Ethics: Retention and Compensation of Professionals

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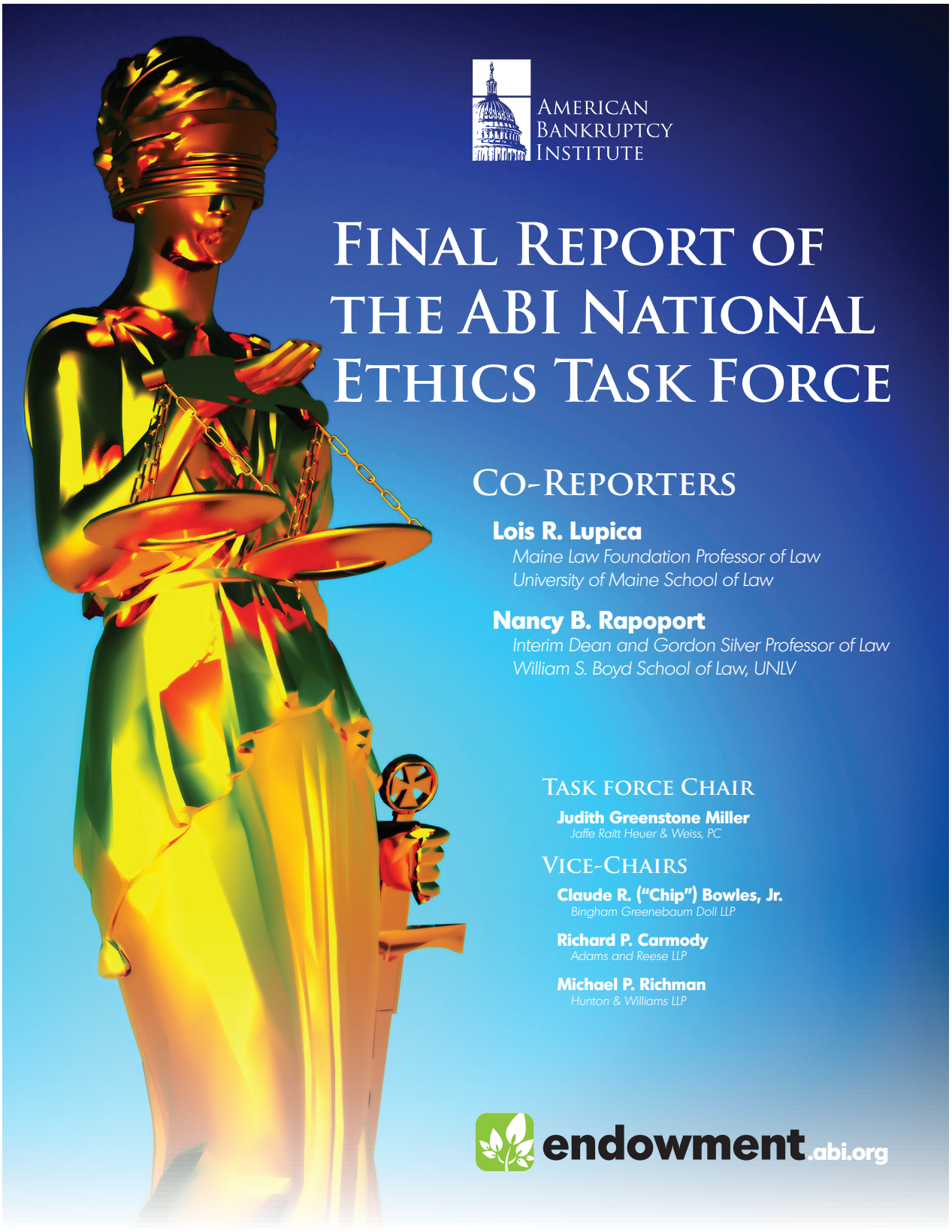
American Bankruptcy Institute
Final Report of the ABI National Ethics Task Force
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April 21, 2013

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Proposed Amendments to Rule 2014

Introduction[1]

Sections 327[2] and 1103[3] of the Bankruptcy Code set forth specific standards that proposed professionals must meet in order to be retained as an estate or committee professional.[4] Each of these provisions requires the professional in question to meet certain standards relating to their independence from parties other than their client in a case.[5] As noted by several courts, "[t]he purpose of Rule 2014(a) is to provide the court and the United States trustee with information to determine whether the professional's employment is in the best interest of the estate. . . . Rule 2014 disclosures are to be strictly construed and failure to disclose relevant connections is an independent basis for the bankruptcy court to disallow fees or to disqualify the professional from the case."[6]

In order for courts, the Office of the U.S. Trustee and other parties in interest to evaluate employment applications, Federal Rule of Bankruptcy Procedure 2014 requires professionals to disclose to the court those facts related to actual or potential conflicts of interests they may have.[7] FRBP 2014 currently provides:

> (a) Application for an order of employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing

[1] The Reporters are grateful to Chip Bowles for all of his hard work on this project.

[2] 11 U.S.C. § 327 (2013).

[3] 11 U.S.C. § 1103 (2013).

[4] *See, e.g., In re* Crivello, 134 F.3d 831, 836 (7th Cir. 1998).

[5] *See* 11 U.S.C. § 101(14) (2013) (definition of disinterested person); *In re* Marvel Entertainment Corp., 140 F.3d 463, 476 (3rd Cir. 1998) (discussing adverse interests and actual vs. potential conflicts of interest).

[6] *See, e.g.,* Exco Res. v. Milbank (*In re* Enron Corp.), No. 02 Civ. 5638 (BSJ), 2003 U.S. Dist. WL 223455, at *4 (S.D.N.Y. Jan. 28, 2003); Banner v. Cohen, Estis & Assocs., LLP. (*In re* Balco Equities Ltd.), 345 B.R. 87, 111 (Bankr. S.D.N.Y. 2006).)

[7] Of course, there are state ethics rules that are implicated as well, including issues related to conflicts of interest and candor to the tribunal. We are focusing here on the bankruptcy issues. For a discussion of the application of Rule 2014, *see generally,* U.S. v. Gellene, 182 F.3d 578, 582 (7th Cir. 1999); Halbert v. Yousif, 225 B.R. 336, 346 (E.D. Mich. 1998). *See also In re* Plaza Hotel Corp., 111 B.R. 882, 883 (Bankr. E.D. Cal. 1990), *aff'd* without op., 123 B.R. 466 (9th Cir. BAP 1990); *In re* Gluth Bros. Constr., 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011); *In re* Bellevue Place Assocs., 171 B.R. 615, 626 (Bankr. N.D. Ill. 1994) (holding that purpose of 2014 "is to avoid even appearance of a conflict regardless of the integrity of the professional seeking to be employed").

> the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.
>
> (b) Services rendered by member or associate of firm of attorneys or accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation or individual may act as attorney or accountant so employed, without further order of the court.

