Great Debates

Douglas Deustch, Moderator
Clifford Chance US LLP; New York

A "workaround" contract provision is enforceable after *Baker Botts v. ASARCO*.

Pro: Michael R. Nestor
Young Conaway Stargatt & Taylor, LLP; Wilmington, Del.

Con: Nan Roberts Eitel
Executive Office of the U.S. Trustee; Washington, D.C.

If a mortgage includes a security interest in a mortgage escrow account, the mortgage loan can be modified under § 1322.

Pro: Edward C. Boltz
The Law Offices of John T. Orcutt, PC; Durham, N.C.

Con: Hon. Eugene R. Wedoff (ret.)
Oak Park, Ill.

Section 1129(a) requires an impaired accepting class for each debtor.

Pro: Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

Con: Hon. James M. Peck (ret.)
Morrison & Foerster LLP; New York

THE UNITED STATES DEPARTMENT of JUSTICE

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

1. After *ASARCO*, will the USTP object to defense fees incurred after an objection has been filed in court?
2. Will the USTP rely on *ASARCO* to object to fees incurred in preparing a fee application?
3. After *ASARCO*, will the USTP object to defense fees incurred negotiating or explaining fee applications *before an objection is filed in court?*
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*?
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?
6. How will the USTP handle pending cases with requests for fees incurred in defending fee applications?
7. Will the USTP continue to object to billing for the preparation of invoices submitted in support of a fee application?
8. Will the USTP object to non-legal professionals seeking the reimbursement of legal fees for defending objections to fee applications?

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.

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
BOOMERANG TUBE, INC., et al.,	)	Case No. 15-11247
	)	
Debtors	)	Jointly Administered
	)	
	)	

OPINION[1]

Before the Court are the Objections of the United States Trustee (the "UST") to the Applications of Brown Rudnick LLP, and Morris, Nichols, Arsht & Tunnel LLP ("Committee Counsel") as counsel to the Official Committee of Unsecured Creditors (the "Committee") of Boomerang Tube, LLC (the "Debtor") because they include a provision indemnifying them for expenses incurred in any successful defense of their fees. For the reasons stated below, the Court will sustain the UST's objection.

I. BACKGROUND

On June 9, 2015, the Debtor and its affiliates filed chapter 11 petitions. The UST appointed the Committee, which thereafter retained counsel. Committee Counsel each seek approval under section 328(a) of a provision in their retention applications entitling them to compensation from the Debtors' estates (subject

[1] This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure, which is made applicable to contested matters by Rule 9014 of the Federal Rules of Bankruptcy Procedure.

to approval by the Court pursuant to sections 330 and 331) for any fees, costs or expenses, arising from the successful defense of their fees.

The UST objected to the inclusion of the fee defense provisions in the retention applications.[2] The UST contends that the provision is precluded by the recent Supreme Court holding in ASARCO. See Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158, 2169 (2015). The UST also argues that the fee defense provisions should not be approved because such fees are outside the scope of employment and are unreasonable.

The Court heard argument and ordered supplemental briefings on the issue at the hearing held on August 11, 2015. The matter is now ripe for decision.

II. JURISDICTION

The Court has jurisdiction over this contested matter. 28 U.S.C. §§ 1334 & 157(b)(1).

III. DISCUSSION

The UST advances three arguments in its objection: (1) the Supreme Court decision in ASARCO directly bars the fee defense provisions; (2) section 328(a) creates no exception to the

[2] The retention applications have been approved without the fee defense provision, pending ruling by the Court on the UST's objection to that provision.

American Rule's general prohibition against fee shifting; and (3) the fee defense provisions cannot be approved under section 328(a) because they are unreasonable and seek to compensate professionals for work not within the scope of their employment.

A. The ASARCO Decision

The UST argues that the fee defense provisions are barred by the Supreme Court's decision in ASARCO. In ASARCO, the Supreme Court affirmed the Fifth Circuit's denial of fees to debtor's counsel for defending its fees from objections raised by the debtor. The Supreme Court stated that the "basic point of reference when considering the award of attorney's fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise." ASARCO, 135 S. Ct. at 2164 (quoting Hardt v. Reliance Std. Life Ins. Co., 560 U.S. 242, 252-53 (2010)). The Court held that any statutory departures from the American Rule must be "specific and explicit" and must "authorize the award of 'a reasonable attorney's fee,' 'fees,' or 'litigation costs,' and usually refer to a 'prevailing party' in the context of an 'adversarial action.'" Id. at 2164.

Applying this two-part test, the Supreme Court ruled that Congress did not depart from the American Rule in section 330(a) of the Bankruptcy Code. Id. Rather, that section only allows a court to award "reasonable compensation for actual, necessary

services rendered." Id. at 2165. The Supreme Court found that that phrase "neither specifically nor explicitly authorizes courts to shift the costs of adversarial litigation from one side to the other - in this case, from the attorneys seeking fees to the administrator of the estate - as most statutes that displace the American Rule do." Id. As a result, the Court held that the fees incurred in defending the firm's fee application were not compensable from the estate. Id. at 2169.

The UST argues that ASARCO is binding precedent which mandates that the Court deny the fee defense provisions in Committee Counsel's retention applications.

The Committee responds that ASARCO does not prohibit the fee defense provisions because in that case the Supreme Court found only that section 330(a) of the Bankruptcy Code did not contain an express statutory exception to the American Rule. Id. at 2164. In this case, the Committee is seeking approval of the fee defense provisions under section 328(a) not section 330. Therefore, the Committee argues that ASARCO is not applicable binding precedent.

The UST disagrees, contending that the Committee's professionals - though retained under section 328 - can only be compensated under section 330. Therefore, the UST argues that ASARCO is directly on point: section 330 is not a statutory

exception to the American Rule that attorneys' fees for defending a fee application cannot be paid by the estate.

The Committee acknowledges that its professionals get paid under section 330 but note that section 328 is an express exception to section 330[3] and that section 328 allows compensation to professionals (if approved in advance by the court) that would otherwise not be available under section 330 (such as fixed fees, contingent fees, etc.). The Committee, therefore, contends that the Court has the authority under section 328 to approve the fee defense provisions.

The Court concludes that although section 328 is an exception to section 330, it, like section 330, is not a "specific and explicit" statute which "authorize[s] the award of 'a reasonable attorney's fee,' 'fees,' or 'litigation costs,'" that "refer[s] to a 'prevailing party' in the context of an 'adversarial action.'" ASARCO, 135 S. Ct. at 2164. Section 328 merely provides that, with court approval, a professional may be employed "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis." 11 U.S.C. § 328(a). The text does not refer to the award of defense fees to a prevailing party. Therefore, the Court concludes that section

[3] Section 330 provides that "subject to sections . . . 328 . . ., the court may award to [professionals] . . . reasonable compensation for actual, necessary services rendered by the [professional]." 11 U.S.C. § 330(a).

328 does not provide a statutory exception to the American Rule and cannot provide authority for approval of the fee defense provisions.

The Court finds it significant that Congress did provide in several sections of the Bankruptcy Code the express language necessary to create an exception to the American Rule. See, e.g., 11 U.S.C. § 110(i)(1)(C) (providing that court shall order a petition preparer to pay reasonable attorneys' fees and costs to the debtor if the petition preparer violates that section); 11 U.S.C. § 303(i)(1)(B) (providing that court may order unsuccessful involuntary petition filers to pay reasonable attorneys's fees to the alleged debtor); 11 U.S.C. § 362(k)(1) (providing that court may order creditor who violates the automatic stay to pay debtor actual damages, including costs and attorneys' fees); 11 U.S.C. § 526(c)(2) (providing that a debt relief agency which violates the statute shall be liable for reasonable attorneys' fees and costs); 11 U.S.C. § 707(b)(4)(A) (providing that the court may order that the trustee's attorneys' fees and costs for successful prosecution of a motion to dismiss be paid by an attorney who files a petition in violation of Rule 11); 11 U.S.C. § 707(b)(5)(A) (authorizing the award of costs and attorneys' fees to a debtor who successfully defeats a motion to dismiss filed by a party in interest other than the trustee or UST).

Neither section 330 nor section 328 contain similar express language awarding attorneys' fees for successful prosecution of a defense to a fee objection. Therefore, the Court concludes that section 328, like section 330, does not provide an exception to the American Rule and cannot support the fee defense provisions at issue under the Supreme Court's ruling in ASARCO.

B. Contract Exception to the American Rule

The Committee argues that the Supreme Court in ASARCO did not rule that section 330 (or any other provision of the Bankruptcy Code) prohibited the allowance of defense fees. Rather, the Supreme Court merely held that section 330 did not contain a specific or explicit exception to the American Rule authorizing their payment. ASARCO, 135 S. Ct. at 2169 ("Section 330(a)(1) itself does not authorize the award of fees for defending a fee application, and that is the end of the matter."). The Committee further argues that the Supreme Court in ASARCO acknowledged that, in addition to a statutory exception to the American Rule, there could be an exception by contract. ASARCO, 135 S. Ct. at 2164 ("Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise.") (emphasis added) (citing Hardt v. Reliance Std. Life Ins. Co., 560 U.S. 242, 252-53 (2010)).

The UST responds that the parties' consent cannot override the statute. It argues that if the ASARCO prohibition on

allowance of defense fees could be overridden by consent, other Code provisions relating to compensation could as well - including prohibitions on compensation for unnecessary or duplicative services or fee-splitting. 11 U.S.C. §§ 330(a)4) & 504.

The Court agrees with the Committee that the Supreme Court in ASARCO did not hold that section 330 prohibits the allowance of defense fees and merely held that it did not expressly authorize them. The application of that holding to section 328 is the same: that section does not prohibit defense fees, it simply does not expressly authorize them. Therefore, the Court agrees with the Committee's argument that the contract exception to the American Rule is not precluded by the ruling in ASARCO. The Court nonetheless agrees with the UST's assertion that the parties cannot, by contract, violate another provision of the Code. Therefore, although the Committee is correct that the ASARCO Court did acknowledge a contractual exception to the American Rule, any such contract has to be consistent with the other provisions of the Bankruptcy Code.

1. Are the retention agreements contracts?

The Committee contends that the retention agreements with Committee Counsel are contracts. See, e.g., In re ASARCO, LLC, 702 F.3d 250, 268 (5th Cir. 2012) ("In disputes governed by § 328(a), the contractual arrangement is supreme, and we shall

enforce the contract as written.") (emphasis added); In re Nat'l Gypsum Co., 123 F.3d 861, 863 (5th Cir. 1997) ("Courts must protect [§ 328(a)] agreements and expectations, once found to be acceptable.") (emphasis added); U.S. Trustee v. Newmark Retail Fin. Advisors LLC (In re Joan & David Helpern, Inc.), No. 00 CIV. 3601 (JSM), 2000 WL 1800690, at *1 (S.D.N.Y. Dec. 6, 2000) (affirming bankruptcy court approval of indemnification provision in financial advisor's professional services contract under section 328(a) because they are not per se unreasonable); In re Merced Falls Ranch, LLC, Bankr. No. , 2012 WL 8255520, at *4 (Bankr. E.D. Cal. Oct. 16, 2012) ("Once § 328(a) is invoked, the bankruptcy court has limited discretion to vary the contractual terms of that employment.") (emphasis added). But see In re United Artists Theatre Co., 315 F.3d 217, 234 (3d Cir. 2003) (approving indemnification agreement of financial advisor with modifications eliminating indemnification for gross negligence or breach of contract).

The UST argues that the contract exception is not available because professionals' employment and compensation rights in bankruptcy are not bestowed by "contract." Instead, they are created by statute. Under the Bankruptcy Code, any employment agreement must be filed with and approved by the Court. 11 U.S.C. §§ 327, 328 & 1103. Regardless of how it is named, the UST contends that a professional's retention application is a

request of a judge, acting within the constraints of the Bankruptcy Code, to approve their terms of employment. The order so approving the employment is a Court Order not a contract between two parties. Cf. Restatement (Second) of Contracts 9 (1981) (defining a contract as an agreement between two parties, a promisor and a promisee). Further, the UST notes that the scope of the permissible terms of employment is governed by the Bankruptcy Code, not the parties' agreement. See, e.g., In re Fed. Mogul-Global, Inc., 348 F.3d 390, 397-98 (3d Cir. 2003) (holding that bankruptcy court could approve professional's employment on terms and conditions different from those proposed by the committee that the court found were necessary to satisfy the requirement of reasonableness under section 328(a)).

