



AMERICAN
BANKRUPTCY
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2019 Mid-Atlantic Bankruptcy Workshop

Fee-Application/Compensation Issues

Paul H. Deutch, Moderator

Omni Management Group, Inc.; New York

Monique B. DiSabatino

Saul Ewing Arnstein & Lehr LLP; Wilmington, Del.

Timothy J. Fox, Jr.

Office of the U.S. Trustee; Wilmington, Del.

Christopher A. Jones

Whiteford Taylor Preston LLP; Falls Church, Va.

Hon. Michael B. Kaplan

U.S. Bankruptcy Court (D. N.J.); Trenton

Fee Application & Compensation Issues

ABI Mid-Atlantic Conference
August 2019

Overview

- Issues with Interim Compensation Procedures
- Review of Fees in Chapter 11 Cases
 - Fee Examiners/Fee Committees
 - Large Fee Guidelines – Best Practices
 - *Asarco* – 4 Years Later
- Implications of Review under Sections 328 and 330
- Lessons from Recent Cases Involving Professional Compensation
- Fee Issues in Consumer Cases
- Recovery of Attorneys' Fees in Dismissed Cases

Interim Compensation Procedures

- Discussion Topics:
 - Uniformity of interim compensation procedures between jurisdictions
 - Use form of fee applications
 - Deadlines for filing monthly statements/interim applications
 - Minimum amount for application to be filed
 - Timeliness of monthly fee statements and interim fee applications
 - Allocation of fees between estates
 - Applicable law and customary practice in the jurisdiction
 - When to implement a fee review entity in an appropriate case

Review of Fees in Chapter 11 Cases

Fee Examiners - What are they?

- Many professionals employed in a bankruptcy case: attorneys, accountants, financial advisors, investment bankers, etc.
- It is the duty and function of the Court to review all fee applications, whether objections were filed or not.
 - It is the Court's responsibility to review applications for compensation and reimbursement of expenses and to enter appropriate Orders on them pursuant to Bankruptcy Code section 330.
- By appointing a fee examiner, court is outsourcing this function to an independent third party. They are treated as an officer of the Court.
- Fee examiner can be a fee auditor (uses computer programs to analyze entries), a fee review committee, or a person that reviews fees for reasonableness.
- The Office of the United States Trustee also reviews fees application pursuant to 28 U.S.C. § 586(a)(3)(A).

Fee Examiners

- Compensation: Fee examiners are entitled to compensation from the Debtors' estates for reasonable fees and expenses.
 - File fee applications.
 - Rates are disclosed in the proposed fee examiner order
- Appointment is pursuant to section 105(a) of the Code or Local Rule
 - Delaware Local Rule 2016-2(j): "The Court may, in its discretion or on motion of any party, appoint a fee examiner to review fee applications and make recommendations for approval. On conversion, the authority of the fee examiner ends unless retained by the chapter 7 trustee or otherwise ordered by the Court."

Fee Examiners - When/how are they appointed?

- Depends on jurisdiction and size and complexity of the case, number of professionals retained:
 - **Delaware:**
 - Judges Shannon and Sontchi have standing orders appointing fee examiners
 - Other Judges – chambers will contact you to tell you to submit a list of potential names after conferring with other parties.
- *In re City of Detroit, Michigan*, Case No. 13-53846 (TJT) (Bankr. E.D. Mich. 2013) – Judge Rhodes entered an order establishing a “comment period” for a fee examiner.
 - Interested parties could submitted suggestions for a fee examiner.
- *In re PG&E Corp., et al.*, Case No. 19-30088 (DM) (Bankr. N.D. Cal. 2019) – UST filed a motion for the appointment of a fee examiner.

Fee Examiners - Tasks & Best Practices

- **What Do Examiners Do?**
- Review fee applications and provide comments.
- Submit to reports to the Court regarding the outcome of their review of each application.
- Courts are deferential to fee examiner reports.
- Potential for additional comments or questions but generally a resolution reflected in an examiner report is sufficient.
- **Best Practices**
- Key Issues to Identify in Bills:
 - Vague Entries
 - Block-Billing (Review and analyze...)
 - Duplicative entries
 - Inconsistent entries
 - Overstaffing and mis-staffing
 - Overbilling
 - Expenses
- Talk through issues – sometimes context is helpful.
- Respond promptly and clearly
- Ensure that applications comply with Locals Rules and guidelines.

Fee Review Entities Other than a Fee Examiner

- In addition to the Fee Examiner, the Large Case Fee Guidelines provide for two other models:
 - Fee Review Committees
 - Fee Review Committees with an Independent Member
- Those models share a lot in common, with the main difference between the two being that the Fee Committee with an Independent Member is essentially a Fee Examiner.