Currently, FRBP 2014 does not limit the extent of disclosure of a professional's connections[8] with: (i) the debtor; (ii) any creditors of the debtor; (iii) other parties in interest; (iv) attorneys of the debtor, creditors, and parties in interest; (v) accountants for the debtor, creditors, and parties in interest; and (vi) the United States Trustee and persons employed by the U.S. Trustee's office (collectively, "2014 Parties"). Indeed, most courts that have addressed this issue have held that professionals have little, if any, discretion in determining whether a connection is "relevant" to their employment application.[9]

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[8] *See In re* Gluth Bros. Constr., 459 B.R. 351, 364 (Bankr. N.D. Ill. 2011), where the court stated:

> The term "connections" used in Rule 2014(a) is considerably broader than the terms "disinterested" and "interest adverse to the estate" used in Section 327(a). Thus an attorney must disclose a connection even if he does not believe it would disqualify him under Section 327(a). As the Seventh Circuit Court of Appeals has stated, professionals "cannot pick and choose which connections are irrelevant or trivial." U.S. v. Gellene, 182 F.3d 578, 588 (7th Cir. 1999) (internal citation omitted). Instead, no "matter how trivial a connection appears to the professional seeking employment, it must be disclosed." *In re* Envirodyne Indus., 150 B.R. 1008, 1021 (Bankr. N.D. Ill. 1993) (Schwartz, J.). Counsel who "fail to disclose timely and completely their connections proceed at their own risk because failure to disclose is sufficient grounds to revoke an employment order and deny compensation." Gellene, 182 F. 3d at 588 (quoting *In re* Crivello, 134 F.3d 831, 836 (7th Cir. 1998)). Thus "denial of fees or disqualification may be justified [33] even when the professional is in fact disinterested." *In re* Raymond Professional Group, Inc., 421 B.R. 891, 906 (Bankr. N.D. Ill. 2009) (quoting *In re* Midway Indus. Contractors, 272 B.R. 651, 662 (Bankr. N.D. Ill. 2001)).

[9] *See generally In re* Crivello, 134 F.3d 831 (7th Cir. 1998); *In re* Park-Helena Corp., 63 F.3d 877 (9th Cir. 1995); Rome v. Braunstein, 19 F.3d 54 (1st Cir. 1994); *see also In re* Rusty Jones, Inc., 134 B.R. 321, 346 (Bankr. D. Ill. 1991) (noting the fact the professional owned a hot dog stand over 20 years before the bankruptcy with an indirect owner of the debtor was a *de minimis* connection).

The broad but undefined term "connection" has led to confusion[10] over the appropriate level of inclusiveness in disclosures.[11] The uncertainty surrounding the meaning of "connection" has also led to attempts by professionals to argue that some important "connections are immaterial."[12] The following proposed new FRBP 2014 is an effort to provide clarity to professionals concerning what relevant connections must be disclosed, as well as to provide improved information for courts and other parties to use in determining a professional's eligibility for employment.

Current Rule 2014

Current Rule 2014 reads as follows:

> (a) Application for and Order of Employment. An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to §327, §1103, or §1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.
>
> (b) Services Rendered by Member or Associate of Firm of Attorneys or Accountants. If, under the Code and this rule, a law partnership or corporation is employed as an attorney, or an

[10] In re *Rusty Jones, Inc.,* at 346, 134 B.R. 321 (Bankr. D. Ill. 1991) (discussing whether ownership of a hot dog stand with a 2014 party 20 years before bankruptcy was filed was a connection required to be disclosed).

[11] *In re* EWC, 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992) ("duty of professionals is to disclose all connections with the debtor, debtor in possession, insiders, creditors and parties in interest . . . they cannot pick and choose which connections are irrelevant or trivial . . . No matter how old the connection, no matter how trivial it appears, the professional seeking employment must disclose it.").

[12] *See In re* etoys Inc., 331 B.R. 176, 197 (Bankr. D. Del. 2005) (committee counsel, which was ultimately sanctioned $750,000, argued failure to disclose business arrangement between committee counsel and the president of the debtor was not disqualifying as committee counsel was not required to be disinterested under 11 U.S.C. § 1103).

accounting partnership or corporation is employed as an accountant, or if a named attorney or accountant is employed, any partner, member, or regular associate of the partnership, corporation, or individual may act as attorney or accountant so employed, without further order of the court.

Proposed Amended Rule 2014

In comparison, the proposed amended Rule 2014 provides:

(a) APPLICATION FOR AND ORDER OF EMPLOYMENT. An application for an order approving the employment of a professional under § 327, § 1103, or § 1114 of the Code shall be made in writing and shall be made by the trustee, debtor in possession, or committee.[13] The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States Trustee. The application shall contain:

(1) specific facts demonstrating the necessity for the employment;
(2) the identity of the professional to be employed, the reasons for the selection of the professional, and the list of the professional's employees, members, owners, and partners most likely to work on the matter;
(3) a description of the professional services to be rendered;
(4) a description of any proposed arrangement for compensation, including a statement of whether the professional is seeking approval of compensation standards under 11 U.S.C. § 328(a);
(5) a statement that, to the best of the applicant's knowledge, the professional is eligible under the Code for employment for the purposes set forth in the application;
(6) a description of the investigation undertaken and the procedures used by the applicant to determine that the professional is eligible for the proposed employment, including specifically the actions that the professional undertook to identify those connections that are material under the circumstances, including personal, business, and professional connections, that would be relevant to the court in determining whether the professional was free of any disqualifying current or potential bias;
(7) if the professional is to be employed in multiple affiliated cases, a description of relevant inter-company relationships, including any potential conflicts among the affiliated debtors and any proposed allocation of compensation of the professional to be paid by each affiliate; and
(8) for professionals seeking approval of employment by a committee,
(a) a statement of the process by which the professional sought employment by that committee, including interactions with other professionals; and

[13] As for court-appointed experts, we expect that a court will set its own disclosure procedures for them.

(b) a disclosure of any direct and indirect contacts and communications with a person eligible for the committee or who sought to be appointed to the committee.

(b) STATEMENT OF PROFESSIONAL. The application shall be accompanied by a verified statement by an authorized representative of the professional, made according to the best of that person's knowledge, information, and belief, and formed after an inquiry reasonable under the circumstances, that shall:

(1) state that the professional is eligible under the Code for employment for the purposes set forth in the application;
(2) describe the investigation undertaken and the procedures used by the professional in order to make its determination of eligibility for the employment set forth in the application;
(3) describe any interest that the professional, or any employee, member, owner, or partner of the professional, holds or that the professional represents that is adverse to the estate;
(4) describe any relationship that the professional, or any employee, member, owner, or partner of the professional, has that would implicate Federal Rule of Bankruptcy Procedure 5002 [Restrictions on Appointments];
(5) state whether the professional, or any employee, member, owner, or partner of the professional, has shared or has agreed to share any compensation with any person, other than an employee, member, owner, or partner of the professional, and if so, describe the terms of any such arrangement;
(6) disclose the source and describe the amount of any retainer to be paid, and if such retainer is to be paid from a creditor's collateral, whether such use is within the scope of authorized use of that collateral;
(7) describe any guarantee of payment, enhancements of payment, or any collateral securing the payment of compensation and state the relationship of the guarantor with the debtor or committee and the professional;
(8) disclose any payments for prepetition work received by the professional within 90 days of the petition's filing, and all facts that may be relevant to a preference analysis under 11 U.S.C. § 547;
(9) disclose any conflicts waiver requested or obtained and the scope of that waiver, including any waiver limitations on actions the professional may or may not take during the case; and
(10) describe the Relevant Connections, as defined in subsection (c) below, including any applicable materiality thresholds used, with the following persons, parties, or entities:
    (A) the debtor;
    (B) creditors of the estate;
    (C) known or anticipated post-petition creditors of the estate;
    (D) equity security holders of the debtor or of affiliates of the debtor;
    (E) officers and directors of the debtor;
    (F) parties that are insiders of the debtors or that were insiders of the debtor within 2 years before the date of the filing of the petition;
    (G) any investment banker for any outstanding security of the debtor;
    (H) the United States trustee;

(I) customers of the debtor or vendors to the debtor whose transactions with the debtor as of the petition date constitute a material portion of the debtor's business;
(J) parties to executory contracts and unexpired leases;
(K) utility service providers;
(L) governmental units and officials and employees thereof;
(M) members of any committee appointed under 11 U.S.C § 1102 or otherwise subject to disclosure under Rule 2019;
(N) any identified potential asset purchasers; and
(O) any professional employed by any of the above persons, parties or entities.