The Court agrees with the Committee that the retention agreement is a contract. However, it is not a bi-lateral one; rather, it is subject to objection by other parties and is ultimately subject to approval (and modification) by the Court. See, e.g., Fed. Mogul-Global, 348 F.3d at 397-98; United Artists, 315 F.3d at 234.

2. Is the contract an exception to the American Rule?

It is not enough, however, that the retention agreements be contracts, however. They must be contractual exceptions to the American Rule. The UST argues that they are not exceptions to the American Rule because they are not agreements by two parties

that in the event of litigation between them, the loser will pay the winner's legal costs. In this case, the UST notes that the agreement is a one-way street: Committee Counsel seeks a ruling that the estate is liable for their legal fees but make no similar commitment to the estate. The UST argues that the Committee cannot by contract require a third party (the estate) to pay their legal fees in the event of litigation by someone else. See, e.g., Motorsport Eng'g, Inc. v. Maserati SPA, 316 F.3d 26, 29 (1st Cir. 2002) (holding that a third party - even if it is a beneficiary of a contract - cannot be bound by a contract it did not sign or otherwise assent to); Abraham Zion Corp. v. Lebow, 761 F.2d 93, 103 (2d Cir. 1985) (same).

The Court agrees with the UST that the retention agreements in this case are not contractual exceptions to the American Rule. Here, there is not a contract between two parties providing that each will be responsible for the other's legal fees if it loses a dispute between them. Rather, here there is a contract between two parties (the Committee and Committee Counsel) that in the event Committee Counsel win a challenge to their fees, a third party (the estate) will pay their defense costs even if the estate is not the party who objected. As the UST notes, this is not the typical contract modifying the American Rule.

Nor can this contract bind the estate, which is not a party to it. Motorsport Eng'g, 316 F.3d at 29; Abraham Zion Corp., 761

F.2d at 103. The fact that it was negotiated between sophisticated parties (the Committee and Committee Counsel) is beside the point; it seeks to bind a non-party to that agreement.

Finally, it is clear that retention agreements in bankruptcy are not simply contractual matters. It is the obligation of the Bankruptcy Court to approve the terms of employment of professionals, in accordance with the provisions of the Bankruptcy Code, regardless of the terms articulated in the employment contract. Therefore, if the Court finds that a contract that the Debtor or the Committee negotiated is impermissible, the Court may not approve it or may modify it. See, e.g., Fed. Mogul-Global, 348 F.3d at 397-98 (holding that bankruptcy court could approve professional's employment on terms and conditions different from those proposed by the committee that the court found were necessary to satisfy the requirement of reasonableness under section 328(a)); United Artists, 315 F.3d at 234 (affirming approval of indemnification agreement in financial advisors' retention application but with two modifications required by the Court).

Therefore, the Court concludes that the retention agreements are not contractual exceptions to the American Rule. Even if they were, however, the Court must still determine if they are permissible under the Bankruptcy Code.

C. Scope of Section 328(a)

The UST argues that even if ASARCO did not directly preclude approval of the fee defense provisions, they cannot be approved under section 328 because they do not fit the scope of that section. It argues that the provisions are not "reasonable terms and conditions of employment" of a committee professional employed under section 1103. 11 U.S.C. § 328(a). The UST contends that all such terms of employment must actually relate to the services to be rendered by the professionals, i.e., the representation of the Committee and its interests. It argues that defending their own fees is not a service performed by Committee Counsel for the Committee but instead are services they are performing only for themselves. ASARCO, 135 S. Ct. at 2165 ("The term 'services' ordinarily refers to 'labor performed for another.' . . . Time spent litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described as 'labor performed for' - let alone 'disinterested service to' - that administrator.").

The Court agrees with the UST. The fee defense provisions are not reasonable terms for the employment of Committee Counsel because they do not involve any services for the Committee. Rather, they are for services performed by Committee Counsel only for their own interests.

The Committee argues nonetheless that "[c]ourts generally hold that exculpation and indemnification clauses are permissible in retention agreements if the clauses are reasonable in accordance with 11 U.S.C. § 328(a)." In re Firstline Corp., No. 06-70145, 2007 WL 269086, at *2 (Bankr. M.D. Ga. Jan. 25, 2007) (citing United Artists, 315 F.3d at 230). See also, In re DEC Int'l, Inc., 282 B.R. 423, 424 (W.D. Wis. 2002) (rejecting UST's argument that indemnification provisions are per se invalid as against public policy); In re Potter, 377 B.R. 305, 308 (Bankr. D.N.M. 2007) (approving provision allowing fees for defending fees from objection by third party because similar provision had been approved in another attorney's retention application); In re Joan & David Halpern, Inc., 248 B.R. 43, 47 (Bankr. S.D.N.Y. 2000) (allowing provision as reasonable in that case because state trust and corporate law allows indemnification of fiduciaries).

There are, of course, cases which disagree with this general proposition. See, e.g., In re Drexel Burnham Lambert Group, Inc., 133 B.R. 13, 27 (Bankr. S.D.N.Y. 1991) (stating that indemnification provisions for investment bankers are inappropriate); In re Mortgage & Realty Trust, 123 B.R. 626, 630-31 (Bankr. C.D. Cal. 1991) (disallowing any indemnity provision as inconsistent with professionalism); In re Allegheny Int'l, Inc., 100 B.R. 244, 247 (Bankr. W.D. Pa. 1989) (disallowing

indemnification for ordinary negligence in financial advisor's retention because "holding a fiduciary harmless for ordinary negligence is shockingly inconsistent with the strict standard of conduct for fiduciaries.").

The Third Circuit, however, has held that indemnification provisions sought by professionals may be approved as reasonable under section 328(a), but with limits. United Artists, 315 F.3d at 230 ("Our approach is 'market driven,' not 'market-determined,' especially in the realm of bankruptcy, where courts play a special supervisory role. With the understanding and limitations set out below, we believe [the financial advisor's] indemnification agreement to be reasonable and therefore permissible under § 328.").

That case though predated the ASARCO decision and did not address whether section 328(a) is an explicit statutory exception, or whether a retention agreement approved under that section is a contractual exception, to the American Rule. In addition, it dealt with indemnification of financial advisors, which were typically provided similar protections outside bankruptcy. Id. at 229.

In this case, the Court asked the parties to provide evidence that similar indemnification provisions are normally provided to counsel in non-bankruptcy contexts. (Tr. 8/11/2015 at 21:1-24, 48:15-24.) In its Supplemental Brief, the Committee

again cited to numerous bankruptcy cases where indemnification provisions and fees for successfully defending fees have been approved. (D.I. 393 at 3-5.) The Committee also noted that the UST guidelines permit award of such fees if it is judicially allowed in the district.

The citation to the UST guidelines is not compelling. The UST guidelines generally state that the UST will object to requests for fees defending fee applications.[4]

The cases cited by the Committee are not persuasive because they all predate ASARCO and most involve cases granting fees in bankruptcy cases for defending fee applications with little

[4] Section B(2)(g) of Appendix B - Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under 11 U.S.C. § 330 for Attorneys in Larger Chapter 11 Cases provides:

> Contesting or litigating fee objections. Whether the fee application seeks compensation for time spent explaining or defending monthly invoices or fee applications that would normally not be compensable outside of bankruptcy. Most are not compensable because professionals typically do not charge clients for time spent explaining or defending a bill. The USTP's position is that awarding compensation for matters related to a fee application after its initial preparation is generally inappropriate, unless those activities fall within a judicial exception applicable within the district (such as litigating an objection to the application where the applicant substantially prevails). Thus, the United States Trustee may object to time spent explaining the fees, negotiating objections, and litigating contested fee matters that are properly characterized as work that is for the benefit of the professional and not the estate.

(emphasis added).

analysis of why such services benefitted the estate or counsel's client.[5] (D.I. 393 at 3-5.)

The Committee argues nonetheless that fee defense provisions are common in the non-bankruptcy market and are, therefore, reasonable terms of compensation under section 328. Though that is not dispositive, the Third Circuit found that "some reference to the market is not out of place when considering whether terms of retention are 'reasonable' in the bankruptcy context." United Artists, 315 F.3d at 229 (citing In re Busy Beaver Bldg. Ctrs., Inc., 19 F.3d 833, 852 (3d Cir. 1994)). In support of its market argument, the Committee cites decisions in eleven states, including Delaware, where courts or state bar disciplinary authorities have held that similar indemnification provisions are permissible and do not run afoul of the Model Rules of Professional Conduct. (D.I. 393 at 8-9.)

The UST responds that this market-driven approach was expressly rejected by the Supreme Court in ASARCO and is no longer valid:

> [W]e find this policy argument [to follow the market approach, made by the UST] unconvincing. 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

[5] The Committee also cites two bare orders. The Court does not consider bare orders persuasive authority, because it is usually not clear from the order whether the court considered the issue or what its reasoning was if it did.

> any disparity between bankruptcy and nonbankruptcy lawyers.

ASARCO, 135 S. Ct. at 2168. Therefore, the UST contends that this Court is bound to follow the Supreme Court's holding on this point (even if it is dicta) and may not rely on a market-determined approach as a basis for allowing Committee Counsel to get fee defense costs and fees. See, e.g., Cuevas v. U.S., 778 F.3d 267, 272-73 (1st Cir. 2015) ("federal appellate courts are bound by the Supreme Court's considered dicta almost as firmly as by the Court's outright holdings, particularly when, as here, a dictum is of recent vintage and not enfeebled by any subsequent statement.") (quoting McCoy v. Mass. Inst. of Tech., 950 F.2d 13, 19 (1st Cir. 1991). Accord In re McDonald, 205 F.3d 606, 612-13 (3d Cir. 2000) ("But even if the discussion of § 506(a) could be accurately characterized as dictum — and we think it cannot be — we should not idly ignore considered statements the Supreme Court makes in dicta. The Supreme Court uses dicta to help control and influence the many issues it cannot decide because of its limited docket.").

The Committee counters that the ASARCO decision dealt with section 330 and that the market approach is a valid test of reasonableness under section 328. United Artists, 315 F.3d at 230.

The UST responds that in determining reasonableness under section 328, the Third Circuit has stated that courts should

consider the same factors as those under section 330. See, e.g., Fed. Mogul-Global, 348 F.3d at 407-08 ("It is well established that '[i]dentical words used in different parts of the same act are intended to have the same meaning.' . . . Though we need not decide whether Congress intended to limit Bankruptcy Courts to considering only the Section 330(a)(1) factors when determining the reasonableness of a requested fee structure under Section 328(a), we believe that the Section 330(a)(1) factors may be taken into account in asking whether a fee request is reasonable.") (citations omitted). Therefore, the UST contends that the Supreme Court's ruling in ASARCO precludes the Court's consideration of the market in determining the reasonableness of the indemnification agreements.

The Court agrees with the UST. The cases that considered market factors relevant to the question of whether defense fees can be recovered all pre-dated the ASARCO decision which expressly rejected the consideration of such factors in determining that issue. Therefore, the Court concludes that ASARCO prevents the Court from concluding that section 328 permits defense fees even if they were routinely allowed by the market in bankruptcy or non-bankruptcy contexts prior to that ruling.