Fee Committees

- The Fee Committee is to be composed of representatives from the Debtors, the Official Unsecured Creditors Committee, any other official committee, and the U.S. Trustee.
- Those representatives are to be from the company, the individual members composing the committees, and the U.S. Trustee, rather than any of the retained professionals whose fees will be reviewed by the Fee Committee.
- One member of the Fee Committee will act as a chairman with administrative functions, but the Fee Committee should take action by majority vote (mechanisms should be included in the order to deal with potential tie votes).

Fee Committees with an Independent Member

- This model of fee review entity is the same as the Fee Committee but with an Independent Member appointed to serve as chairman (while it could be conceivably anyone with relevant bankruptcy and professional fee experience, it is often an individual that serves as a standalone fee examiner).
- By having the Independent Member, any voting deadlocks by the Fee Committee have a built in mechanism to break the deadlock, as the Independent Member's vote should be determinative.
- This model has been used in very large chapter 11 cases, including:
 - *In re Lehman Brothers Holdings Inc.*, Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. 2008)
 - *In re Energy Future Holdings Corp.*, Case No. 14-10979 (CSS) (Bankr. D. Del. 2014)
 - *In re Caesars Entertainment Operating Co., Inc.*, Case No. 15 B 1145 (Bankr. N.D. Ill. 2015)

Best Practices in Large Fee Guidelines Cases

Compensation and Reimbursement of Expenses Filed under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases (the “LCFG”)

- Applicable when assets and liabilities equal exceed \$50 million each
- The LCFG have been effective since November 2013
- Requires attorney professionals to provide additional disclosures, allowing the Court, Fee Review Entities, and the U.S. Trustee to better review fee applications for reasonableness.

Key Features of the LCFG

- Disclosing variation from billing arrangements, variations in hourly rates based on geographic location of the case, changes in the terms of the representation from those in the 12 months preceding the petition, and if the client has approved a budget and staffing plan;
- Filing of a client declaration in support of the retention application demonstrating steps taken to ensure the applicant firm’s rates are market, the number of firms interviewed, procedures the client has established to monitor fees and manage costs;
- Preparing Budgets and Staffing Plans;
- Providing searchable electronic data contemporaneously with filed fee application generally in LEDES Data Text format;
- Providing Comparable Rate Disclosures

Disclosures by the Firm Applicant & Client Declaration

- **Disclosures:**

- Important that these contain sufficient detail when an affirmative response is provided;
- If variations in billing arrangement exist between the prepetition and postpetition period, the applicant should be prepared to accommodate requests to have the fee arrangement track what was done prepetition to avoid perception they are now receiving a “bankruptcy premium” for their work.

- **Client Declaration**

- Will vary based on the circumstances of the retention;
- Should include information specifically about how the arrangement arose, and not simply be a form document.

Budget and Staffing Plans

- Real effort necessary;
- Time to put in the work is at the outset of the case, not after all the work has been done;
- Material Variations can happen, the important thing is disclosure and explaining the why the outcome was different than anticipated.

Electronic Data

- Most firms use the LEDES format to underlie their billing software;
- If unsure about how to procure the information reach out to your firm's billing department;
- Providing this data early on will help parties reviewing the fees to provide comments to avoid issues later on that could result in fee objections.

Comparable Rate Disclosures

- There are several options for how to report this information, but the firm should be consistent in how it does it throughout the case;
- Important to provide both an aggregate figure, and the subcategories (blended rate for partners, of counsel, associates, paraprofessionals);
- For Bankruptcy Boutiques, exclude all estate-billed engagements from the calculation of the firm-wide rate;
- Optional exclusions – pro bono engagements and representations of charitable organizations;
- Providing information and explanations as appropriate.

Implications of Review under 328 and 330 of the Code

- **Section 328 of the Bankruptcy Code:**
- (a) 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 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.**
- Under 328(a), reasonableness is judged in advance, and the issue is not revisited except in very narrow circumstances.
- The statute “creates a ‘high hurdle’ for a movant seeking to revise the terms governing a professional’s compensation *ex post facto*.” *ASARCO, LLC v. Barclays Capital, Inc. (In re ASARCO)*, 702 F.3d 250, 258 (5th Cir. 2015). It means that the developments must have been *incapable* of anticipation, not merely unanticipated. *E.g. In re John Q. Hammons Fall 2006, LLC*, No. 16-21142 (RDB), 2019 WL 112310, at *10 (Bankr. D. Kan. Mar. 8, 2019).

