AMERICAN BANKRUPTCY INSTITUTE

2019 Winter Leadership Conference

Hit 'Em Below the Belt (and in the Wallet): Professional Fees and Leverage Post-*ASARCO*

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U.S. Bankruptcy Court (N.D. Tex.); Dallas

CONCURRENT SESSION

2019

Hit 'Em Below the Belt (and in the Wallet)

Professional Fees and Leverage Post-*Asarco*

Panelists

- Hannah L. Blumenstiel, U.S. Bankruptcy Judge (N.D. Cal. – San Francisco)
- Kathryn A. Coleman, Hughes Hubbard & Reed LLP (New York) -- Moderator
- Kyle S. Hirsch, Bryan Cave Leighton Paisner LLC (Phoenix)
- Dan T. Moss, Jones Day LLP (Washington, D.C.)
- Neal L. Wolf, Hanson Bridgett LLP (San Francisco)

Employment & Retainer

- Counsel engaged to advise on restructuring options and immediately starts working
- No prior relationship with client
- 3 weeks later – client pays $150K retainer in 2 installments
- The day after receiving second installment, counsel issues an invoice for $137K
- With client's approval, invoice is paid from retainer
- Going forward, retainer is replenished (first to $150K, then to $400K), upon payment of invoices
- Ch. 11 case filed – retainer applied to pay counsel's pre-petition fees, then replenished to $400K
- Retention application discloses all payments and draws no objection; employment order entered and becomes final

Creditor's Challenge

- DIP files a plan of reorganization that releases all preference actions
- Committee files motion under FRCP 60(b)/FRBP 9024 for relief from DIP counsel's employment order, on the ground counsel had received preferential payments
  - Theory: Counsel had done work before receiving retainer, which meant payment of retainer was on account of an antecedent debt and was a preference
- UST joins Committee's motion and objects to confirmation
- Counsel's response: Debt not incurred until first invoice sent (after receiving retainer)
  - Theory: Analogous to ability to maintain disinterestedness by waiving any pre-petition claim
- Who wins?

In re Pillowtex, Inc., 304 F.3d 246 (3d Cir. 2002)

- Facts
  - In year prior to Petition Date, counsel for DIP received payments totaling $2.5MM
  - $1.0MM received in 90 days pre-petition
  - One day prior to the Petition Date, counsel received a $300,000 retainer, of which $100,000 was applied to pre-petition fees
  - UST objected to retention application, arguing that counsel was not disinterested because it had received payments that could be avoided as preferences
  - Counsel proposed that, if a final judgment is entered declaring it to have received an avoidable preference, it would repay the preferential payment and waive any related claim
  - BK approves retention; District Court affirms
  - Third Circuit reverses and remands

In re Pillowtex, Inc., 304 F.3d 246 (3d Cir. 2002)

- Issue: Whether Bankruptcy Court/District Court abused their discretion in entering/affirming retention order without determining whether counsel had, in fact, received an avoidable preference
- Held: "[W]hen there has been a facially plausible claim of a substantial preference, the district court and/or the bankruptcy court cannot avoid the clear mandate of [11 U.S.C. § 327(a)] by the mere expedient of approving retention conditional on a later determination of the preference issue"
  - "[T]he District Court must hold a hearing on whether [counsel] received a preference, and [we] will remand for that purpose"
- Rationale:
  - In re Marvel Ent't Group, Inc., 140 F.3d 463, 477 (3d Cir. 1998) (under section 327(a) the district court could disqualify counsel "only if it had an actual or potential conflict of interest")

In re Pillowtex, Inc., 304 F.3d 246 (3d Cir. 2002)

- In re First Jersey Securities, Inc., 180 F.3d 504, 509 (3d Cir. 1999) ("[w]here there is an actual conflict of interest . . . disqualification is mandatory")
- Record was inconclusive as to the ordinary course of business between debtor and counsel, whether the allegedly preferential payments pertained to work done in preparation for bankruptcy or pertained to non-bankruptcy work
- Distinguished caselaw cited by counsel in support of retention subject to agreement to waive any claim against the estate if ordered to disgorge a preference by pointing out that, in those cases, counsel had been retained with a waiver in place, whereas counsel in case at bar proposed only a conditional, future waiver
- Questioned the likelihood that counsel for the estate would sue itself for a preference

Baker Botts v. ASARCO LLC, 135 S. Ct. 2158 (2015)

- Facts:
  - Counsel for DIP employed under 11 U.S.C. § 327(a)
  - Prosecuted a fraudulent transfer action against DIP's parent company and obtained a judgment worth between $7-10B, enough to pay all creditors in full
  - Counsel filed fee applications, seeking compensation under 11 U.S.C. § 330(a)(1)
  - Debtor (under control of its parent, the judgement-debtor) objects to fee applications
  - After extensive discovery and a six-day trial, bankruptcy court overruled objection and awarded counsel $120MM in fees + $4.1MM fee enhancement for exceptional work + $5.0MM for the time spent defending fee applications
  - District Court affirms award of fees for defending fee applications
  - Fifth Circuit reverses award of fees incurred in defending fee applications because:
    - Counsel – not the estate – benefited from defending the fee applications
    - American Rule dictates that counsel could not look to other parties (the Debtor) absent explicit statutory authority, which is not found in the Bankruptcy Code

Baker Botts v. ASARCO LLC, 135 S. Ct. 2158 (2015)

- SCOTUS affirms (6-3)
- American Rule stands; SCOTUS has historically departed from that rule only in the face of "specific and explicit provisions for the allowance of attorneys' fees under selected statutes"
- § 330(a)(1) permits fees only for services rendered to the estate, which does not constitute an exception to the American Rule
- Fee defense litigation does not constitute services rendered to the estate
- Rejected the argument that § 330(a)(1)'s instruction to allow "reasonable" compensation should be read to permit fees for defending fee applications
- Rejected a policy argument that a ruling adverse to counsel would discourage talented attorneys from taking on bankruptcy work; not sufficient to justify deviation from the American Rule and no need to reach policy considerations because § 330(a)(1) is unambiguous