D. Expenses under Section 328(a)

The Committee also argues that, even though section 328(a) does not contain an express exception to the American Rule, it nonetheless permits the approval of the fee defense provision as reasonable expenses of serving as counsel for the Committee. It cites cases allowing as expenses, attorneys' fees incurred by estate professionals for both retention and defense of fees under section 328(a) as reasonable. See, e.g., In re Borders Grp., Inc., 456 B. R. 195, 213 (Bankr. S.D.N.Y. 2011) ("Retained professionals that retain outside counsel only to represent the professional in connection with retention or preparation of fee applications may be reimbursed for reasonable expenses of such counsel when the engagement agreement and retention order provide for such expense reimbursement."); Geneva Steel Co., 258 B.R. 799, 803 (Bankr. D. Utah 2001) (holding that the reimbursement of reasonable fees and expenses incurred by advisor's law firm is allowable because the advisor's retention agreement required the debtor to indemnify the advisor for all reasonable expenses including fees, expenses, and disbursements of counsel). The Committee argues that this case is distinguishable from ASARCO because in that case there was not an agreement in advance under section 328(a) to pay the expenses associated with defense of counsel's fees.

The Court finds this argument unavailing. Again, the cases all pre-date ASARCO. Further, there is no difference in the analysis between approving the defense costs as fees (because the retained professional defends its own fees) or as expenses (because the retained professional hires outside counsel to represent it). Both are subject to the American Rule and to the Supreme Court's ruling in ASARCO. (The Supreme Court in ASARCO dealt with section 330(a)(1) which governs both fees and expenses.) Nor is there any suggestion in ASARCO that the Court's ruling would have been different if there had been an agreement in advance under section 328(a).

Further, as noted above, section 328(a) permits only approval of fees or expenses for performing services for the Committee. In this case, the expenses sought would be for services performed for the professionals, not for the Committee. Therefore, the Court concludes that the fee defense provision is not a reasonable term of employment for serving as Committee Counsel.

IV. CONCLUSION

For all the foregoing reasons, the Court will deny the request for approval of the fee defense provision in the retention applications of Committee Counsel.[6]

An appropriate Order is attached.

Dated: January 29, 2016

BY THE COURT:

Mary F. Walrath
United States Bankruptcy Judge

[6] The Court would reach the same conclusion if the fee defense provisions were in a retention agreement filed by any professional under section 328(a) - including one retained by the debtor. Such provisions are not statutory or contractual exceptions to the American Rule and are not reasonable terms of employment of professionals.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHER DISTRICT OF ILLINOIS
EASTERN DIVISION

BLETCHLEY HOTEL AT O'HARE FIELD LLC, **Appellant,** **v.** **RIVER ROAD HOTEL PARTNERS, LLC and FBR CAPITAL MARKETS & CO.,** **Appellees.**	**Appeal from the United States Bankruptcy Court for the Northern District of Illinois, Eastern Div.** **Bankr. Case No. 09-bk-30029** **Case No. 15 C 8063** **Judge Harry D. Leinenweber**

MEMORANDUM OPINION AND ORDER

Before the Court is an appeal from a judgment by the United States Bankruptcy Court for the Northern District of Illinois brought by Bletchley Hotel at O'Hare Field LLC ("Bletchley"), and the cross-appeal of FBR Capital Markets & Co. ("FBR"). FBR also moves to have Bletchley's appeal dismissed as frivolous, [ECF No. 31]. For the reasons stated herein, the decision of the Bankruptcy Court is affirmed, and FBR's Motion is denied.

I. BACKGROUND

This appeal stems from the bankruptcy of River Road Hotel Partners, LLC and its affiliates ("the Debtors"). The bankruptcy relates to the commercial failure of the former Intercontinental Hotel at O'Hare Airport, which opened its doors right before the start of the financial crisis in 2008. When

the business went south and the Debtors began to contemplate Chapter 11 bankruptcy, they hired FBR as their financial advisor to oversee a planned restructuring. The parties signed an engagement letter in August of 2009 detailing the terms of their agreement. The Bankruptcy Court officially approved Debtors' retention of FBR in September of 2009 in a court order ("the Retention Order"). The interplay between language in the engagement letter and the Retention Order form the bulk of the basis for this appeal.

The engagement letter set out several types of fees that Debtors would pay to FBR for its work. Central to this dispute is the "restructuring fee," a fee contingent on an eventual restructuring. FBR performed services under the contract for 22 months and still had not closed a deal when a third-party, Amalgamated Bank, proposed its own Chapter 11 restructuring plan, pursuant to which the Debtors would lose all of their assets. The Bankruptcy Court approved Amalgamated's plan on July 7, 2011. The plan created Bletchley Hotel at O'Hare LLC ("Bletchley"), which was responsible for the payment of expenses and is the entity bringing this appeal. FBR's efforts as financial advisor thus failed; it was not the party responsible for the final, successful restructuring.

Whether FBR is entitled to the restructuring fee turns on how the relevant documents define the fee. It was "payable

concurrently with the consummation of any Restructuring." (App. Appellants' Br. Ex. 3). The engagement letter defined a "restructuring," in relevant part, as "any restructuring, reorganization and/or recapitalization . . . that involves all or a significant portion of the Company's outstanding indebtedness." *Id.* The fee amount was to be computed as a percentage of the total indebtedness involved in the final transaction.

At first blush, this all seems simple enough: the restructuring fee was payable upon the occurrence of any restructuring, regardless of whether it was completed by FBR. This Court previously held, however, that the Bankruptcy Court's Retention Order implementing the terms of the engagement letter created some ambiguity surrounding the fee. *See, FBR Capital Markets & Co. v. Bletchley Hotel at O'Hare LLC,* 2013 WL 5408848 (N.D. Ill. September 24, 2013). Specifically, the Retention Order stated that the payment of the restructuring fee would be "contingent upon the consummation of a restructuring contemplated by the engagement letter." (App. Appellants' Br. Ex. 4). Of that language, this Court previously observed: "By indicating that some restructurings would be contemplated by the Engagement Letter and others would not, the Retention Order creates an ambiguity regarding which restructurings count. Even though the Engagement Letter is broad, it does not answer that

question." *FBR*, 2013 WL 5408848, at *3. Due to the ambiguity, the Court remanded the case back to the Bankruptcy Court for a bench trial to consider extrinsic evidence and decide which restructurings were contemplated under the agreement.

The evidence introduced at trial proved inconclusive on this issue. The Bankruptcy Court's findings of fact adeptly explain the impasse, *see, In re River Road Hotel Partners, LLC*, 520 B.R. 691 (Bankr. N.D. Ill. 2014); the following is only a brief recap. FBR's witnesses testified that they understood the contract at the time of drafting in the terms most favorable to their side. For example, Brian Taylor, a director at FBR who helped draft the engagement letter, testified that he did not intend the restructuring fee's payment to be conditioned on FBR's success as opposed to some other party. He claimed that FBR never would have accepted such a deal. Steven Goldberg, another key employee of FBR, made similar statements when deposed. David Neff, counsel for the Debtors, had input into the proposed Retention Order. He made some modifications to a draft, but added no language to make payment of the restructuring fee explicitly contingent on FBR's closure of a deal. At trial, he did not offer a clear rationale for why he failed to include more specific language that would support the interpretation of the engagement letter now advanced by Bletchley. Neff merely insisted that the Retention Order should

reflect that payment of the fee be contingent on a restructuring "contemplated by the engagement letter." And to reiterate, the engagement letter broadly defines a restructuring without reference to a particular party.

The Bankruptcy Court ultimately found that the Debtors were responsible for the ambiguity and so it should be construed against Bletchley; the court thus ruled in favor of FBR and ordered Bletchley to pay the restructuring fee. This Court reviews the Bankruptcy Court's findings of fact for clear error, and reviews questions of law *de novo*. *See, In re Kerns*, 111 B.R. 777 (S.D. Ind. 1990).

II. BLETCHLEY'S APPEAL

Bletchley makes several arguments claiming the court erred, but none are convincing. For example, it claims the bankruptcy court analyzed the case as if there were no ambiguity, but that's clearly false. The court's opinion is replete with references to the ambiguity and efforts to resolve it. Bletchley makes two other material arguments for how the bankruptcy court erred: that the court (1) misunderstood who carried the burden of proof, such that when the extrinsic evidence established a tie, FBR had failed to carry its burden and should have lost; and (2) erred in construing the ambiguity against Bletchley (applying the principle of *contra proferentem*). The Court need not consider these arguments

however, because it finds the evidence amply supports an inference that the Debtors intended to pay the restructuring fee all along. Therefore, even if the bankruptcy court did err in its analysis, the error was harmless.

The negotiations leading up to the final version of the engagement letter reveal much about the parties' intentions. In addition to the restructuring fee, the Debtors agreed to pay FBR a one-time retention fee and a recurring monthly fee. In the initial draft of the engagement letter, the retainer was set at $165,000, the monthly fee was set at $165,000 per month, and the restructuring fee was set at 90 basis points of the total indebtedness attendant to a final restructuring. The next draft lowered the retainer and monthly fees to $150,000 and kept the restructuring fee at 90 basis points. Another draft dramatically reduced the retainer and monthly fees to $20,000, while the restructuring fee increased to 125 basis points. The final draft decreased the monthly fee to only $10,000, set the retainer at $50,000, and increased the restructuring fee again, this time to 135 basis points. FBR director Brian Taylor testified that the monthly fee and retainer in the final draft, which were below the relevant market rates, were reduced because the Debtors were experiencing cash flow issues. FBR's employees further testified that FBR would not have agreed to a $10,000

monthly fee if not for the concomitant increase in the restructuring fee.

There is strong circumstantial evidence from this course of dealing that FBR meant to shift fees for its monthly work into the contingent restructuring fee. A quick breakdown of the numbers bears out this point. FBR worked on the restructuring for about 22 months. At $10,000 per month, that entitled them to $220,000 in monthly fees. Recall that Taylor testified that $10,000 was below market rate for this type of transaction. Indeed, if FBR had received the $165,000 per month it originally sought in the first draft, it would have been entitled to $3.6 million in monthly fees alone, all else being equal. Now consider the increase in the restructuring fee: 135 basis points of total indebtedness entitled FBR to a $2.4 million restructuring fee after Amalgamated swept in and closed a deal. That means the total indebtedness involved in the transaction was roughly $178 million. If FBR had received 90 basis points, as contemplated in the initial draft of the engagement letter, the restructuring fee would have equaled about $1.6 million. The upshot is that the amount FBR gained by increasing the restructuring fee (about $800,000) was nowhere near sufficient to offset the amount it lost by substantially lowering the monthly fee (around $3.3 million for 22 months of work).

So it is extremely unlikely FBR meant to take on more risk by increasing the restructuring fee and tying it exclusively to their success; it is much more likely that FBR only meant to delay receipt of full payment for its services due to the Debtors' cash flow problems. It accomplished this by drastically lowering the initially-contemplated monthly fees and raising the restructuring fee, which it intended to collect regardless of who facilitated the final restructuring. If the Debtors did not realize this, they should have; the negotiations coupled with the broad definition of "restructuring" in the engagement letter strongly suggest that FBR is entitled to the fee. Moreover, this is not the only agreement of its type to define broadly the term "restructuring fee" and to entitle the financial advisor to contingent fees regardless of who closes the deal. *See, In re Borders Group, Inc.*, 2011 WL 6026158, at *3-5 (Bank. S.D.N.Y. December 5, 2011).

In an unrelated argument, Bletchley contends that another Bankruptcy Court in this district – a court different from the one that conducted the bench trial at issue here – erred by concluding FBR lacked the disinterestedness required to be appointed as financial advisor. *See*, 11 U.S.C. 327(a). That argument has been waived. Judge Black ruled on this issue in 2012 when deciding a motion for summary judgment brought by FBR. *See, In re River Road Partners, LLC*, 2012 WL 6585506 (Bankr.

N.D. Ill. December 17, 2012). He denied the motion and granted summary judgment *sua sponte* for Bletchley. That was a final, appealable order at the time; FBR appealed to this Court, objecting to the portion of the opinion that denied it the restructuring fee. Bletchley did not cross-appeal, and at no point in those proceedings did it raise an argument about FBR's disinterestedness. *See,* Case No. 1:13-cv-00746. So when this Court remanded back to the Bankruptcy Court for proceedings related to the restructuring fee, the question of disinterestedness was already waived and as a result, not within the scope of the remand. *See, United States v. Husband*, 312 F.3d 247, 250-51 (7th Cir. 2002) ("[A]ny issue that could have been but was not raised on appeal is waived and thus not remanded.").