All disclosures made under this Rule shall be made in a format that describes the Relevant Connections in sufficient detail so the court and parties in interest may recognize potential biases and conflicts. For the Relevant Connections listed in subparagraph (b)(10), such disclosures should also be indicated in a grid substantially conforming to the New Proposed Official Form for Rule 2014 Disclosures, and that grid should cross-reference the relevant paragraphs in the narrative disclosure itself.

(c) RELEVANT CONNECTION. For purposes of this Rule, and unless otherwise defined by the court, "Relevant Connection" means,
(1) any connection with a person or entity listed in subsection (b) that:
(A) on or within two years of the filing of the petition, generated a material amount of income and/or transfers;
(B) involved or was related to property of the estate with a material value;
(C) involved a material business venture with the person or entity; or
(D) involved working for the person or entity as a professional and generating a material amount of fees in the two years prior to the filing of the petition;
(2) any connection with the court to which the employment application is being submitted;
(3) any connection with the United States Trustee or any person employed in the office of the United States Trustee; or
(4) any other connection constituting a personal, professional, or business relationship that could reasonably be determined to be significant in its evaluation of whether a professional is qualified to be employed.

With respect to each Relevant Connection, the applicant shall disclose personal and professional relationships and other connections relevant to determining the existence of bias or influence on professional judgment. Any materiality threshold used by the applicant for each Relevant Connection shall be set forth in the application. If the court directs use of a different threshold, the professional shall amend its disclosures to conform to such threshold. The list of Relevant Connections is intended to be comprehensive and encompass connections relevant to the court's consideration of the application. Any additional relevant connections necessary to prevent the application and the professional's verified statement from being materially misleading shall be included.

(d) SERVICE AND TRANSMITTAL OF APPLICATION. The applicant shall serve a copy of the application on:

(A) the United States trustee;
(B) the debtor and the debtor's attorney;
(C) any committee elected under § 705 or appointed under § 1102, or, if the case is a chapter 9 case or a chapter 11 case and no committee of unsecured creditors has been appointed, on the creditors included on the list filed under Rule 1007(d); and
(D) any other entity as the court may direct.

(e) SERVICES RENDERED BY MEMBER OR ASSOCIATE OF FIRM OF EMPLOYED PROFESSIONAL. If the court approves the employment of an individual, partnership, corporation, or other business entity, then any employee, member, owner, or partner of the professional working with the professional so employed may act as a professional so employed, without further order of the court, provided that the employee, member, owner, or partner of the professional has not been screened off from the employment due to a conflict of interest. If a partnership is employed, a further order approving employment is not required if the partnership agreement has been amended solely because of the addition or withdrawal of a partner.

(f) SUPPLEMENTAL STATEMENT OF PROFESSIONAL.

(1) The professional has a continuing duty to file a supplemental statement regarding any new Relevant Connections for as long as the professional is employed.
(2) The professional shall regularly undertake a reasonable investigation to determine whether any additional Relevant Connections have developed and whether previously disclosed Relevant Connections should be updated, and in any event, shall undertake an investigation at the following times:
   (A) before filing any adversary proceeding or before filing a response to any such adversary proceeding involving such professional;
   (B) within 28 days after any amendment to bankruptcy schedules is filed;
   (C) when a bidder for estate assets or purchase of estate assets outside the ordinary course of business is publicly identified; and
   (D) before filing any interim or final fee application.
(3) Such supplemental statements shall be served on each entity listed in Rule 2014(c), and, unless the case is a chapter 9 case, on the United States Trustee.

(g) The court may set a threshold for materiality of Relevant Connections.

Comment on Proposed Amended Rule 2014

The appropriate threshold will vary depending on the size and type of case, and the applicable Relevant Connection. For a strip mall "mom & pop" debtor, a minimum threshold on size of creditor claims used to determine which names to check for conflicts would likely not be appropriate. A *Delta Airlines* or *Enron* case, on the other hand, would likely warrant a considerably higher threshold. Likewise, all equity owners would need to be disclosed for a small debtor, but for a publicly-traded debtor, a securities law threshold for identified equity owners would be an appropriate threshold. There will be significant variance in threshold levels given the range of case sizes. It is likely that Delaware and New York City courts would allow higher thresholds that would be considered unacceptable in other jurisdictions. If the thresholds used are set forth—and parties in interest and the court have the opportunity to question them—at the beginning of the case, the Rule is flexible enough to be used across the board in all parts of the country.

New Proposed Official Form for Rule 2014 Disclosures

Name and position of professional with Relevant Connection [1]	Debtor	Creditor	Known or anticipated Pre-petition creditors	Equity security holders	Insiders	Investment bankers	U.S. Trustee	Customers /vendors	Parties to executory contracts or unexpired leases	Utility service providers	Governmental units and employees thereof	Committee members	Potential asset buyers	Any professional of any entity listed	Description of Relevant Connection[2]
Mary White, Partner		X			X		X								See ¶ a., c, & f.
Bill Black, Partner		X		X		X				X					See ¶ a., d, g & h.
Deb Gray, Associate		X		X			X								See ¶ a., d, & i.
Sam Blue, Paralegal		X													See ¶ a.

[1] Cross-reference with paragraph in Application itself.

[2] Cross-reference with paragraph in Application itself.

This form is new and implements Revised Rule 2014, which relates to the disclosure of relevant connections for retention purposes. The individual completing the form must sign and date it. By doing so, he or she declares under penalty of perjury that the information provided is true and correct to the best of that individual's knowledge, information, and reasonable belief. The signature is also a certification that the standards of Rule 9011(b) are satisfied.

A Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328

Introduction[1]

Section 327 of the Bankruptcy Code sets forth the standards for the employment of professional persons by trustees and debtors-in-possession.[2] Section 327(a) indicates that a trustee or debtor-in-possession, with the court's approval, may employ various professional persons to represent and assist in carrying out the duties prescribed under the Bankruptcy Code. For the purposes of section 327(a), the definition of "professional person" is generally limited to attorneys, accountants, appraisers, auctioneers, financial advisors, and others who play a central role in the case.[3]

Section 327(a) establishes that a professional person can be retained only if such person does not "hold or represent an adverse interest to the estate" and is a "disinterested person."[4] The professional's duty to meet those requirements continues throughout the case.[5] The retention process is designed to ensure public confidence in the bankruptcy system, prevent abuses, and achieve a degree of efficiency in the administration of a Chapter 11 case. The requirements of 11 U.S.C. § 327 "serve the important policy of ensuring that all professionals … tender undivided

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[1] The Reporters gratefully thank Andy Vara for his thorough and helpful report on this topic.

[2] 11 U.S.C. § 1107(a).

[3] *See, e.g., In re* Renaissance Residential of Countryside LLC, 423 B.R. 848, 858 (Bankr. N.D. Ill. 2010); Comm. of Asbestos-Related Litigants and/or Creditors v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 60 B.R. 612, 620 (Bankr. S.D.N.Y. 1986).

[4] 11 U.S.C. § 327(a); *see also* Neben & Starrett, Inc. v. Chartwell Fin. Corp. (*In re* Park Helena Corp.), 63 F. 3d 877 (9th Cir. 1995), *cert. denied*, 516 U.S. 1049 (1996); *In re* Granite Partners, 219 B.R. 22 (Bankr. S.D.N.Y. 1998).

[5] Section 328, titled "Limitation on compensation of professional persons," provides in part:

> (c) Except as provided in section 327(c), 327(e), or 1107(b) of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 or 1103 of this title if, at any time during such professional person's employment under section 327 or 1103 of this title, such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is to be employed.

