Professional Fees under the Bankruptcy Code:
Where Have We Been and Where Are We Going?

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Recent financial meltdowns, which resulted in both non-bankruptcy bailouts and chapter 11 filings by some of the largest corporations in the United States, have focused public attention on large salaries and management benefits at these companies. There is a sense that some are doing exceptionally well while presiding over the demise of companies that either directly or indirectly affected the savings or the livelihood of countless Americans.

Not surprisingly, public attention also has focused on professional fees in major chapter 11 cases. The raw numbers are eye-catching, running into the hundreds of millions of dollars. Although professionals are quick to defend their fees and expenses, billing rates of $1,000 per hour for partners and $400 for inexperienced associates are difficult to explain in our current economic climate. Evidence of improper expense reimbursements, even small ones (*e.g.*, a professional billing an estate for a pack of chewing gum), reinforces the perception of abusive billing. While such reimbursements are frequently dismissed as isolated mistakes, the picture that emerges can be one of professionals who see the bankruptcy estate as an easy source of revenue.

Fee issues are not new. Almost since the advent of the Bankruptcy Code in 1979, courts and others have struggled with how to assure that professionals are fairly compensated and that their fees are "reasonable," the touchstone for professional compensation. U.S. Trustees are specifically required by statute to review and comment on fee applications. Given the tens of thousands of pages of fee applications filed in every major case, this is a daunting task, but one that the U.S. Trustee Program (USTP) strives to accomplish within the limits of its resources.

Practice Before 1994

Under the former Bankruptcy Act, the "economy of administration" standard prevailed. That standard required the courts to consider the public interest in conserving and administering the estate as efficiently as possible.[2] Many concluded that this standard effectively kept the "best and brightest" attorneys out of the bankruptcy practice, as they could make more in other fields.

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[2] *See Massachusetts Mutual Life Ins. Co. v. J. H. Brock*, 405 F.2d 429, 432-33 (5th Cir. 1968), *cert. denied*, 395 U.S. 906, 89 S. Ct. 1748 (1969) ("[t]he public interest which is inherent in all bankruptcy matters must be considered in awarding fees"); *Robinson v. American Benefit Life Ins. Co. (In re First Colonial Corp. of America)*, 544 F. 2d 1291, 1299 (5th Cir. 1977) (a strong policy of the Bankruptcy Act was that the estate be administered as efficiently as possible).

Under the Bankruptcy Reform Act of 1978, Congress implemented a new standard intended to create a highly skilled and competent bankruptcy bar.[3] As originally enacted, 11 U.S.C. § 330(a) was short and to the point: reasonable compensation for actual, necessary services would be based on the time, the nature, the extent, and the value of the services, and the cost of comparable services outside of bankruptcy.[4] Thus, Congress expressly rejected the economy of administration standard as outdated and replaced it with a new standard that emphasizes the "cost of comparable services."[5] Professionals performing services in bankruptcy cases are to be paid at the same rate as professionals performing comparable services in non-bankruptcy cases.

1994 Amendments and USTP Fee Guidelines

Complaints about the size of fees in chapter 11 arose in the late 1980s and early 1990s. Senator Howard Metzenbaum from Ohio proposed that the economy of administration standard be reinstated.[6] Professionals were simultaneously clamoring for more consistency in what information was required in fee applications.

In 1994, Congress amended § 330 to address these concerns and "fleshed out" the statute considerably.[7] Although the amendments did not reimpose the economy of administration principle, they were seemingly aimed toward curbing perceived billing abuses.

Congress also amended 28 U.S.C. § 586 to require the Executive Office for U.S. Trustees to adopt "procedural guidelines" and the U.S. Trustee to review applications in accordance with those guidelines. Accordingly, in 1996, the Executive Office adopted "Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses" filed under § 330 ("guidelines").[8] As required by Congress, the guidelines are procedural and "focus on disclosure of information relevant to a proper award under the law."[9]

It is not clear, however, that the 1994 amendments enhanced the ability of the courts, the USTP, or parties in interest to identify unreasonable fee requests. The most beautifully crafted

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[3]H.R. Rep. No. 95-595, at 300 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5963, 6286.

[4]11 U.S.C. § 330(a) (as enacted in Bankruptcy Reform Act of 1978).

[5]*See* 124 Cong. Rec. H11091-92 (1978).

[6]*See* discussion in Roger M. Whelan, *et al.*, "Professional Compensation Reform: New Ideas or Old Failings?" 1 Am. Bankr. Inst. L. Rev. 407 (1993).

[7]*See* H.R. Rep. No. 103-834, at 33 (1994).

[8]The guidelines are published in the Code of Federal Regulations as an appendix to Part 58 of 28 CFR.

[9]Guidelines, (a)(5).

fee applications conforming to the procedural guidelines can–and often do–seek the allowance of unreasonable fees.

'Standard' Fee Review under § 330

Fee application review has in many ways become a standardized, almost mechanical process. A USTP attorney or analyst will look for patterns of billing abuses, including, among others: billing in rounded time increments; inadequate descriptions; unnecessary attendance at hearings by multiple professionals; duplicative or unnecessary services; inappropriate staffing by professionals with too much or too little experience; overhead expenses disguised as professional or paraprofessional services; and inappropriate expenses. Some abuses are relatively easy to spot, but others are not unless the reviewer has followed the case extremely closely and is intimately aware of all aspects of the case. It is not realistic to expect a USTP attorney to maintain this level of engagement with every chapter 11 case given the scope of responsibilities under § 586.