III. FBR'S CROSS-APPEAL

FBR cross-appeals, and argues that the Bankruptcy Court erred by denying it reimbursement for its legal expenses related to this litigation. It seeks $1.8 million, mostly attributable to the attorneys' fees it paid in defense of its request for the restructuring fee. But the Bankruptcy Court correctly denied this request.

A professional such as FBR is approved by the Bankruptcy Court and employed pursuant to 11 U.S.C. § 327. Two sections govern compensation for such a professional; the one at issue on

FBR's cross-appeal is Section 330. Section 330 states that "the court may award . . . reasonable compensation for actual, necessary services rendered . . . and reimbursement for actual, necessary expenses." 11 U.S.C. § 330(a)(1)(A)-(B). That Section further provides that "[i]n 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 . . . ." 11 U.S.C. § 330(a)(3). The Bankruptcy Court's Retention Order provided that "the reimbursement of all FBR's out-of-pocket expenses shall be subject to further review and approval by the Court pursuant to section 330 of the Bankruptcy Code. . . ." (App. Appellants' Br. Ex. 4).

Both the Debtors and the United States Trustee (who filed a brief as *amicus curiae*) argue that FBR's position on reimbursement is foreclosed by a recent Supreme Court decision, *Baker Botts LLP v. ASARCO LLC*, 135 S.Ct. 2158 (2015). *ASARCO* involved attorneys appointed as professionals under Section 327 who performed legal services for a debtor; afterward, the attorneys requested fees, which the debtor's parent company challenged. The attorneys ultimately were awarded fees for their work done for the bankruptcy estate under Section 330, but they were denied reimbursement for the legal expenses incurred in litigating over those fees (similar to the present case).

The attorneys appealed, arguing that they were entitled to compensation for the time spent litigating their fee applications.

The Supreme Court disagreed, holding that "[b]ecause § 330(a)(1) does not explicitly override the American Rule with respect to fee-defense litigation, it does not permit bankruptcy courts to award compensation for such litigation." *ASARCO*, 135 S.Ct. at 2169. The "American Rule," of course, simply dictates that each party is responsible for its own attorneys' fees unless a statute or contract provides otherwise. Crucial to the Supreme Court's decision was the statutory language of Section 330(a)(1): compensation is available "only for '*actual, necessary services rendered*.'" *Id.* at 2165 (quoting 11 U.S.C. § 330(a)(1)). The Supreme Court went on to explain: "Time spent litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described as labor performed for — let alone disinterested service to — that administrator." *Id.* (internal quotations omitted). And Section 330(a)(1) allows only compensation for work performed *in service* of the bankruptcy estate.

ASARCO is directly on point – FBR may not receive compensation for its fee-related litigation under Section 330(a)(1). FBR counters that this case is different, because it involves a non-legal professional, as opposed to the

lawyers in *ASARCO*. But according to the Supreme Court, that's an irrelevant distinction; Sections 327(a) and 330(a) apply to all professionals, and *ASARCO*'s discussion is cast in broad language to include all professionals, not just attorneys. Nor is it relevant that FBR already paid the fees to its attorneys and now seeks "reimbursement" rather than a direct payment for services – FBR still seeks compensation for funds expended in fee-related litigation, which brings the matter directly under *ASARCO*'s ruling. FBR's attempt to differentiate meaningfully Section 330(a)(1)(A) from 330(a)(1)(B) fails also, because *ASARCO* explicitly cited both of those subparts and held, "This text cannot displace the American Rule with respect to fee-defense litigation." *ASARCO*, 135 S.Ct. at 2165.

FBR's strongest argument is that the engagement letter acts as a stand-alone contract, providing that FBR will be reimbursed for legal fees and expenses "in connection with" its services or for expenses incurred "related to or result[ing] from [] performance . . . of the services contemplated by . . . this agreement." (App. Appellants' Br. Ex. 3). Therefore, FBR contends, under a straightforward interpretation, the engagement letter overrides the default American Rule, and entitles FBR to reimbursement for its fee-related litigation. But the Bankruptcy Court's Retention Order is a companion document to the engagement letter that authorized and implemented the terms

of the engagement; in doing so, it supplemented the engagement letter with the following stipulation: "[T]he reimbursement of all FBR's out-of-pocket expenses shall be subject to further review and approval by the Court pursuant to section 330 of the Bankruptcy Code." By making out-of-pocket expenses subject to Section 330 review, the Retention Order bound the Bankruptcy Court to abide by the statute. The Supreme Court in *ASARCO* was animated in part by deference to legislative intent in drafting Section 330 and the public policy behind it: Compensation reviewed under that section should be limited to compensation for work performed in service of the bankruptcy estate, and cannot include fees for work a professional completes on its own behalf. *ASARCO*, 135 S.Ct. at 2165. The Bankruptcy Court had to consider compensation in that context and thus was correct to deny FBR the $1.8 million in attorneys' fees and costs.

FBR also believes it is entitled to the attorneys' fees on separate grounds, solely because Bletchley's litigation has been "vexatious." In fact, FBR now raises a litany of abuses that Bletchley allegedly perpetrated below in the bankruptcy proceedings. If that's true, FBR should have moved for sanctions at the time (it never did). To show now that the Bankruptcy Court erred in not awarding attorneys' fees for misconduct, FBR needs evidence of objective bad faith on the part of Bletchley in pursuing this litigation. *See, Dal Pozzo*

v. Basic Machinery Co., 463 F.3d 609, 614 (7th Cir. 2006). But this Court previously found that the parties' agreement was ambiguous and remanded for a trial on the issue of fees. Bletchley was unhappy with the result, but this Court's opinion and the Bankruptcy Court's findings of fact obviously demonstrate the questions were thorny and not free from doubt. Bletchley appealed a close question, as was its right; there is nothing to suggest that it did so in bad faith. FBR's request for attorneys' fees on this basis is denied as well. And for the same reasons, the Court denies FBR's separate Motion to Dismiss Bletchley's appeal as frivolous.

IV. CONCLUSION

For the reasons stated herein, the Court affirms the decision of the Bankruptcy Court and denies FBR's Motion to Dismiss the appeal as frivolous [ECF No. 31]).

IT IS SO ORDERED.

Harry D. Leinenweber, Judge
United States District Court

Dated: August 4, 2016

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
	:	
SAMSON RESOURCES CORPORATION, *et al.*,	:	Case No. 15-11934 (CSS)
	:	
	:	Jointly Administered
	:	
Debtors.	:	**U.S. Trustee's Objection Deadline: November 23, 2015**
	:	**Debtors' Response Deadline: December 7, 2015**
	:	**U.S. Trustee's Reply Deadline: December 10, 2015**
	:	**(if any)**

ACTING UNITED STATES TRUSTEE'S OBJECTION TO THE APPLICATION TO EMPLOY KIRKLAND & ELLIS LLP AND KIRKLAND & ELLIS INTERNATIONAL LLP AS ATTORNEYS FOR THE DEBTORS AND DEBTORS IN POSSESSION EFFECTIVE *NUNC PRO TUNC* TO THE PETITION DATE (D.I. 119)

In support of his Objection to the *Application to Employ Kirkland & Ellis LLP and Kirkland & Ellis International LLP as Attorneys for the Debtors and Debtors in Possession Effective Nunc Pro Tunc to the Petition Date* ("Retention Application") (D.I. 119),[1] Andrew R. Vara, the Acting United States Trustee for Region 3 ("U.S. Trustee"), by and through his counsel, respectfully states as follows:

I. SUMMARY OF ARGUMENT

1. Kirkland & Ellis LLP and Kirkland & Ellis International LLP (together, "Kirkland") seek to be paid from the Debtors' estates, subject to approval by the Court pursuant to 11 U.S.C. §§ 328(a), 330 and 331 "for all fees and expenses" which include those arising out of the successful defense of any fee application by Kirkland in these bankruptcy cases in response to any objection to its fees or expenses (the "Reimbursement Provisions"). D.I. 119 at p. 7 n.7. Such a broad provision violates the Code and the American Rule, ignores the express directives of the United States Supreme Court, and is otherwise unreasonable. The Supreme

[1] Unless otherwise defined herein, capitalized terms shall have the same meaning and context as those capitalized terms included in the referenced or cited document or pleading.

Court recently held that section 330(a) of the Code does not authorize a court to approve a law firm's fee for litigating its fee application. *Baker Botts LLP v. ASARCO LLC*, ___ U.S. ___, 135 S. Ct. 2158 (2015). For five separate and independent reasons, Kirkland cannot circumvent *ASARCO* by having the same fees approved as a term or condition of its employment under section 328(a) of the Code. Therefore, the Court should deny the Debtors' request for approval of the Reimbursement Provisions.

II. JURISDICTION

2. The Court has jurisdiction to hear this Objection.

3. Pursuant to 28 U.S.C. § 586, the U.S. Trustee is generally charged with overseeing the administration of chapter 11 cases filed in this District. 28 U.S.C. § 586. Under Section 586 and Section 307 of the Bankruptcy Code, Congress charged the U.S. Trustee with broad responsibilities in chapter 11 cases and the standing to rise and be heard on any issue in any case or proceeding. 11 U.S.C. § 307; *see also United States Trustee v. Columbia Gas Sys., Inc.* (*In re Columbia Gas Sys., Inc.*), 33 F.3d 294, 295-96 (3d Cir. 1994) (the U.S. Trustee has "public interest standing" under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the United States Trustee as a "watchdog").

4. Pursuant to section 307 of title 11 of the United States Code (the "Code"), the U. S. Trustee has standing to be heard with regard to the above-referenced Objection.

III. BACKGROUND

5. On September 16, 2015 (the "Petition Date"), Samsung Resources Corporation and nine of its subsidiaries and affiliates (collectively, the "Debtors") commenced these voluntary chapter 11 cases which were procedurally consolidated for joint administration

by this Court. D.I. 1 & 70.

6. On September 30, 2015, the U.S. Trustee appointed the Official Committee of Unsecured Creditors (the "Committee") under section 1102 of the Bankruptcy Code.

7. On September 25, 2015, the Debtors filed the Retention Application seeking authorization to employ Kirkland as their attorneys, *nunc pro tunc* to the Petition Date. D.I. 119.

8. The Retention Application described Kirkland's policy when charging clients for expenses. In that paragraph, the application included the following footnote about fees:

> [T]he Engagement Letter provides that the Debtors will reimburse Kirkland for all fees and expenses, including the amount of Kirkland's attorney and paralegal time at normal billing rates incurred in connection with disputes brought by or against any third party relating to legal services Kirkland provides to the Debtors. To the extent required, such fees should be allowed pursuant to section 328(a) of the Bankruptcy Code, which permits employment on any reasonable terms and conditions. *See* 11 U.S.C. § 328(a). *Cf. Baker Botts L.L.P. v. ASARCO LLC*, 576 U.S. __, 135 S.Ct. 2158 (2015).

D.I. 119 at p. 7 n.7. This language appears again in the Declaration of Joshua A. Sussberg, P.C. attached as an exhibit to the Retention Application. *Id.*, Ex. B at p. 6 n.7.

9. The Engagement Letter, (*id.*, Ex. 1), addressed to Andrew Kidd, general counsel of the Debtors, states under the heading "Reimbursement of Expenses":

> You agree promptly to reimburse us for all fees and expenses, including the amount of K&E LLP's attorney and paralegal time at normal billing rates, as incurred by us in connection with participating in, preparing for, or responding to any action, claim, suit or proceeding brought by or against any third-party that relates to the legal services provided by us under the Agreement.

Id. at 5.

10. Collectively, the provisions in ¶¶ 7-8, *supra*, are referred to as the "Reimbursement Provisions."

11. On October 29, 2015, this Court entered an order authorizing the retention of Kirkland minus "the provisions of the Engagement Letter regarding reimbursement of those fees and expenses incurred in connection with participating in, preparing for, or responding to any action, claims, suit, or proceeding brought by or against any third party that relates to the legal service provided thereunder (the 'Reimbursement Provisions')" and reserved the issue of the Reimbursement Provisions for further briefing and argument. D.I. 295 at ¶ 5.