Section 328(c) applies to professionals retained under Section 327 or 1103. This section allows the bankruptcy court to deny compensation if a retained professional fails to be disinterested or represents or holds an interest adverse to the estate with respect to the matter on which such professional has been employed. Although focusing on the allowance of fees, as opposed to articulating a standard for retention, Section 328(c) appears to incorporate the disinterestedness and adverse interest standards under Section 327 into considerations governing the selection of professionals by Committees under Section 1103. *In re* Caldor, Inc., 193 B.R. 165, 170-71 (Bankr. S.D.N.Y. 1996).

loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities."[6] Court approval of a professional person's employment is contingent upon the court's finding that the applicant has met a two-pronged test. Under section 327(a), the professional (1) must be disinterested; and (2) must not hold or represent an interest adverse to the estate.[7] Other parts of section 327 govern special counsel for the estate[8] and the effect of a professional's representation of a creditor on his or her eligibility for employment.[9] The retention provisions embodied in the Bankruptcy Code "create an ongoing duty on the part of professionals hired by the estate to avoid conflicts of interest."[10]

There are other provisions in the Bankruptcy Code beyond section 327 that address the issue of the employment, and specifically the compensation of professionals. As one commentator has explained,

> The other statutory provision requiring court approval of employment is section 1103, which covers the employment of professionals working for committees. 11 U.S.C. § 1103 permits a committee that has been appointed under section 1102 to employ professionals for the benefit of the committee, provided that the professional may not concurrently "represent any other entity having an adverse interest in connection with the case."[11]
>
> Some professionals have focused their attention on section 328,[12] which allows for a variety of creative compensation structures ("on any reasonable terms and conditions of

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[6] Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).

[7] The question of whether a professional meets these tests is one for the court to adjudicate after full disclosure of the facts in accordance with FED. R. BANKR. P. 2014. *In re* Filene's Basement, Inc., 239 B.R. 850 (Bankr. D. Mass. 1999); *In re* Leslie Fay Cos., Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994).

[8] 11 U.S.C. § 327(e).

[9] 11 U.S.C. § 327(c).

[10] *In re* Creative Desperation, Inc., 415 B.R. 882, 896 (Bankr. S.D. Fla. 2009).

[11] Section 1103(a) provides: "At a scheduled meeting of a committee appointed under section 1102 of this title, at which a majority of the members of such committee are present, and with the court's approval, such committee may select and authorize the employment by such committee of one or more attorneys, accountants, or other agents, to represent or perform services for such committee." There's a bit of a gap between sections 327 and 1103: "It's a little trickier for getting court approval for those professionals whom committees want to employ. Section 1103(a) gives committees the authority to seek court approval for the employment of professionals, but section 327 speaks only of employing professionals for the trustee (and, via section 1107, for the debtor in possession). That's a drafting glitch that omits employment approval for committee professionals." Nancy B. Rapoport, *The Case for Value Billing in Chapter 11,* 7 J. BUS. L. & TECH. LAW 117, 124 (2012) [hereinafter *Value Billing*]. Most courts solve this problem by using section 328(a) as the appointing authority for committee professionals; the other way is to use section 1103 itself as the authority. *See id.* at 122-23.

[12] 11 U.S.C. § 328(a) provides:

> The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, 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

employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis"). But—at least for professionals employed by the trustee or debtor in possession—section 328 is more properly read as elaborating the latitude that a court has in approving compensation arrangements, rather than as separate authority for appointment. Under section 328, the court may only "allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, 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"—a much more difficult standard for the court to meet. In other words, compensation arrangements made pursuant to section 328 protect the professional's compensation structure far more aggressively than those made pursuant to section 327.[13]

Section 330(a)(3) provides the roadmap for reviewing compensation:

> In determining the amount of reasonable compensation to be awarded to an examiner, trustee under Chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—
>
> (A) the time spent on such services;
> (B) the rates charged for such services;
> (C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;
> (D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
> (E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
> (F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.[14]

Traditionally, a court's review of compensation for professionals appointed under section 327 focuses on the "lodestar" method (hours multiplied by hourly rate)[15] as part of its determination

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> contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, 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.

[13] *Value Billing, supra* n. 11, at 122-23 (footnotes omitted).

[14] 11 U.S.C. § 330(a)(3).

[15] In Matter of Pilgrim's Pride Corp., 690 F.3d 650, 655 (5th Cir. 2012), the Fifth Circuit defined the lodestar amount as "the number of hours reasonably expended multiplied by the prevailing hourly rate in the community for similar work." *Id.* (quoting *In re* Lawler, 807 F.2d 1207, 1211 (5th Cir.1987)).

of the reasonableness of that compensation. Because the lodestar method does not, in itself, contemplate success fees or fee enhancements based on particular benchmarks, professionals, such as financial advisors and investment bankers, have sought the approval of non-lodestar types of compensation under section 328.[16] Compensation formats approved pursuant to section 328 can only be reconsidered "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."[17] Under section 328, the compensation method used to calculate professional fees receive up-front approval.[18] Such pre-determination differs from the ordinary retrospective fee review and analysis performed when employment is approved under section 327.

On the theory that a discussion of "best practices" for compensation approved under section 328 would be useful for courts and those professionals seeking such approval, the Task Force suggests a particular framework for professionals seeking approval of their compensation methods under that section.[19]

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[16] Trustees, debtors-in-possession, and official committees sometimes use section 328 to obtain pre-approval of the terms through which the fees of certain professionals, such as special counsel, financial advisors or investment bankers, will be allowed and paid on an interim basis or at the conclusion of the engagement. "Absent approval of compensation under § 328, the court awards a professional employed under § 327 "reasonable compensation for actual, necessary services rendered by [the professional] . . . , based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title," as well as "reimbursement for actual, necessary expenses." Nischwitz v. Miskovic (*In re* Airspect Air Inc.), 385 F .3d 915, 920 (6th Cir. 2004).

[17] In *Pilgrim's Pride,* the Fifth Circuit held that bankruptcy courts could award fee enhancements under certain circumstances, notwithstanding the Supreme Court's ruling in another, non-bankruptcy, case limiting the ability of courts to award fee enhancements. *Id.* at 667. The professional in *Pilgrim's Pride* sought a fee enhancement at the end of a very successful case. *Id.* at 653. That fee enhancement was later affirmed. In Matter of Pilgrim's Pride Corp., 690 F.3d 650, 667 (5th Cir. 2012) (affirming the bankruptcy court's order of a $1 million fee enhancement).

[18] In most instances in which a professional seeks approval of a section 328 compensation formula, the United States Trustee will seek to preserve a "back-end" review and objection for its office and for the bankruptcy court despite the pre-approval that is binding on all other parties in interest (unless developments incapable of being anticipated ultimately show the improvidence of approving the form of compensation).

[19] The Task Force is aware that some law firms are moving in the direction of alternative fee arrangements, such as flat-rate billing and success fee benchmarks. This Report is not intended to review the variety of creative compensation arrangements for which professionals can seek approval under section 328. Some of these alternative compensation arrangements are even referenced in the United States Trustee Program's Updated Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases ("Proposed Guidelines"), available at

http://www.justice.gov/ust/eo/rules_regulations/guidelines/docs/proposed/AppendixB_Fee_Guidelines_Exhibits_Comments.pdf. *See, e.g.,* Proposed Guidelines at 20.

Framework for Pre-Approval of Terms for Retention and Compensation Under 11 U.S.C. § 328

1. **Be clear about the Bankruptcy Code provision under which approval is being sought.**

2. **A bankruptcy court has wide discretion to decide whether a proposed arrangement is or is not reasonable or appropriate**.

