their agreement with the debtor, KPMG and Roth each received a success fee of $595,000, which represented 1.25% of the $50 million debt-to-equity conversion that was obtained (less retainer and engagement fees already paid). *Id.* at 440.

B. Standards and Issues

When a debtor retains a professional, the bankruptcy court generally must approve both the retention and the compensation paid to the professional. 11 U.S.C. §§ 327(a), 328(a), 1103. *See, e.g.*, *In re Northwest Airlines Corp.*, 382 B.R. 632, 639 (Bankr. S.D.N.Y 2008). Pre-approval by the court serves dual functions: it ensures the debtor is getting a fair deal, and it assures the professional that "the amount of compensation approved will not be modified . . . unless it is proven that the amount was 'improvident in light of developments not capable of being anticipated at the time.'" *Id.* (quoting *F.V. Steel & Wire Co. v. Houlihan Lokey Howard & Zukin Capital, L.P.*, 350 B.R. 835, 838-39 (E.D. Wis. 2006)).

Success fees can be negotiated up front with the debtor and approved by the court under section 328. *See, e.g.*, *Valence Tech.*, 647 F. App'x at 440. But that is not required. In the event that a debtor has a success-fee arrangement with a professional that is not pre-approved by a court, the fee can still be paid if it passes muster under section 330. *See, e.g.*, *Residential Capital*, 504 B.R. at 364 and *In re*

XO Comms., Inc., 398 B.R. 106, 108 (Bankr. S.D.N.Y. 2008). Success fees are particularly susceptible to review under the backward-looking section 330: they generally hinge on the occurrence of future events, and therefore depend on facts and events not knowable to the parties at the time of engagement. *See XO Comms.*, 398 B.R. at 114-19 (discussing sections 328 and 330 and success fees and calculating same).

Section 330 requires that a fee be reasonable, adjudged after notice and a hearing, for approval. *See, e.g.*, *Residential Capital*, 504 B.R. at 364. "Section 330(a) provides specific criteria for the court to consider when making its determination, including the time the professional spent on the services, the rates charged for the services . . . whether the services were necessary or beneficial at the time that they were rendered, and whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or tax addressed." *Northwest Airlines*, 382 B.R. at 644-45 (internal quotations omitted). The court also evaluates "whether the services were or were not reasonably likely to benefit the debtor's estate or necessary to the administration of the case." *Id.* (internal quotations omitted). This review thus incorporates the "lodestar" analysis of fees common in litigation. *Id.* (collecting cases). *See* 11 U.S.C. § 330(a)(3) (establishing factors to be considered). Courts in the Second Circuit have additionally "adopted a market-driven approach in which the cost of comparable services is a significant factor in determining reasonableness of fees." *Residential Capital*, 504 B.R. at 368.

C. Fees on Fees

Roughly three years ago, the Supreme Court issued its opinion in *Baker Botts v. ASARCO LLC*, 576 U.S. __, 135 S. Ct. 2158 (2015). That case concerned the retention of two firms to pursue fraudulent transfer claims against ASARCO's parent corporation. 135 S. Ct. at 2163. Those firms obtained a significant outcome: a judgment worth between $7 billion and $10 billion—which was found to have "contributed to a successful reorganization in which all of ASARCO's creditors were paid in full." *Id.*

Buoyed by the result, the firms sought compensation under section 330(a)(1). A trial followed, as did a $120 million award for the law firms, a $4.1 million "enhancement for exceptional performance[,]" and $5 million "for time spent litigating in defense of their fee applications." *Id.* The district court, in relevant part, affirmed the award of fees incurred defending the firms' fee award. The Fifth Circuit reversed, holding that the Bankruptcy Code did not displace the "American Rule" that each party pays its own attorneys' fees and costs. *Id.*

The Supreme Court affirmed. The Court began from the "basic point of reference" that the American Rule is a "bedrock principle" that has roots in American "common law reaching back to at least the 18th century." 135 S. Ct. at 2164. Some departures from this principle occur, but only when they are explicitly and specifically provided for by statute. *Id.* The question before the *Baker Botts* Court, then, was whether Congress explicitly and specifically displaced the American Rule "to permit compensation for fee-defense litigation by professionals hired to assist trustees in bankruptcy proceedings." *Id.* With the question so framed, the result was not much in doubt (though three justices did dissent): the Court agreed with the Fifth Circuit that the Bankruptcy Code does not permit "fees on fees."

The analysis was straightforward. The Court started with the text of section 330(a)(1), which provides that professionals can be compensated for "all manner of work done *in service* of the estate administrator—more specifically, "reasonably compensation" can be paid only for "*actual, necessary services rendered.*" *Id.* at 2165 (emphases in original). Applying the dictionary definition of "services" as "labor performed for another[,]" the Court concluded that "[t]ime spent litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described as 'labor performed for'—let alone 'disinterested service to'—that administrator." *Id.* The Court therefore affirmed the decision below—i.e., that the firms could not recover the fees they incurred defending their fee awards. *Id.* at 2166. Put simply, "[h]ad Congress wished to shift the burdens of fee-defense litigation under section 330(a)(1) . . . it easily could have done so." *Id.*

Of course, the *Baker Botts* holding is a default rule dependent on the text of the Bankruptcy Code. Parties may be able to contract around it—and they are starting to do so. Early decisions questioned whether such arrangements complied with the Bankruptcy Code. *See, e.g.*, *In re Boomerang Tube, Inc.*, No. 15-11247 (Bankr. D. Del. Jan. 29, 2016). Recent decisions are more accepting. *See, e.g.*, *In re Hungry Horse, LLC*, No. 16-11222 (Bankr. D.N.M. Sept. 20, 2017) and *In re Nortel Networks Inc.*, No. 09-10138 (Bankr. D. Del. Mar. 8, 2017).