IV. ARGUMENT

A. Section 328(a) Creates No Exception to the American Rule's General Prohibition Against Shifting Fees.

1. Section 328(a) Is Not a Fee-Shifting Statute.

12. In *ASARCO*, the Court stated that the "basic point of reference when considering the award of attorney's fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise." *Id.* at 2164 (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252–253 (2010)). Although statutory provisions overruling the American Rule "take various forms," any statutory departures from the American Rule must be contained in "specific and explicit provisions." *Id.* The Court further ruled that a fee-shifting statute typically must both (1) "authorize the award of 'a reasonable attorney's fee,' 'fees,' or 'litigation costs,' and [(2)] usually refer to a 'prevailing party' in the context of an adversarial 'action.'" *Id.*

13. Applying this two-part test, the Court ruled that Congress did not depart from the American Rule in section 330(a) of the Code. *Id.* Rather, the statute allows a court to award only "reasonable compensation for actual, necessary services rendered." *Id.* at 2165. The

Court reasoned that section 330(a) authorizes a court to award fees for work done to assist the estate in the bankruptcy case, but it does not specifically or explicitly award fees to a "'prevailing party' in the context of an adversarial 'action.'" *Id.* at 2164. Relying on the bedrock principle of the American Rule, the Court held that 11 U.S.C. "§ 330(a)(1) [does not] permit[] a bankruptcy court to award attorneys' fees for work performed in defending a fee application." *Id.* at 2164.

14. For the same reasons articulated by the Court in *ASARCO*, the Reimbursement Provisions cannot be approved here. Section 328(a) of the Code, like section 330(a), does not overcome the American Rule's presumption that each party will pay its own fees for fee defense litigation. Section 328(a) provides that, with the court's approval, a professional may be employed "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis." 11 U.S.C. § 328. This text does not "specifically" or "explicitly" allow a "prevailing party" to recover its fees from the other party in an "adversarial action," s*ee id.* at 2164-65, and, therefore, it too fails to satisfy the second prong of the *ASARCO* test. Because section 328(a) does not expressly vary the American Rule against fee shifting, the Reimbursement Provisions cannot be approved.

15. In *ASARCO*, the Court also found it significant that certain Code provisions, unlike sections 328(a) and 330(a), *do* explicitly shift a prevailing party's fees to the other side. *ASARCO*, 135 S. Ct. at 2164 (citing as an example 28 U.S.C. § 2412(d)(1)(A)). Those include:

- **11 U.S.C. § 110(i)(1)(C)** (providing that "the court shall order the bankruptcy petition preparer to pay to the debtor . . . reasonable attorneys' fees and costs");

- **11 U.S.C. § 303(i)(1)(B)** (providing that unsuccessful involuntary petitioners may be ordered to pay "a reasonable attorney's fee" to the alleged debtor);
- **11 U.S.C. § 362(k)(1)** (providing that "an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees . . ." from the violating creditor);
- **11 U.S.C. § 526(c)(2)** (providing that a debt relief agency shall be liable to an assisted person "for reasonable attorneys' fees and costs" if it is found liable under the statute);
- **11 U.S.C. § 707(b)(4)(A)** (providing that a trustee who successfully prosecutes a motion to dismiss may recover from the debtor's attorney who filed the petition "all reasonable costs in prosecuting [the] motion . . . including reasonable attorneys' fees" when specific criteria are met); and
- **11 U.S.C. § 707(b)(5)(A)** (providing that a court "may award" to certain debtors, who defeat a motion to dismiss, "all reasonable costs (including reasonable attorneys' fees").

These Code fee-shifting provisions confirm that Congress did not draft either section 328(a) or section 330(a) in a way that shifts a prevailing party's fees to the loser.[2] Section 328(a), just like section 330(a), stands in stark contrast to the Code provisions that expressly require a losing party to pay the prevailing party's litigation costs, including their attorneys' fees. Congress knows how to shift litigation fees in bankruptcy when it wants them shifted, and it did not shift them under section 328(a).

2. The Reimbursement Provisions Are Not a "Contract."

16. In addition, the Debtors' request for approval of Kirkland's Reimbursement Provisions cannot evade *ASARCO* under a contract theory. Kirkland's request to be compensated for "all fees and expenses," including its legal defense costs, does not constitute a "contract"—and even if it did, that contract could not be enforced in a manner that violates the Code.

[2] None of these provisions shift the fee burden from the prevailing party *to the estate*.

17. Professionals' employment and compensation rights in bankruptcy are not bestowed by "contract." Instead, the retention and payment of professionals is governed by statute. Under the Code, an employment application under section 327 or 1103 is filed with the court, which may also approve reasonable terms and conditions of a professional's employment under section 328(a). *See* 11 U.S.C. § 328(a) (providing that "a committee . . . with the court's approval, may employ or authorize the employment of a professional person"). Regardless of how it is titled, the application is not a contract because it is not an agreement. It is a request that a judge, acting within the constraints of section 328(a), authorize the term or condition of employment. And what a judge can approve is a matter of federal statutory law, not the law of contracts. *In re Federal Mogul-Global, Inc.*, 348 F.3d 390, 397-98 (3d Cir. 2003) (holding that bankruptcy court could approve professional's employment on terms and conditions that were not proposed by the committee but that the court found necessary to satisfy the requirement of reasonableness under section 328(a)).[3]

18. The proposed order approving the application is also not a contract. First, any rights or obligations created by the order are the result of the court's approval, not the agreement of the party to be obligated. RESTATEMENT (SECOND) OF CONTRACTS 9 (1981) (providing that "[t]here must be at least two parties to a contract, a promisor and a promisee."). Second, as stated above, the scope of permissible terms is governed by federal statute, not the agreement of the parties. *Federal Mogul*, 348 F.3d at 397-98. So while an order approving

[3] *See also In re River Rd. Hotel Partners, LLC*, 536 B.R. 228, 241 (Bankr. N.D. Ill. 2015). In the *River Road* case, a financial advisor sought a $1.8 million dollar expense reimbursement, the majority of which was incurred for attorney's fees in defense of the advisor's fee request. The financial advisor claimed that *ASARCO* did not apply to its request because a pre-approved contractual indemnity term independently authorized the defense fees. The court considered and rejected this contract-based argument. In particular, the court found the defense fees (1) "were not incurred 'in connection with the services provided' under the engagement" and (2) that the fees were not "reasonably likely to benefit the bankruptcy estate or necessary for the administration of the case." 536 B.R. at 241 (*citing* 11 U.S.C. § 330(a)(4)(A)(ii)).

employment terms may create a statutory right, it does not create a contractual one.

19. Finally, the proposal here looks nothing like a contract. The professionals do not propose an agreement between parties who mutually agree that in the event of litigation, the losing party will pay the prevailing party's legal fees. The professionals have not agreed to a reciprocal obligation to pay the estate's (or anyone else's) legal fees should the professionals unsuccessfully litigate objections to their fee applications. Rather, the professionals seek to impose a one-way shift of fees to the estate—not a losing party—and to do so regardless of whether it is the estate or some other party who objects to the fees.

20. A party other than the estate could object since bankruptcy is not a bilateral contract or proceeding. Rather, it is a comprehensive, court-supervised process implicating diverse constituencies with a multiplicity of interests. It is a "collective proceeding through which" creditors' claims are "vindicated for creditors' mutual benefit." *In re A.G. Financial Service Center, Inc.*, 395 F.3d 410, 415 (7th Cir. 2005). As a result, the Code provides "numerous and detailed provisions concerning the employment of professional persons, their compensation and payment." *In re Financial News Network, Inc.*, 134 B.R. 732, 735 (Bankr. S.D.N.Y. 1991). But professionals cannot by contract require third parties to pay their legal fees. Although one can become a third party beneficiary of a contract without giving consent, the law does not recognize unilateral imposition of contractual obligations on third party benefactors. *See Motorsport Eng'g, Inc. v. Maserati SPA*, 316 F.3d 26, 29 (1st Cir. 2002) (holding that a third party cannot be bound to a contract it did not sign or otherwise assent to); *Abraham Zion Corp. v. Lebow*, 761 F.2d 93, 103 (2d Cir. 1985) (same).

21. But even if the proposed employment agreement could somehow be construed to be a contract, it cannot be approved. The American Rule's prohibition against fee

shifting can be altered by statute, and it can be altered by contract. But the American Rule cannot be altered by a contract that violates a statute. Courts have an independent obligation to ensure that what they approve is lawful under the Code. *See United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 277 (2010) (holding that bankruptcy courts have the authority to ensure that proposed actions conform to the requirements of the Code). And courts have no power to take actions that violate the Code. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) (stating that whatever "equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"); *Law v Siegel*, __ U.S. __, 134 S. Ct. 1188, 1194 (2014) (holding that "in exercising [its] statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions."). As explained, *infra*, the proposed Reimbursement Provisions violate sections 328 and 330 of the Code. Thus, the provisions of the Debtors' Retention Application seeking approval of the Reimbursement Provisions must be rejected.

B. The Reimbursement Provisions Cannot Be Approved Under Section 328(a) Because They Seek to Pay Professionals for Work Not Within the Scope of Their Employment.

22. Even if the American Rule against fee shifting did not preclude approval of the Reimbursement Provisions, those provisions cannot be authorized because they fall outside the scope of section 328(a), the statutory provision on which the Application ostensibly relies. Section 328(a) only authorizes courts to approve "reasonable terms and conditions of *employment . . . under section 327 or 1103 of this title.*" 11 U.S.C. § 328(a) (emphasis added). Nothing in the text of section 328(a) provides courts with authority to pay a professional from the estate for work outside the scope of the professional's employment under either section 327

or 1103.[4] For this reason, any "terms and conditions" approved under section 328(a) must relate only to activities that a professional could be retained to perform under sections 327 or 1103. *Id.* After *ASARCO*, those activities cannot include the professional's defense of its own fee application.

23. For professionals, the relevant retention provision of the Code is section 327, which is entitled "employment of professional persons" and authorizes the trustee to "employ" professionals "to represent or assist the trustee" or debtor-in-possession "in carrying out the trustee's duties." 11 U.S.C. § 327(a). "Employ" means "to engage the *services* of." THE AMERICAN HERITAGE DICTIONARY 450 (def. 3.a.) (2d ed. 1982) (emphasis added). Black's Law Dictionary defines "employ" as "[t]o engage in one's *service*." BLACK'S LAW DICTIONARY 471 (5th ed. 1979) (emphasis added). Black's Law Dictionary similarly defines "employer" as "[o]ne who employs the *services* of others." *Id.* (emphasis added).

24. In *ASARCO*, the Supreme Court held that the litigation efforts of a professional employed by the estate in defense of its own fees are not services under section 330 and, therefore, not compensable. *See ASARCO*, 135 S. Ct. at 2165 (internal citations omitted). That same analysis precludes paying for fee defense litigation under a section 328(a) term or condition. Employment by a client necessarily entails the professional providing services to the client. *See* RESTATEMENT (SECOND) OF AGENCY 228(1) (1957) (for an action to be within the scope of "employment" it must be "actuated, at least in part, by a purpose *to serve* the master") (emphasis added). A professional defending an objection to its fee application is not serving the client's interest but instead acts for its own benefit and own interests. *ASARCO* compels the

[4] "Congress has not granted us 'roving authority . . . to allow counsel fees . . . whenever [we] might deem them warranted.' [internal citation omitted]. Our job is to follow the text . . . ." *ASARCO*, 135 S. Ct. at 2169 (quoting *Aleyeska Pipeline Serv. Co. v. Wildnerness Soc'y*, 421 U.S. 240, 260 (1975)).

conclusion that a professional does not provide a client "service" when defending an objection to its fee application, and by extension, that doing so is not a term of the professional's "employment" under section 327. Because fees for fee defense are therefore outside the scope of the professional's employment by its client, the Reimbursement Provisions are also outside the scope of what may be authorized under section 328(a) of the Code.