In reaching this decision, the court will carefully examine the circumstances of the particular case. To receive approval under section 328, the moving party must unambiguously specify that it is seeking such pre-approval. Unless the moving party meets all of section 328's conditions, as described in its employment application (and the court approves the professional's method of compensation), the court must review the professional's fee application under section 330 (the lodestar review).

The Fifth Circuit Court of Appeals has provided a clear articulation of the differences between fee review and approval under sections 328 and 330:

> Sections 328 and 330 of the Bankruptcy Code govern attorneys' fees in representing bankruptcy estates. Under 11 U.S.C. § 330, attorneys' fees are reviewed for their reasonableness after representation has concluded. In contrast, section 328 of the Bankruptcy Code allows an attorney seeking to represent a bankruptcy estate to obtain prior court approval of her compensation plan. As this Court has noted, "able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done. That uncertainty continues under the present § 330 . . . ."[20]

Therefore, unless a professional wishes to have his or her fees reviewed under section 330's reasonableness standard, the professional should specify—both in the employment application itself and in the draft order approving such employment—that he or she is seeking approval of the compensation structure under section 328.[21]

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[20] Daniels v. Barron (*In re* Barron), 325 F.3d 690, 692-93 (5th Cir. 2003) (quoting *In re* National Gypsum Co., 123 F.3d 861, 862 (5th Cir. 1997)).

[21] In the Ninth Circuit, the applicant "must invoke . . . section [328] explicitly in the retention application" in order to ensure that that section will govern the review of the professional's fees. Circle K. Corp. v. Houlihan, Lokey, Howard & Zukin Inc. (*In re* Circle K Corp.), 279 F. 3d 669, 674 (9th Cir. 2002). The Sixth Circuit Court of Appeals has adopted a more lenient standard for evaluating whether a compensation structure has been pre-approved under section 328. In the case of Nischwitz v. Miskovic (*In re* Airspect Air Inc.), 385 F.3d 915 (6th Cir. 2004), the Sixth Circuit eschewed the standards of both the Third and Ninth Circuits, holding instead that the analysis rests on the totality of the circumstances, "looking at both the application and the bankruptcy court's order." *Id.* at 922. The Sixth Circuit indicated that relevant factors for courts to consider in their analysis include (1) the existence of a request for preapproval; (2) the reasonableness of the requested compensation; and (3) and an express reference to § 328. *Id.*

3. The party seeking approval of a professional's employment has the burden of proof in its employment application.

The party seeking approval of a professional's compensation arrangement under section 328 should be mindful that he has the burden of proof and must "ensure that the court notes explicitly the terms and conditions if the applicant expects them to be established at that early point."[22] Therefore, professionals seeking retention and approval of a fee structure under either section 327 or 328 must be prepared to put forth specific evidence establishing the reasonableness of the employment agreement. Both the United States Trustee and the bankruptcy court will scrutinize the employment agreement to ensure that it meets the test for approval under the Bankruptcy Code.

Financial advisors and investment bankers should, in particular, take note of the opinion issued by the Bankruptcy Court for the Southern District of Texas in the Chapter11 case of *Energy Partners* when preparing for their employment application hearings. In *Energy Partners*, the Court denied applications filed by both the equity holders' and note-holders' committees to engage separate investment banking firms in order to perform a valuation analysis of the debtor. The Court was highly critical of the proposed fee agreements and the lack of evidence offered by the applicants, beginning its analysis by noting that it does not "take § 328(a) applications lightly" and, in performing its duties as a gatekeeper, the Court "must have a sufficiently strong record when deciding whether to approve a professional under § 328(a)."[23] The Court relied on decisions from the District of Delaware and District of Massachusetts in setting forth a non-exhaustive list of five factors to consider when determining whether to approve employment terms under section 328(a). Such factors include:

> (1) whether terms of an engagement agreement reflect normal business terms in the marketplace; (2) the relationship between the Debtor and the professionals, i.e., whether the parties involved are sophisticated business entities with equal bargaining power who engaged in an arms-length negotiation; (3) whether the retention, as proposed, is in the best interests of the estate; (4) whether there is creditor opposition to the retention and retainer provisions; and (5) whether, given the size, circumstances and posture of the case, the amount of the retainer is itself reasonable, including whether the retainer provides the appropriate level of "risk minimization," especially in light of the existence of any other "risk-minimizing" devices, such as an administrative order and/or a carve-out.[24]

In the *High Voltage Energy Corp.* case, cited in *Energy Partners,* the court used blunt and straightforward language in denying the retention application and highlighting the debtor's failure to present sufficient evidence to warrant the engagement:

> The Court has been given no information about the specific scope and complexity of the assignment or specialized skills needed for it. The Court has been given no information about the prevailing fees in the industry for comparable engagements, either in bankruptcy

[22] Zolfo, Copper & Co. v. Sunbeam-Oster Co. (*In re* Zolfo Cooper), 50 F.3d 253, 262 (3d Cir. 1995).

[23] *In re* Energy Partners, Ltd., 409 B.R. 211, 225 (Bankr. N.D. Tex. 2009).

[24] *In re* Energy Partners, Ltd., 409 at 226 (citing *In re* High Voltage Energy Corp., 311 B.R. 320, 333 (Bankr. D. Mass. 2004) (quoting *In re* Insilco Techs., Inc., 291 B.R. 628, 633 (Bankr. D. Del. 2003)).

> cases or other insolvency or workout situations. The Court has been given no information about how Evercore was selected. The Court has been given no information about the number and qualifications of the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the compensation being paid to the professionals employed by Evercore who are assisting the Debtors. The Court has been given no information about the number of hours these employees have devoted to and intend to devote to assisting the Debtors in restructuring their financial affairs. The Court has merely been provided with vague descriptions of the tasks Evercore intends to perform. Accordingly, the Court simply is not in a position to gauge the reasonableness of the terms and conditions of Evercore's employment at this time and whether the monthly and contingent fees proposed reasonably corresponds to the value of the services which Evercore is being asked to perform.[25]

Debtors, committees, and professionals alike should be aware of the analytical and evidentiary approaches used in section 328 applications in their district and circuit and should be prepared to satisfy the Bankruptcy Court's scrutiny into the propriety and reasonableness of the professional's fee agreement.

4. Lawyers must be mindful of the dictates of state ethics rules.

In addition to knowing and following the directives of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, attorneys retained in bankruptcy cases should not lose sight of the obligations imposed under applicable rules of professional conduct—in particular, the rules addressing the reasonableness of fees and candor to the court.

The standard for fees under state ethics rules is reasonableness.[26] If the reasonableness standard is not met, even a compensation arrangement approved under section 328 does not

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[25] High Voltage Energy Corp., 311 B.R. at 335.

[26] See Model Rule of Professional Conduct R. 1.5 (Fees):

> (a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee 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 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 the circumstances;
>
> (6) the nature and length of the professional relationship with the client;

preclude a court from reviewing those fees—unless the *amount* of the fees was specifically pre-approved.[27] Given that some professionals are beginning to request fee enhancements, the Task Force also recommends that any professional contemplating a fee enhancement based on defined "success" benchmarks should have the method for determining the fee enhancement (and, if possible, the amount of an enhancement itself) approved explicitly at the time that the professional is seeking approval of its employment application under section 328.