- **Section 330 of the Bankruptcy Code:**
 - (a) (1) After notice to the parties in interest and the United States Trustee and a hearing . . . the court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103—
 - (A) **reasonable** compensation 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
 - (B) reimbursement for actual, necessary expenses.
 - (a) (3) In determining the amount of reasonable compensation to be awarded . . . 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;
 - (F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.
- **Section 330 – calls for a review of reasonableness that includes an assessment made after-the-fact**

Exclusions from Section 330 Review

- **Exclusions from 330 Review:**
 - Attorney retention orders typically do not contain provisions limiting review under section 330 of the Code.
 - Investment banker orders typically do contain provisions limited review; however, if the language is not there already, the UST will require that it be carved out of this language (sometimes referred to as the Blackstone Protocol).
- **Implications:**
 - *In re Relativity Fashion, LLC*, No. 15-11989 (MEW), 2016 WL 607005 (Bankr. S.D.N.Y. Dec. 16, 2016) (overruling objections to transaction fees in investment bankers' final fee applications on grounds that the objectors – which consisted of the fee examiner, a secured lender and the debtor – did not have the right to review the fee applications for reasonableness under section 330).
 - *In re Garces Rest. Group, Inc.*, No. 18-19054 (JNP) (Bankr. D.N.J. Jan. 11, 2019) (approving transaction fee of investment banker after upholding committee and trustee's right to object under section 330 to the reasonableness of the fees, finding that transaction fee was reasonable and consistent with similar fees charged in other cases).
- **Relevant factors in determining the reasonableness of a transaction fee include: (i) whether the services rendered were necessary and beneficial to the estate; and (ii) a market-comparison of fees charged for similar services in non-bankruptcy cases**

Implications of *Asarco* - 4 Years Later:

- *Baker Botts LLP v. ASARCO LLC*, 135 S.Ct. 2158 (2015) – held that professionals cannot recover fees from defending fees.
 - Does not provide a statutory exception to the American Rule
- **Can Professionals stipulate to defense fee payments?**
 - *In re Boomerang Tube, Inc.*, 548 B.R. 69 (Bankr. D. Del. 2016)
 - *In re Nortel Networks, Inc.*, Case No. 09-10138 (KG), 2017 WL 932947 (Bankr. D. Del. 2017).
 - *In re Hungry Horse, LLC*, 574 B.R. 740 (Bankr. D.N.M. 2017)
- **Are discussions with the fee examiner compensable?**
 - *In re Stanton*, 559 B.R. 781, 782 (Bankr. M.D.Fla 2016) (ruling that work supplementing a fee application after it was rejected by the U.S. Trustee qualified as preparation for an application, not defending an application, and therefore is not precluded by *Asarco*).

Lessons from Recent Cases Involving Professional Compensation

How NOT to Get Paid in a Chapter 11 Case

- ***In re Earl Gaudio & Son, Inc.*, 2019 WL 1429978 (Bankr. C.D. Ill. 2019) and *In re Earl Gaudio & Son, Inc.*, 2018 WL 3388917 (Bankr. C.D. Ill. 2018)**
- Debtor's counsel failed to disclose connections and potential conflicts of interest until several years into the bankruptcy case.
- Debtor's counsel failed to disclose it's receipt of an interim compensation payment that was not authorized by the Court
- Court found that Debtor's counsel improperly over-billed for various tasks
- Court reduced requested fees by over \$1.2 million and ordered disgorgement of unauthorized interim compensation payment

Cannot Use Hindsight to Judge Reasonableness of Fees

- Counsel for trustee sought final approval of fees and expenses in chapter 7 case with 50% distribution for creditors
- Assets administered included numerous avoidance actions which produced a cash recovery lower than the fees incurred to pursue the claims
- UST objected to professionals fee requests because fees were "substantially disproportionate to the cash recovery" and that the trustee should have abandoned the litigation claims
- Court overruled the objections and approved the fees
- For fees to be compensable they must be "reasonably likely to benefit the debtor's estate" at the time they were rendered, not in "hindsight."
- Even if the benefit of litigation was considered, it included waiver of \$24 million unsecured claim and resulted in discovery of additional assets that benefited the estate

Use of Independent Contractor - Caution

- **In re Wilkerson, 2016 Bankr. LEXIS 2271 (D.C. Bankr. 2016)**
 - “an attorney representing a debtor in a case (as [the contractor]) was required to disclose her agreement for compensation to be paid for representing the debtor ‘whether or not such attorney applies for compensation’ and failure to do so is a violation of 11 U.S.C. § 329 and Rule 2016(b). Id. at *12-13.
 - Firm hiring the independent contractor “was required to file an amended Rule 2016(b) statement once he engaged [the contractor] to work on the brief, as Wilkerson’s agreement to compensate [the firm] for [the contractor’s] services was a new agreement of compensation to be paid. Id. at *13.
 - Court denied compensation the higher rate because “[the firm] dealt with her as an independent contractor, incurred none of the expenses that would be associated with an attorney employed in his firm, and failed to carry his burden of proving that he incurred any meaningful extra cost beyond the \$65 per hour he paid [the contractor].”