25. This conclusion is consistent with the structure of section 328(a). In general, section 328(a) addresses the question of *how* the professional is to be paid, but not the type of services *for which* the professional may be paid. Section 328(a)'s examples all involve forms of payment, and a term authorizing fees for fee defense is not a form of payment. Section 328(a) includes four examples of "reasonable terms and conditions of employment, including [1] on a retainer, [2] on an hourly basis, [3] on a fixed or percentage fee basis, or [4] on a contingent fee basis." 11 U.S.C. § 328(a). Each addresses *how* a professional will be compensated for the work that it does. None addresses the *type* of work for which a professional may be compensated. Rather, the type or scope of work is governed by either section 1103 (represent or perform services for committees) or section 327 (represent or assist trustees or debtors-in-possession).

26. Statutory terms, arguably ambiguous when considered alone, should be given related meaning when grouped together. Under the doctrine of *noscitur a sociis*, the meaning of an ambiguous statutory term may be derived from the meaning of accompanying terms. *In re Cont'l Airlines, Inc*., 932 F.2d 282, 288 (3d Cir. 1991). It follows that the "terms and conditions" that can be approved under section 328(a) should be limited to those addressing the forms of compensation and similar matters, like hourly vs. contingent fees, not the scope of substantive work for which the professional may be compensated, like fee defense litigation. As

a result, section 328(a) does not authorize the Court to approve the Reimbursement Provisions.

C. The Reimbursement Provisions Cannot Be Approved Under Section 328(a) Because They Are Not Reasonable.

27. Not only must section 328(a) terms relate to the scope of employment, they must also be reasonable. Section 328(a) permits courts to approve "any reasonable terms and conditions of employment." 11 U.S.C. § 328(a). A term allowing fees for fee defense is not "reasonable" for two reasons.

28. First, courts should and do consider section 330(a) factors when determining whether a proposed term and condition of employment is reasonable under section 328(a). *Federal Mogul*, 348 F.3d at 407-08. In *Federal Mogul*, Judge, now Justice, Alito writing for the Third Circuit ruled that section 330(a)(1) factors could be considered when determining the reasonableness of a fee structure sought to be approved under section 328(a):

> Section 328(a), as noted above, authorizes the retention of a professional "on any *reasonable* terms and conditions of employment." 11 U.S.C. § 328(a) (emphasis added). Section 330(a)(1) authorizes a Bankruptcy Court to award a professional "reasonable compensation for actual, necessary services rendered," and then lists several criteria to be used in determining the reasonableness of the fees sought. 11 U.S.C. § 330(a)(1). It is well established that "[i]dentical words used in different parts of the same act are intended to have the same meaning." *Barnhart v. Walton*, 535 U.S. 212, 221, 122 S. Ct. 1265, 152 L.Ed.2d 330 (2002) (*quoting Dept. of Revenue of Ore. v. ACF Indus., Inc*., 510 U.S. 332, 342, 114 S. Ct. 843, 127 L.Ed.2d 165 (1994)). **Though we need not decide whether Congress intended to limit Bankruptcy Courts to considering only the Section 330(a)(1) factors when determining the reasonableness of a requested fee structure under Section 328(a), we believe that the Section 330(a)(1) factors may be taken into account in asking whether a fee request is reasonable.** The District Court therefore did not err in considering the Section 330(a)(1) factors when evaluating the reasonableness . . . of the terms and conditions of employment proposed by the Equity Committee.

Id. at 390, 407-08 (emphasis added). As explained by then Judge Alito, the plain statutory text

of section 328(a) allows courts to consider the section 330(a)(1) factors when presented with section 328(a) terms. Although the Third Circuit did not rule that courts must consider the section 330(a)(1) factors when presented with section 328(a) terms, it conclusively stated that it was proper to do so. Based on the plain statutory text and *Federal Mogul*, a term or condition in a retention application providing for compensation that *ASARCO* held cannot legally be awarded under section 330(a)(1) should not be approved under section 328(a) as reasonable.

29. Second, section 327(a)—the employment authorization provision at issue here—specifies that professionals are employed under that section "to represent or assist [the client] . . . in carrying out the . . . duties under this title." committee professionals are employed "to represent or perform services for such committee." 11 U.S.C. 327(a).[5] The Supreme Court has definitively ruled that fee defense litigation is not a client service. *ASARCO*, 135 S. Ct. at 2166 ("The term 'services' in this provision cannot be read to encompass adversarial fee-defense litigation"). Because the Reimbursement Provisions are not related to the work for which Kirkland may be compensated—to represent or assist the client—they are not reasonable and, therefore, cannot be approved under section 328(a). *See Hensley v. Eckerhart*, 461 U.S. 424, 435 (1983) (holding that a fee is not "reasonable" if it is "unrelated to [the] work" for which the attorney is being compensated.).

D. ASARCO Directly Bars the Reimbursement Provisions Because All Compensation Must Be Approved for Final Payment Under Section 330.

30. Professionals are employed under sections 327 or 1103, their terms of employment may be approved under section 328(a), and they are paid under section 330, subject to sections 326, 328, and 329. Sections 330 and 331 are the exclusive Code provisions

[5] *Cf.* 11 U.S.C. § 1103(a) (committee professionals are employed "to represent or perform services for such committee").

authorizing payments to professionals. *In re Ferguson*, 445 B.R. 744, 751 (Bankr. N.D. Tex. 2011). "While section 330(a)(1) makes an award of compensation 'subject to sections 326, 328, and 329,' **sections 330 and 331 are the only provisions of the Code which authorize the payment of professionals**" employed under sections 327 or 1103. *Id.* (emphasis added).

31. Any other interpretation of the interplay between sections 328(a) and 330(a) risks forfeiting a professional's claim for an administrative expense. Only a section 330 award gives professionals an administrative claim against estate assets under 11 U.S.C. § 503(b)(2).[6] *Ferguson*, 445 B.R. at 751 ("[S]ection 503(b)(2) is the only statutory basis for according that status to compensation awarded to persons employed under section 327 (and section 1103)."). *Cf. F/S Airlease II, Inc. v. Simon*, 844 F.2d 99, 108–09 (3d Cir. 1988), *cert. denied*, 488 U.S. 852 (1988) (professional who was not entitled to a section 330 award of compensation and, therefore, ineligible for an administrative expense under section 503(b)(2) may not receive an administrative expense under section 503(b)(1)(A)'s catchall);[7] *In re Garden Ridge Corp.*, 326 B.R. 278, 281 (Bankr. D. Del. 2005) ("[T]he Third Circuit [in *F/S Airlease*] unequivocally held that section 503(b)(1)(A) cannot be used to reimburse professionals for services rendered to the estate.").[8]

32. Because section 330(a)(1) of the Code is the exclusive provision

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[6] Section 503(b)(2) provides that: "After notice and a hearing, there shall be allowed administrative expenses . . . including compensation and reimbursement awarded under section 330(a) of this title." Section 507(a)(2) gives that professional's administrative claim second priority, trumping almost all other types of unsecured claims. 11 U.S.C. § 507(a)(2).

[7] *See also In re Milwaukee Engraving Co*., 219 F.3d 635, 637 (7th Cir. 2000), *cert. denied*, 531 U.S. 1112 (2001); *In re Keren Ltd. P'ship*, 189 F.3d 86, 88 (2d Cir. 1999).

[8] Similarly, section 504's broad fee-sharing prohibition for retained professionals is made operative by reference to those "receiving compensation or reimbursement under section 503(b)(2)." 11 U.S.C. § 504. Section 503(b)(2) applies only to compensation awarded under section 330. If section 330 is not the exclusive authority for awarding compensation to retained professionals, then section 504's fee-sharing prohibition would be rendered meaningless.

authorizing the "award" of compensation to a retained professional, even those with pre-approved terms under section 328(a), *ASARCO* conclusively resolves the matter. Under *ASARCO*, bankruptcy courts may not award section 330(a)(1) fees for fee defense litigation. 135 S. Ct. at 2164. Section 328(a) does not independently authorize the award of these fees and, thus, the Reimbursement Provisions cannot be approved as "reasonable."

E. The Parties Cannot "Consent" to Unauthorized Compensation.

33. The Reimbursement Provisions, even if the parties agree to them, cannot override the statutory requirements discussed above. 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* 11 U.S.C. §§ 326-331, 503; *see also In re Lehman Bros. Holdings, Inc.*, 508 B.R. 283, 294 (S.D.N.Y. 2014) ("The Bankruptcy Code is meant to be a "comprehensive federal scheme . . . to govern" the bankruptcy process. Although flexibility is necessary[,] the federal scheme cannot remain comprehensive if interested parties and bankruptcy courts in each case are free to tweak the law to fit their preferences . . . .") (citations omitted).

34. The Code's numerous limitations on professional compensation—including the limitation on defense fees recognized by *ASARCO*—would be undermined if they could be bypassed through consent. A professional could evade its burden to make the detailed showings required under sections 330 and 503 if payment depended on nothing more than client consent. *See Lehman*, 508 B.R. at 293 (noting the comprehensive nature of section 503(b) was inconsistent with allowing "backdoor" payments through plan provision). And if defense fees prohibited by *ASARCO* could be circumvented by consent, other Code provisions relating to compensation could similarly be evaded—including prohibitions on compensation for unnecessary or duplicative services, *see* 11 U.S.C. § 330(a)(4); on fee-splitting, *see* 11 U.S.C.

§ 504; and on compensation for unretained or non-disinterested professionals, *see* 11 U.S.C. §§ 328(c), 330(a)(1). Even if all creditors were to affirmatively consent to the Reimbursement Provisions, there would be no basis for this Court to create a consent exception to *ASARCO* that contravenes the Code.[9]

[Remainder of page intentionally left blank.]

[9] The absence of objection to one term in a retention application should not be mistaken for affirmative consent. Rather, parties-in-interest may see no economic benefit to objecting when all creditors will share the burden pro rata. *See Lehman*, 508 B.R. at 293, n.8 ("Appellees overstate the amount of consent involved in the approval of section 6.7 [of the plan]. True, majorities of each class of claimant voted for the Plan, but claimants had only an up-or-down vote on the Plan as a whole and could not vote provision-by-provision. . . . Even if a majority of claimants opposed section 6.7, the Plan would still have won a majority if claimants were willing to swallow the relatively small price of $26 million spread across all claimants in exchange for moving the process forward.").

V. CONCLUSION

35. The U.S. Trustee leaves the Debtors to their burden and reserves any and all rights, remedies and obligations to, *inter alia*, complement, supplement, augment, alter and/or modify this Objection, file an appropriate motion and/or conduct any and all discovery as may be deemed necessary or as may be required and to assert such other grounds as may become apparent upon further factual discovery.

WHEREFORE, for the reasons stated above, the U.S. Trustee respectfully requests that this Court enter an order denying the Debtors' request for relief contained in the Retention Application related to the Reimbursement Provisions.[10]

Dated: November 23, 2015
Wilmington, Delaware

Respectfully submitted,

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ACTING UNITED STATES TRUSTEE

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[10] The Court "may approve some of the terms and conditions proposed in an employment application while rejecting others." *Federal Mogul*, 348 F.3d at 398-99 (citing *Zolfo, Cooper & Co. v. Sunbeam-Oster Co*., 50 F.3d 253 (3d Cir. 1995)).