5. Employment applications under section 328 must contain truthful assertions supporting the compensation method.

In the same way that a professional should specify in the employment application that he or she is seeking approval of the compensation method under section 328, the professional should also make sure that the representations in support of the section 328 approval are accurate and truthful. An example of a faulty employment application was at issue in *In re Mirant Corp.*[28] In *Mirant,* the court specifically mentioned its frustration with the representations made by the financial advisors in their employment application: "The court erred seriously in entering orders which left it so little discretion in assessing the work of the financial advisors. Though the court was given to understand [that the] Debtors and the Committees could not obtain competent financial advisors without assurance that there would be substantial 'success' bonuses, whether or not each advisor could show it had earned such a fee, the court has since learned that some financial advisors, at least, will accept

> (7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
> (8) whether the fee is fixed or contingent.
> (b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.
> (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. A contingent fee agreement shall be in a writing signed by the client and shall state 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 after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination. . . .

[27] *See* Committee of Equity Security Holders of Federal–Mogul Corp. v. Official Committee of Unsecured Creditors (*In re* Federal-Mogul, Inc.), 348 F.3d 390, 397-98 (3d Cir. 2003); *see also* Cadle Co. II, Inc. v. Fashion Shop of Kentucky, Inc. (*In re* Fashion Shop of Kentucky), 350 Fed. Appx. 24, 27-28 (6th Cir. 2009).

[28] 354 B.R. 113, 128 (Bankr. N.D. Tex. 2006).

more conventional arrangements in terms of compensation."[29] Although the *Mirant* court determined that its hands were tied in terms of having to award the bonuses under section 328,[30] it was none too happy about the bonuses.

Lawyers seeking section 328 approval for their own employment or for the professionals whom they represent have another reason to be both accurate and truthful. The rules demanding candor toward the tribunal subject a lawyer to sanctions for knowingly making an untrue statement.[31] The time to establish or reinforce a professional's reputation with the court is when the employment application is submitted. Professionals should be mindful of the disclosure requirements set forth in Rule 2014 when preparing employment applications.[32]

[29] *Id.* at 128 (footnote omitted).

[30] *Id.* at 127-31.

[31] For veracity in a lawyer's dealings with a court, see MODEL RULE OF PROFESSIONAL CONDUCT R 3.3 ("(a) A lawyer shall not knowingly . . . (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false. . . ."). For veracity in representing one's client, see MODEL RULE OF PROFESSIONAL CONDUCT R. 4.1 ("In the course of representing a client a lawyer shall not knowingly . . . make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."). And, of course, MODEL RULE OF PROFESSIONAL CONDUCT R. 8.4 creates an independent ethics violation when dishonesty is involved ("It is professional misconduct for a lawyer to . . . (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects; [or] (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation. . . .").

[32] *Cf.* ABI Report of ABI Task Force on Proposed Amendment to Rule 2014 (April 2013).

U.S. TRUSTEE FEE GUIDELINES

FOR ATTORNEYS IN LARGER CHAPTER 11 CASES

WHAT ARE USTP FEE GUIDELINES?

- Required by Statute
- Uniform and Consistent
  - Internal guidance for fee review
  - Expectations of professionals
  - Grounds for possible objections

2

PROCESS FOR ADOPTION

- Two years
- Pre-drafting consultation
- Two drafts for public comment
- DOJ Public Meeting
- Assoc. AG announced June 11, 2013

3

WHEN WILL USTP APPLY THEM?

- Cases filed on or after November 1, 2013
  - Not pending cases
- Retention and fee applications
- Assets of $50 million and liabilities of $50 million—and up
  - Aggregated for jointly administered cases
  - Based on petition values generally
  - No single asset real estate cases

4

OVERVIEW OF MAJOR PROVISIONS

1. Comparable billing disclosures—blended rate
2. Budgets and staffing plans
3. Electronic billing data
4. Client verifications and counsel statements
5. Rate increase disclosures and calculations
6. Co-counsel retention and billing guidance
7. Fee examiner or fee committee models

5

1. CUSTOMARY AND COMPARABLE DISCLOSURES

- Disclose blended hourly rates for comparison
  - Billed or collected
  - Alternative billing
  - Explain methodology
- Limited "safe harbor" without prejudice to UST's right to:
  - Seek more information
  - File an objection
  - Offer other evidence
- Developed with substantial input from National Bankruptcy Conference

6

2. BUDGETS AND STAFFING PLANS

- Consent or court order
- Filed with fee application
- Budgets improve case management

7

MAKING BUDGETS WORK

Confidentiality

- Filed *after* budget period
- Reasonable redactions
- *Filed* budget shows no detail

Predictability

- Short budget periods
- Amend for unforeseen
- Explain "surprises"
- Not a cap or guaranty

8

4. CLIENT VERIFICATION AND COUNSEL STATEMENTS

- Client with retention application
- Applicant with retention application
- Applicant with fee application

9

CONCLUSION

10

FREQUENTLY ASKED QUESTIONS (FAQS) – PROFESSIONAL COMPENSATION

The United States Trustee Program is prohibited from providing legal advice to private individuals. These questions and answers relate to general circumstances involving bankruptcy.

Questions

Answers

1. **After *ASARCO*, will the USTP object to defense fees incurred after an objection has been filed in court?**

   A: Yes. The Supreme Court ruled that attorneys' fees for defending objections to applications for compensation ("defense fees" or "fees-on-fees") are *per se* prohibited because section 330 does not expressly alter the American Rule against fee shifting. *See generally Baker Botts LLP v. ASARCO LLC*, 135 S. Ct. 2158, 2167 (2015). Although the U.S. Trustee Fee Guidelines for Attorneys in Larger Chapter 11 cases ("LCFG") state that billing the estate for defending fee applications is "generally inappropriate" unless the defense fees fall "within a judicial exception applicable within the [judicial] district," LCFG, B.2.g., there are no applicable judicial exceptions after *ASARCO*.

2. **Will the USTP rely on *ASARCO* to object to fees incurred in preparing a fee application?**

   A: No. The Court in *ASARCO* did not disallow reasonable compensation for preparing a fee application and noted that "preparation of a fee application is best understood as a 'servic[e] rendered' to the estate administrator under § 330(a)(1)." 135 S. Ct. at 2167. Thus, reasonable charges for preparing interim and final fee applications are compensable because section 330(a)(1) allows them, and section 330(a)(6) requires that the compensation for the fee application be reasonable in relation to the level and skill required to prepare it. *See* also LCFG, B.2.f. (preparation of a fee application is not required for lawyers practicing in areas other than bankruptcy as a condition to getting paid).

3. **After *ASARCO*, will the USTP object to defense fees incurred negotiating or explaining fee applications *before an objection is filed in court?***

   A: Generally no, but it depends on the facts and circumstances of each case. Work that is an extension of fee application preparation will not generally be objectionable. Thus, good faith communications and

negotiations regarding a well-prepared fee application may be considered an extension of fee application preparation. But patently poor and deficient fee applications that elicit extensive inquiries or negotiations and require extensive amendment may not be considered part of the fee application preparation. For example, fees related to repeated billing errors, such as vague descriptions or block-billing, will draw an objection. In the absence of further court guidance post-*ASARCO*, the USTP will consider many factors in determining whether such defense fees appear to be for the professional's benefit or for the client's and, therefore, objectionable or not. The USTP's goal is to apply *ASARCO* faithfully, while encouraging sound billing practices and professional cooperation and compliance short of litigation, where possible.

4. **Will the USTP object to professionals seeking a pre-approved term of employment that permits the payment of fees-on-fees otherwise disallowed by *ASARCO*?**

   A: Yes. Professionals' employment and compensation rights in bankruptcy arise by statute. *ASARCO's* analysis is relevant to all Bankruptcy Code sections dealing with employment and compensation. First, section 328 permits a professional to seek court approval for any reasonable terms and conditions of employment. But section 328, like section 330, does not contain explicit statutory authority for deviating from the American Rule against fee-shifting. Second, section 328 terms must both relate to the scope of the professional's employment and be reasonable. Paying fees-on-fees is neither a term of employment nor is it reasonable for the estate to pay for work that is not a client service. Third, section 330(a)(1) governs the award of compensation, subject to sections 326, 328, and 329, and *ASARCO* expressly precludes an award of fees-on-fees under section 330(a)(1). (A section 330 award is what gives the professional an administrative claim against estate assets under section 503(b)(2)).