Carve-Outs Can Hurt

- **East Coast Miner, LLC v. Nixon Peabody LLP (In re Licking River Mining, LLC), 911 F.3d 806 (6th Cir. 2018)**
- Chapter 11 case where lender agreed to “carve out” of cash collateral to pay their fees (the “Carve-Out”). Lenders sought termination of use of cash collateral and court ordered parties to prepare a final budget for the Estate Professionals. The Court converted the case to chapter 7. Estate professionals sought payment from Lenders’ pre-petition liens. The Lenders objected arguing that the Carve-Out only applied to the Lender’s postpetition liens and not their prepetition liens. The Bankruptcy Court disagreed and directed that the Estate Professionals be paid out of the Lender’s cash collateral via the Carve-Out. The Lenders Appealed. The U.S. District Court affirmed the decision of the Bankruptcy Court. Sixth Circuit Court of Appeals affirmed.
- **Key holdings:**
 - The Court analyzed the Final Cash Collateral Order as it would any contract. Language in the Order clearly subjected the Lenders’ prepetition liens to the Carve-Out even after conversion to chapter 7. First, the operative paragraph for the Carve-Out contained no distinction between prepetition liens and postpetition liens.
 - Second, the Final Cash Collateral order defines “cash collateral” to include prepetition collateral.
 - Finally, it also specifically stated that its terms survive conversion to chapter 7.

Other Issues for Non-Attorney Compensation

- **In re United Artists Theatre Co.**, 315 F.3d 217, 229 (3d Cir. 2003) is the case most cited for approval of indemnity of professionals
- Indemnity provisions are not always approved
 - **In re Affordable Med Scrubs LLC**, No. 15-33448, 2016 WL 1244771 (Bankr. N.D. Ohio Mar. 29, 2016) (“[t]he court agrees with Bank that the indemnification provision is not a reasonable term of employment in this particular case.”)
 - **In re Comdisco**, 2002 WL 31109431 (N.D.Ill. Sept. 23, 2002)(reasonableness of indemnity for professional advisors depends on the facts of each case).
- **Most courts allow indemnification but not for losses resulting from bad faith, gross negligence, or willful misconduct**

Fee Issues in Consumer Cases - Bifurcated Fees

- What happens where a potential client would gladly pay you Tuesday for a bankruptcy today?
 - *In re Hazlett*, 2019 WL 1567751 (Bankr. D. Utah, April 10, 2019).
 - *Lamie v. U.S. Tr.*, 540 U.S. 526 (2004).
 - *In re Wright*, 591 B.R. 68 (Bankr. N.D. Okla. 2018).
 - *In re Ndon*, 2018 WL 68939745 (Bankr. D. Del., Nov. 8, 2018).
 - *In re Waldo*, 417 B.R. 854, 886 (Bankr. E.D. Tenn. 2009).
- Other Considerations
 - The hallmark of bankruptcy is the “fresh start” offered debtors.
 - In what ways does this practice interfere with the client’s fresh start?
 - How concerned should courts be with this interference?
 - Who should be offered a bifurcated fee?
 - In what ways do such individuals differ from other potential debtors?
 - Should counsel advise them to seek pro- or low bono representation?
 - Is the bankruptcy discharge a sufficient benefit for such individuals?

Recovery of Attorneys' Fees in Dismissed Cases

- Once the bankruptcy case is dismissed, can you get paid?
- Most dismissals are structured: interim dismissal order, followed by final order to be submitted under a certification of counsel that confirms, *inter alia*, that professionals have been paid on account of approved final fee applications.
- If no court order allowing fees is entered before case is dismissed:
 - Broad- Scope Approach
 - Considers whether approval is required for a professional to have a valid and enforceable right to fees incurred in a bankruptcy case.
 - *Dery v. Cumberland Cas. & Sur. Co. (In re 5900 Assocs. Inc.)*, 468 F.3d 326 (6th Cir. 2006) (holding that dismissal of case did not abrogate court's duty to review fees under 330 [and thus portion of post-dismissal fees attributable to work performed during case but for which an application was never filed, was not approved]).
 - Narrow-Scope Approach
 - Majority view
 - Focuses on whether Court approval of fees under section 330 of the Code is required only when seeking a claim against estate property – in which case, bankruptcy court approval is not needed to pursue fees against a debtor whose case is dismissed.
 - See *Barron v. Countryman*, 432 F.3d 590, 595 (5th Cir. 2005); *Ferrara & Hantman v. Alvarez (in re Engel)*, 124 F.3d 567, 577 (3d Cir. 1997).