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
SAMSON RESOURCES CORPORATION, *et al.*,	:	Case No. 15-11934 (CSS)
	:	(Jointly Administered)
Debtors.	:	**RE: D.I. Nos. 119, 221, 228, 295, 389, 399, 409, 439**

UNITED STATES TRUSTEE'S REPLY IN FURTHER SUPPORT OF OBJECTION TO APPLICATIONS TO EMPLOY KIRKLAND & ELLIS LLP, KIRKLAND INTERNATIONAL LLP, AND KLEHR HARRISON HARVEY BRANZBURG LLP

In further support of his objections to the respective employment applications of Kirkland & Ellis LLP and Kirkland & Ellis International LLP (together, "Kirkland") and Klehr Harrison Harvey Branzburg LLP ("Klehr"), and in reply to the responses to the objections filed by Kirkland (D.I. 389) (hereafter "Resp.") and Klehr (D.I. 440), Andrew R. Vara, the Acting United States Trustee for Region 3 ("U.S. Trustee"), by and through his counsel, respectfully states as follows: [1]

I. SUMMARY OF ARGUMENT

1. On June 15, 2015, the United States Supreme Court handed down its decision in *Baker Botts L.L.P. v. ASARCO LLC*, __ U.S. __, 135 S. Ct. 2158 (2015), a ruling that sharply limits the ability of bankruptcy professionals to charge the bankruptcy estate "fees on fees" for defending objections to their own fee applications. As Kirkland correctly points out, the legal

[1] The U.S. Trustee's initial objections to the applications of both Kirkland and Klehr were largely identical, and in its reply to the U.S. Trustee's objection, Klehr incorporated the arguments of Kirkland in their entirety. For the sake of clarity, this reply will be directed to the arguments raised by Kirkland; except where expressly indicated, all discussion of Kirkland should be understood as equally pertinent to Klehr. In addition, unless otherwise defined, capitalized terms shall have the same meaning and context as those capitalized terms included in the U.S. Trustee's original Objection.

standard announced by the Supreme Court in *ASARCO* was somewhat different from the standard which the government urged the court to adopt in its amicus brief. But the Supreme Court has spoken, and the U.S. Trustee is bound by its holding. So too are Kirkland and Klehr, and so too is this Court.

2. Kirkland nevertheless urges that this Court refuse to apply *ASARCO* in this case, and would have this Court confine the Supreme Court's decision to its facts in a way that would enable essentially any future professional to sidestep its holdings—thus limiting the practical effect of *ASARCO*, perhaps, to only cases that arise under the exact same unique factual circumstances as were present in *ASARCO* itself. But Kirkland's extremely narrow reading of *ASARCO* cannot be reconciled with the Supreme Court's actual reasoning, which was based on fundamental principles not confinable to the facts of any particular case. Furthermore, in its efforts to escape the consequences of the *ASARCO* holdings, Kirkland would have this Court rewrite long-settled interpretations of section 328 of the Bankruptcy Code, transforming that section into a free-floating authorization for debtors to compensate professionals subject to nothing more than a vaguely-defined reasonableness standard—a result which would both gut the carefully-crafted compensation provisions of the Bankruptcy Code, and which would undercut the ability of the Court and parties to effectively review fees. This Court should decline to do so.

II. ARGUMENT

A. ***ASARCO* Cannot Be Distinguished.**

3. Kirkland proposes three grounds on which this Court could find *ASARCO* distinguishable. First, Kirkland argues that *ASARCO* does not apply here because, in effect, the applicant in *ASARCO* relied on the wrong section of the Bankruptcy Code—section

330(a)(1)(A), instead of section 328 (or, alternatively, section 330(a)(1)(B)), as Kirkland and Klehr have done here. (Resp. 3). Second, Kirkland argues that the analysis in *ASARCO* does not apply because that case involved an objection filed by a party that stepped into the shoes of the reorganized debtor, whereas Kirkland and Klehr only seek fees on fees for objections filed by parties other than the debtor. (Resp. 10). Finally, Kirkland argues that its request for fees on fees is not subject to *ASARCO* because it has been memorialized in an engagement letter with the Debtors. (Resp. 11).

4. None of these attempts to distinguish *ASARCO* addresses the substance of that decision. *ASARCO* contains two separate principal holdings, each of which independently precludes Kirkland from being compensated for defending its own fee applications. First, *ASARCO* held that a professional's defense of its own fee application is not a "service" within the meaning of the Bankruptcy Code. *ASARCO*, 135 S. Ct. at 2165. Second, the Supreme Court held that disputes over bankruptcy compensation, like civil litigation, is subject to the "American Rule," creating a presumption that "[e]ach litigant pays his own attorney fees, win or lose," and that the American Rule's presumption can only be overcome by a "specific and explicit" statutory exception. *Id.* at 2164 (*quoting Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252-53 (2010) and *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 260 (1975)). Here, although the present matter comes to the Court in a different procedural posture than *ASARCO*, that difference does not justify a departure from the Supreme Court's holdings.

(i) <u>Under both sections 328 and 330, provision of a "service" is an indispensable requirement for professional compensation.</u>

5. In its attempt to limit *ASARCO* to applications filed under section 330(a)(1)(A), but not to motions under section 328, Kirkland relies primarily on a difference in wording

between the two sections: section 330(a) refers to "reasonable compensation for actual, necessary, services," while section 328 refers to "reasonable terms and conditions of employment." (Resp. 3). But this does not mean that the two sections provide completely separate and contradictory criteria for what may be compensated in a bankruptcy case. And because the requirement of a "service" is at least implicitly present in both sections, *ASARCO*'s principal holding applies regardless of whether approval is sought under section 328 or section 330.

6. As discussed at greater length in the U.S. Trustee's original Objection, there is no reason to treat sections 328 and 330 as providing alternative, contradictory pathways to compensation; rather, they both form part of a single, comprehensive compensation scheme. (Obj. 13-14). Furthermore, the textual difference between the two sections merely reflects the fact that they address different subject matter: section 330(a)(1)(A) defines what compensation may be "for"—that is, it answers the question of *what* may be compensated—while section 328 describes "terms and conditions"—in other words, *how* compensation is to be determined. In this case, the question before the Court is not how Kirkland's potential fees on fees should be computed, but whether they may be reimbursed at all; to answer that question, the Court must look not to section 328, but to section 330—and *ASARCO*.

7. Even if section 328 were treated as independent, free-standing authority to pay fees, as Kirkland apparently suggests, its argument also fails because provision of a future "service" is also an indirect requirement for approval under section 328. Under section 328(a), the language "on reasonable terms and conditions of employment" directly follows and, thus, modifies the language allowing the court to authorize "employment of a professional person under section 327 or 1103." So when the entire provision is read as a whole, it is not sufficient

for an employment term to be "reasonable" under section 328; that term must also relate to some employment under section 327. Under section 327, in turn, employment requires that the professional "represent or assist" the trustee. This is very similar to the formula that the Supreme Court used to define the word "service" in *ASARCO* (*i.e.,* defined as "action of serving, helping, or benefiting; conduct tending to the welfare or advantage of another"). *ASARCO*, 135 S. Ct. at 2165 (citation omitted). As a result, a professional may only be retained under section 327 to provide a "service" to the trustee—and by extension, the same limitation must also apply to section 328(a).

8. This conclusion finds further support in the text of the other subsections of section 328, all of which assume the existence of a "service" to be provided by the section 327 professional. Thus, section 328(b) limits the "services" for which a trustee acting as his own attorney or accountant may be compensated, and section 328(c) authorizes the court to deny allowance of "compensation of services" for professionals who are not disinterested. If Congress had intended the provision of a "service" to be optional under section 328, as Kirkland apparently suggests, both of these subsections presumably would have been drafted much differently.

9. In short, Kirkland's attempt to distinguish section 328 from section 330 would be persuasive if, and only if, this Court were willing to conclude that section 328 allowed professionals to receive compensation for non-services as well as for services (as well as, by the same logic, for services that are not actual and not necessary). This conclusion would not only be textually unsustainable, but it would also lead to plainly absurd results. Were Kirkland's reading of section 328 correct, for example, it would be permissible for an estate professional to be employed and paid with estate funds for doing work on behalf of a non-debtor affiliate, or a

third party, or even for doing nothing at all. None of the cases cited by Kirkland provide support for such an absurd result, and Kirkland cannot point to a single instance in which a court has explicitly authorized compensation to a professional under section 328 in the absence of a proposed service.[2]

10. Alternatively, and in an argument that appears to be in tension with its claim that section 330 is inapplicable to its request for preapproval, Kirkland suggests that its fees on fees are exempt from *ASARCO* because they can eventually be approved as an "expense" under section 330(a)(1)(B)—a section which Kirkland also characterizes as one that is "not limited to 'services' rendered directly to the debtor." (Resp. 21). This argument suffers from the same textual flaw as does Kirkland's analysis of section 328: subsection (B)'s authorization of reimbursement for "actual, necessary expenses" does not exist in isolation. Rather, those expenses must be "necessary" to an estate service compensable under subparagraph (A). *See In re Specialty Plywood, Inc.*, 160 B.R. 627, 632 (B.A.P. 9th Cir. 1993), *opinion withdrawn upon settlement by parties,* 166 B.R. 153 (B.A.P. 9th Cir. 1994) (denying auctioneer's expenses attributable to sale of non-estate property and holding that an expense "is necessary if it was incurred because it was required to accomplish properly the task for which the professional was

[2] Needless to say, the pre-*ASARCO* orders cited by Kirkland in which fees on fees were approved provide no such authority. Before *ASARCO*, it would have been possible to argue, as the appellant did in *ASARCO*, that fee defense is a service to the estate, or (as the government argued), that it could be authorized as part of the compensation for the underlying services. But both of these arguments were expressly rejected by the *ASARCO* majority. *See ASARCO*, 135 S. Ct. at 2166-67. In any event, none of the fee cases discussed by Kirkland uphold fees on fees while simultaneously denying that those fees were for a "service."

employed"). Therefore Kirkland cannot rely on subsection 330(a)(1)(B) to evade the necessity of demonstrating a "service."[3]

(ii) The Supreme Court's analysis of the American Rule applies equally to sections 328 and 330.

11. There is equally little basis to distinguish the Supreme Court's second holding, regarding the application of the American Rule, based on the procedural difference between section 330 fee application and a section 328 retention application. The Supreme Court's invocation of the American Rule was not triggered by any particular language in section 330. Rather, it was stated as a general presumption, applicable to the professional compensation provisions of the Bankruptcy Code as a whole. *ASARCO*, 135 S. Ct. at 2164. For this reason, any request for fees on fees based on section 328 is subject to the exact same limitation as a request under section 330—it may not be authorized "absent explicit statutory authority." *Id.* (internal citation omitted).

12. Kirkland argues, in effect, that the Court should find the "explicit statutory authority" required by *ASARCO* in the words "reasonable terms and conditions of employment," included in section 328. Yet there is no reason why this phrase—which never explicitly mentions fee application defense costs—should be treated as any more or less of an explicit departure from the American Rule than the equivalent "reasonable compensation" language of section 330. In any event, the *ASARCO* decision clearly outlines the types of statutory phrases

[3] Even apart from the fact that it does not overcome the statutory requirement of a service, Kirkland's 330(a)(1)(B) theory presents other difficulties. First, any request to approve expenses under section 330 is premature, since there is no section 330 application before the Court and none of the expenses at issue have been incurred. Furthermore, unlike fees, expenses generally may not be preapproved under section 328. *In re Cal Farm Supply Co.*, 110 B.R. 461, 465 (Bankr. E.D. Cal. 1989); 3 COLLIER ON BANKRUPTCY ¶ 328.02[1] (16th Ed. 2010). Finally, Kirkland presents no explanation for why legal services rendered to itself by its own attorneys can be reclassified as an actual "expense" to Kirkland.

that a court should identify before concluding that a statute has departed from the American Rule: as the Supreme Court noted, these departures "tend to authorize the award of 'a reasonable attorney's fee,' 'fee,' or 'litigation costs,' and usually refer to a 'prevailing party' in the context of an adversarial 'action.'" *Id.* None of these phrases appears in section 328, any more than they do in section 330, and *ASARCO* cannot be distinguished on that basis.

(ii) *ASARCO* cannot be distinguished based on the identity of the objecting party.

13. Kirkland also attempts to distinguish *ASARCO*'s treatment of the American Rule on the grounds that in that case, the party objecting to the applicant's fees was the reorganized debtor, while its proposed fees will only be payable in the event that the objector is a party other than the debtor. To Kirkland, this means that the application of the American Rule here is a "distinct issue" not controlled by the Supreme Court's decision. (Resp. 7).