   In addition, estate-paid professionals cannot by consent or contract create an exception to pay what the Code does not allow. *See In re Lehman Bros. Holdings, Inc.,* 508 B.R. 283, 294 (S.D.N.Y. 2014). The Code, through sections 326-331 and 503, regulates both professional compensation and administrative expenses paid from the estate in a comprehensive way that parties are not free to rewrite. *See id.* Thus, fees cannot be shifted by a contract that violates a statute, and the USTP will generally object to efforts to pay fees-on-fees in circumvention of *ASARCO*.

5. **Will the USTP object if a professional seeks a higher rate or enhanced compensation, *i.e.*, a bankruptcy premium, than that charged for comparable non-bankruptcy engagements based on the purported risk of non-payment for future fee litigation and resulting dilution of its bankruptcy compensation?**

   A: Yes. The Court in *ASARCO* considered—and rejected—the idea of bankruptcy premiums or enhancements based on the risk of "dilution." "In our legal system, no attorneys, regardless of whether they practice in bankruptcy, are entitled to receive fees for fee-defense litigation absent express statutory authorization. Requiring bankruptcy attorneys to pay for the defense of their fees thus will not result in any disparity between bankruptcy and nonbankruptcy lawyers." *ASARCO*, 135 S. Ct. at 2168. This analysis is consistent with section 330(a)(3)'s standard that a bankruptcy practitioner's reasonable compensation is what is customary and comparable to a non-bankruptcy practitioner's, i.e., market rates and billing practices. See 11 U.S.C. § 330 (a)(3)(F). To the extent the Fifth Circuit suggested otherwise in its earlier *ASARCO* decision, 751 F.2d 291 (5th Cir. 2014), the Supreme Court disagreed.

   Moreover, dilution risk is minimal. *ASARCO* is an exceedingly rare case for many reasons. First, *ASARCO* involved the very unusual circumstance where management of the reorganized debtor was again controlled by the parent upon confirmation. Post-confirmation management was uniquely motivated to be hostile to debtor's bankruptcy counsel because bankruptcy counsel had represented the debtor in obtaining an extraordinarily large judgment against the parent during the bankruptcy—and any reduction in fees would have been a dollar-for-dollar economic benefit to the parent. Second, the fee defense costs were $5 million, reflecting again the very unusual nature of the case. Third, in many cases,

the USTP is the only party that objects to a fee application. *See In re Busy Beaver Building Centers, Inc.,* 19 F.3d 833 (3rd Cir. 1994). Finally, because an objecting party must pay its own attorneys' fees to pursue fee objections, this should discourage frivolous objections. And to the extent there are bad faith or frivolous fee objections, the Court noted that a bankruptcy professional can avail itself of Rule 9011 sanctions. 135 S. Ct. at 2168, n.4.

6. **How will the USTP handle pending cases with requests for fees incurred in defending fee applications?**

   A: Any newly filed interim application and any final application containing a request for defense fees *for the first time* should be reviewed under the standards discussed above. That is, if the fees-on-fees resulted from fee litigation, an objection is generally appropriate. If no fee objection was ever filed, then whether the fees-on-fees are objectionable depends on the facts and circumstances of the case.

   If fees-on-fees have been previously awarded on an interim application that would have been disallowed under *ASARCO's* ruling, the USTP should determine whether an objection at the final application stage is advisable based on controlling law within the jurisdiction.

7. **Will the USTP continue to object to billing for the preparation of invoices submitted in support of a fee application?**

   A: Yes. There is no statutory authorization to shift fees for preparing invoices (as opposed to fee applications) to the estate, and the Court in *ASARCO* did not rule otherwise.

   As explained in the LCFG, "routine billing activities . . . typically are not compensable outside of bankruptcy. Most are not compensable because professionals do not charge a client for preparing invoices, even if detailed. Reasonable charges for preparing interim and final fee applications, however, are compensable, because the preparation of a fee application is not required for lawyers practicing in areas other than bankruptcy as a condition to getting paid." LCFG, B.2.f. This rationale applies to all cases, including those not subject to the LCFG.

8. **Will the USTP object to non-legal professionals seeking the reimbursement of legal fees for defending objections to fee applications?**

   A: Yes, using standards analogous to those discussed above that apply to attorneys seeking compensation for fee defense work. Regardless of whether the fee defense request is made by a legal or financial professional, the result must be the same based on *ASARCO*: A professional's legal fees for litigating fee objections cannot be paid. Non-lawyer professionals, such as financial advisors, are entitled to no better and no worse treatment than lawyers with respect to legal fees for defending objections to fee applications in a bankruptcy case.

   Because legal fees for defending fee application objections cannot be paid as compensation under section 330(a)(1)(A), those same legal fees cannot be reimbursed as expenses under section 330(a)(1)(B). Section 330(a)(1)(B) allows the award of "necessary" expenses. But those expenses must relate and be incident to the work for which the professional can be compensated under section 330(a)(1)(A). Otherwise, in *ASARCO*, Baker Botts need only have retained outside counsel to defend its fee applications and expensed the legal fees for reimbursement rather than seek compensation for them.

Updated September 25, 2015

DEPARTMENT OF JUSTICE, EXECUTIVE OFFICE FOR U.S. TRUSTEES
2013 FEE GUIDELINES FOR ATTORNEYS IN LARGER CHAPTER 11 CASES:
SUMMARY OF MATERIAL DIFFERENCES FROM 1996 GUIDELINES

1. CUSTOMARY AND COMPARABLE COMPENSATION DISCLOSURES
- a. Disclose firm's non-bankruptcy blended hourly rates by category of timekeeper
- b. Limited "safe harbor" from USTP objection

2. BUDGETS AND STAFFING PLANS
- a. By consent or court order
- b. Hours and fees per task code; no narrative or description
- c. Disclosed with fee application
- d. If fee application exceeds budget by 10%, explain why

3. ELECTRONIC BILLING DATA
- a. Provide billing data as maintained by firm to court, USTP, and major parties; other parties on request
- b. Virtually all firms and clients use LEDES (legal electronic data exchange standard) data (LEDES.org)

4. CLIENT AND APPLICANT STATEMENTS
- a. Applicant with retention application
- b. Client with retention application (verified)
- c. Applicant with fee application

5. RATE INCREASE DISCLOSURES AND CALCULATIONS
- a. Questions on disclosure and approval of rate increases in applicant statement (4 above)
- b. Disclose initial rate and current rate for each timekeeper
- c. Disclose number of rate increases since case inception for each timekeeper
- d. Calculate total compensation requested with and without rate increases

6. EFFICIENCY CO-COUNSEL RETENTION AND BILLING GUIDANCE
- a. Encouraged for routine work at lower cost
- b. Compare billing rates and terms with lead counsel; demonstrate projected savings to estate
- c. Avoid duplication

7. FEE EXAMINER AND FEE COMMITTEE MODELS
- a. Three models
  - i. Fee examiner (not § 1104)
  - ii. Fee committee with independent chair
  - iii. Fee committee
- b. Experienced bankruptcy professional
  - i. Not a prohibited special master; court must still adjudicate issues and award fees
  - ii. More than fee auditor focused solely on numbers

8. FIVE MODEL FORMS (PDF fillable model forms will be available on USTP website)
- a. Exhibit A: Customary and Comparable Compensation Disclosures
- b. Exhibit B: Summary of Timekeepers Included in this Application
- c. Exhibit C: Budget and Staffing Plan
- d. Exhibit D: Summary of Compensation by Project Category
- e. Exhibit E: Summary Cover Sheet of Fee Application

UNITED STATES TRUSTEE PROGRAM

FREQUENTLY ASKED QUESTIONS: FEE GUIDELINES FOR ATTORNEYS IN LARGER CHAPTER 11 CASES

Professional Compensation in Bankruptcy

Q. How are bankruptcy attorneys paid under the Bankruptcy Code?

A. Under the Bankruptcy Code, attorneys and other professionals who provide services for the debtor and official committees are entitled to be paid from the bankruptcy estate – the pool of assets and monies otherwise available to pay creditors – but the attorneys and other professionals must first file applications to be paid with the court and have the court approve the payments. Section 330 of the Bankruptcy Code says fees must be reasonable and necessary, and comparable to what attorneys charge outside of bankruptcy cases. Applicants must prove that their fees and expenses comply with the Bankruptcy Code before the court may enter an order directing the bankruptcy estate to pay the fees.

Q. What role does the U.S. Trustee Program (USTP) play in bankruptcy compensation?

A. One of the U.S. Trustee's statutory duties is to review, comment, and object, where appropriate, to fee applications that do not satisfy the standards for payment under the Bankruptcy Code. Once the U.S. Trustee objects to fees, it is up to the court to decide if any or all of the fees should be awarded. Often, the USTP is the only party to object to professional compensation.

Q. If the Bankruptcy Code establishes what fees and expenses can be paid, why does the USTP have Guidelines?

A. The Guidelines, which are mandated by law, are an important statement of policy governing the USTP's review of fee applications filed by attorneys in large chapter 11 cases. The Guidelines do not supersede statutes, rules, or court orders, but they do communicate the criteria used by U.S. Trustees in reviewing fee applications, the USTP's expectations of professionals, and possible bases for U.S. Trustees' objections to the payment of fees and reimbursement of expenses.

Q. Does the court adjudicate all USTP objections to fees?

A. Not necessarily. Many times, the U.S. Trustee will ask questions or seek more information from the professionals before filing an objection, and the answers or information may resolve the U.S. Trustee's need to object. In other instances, the U.S. Trustee may object and then reach an accord that resolves the objection. In either case, the court must review and determine whether to award the compensation and may reach a different conclusion than did the U.S. Trustee.

Purpose and Content of the Guidelines

Q. Why did the USTP update the Guidelines?

A. The Guidelines were originally published in 1996. Since then, there have been significant changes in the legal industry and the complexity of business reorganization cases. The nature of many large bankruptcy cases has grown more complex as new financial practices and financial instruments have entered the marketplace. In addition, enormous amounts of money are at stake in large bankruptcy cases, including huge professional fees, which can reduce public confidence in the bankruptcy system. Further, law firm billing practices and law office technology have undergone profound changes, such as the common use of discounts and budgets in non-bankruptcy cases.

Q. What are the primary goals of the Guidelines?

A. The primary goals are (1) to ensure that attorneys' fees in larger chapter 11 bankruptcy cases are subject to the same client-driven market forces, scrutiny, and accountability that apply in non-bankruptcy cases and (2) to increase disclosure and transparency in the bankruptcy compensation process for attorneys.

Q. To what cases do the Guidelines apply?

A. The Guidelines apply to chapter 11 cases with $50 million or more in assets and $50 million or more in liabilities, aggregated for jointly administered cases and excluding single-asset real estate cases (cases where the debtor's sole asset is a piece of real property). These values are based on the information in the bankruptcy petition.

Q. When do the Guidelines take effect, and what provisions apply until then?

A. The Guidelines take effect in cases filed on or after November 1, 2013, for attorneys in larger chapter 11 cases. Until then, the 1996 Guidelines apply. On and after November 1, 2013, the 1996 Guidelines continue in effect for all other professionals and for attorneys in chapter 11 cases below the large case threshold.

Q. Overall, what do the Guidelines do?

A. In general, the Guidelines provide for:

- A showing that rates charged reflect market rates outside of bankruptcy.
- The use of budgets and staffing plans.
- Disclosure of rate increases that occur during the representation.
- Use of rates that are based on the attorney's home office location.
- The submission of billing records in an open, searchable electronic format.
- The use of independent fee committees and fee examiners.

- The use of model forms and templates for applications for compensation and expenses.

Q. Why is the USTP so concerned about "market rates" for attorneys?

A. Section 330 of the Bankruptcy Code requires courts to determine "reasonable compensation for actual, necessary services" based on factors that include "customary compensation charged by comparably skilled practitioners in cases other than" bankruptcy cases – in other words, the market rate.

Q. Under the Guidelines, how do attorneys provide information on market rates?

A. Attorneys may provide an average, or "blended," hourly rate charged by professionals in their law firm or selected offices of their law firm.

Q. Why does the USTP want budget and staffing plans, and why require a court order for them?

A. Requesting budget and staffing plans is consistent with practices used in non-bankruptcy cases to manage legal costs. The USTP's budget and staffing plan templates are modeled after those used by the Association of Corporate Counsel. The Guidelines provide for a court order in cases where the parties do not consent to providing a budget.

Q. Do the Guidelines permit attorneys to increase their rates during a bankruptcy case?

A. The Guidelines contain provisions pertaining to notice and approval of rate increases. Rate increases may be significant and, therefore, the court and the parties should have the opportunity to consider whether the increases are reasonable. Case law on this issue may differ from district to district, and the USTP will seek to challenge settled law where appropriate.

Q. What if an attorney works on a case in a location other than his or her home office, and market rates are different in the two locations?

A. The Guidelines allow attorneys to charge customary rates from their "home forum," but not to charge higher rates in a case pending in a higher priced forum.

Q. How does the USTP enforce the Guidelines?

A. USTP staff adhere to the Guidelines when reviewing and commenting on the fee applications of attorneys. Only the court has the authority to award compensation and reimbursement under section 330 of the Bankruptcy Code. If litigants challenge the Guidelines by asking the bankruptcy court not to follow them, the USTP will vigorously defend the Guidelines and file appeals as appropriate.

Process for Updating the Guidelines

Q. Was the public involved in the updating process?

A. Yes, the USTP went to great lengths to solicit public input on the proposed Guidelines. In November 2011, the USTP posted an initial draft and invited public comments. In June 2012, the USTP conducted a public hearing at Department of Justice headquarters in Washington, DC. In November 2012, the USTP posted a second draft, which included an analysis of the comments on the first draft, and invited comments on the second draft before promulgating the final Guidelines.

Q. Why did the USTP publicize the proposed Guidelines so widely?

A. The Guidelines represent a significant step forward in increasing transparency and accountability in chapter 11 professional fees. While the Guidelines are not subject to the notice and comment process of the Administrative Procedure Act, the USTP publicized them widely because of their importance to the bankruptcy system and the extraordinary amount of interest in them.

Additional Information

Q. What about the USTP Guidelines for other types of professionals and cases?

A. These Guidelines are part of a multi-step revision process. Until the USTP adopts superseding guidelines in the next phases of revisions, the 1996 Guidelines will continue in effect for the review of fee applications filed in large chapter 11 cases by professionals who are not attorneys; in all chapter 11 cases below the large case threshold; and in cases under other chapters of the Bankruptcy Code.

Q**. Where are the Guidelines published?**

A. In addition to being posted on the USTP's Web site, the Guidelines will be published in the Federal Register.