14. Here again, this is a distinction without a difference. Contrary to Kirkland's suggestion, the Supreme Court's American Rule jurisprudence is not limited to cases involving litigation between attorneys and their clients. Although *ASARCO* presented that scenario, the principal case it relied on, *Alyeska,* did not. Instead, that case, like most fee shifting cases, involved an award of attorney fees in a dispute between a third party and the law firm's client. *Alyeska*, 421 U.S. at 242. Notably, Kirkland does not cite to a single case suggesting that the American Rule operates differently in lawsuits between law firms and their clients.

15. Kirkland's argument, moreover, rests on the assumption that objections to compensation should receive different treatment depending on whether the debtor-in-possession is the objector. But Congress did not design the bankruptcy compensation system in this way. Unlike a non-bankruptcy engagement, review of a professional's fee application in bankruptcy is

a collective proceeding, in which every party in interest in the bankruptcy case has a right to object. *See* 11 U.S.C. §§ 330(a), 1109(b). Indeed, in the case of the U.S. Trustee, the filing of objections to fee applications was considered so central to the U.S. Trustee's mission that Congress chose to list it first among the U.S. Trustee's duties in chapter 11 cases. *See* 28 U.S.C. § 586(a)(3)(A). There is, moreover, a sound reason for this policy: in the typical chapter 11 case, the payment of excessive or objectionable fees will ultimately be borne by creditors, whose recoveries will be reduced, and it is therefore the creditors, not the debtor-in-possession, who have the greatest financial stake in litigating objections. For this reason, the Court should not approve a retention provision that elevates the debtor-in-possession's ability to object to fees above that of all other parties.

16. Finally, it should be noted that cases such as *ASARCO*, in which a debtor professional's fee request was opposed by its own client, are vanishingly rare, as the debtor "will often not object to its attorney's fee application because the fees will frequently be derived from its creditors' award rather than its own assets." *In re Busy Beaver Bldg. Centers, Inc.*, 19 F.3d 833, 843 (3d Cir. 1994). Were *ASARCO* strictly limited to attorney-client fee disputes, as Kirkland suggests, its impact would be felt in only a negligible number of cases. The Supreme Court generally does not issue rulings that are intended to be of limited practical impact outside of the immediate case before it. *U.S. v. Johnson*, 268 U.S. 220, 227 (1925) (stating that the Court does "not grant a certiorari to review evidence and discuss specific facts"); Sup. Ct. R. 10 (providing that a "petition for a writ of certiorari will be granted only for compelling reasons" and will "rarely [be] granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law").

(iv) The Engagement Letter does not create an exception to *ASARCO*.

17. Lastly, Kirkland suggests that its request for fees falls within a contractual exception to *ASARCO*, based on the terms of its Engagement Letter. (Resp. 11). This argument fails for at least two reasons. First, as discussed in the U.S. Trustee's Objection, the Bankruptcy Code's limitations on compensation cannot be rescinded through a private contractual agreement, and the debtor may not usurp the court's role in determining what fees should be allowed. (Obj. 15). Furthermore, the U.S. Trustee notes that to the extent Kirkland's work is not a compensable "service" within the meaning of the Bankruptcy Code, Kirkland cannot transform that work into a "service" simply by describing it as such in an engagement letter.

18. Second, even if there were a valid contractual exception to *ASARCO*, the Engagement Letter should be given no deference because its only practical effect is to adjust the rights of third parties who are not signatories to the agreement. Kirkland's Engagement Letter provides a right to fees on fees in any future fee dispute except disputes in which the Debtors are the objecting party. Yet it is only the Debtors, and not the other potential objectors affected by the fee provision, who have signed on to the Engagement Letter. Even if the Debtors somehow had the ability to set contractually the terms of their own potential fee objections, they do not have the right to make such concessions on behalf of the Committee, other creditors, or the U.S. Trustee.

B. A Retention Provision Which Seeks To Negate A Specific Prohibition Of The Bankruptcy Code Is Not "Reasonable" For Purposes Of Section 328(a).

19. Kirkland's fee defense provision violates the Bankruptcy Code for another reason: by its plain terms, that provision seeks approval of a category of compensation that, because of *ASARCO*, could not be approved directly under section 330. Even if the Court considers section

328 under a simple reasonableness standard and in isolation, as Kirkland suggests,[4] this Court cannot find that a proposed retention term is "reasonable" if its sole purpose is to circumvent another section of the Bankruptcy Code.

20. The Third Circuit's decision in *In re Federal Mogul-Global Inc*., 348 F.3d 390 (3rd Cir. 2003) is instructive here. In that decision, now-Justice Alito recognized that a determination of reasonableness under section 328 does not exist in a vacuum, but may properly consider whether those fees ultimately could be allowable under 330(a)(1). It is true, as Kirkland points out, that *Federal Mogul* does not direct courts to apply section 330 factors mechanically when considering a section 328 request. But neither does that decision authorize courts to use section 328 to utterly negate section 330, as Kirkland would have the Court do here. Nor does it allow professionals to obtain front-end approval, under section 328, of fees that would be categorically prohibited if sought at the back end under section 330.

21. The Supreme Court has held that "in exercising . . . statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions." *Law v. Siegel*, __ U.S. __, 134 S. Ct. 1188, 1194 (2014). Under similar circumstances, courts have concluded that the authorization to approve "reasonable" terms under section 328 does not create a license for courts to grant relief that is prohibited by other sections of the Bankruptcy Code. Thus, in decisions involving the treatment of pre-petition retainers, courts have held that where an

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[4] Rather than discuss the central question presented by its motion—that is, whether a retention provision that circumvents a prohibition of the Bankruptcy Code can ever be "reasonable"—Kirkland devotes the bulk of its discussion of the deferential, "improvident" standard of review applied by courts in cases under that section. (Resp. 4-7). But that standard of review has no bearing here. The improvidently-granted standard is employed during the final review of fees after the prospective terms and conditions have already been approved under section 328. 11 U.S.C. § 328(a), 3 COLLIER ON BANKRUPTCY ¶ 328.03[1] (16th Ed. 2010). It has no bearing on whether the term should be approved as reasonable in the first place, which is the issue here.

engagement term seeks to "circumvent the explicit and implicit requirements of the Bankruptcy Code and Rules," it is "inherently unreasonable" for purposes of section 328(a). *In re NBI, Inc.*, 129 B.R. 212, 222 (Bankr. D. Colo. 1991); *see also In re Bressman*, 214 B.R. 131 (Bankr. D.N.J. 1997) (same). The same principle applies here.

C. Kirkland's Arguments Based On Pre-*ASARCO* And Non-Bankruptcy Decisions Have No Relevance To The Question Before This Court.

22. Although Kirkland cites a long list of bankruptcy cases upholding fee defense provisions in support of its contention that these provisions are reasonable (Resp. 13-14), those cases are distinguishable for a simple reason: all of them pre-date *ASARCO*. Indeed, the U.S. Trustee notes that virtually every single one of these decisions involved an application for approval of fees under sections 330 or 331, and as such those decisions have now been overruled by *ASARCO*.[5] In any event, none of the decisions cited by Kirkland considered the issue of whether fees on fees are allowable under the changed legal environment created by *ASARCO*, and none stands for the proposition that those fees can be "reasonable" where they are being sought in contravention of, rather than pursuant to, sections 327 and 330.

23. Similarly, there is no merit to Kirkland's argument that the Court should uphold the Fee Expense Provision because it is an "established practice" outside of bankruptcy. Not every practice that is permissible in a state court, non-bankruptcy setting is automatically permissible in bankruptcy. *See Bressman*, 214 B.R. at 144 (concluding that arguments based on propriety of retainers under state law were "unpersuasive" to question of whether retainers were

[5] The court's order in *In re Merced Falls Ranch, LLC*, 2013 WL 315538 (E.D. Cal. Jun 20, 2013) is apparently miscaptioned as an order under section 328, but actually relates to a final fee application, and not a request to preapprove a term of employment. The remaining 24 authorities cited by Kirkland involve fee applications under section 330. For this reason, Kirkland's entire two-page list of citations does not appear to contain a single authority that is even remotely relevant to its section 328 argument.

permissible under section 328); *see also United Artists Theatre Co. v. Walton*, 315 F.3d 217, 230 (3d Cir. 2003) ("that indemnification provisions like Houlihan Lokey's are now common in the marketplace does not automatically make them 'reasonable' under § 328"). Kirkland offers no authority for its suggestion that non-bankruptcy custom can overcome the terms of the Bankruptcy Code, much less a decision of the Supreme Court. Furthermore, Kirkland's assertion that it is merely following established practice is misleading: even assuming that the Fee Expense Provision is a standard part of Kirkland's engagement letter, the U.S. Trustee is aware of no instance prior to *ASARCO* in which Kirkland or Klehr sought pre-approval of that provision under section 328, and Kirkland identifies no such instances in its Response. Rather, the relief they now seek appears to be a novel litigation tactic that arose only after, and presumably in direct response to, the Supreme Court's *ASARCO* decision. Therefore, even if the practice of seeking reimbursement for fee defense costs was a customary practice before *ASARCO*, the tactic of seeking those fees on a preapproved basis through section 328 was not.

24. Lastly, Kirkland argues that the U.S. Trustee's interpretation of *ASARCO* may conflict with a series of older Third Circuit decisions upholding indemnification provisions for financial advisors. *See United Artists,* 315 F.3d 217 (upholding plan provision that provided limited indemnification rights to financial advisor). The U.S. Trustee agrees that the question of the extent to which *United Artists* remains good law after *ASARCO* is a significant legal issue that may eventually need to be addressed by courts in the Third Circuit. But there is no need for this Court to decide that issue here. Kirkland and Klehr are not financial advisors, they are not seeking to be indemnified pursuant to a plan provision, and the request for fees on fees is significantly different in scope from the plan provision at issue in *United Artists*, which limited the liability of estate fiduciaries for actions taken in connection with the reorganization plan. *Id.*

at 225. Any ruling by this Court on whether *United Artists*-type indemnity provisions are still permissible would be an advisory opinion. Although the circuit decision in *United Artists* cannot trump the Supreme Court decision in *ASARCO* in any event, the U.S. Trustee submits that these questions should be reserved for a case in which they are directly at issue.

III. CONCLUSION

25. The issue before this Court is not whether the Supreme Court should have decided *ASARCO* differently. This Court is bound to follow the precedent of the Supreme Court, and to the extent Kirkland disagrees with that decision, it must look to Congress, not the bankruptcy courts, for relief.

26. Moreover, this Court should not blind itself to the troubling consequences that would result from adopting Kirkland's theory of section 328. In order to successfully distinguish *ASARCO*, this Court would be required to adopt a series of untextual and unprecedented holdings, all of which will have implications for matters well beyond the simple defense-fees question that is at issue here. In order to grant Kirkland the relief it seeks, this Court would be required, first, to hold that professionals can be paid under section 328 even in the absence of a service to the estate. Second, this Court would be required to hold that a private, prepetition agreement between a debtor-in-possession and its counsel, so long as it is somehow deemed commercially "reasonable," can be used to trump any limitation on compensation contained elsewhere in the Bankruptcy Code. Finally, this Court would be required to find that a debtor-in-possession can contractually bind not simply itself, but creditors, other parties-in-interest, and the United States Trustee regarding the terms of their possible objections to the fees of its professionals.

27. This result would not simply be a road map for any other law firm in this Court to circumvent *ASARCO*. As the U.S. Trustee previously observed, it would also be a road map for professionals to circumvent virtually any other statutory safeguard for professional compensation. (Obj. 15-16). There is simply no reason for the Court to undermine its own oversight of fees in this manner.

WHEREFORE, for the reasons stated above and in its previous Objection, the U.S. Trustee respectfully requests that this Court enter an order denying the Debtors' request for relief contained in the Retention Application related to the Reimbursement Provisions.

Dated: December 21, 2015
Wilmington, Delaware

Respectfully submitted,

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ACTING UNITED STATES TRUSTEE

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