The applicant bears the burden of establishing the reasonableness of the fees and expenses sought.[10] As a practical matter, however, the burden of proof has been inverted in the application and review process. The proper burden of proof should "not be taken lightly, especially given that every dollar expended on legal fees results in a dollar less that is available for distribution to the creditors."[11] Absent an objection from the U.S. Trustee, fee applications typically receive very little scrutiny:

> Apart from the U.S. Trustee, the parties typically have no motive for objecting to other professionals' fee petitions. As *Busy Beaver* noted, "[t]he 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." 19 F.3d at 843. Additionally, attorneys for the creditors may refrain from objecting as a professional courtesy, for fear of retaliation, or any other number of reasons.[12]

Courts acknowledge that they have an independent duty to scrutinize fees.[13] But most judges and their staffs are not likely to review thousands of pages of applications and bills with a fine-toothed comb when their resources are also limited. "[M]any bankruptcy courts have bemoaned their duty to review fee applications as a thankless, onerous burden, one which consumes a significant share of a bankruptcy judge's time."[14]

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[10]*In re Keene Corp.*, 205 B.R. 690, 695 (Bankr. S.D.N.Y. 1997).

[11]*In re Spanjer Bros., Inc.*, 191 B.R. 738, 747 (Bankr. N.D. Ill. 1996).

[12]*In re Armstrong World Industries, Inc.*, 366 B.R. 278, 281 n.2 (D. Del. 2007).

[13]*Id.*

[14]*In re Busy Beaver Bldg. Centers, Inc.*, 19 F.3d 833, 843 (3rd Cir. 1994).

Even absent resource limitations, some judges do not seem overly offended by abusive billing practices. For instance, in one case, the U.S. Trustee objected to an application by debtor's counsel seeking reimbursement of over $1,000 for a meal with two corporate officers. The bankruptcy court discounted the objection, stating that the attorney may not have felt like "going for hot dogs," and it "must have been a very nice wine list."[15] In overruling another U.S. Trustee objection in the same case, the court reasoned: "They're not interested in getting sweaty and dirty while they're on the job. . . . [T]here's a certain *noblesse oblige*, if I might put it that way, quality to these types of [car service] expenses. . . ."[16] It is difficult to make much headway against billing abuses when sailing into this type of judicial headwind.

Fee Committees, Fee Examiners and Budgets

Bankruptcy courts have employed various mechanisms in an effort to review and control professional compensation, including fee committees, fee examiners and budgets. One of the earliest uses of a fee examiner occurred in the *Continental Airlines* case in Delaware.[17] Since then, many other courts, including the Southern District of New York, have appointed fee committees or auditors in, among other cases: *Bethlehem Steel*, *Bradlees*, *Enron*, *Worldcom*, *Adelphia*, *Lehman* and *General Growth Properties*. In some cases, the court will appoint an individual to serve as the "fee examiner," as in *General Motors*. The fee examiner generally works independently of constituencies in the case.

Fee committees themselves can differ in composition and approach. Some courts have appointed intra-party fee committees made up of constituency representatives and a USTP representative. The *Worldcom*, *Adelphia* and *General Growth Properties* fee committees fit this model. Another model is a fee committee with an independent court-appointed chair, the U.S. Trustee and constituency representatives. The *Enron* and *Lehman* fee committees are examples of this model.

The question arises whether fee committees "work." A vigilant fee committee will improve the quality of applications in a case and, perhaps, deter unreasonable billing practices. Egregious billing abuses can be caught early and eliminated. But this level of scrutiny is not inexpensive, particularly when a fee committee retains professionals. The cost of the fee committee can devour a major portion of any fee or expense reductions it obtains.[18]

Whether fee committees can successfully address the larger issue of reasonableness is likewise subject to question. With the exception of the U.S. Trustee and any independent chair,

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[15] *In re Solutia, Inc.*, Transcript of Motions Hearing Before The Hon. Prudence Carter Beatty, U.S. Bankruptcy Judge (now retired), April 17, 2008, at 53-55.

[16] *Id*. at 49.

[17] *See In re Continental Airlines*, 150 B.R. 334, 338 (D. Del. 1993) (acknowledging that the "section 330 fee review process alone presented the [bankruptcy] court with a daunting task").

[18] *Chadbourne to Tribune Fee Examiner: We Want That $13,639, Please*, http://amlawdaily.typepad.com/amlawdaily/2009/09/chadbourne-fee-examiner.html.

members of the committee are almost always members of the constituencies whose professionals' fees are under review. The dynamics of the case carry into the fee committee meetings.

Many orders establishing fee committees or fee examiners also require the submission of budgets by professionals.[19] The jury is out on the efficacy of budgets. Occasionally, a budget will flag potential duplication of effort before it occurs. On balance, however, the budgeting process does not appear to impose significant billing discipline.

Is There Really a Problem with Fees?

Many in the industry claim that professional fees in major chapter 11 cases are not "too high." Recent scholarship has relied heavily on statistical analysis of data pulled from the public record. Stephen Lubben of Seton Hall University School of Law, after analyzing a substantial database developed under a grant from the American Bankruptcy Institute, suggests that the size of the debtor (measured by assets and liabilities), number of professionals appointed and whether a committee was appointed are more important determinants of fee levels than professional avarice or the length of time the debtor is in chapter 11.[20] His analysis is basically "values neutral," but he expounds statistical models that could enable one to predict what the professional fees and expenses might be in a particular case.

By contrast, Lynn LoPucki and Joseph Doherty of the UCLA Law School have concluded, based upon their statistical analysis of a database of information from "large" chapter 11 cases, that three variables–asset size, case duration and the number of professional firms working in a case–account for 87 percent of the variance in professional fees and expenses in large public company bankruptcy cases.[21] They conclude that these variables might not be surrogates for the true determinants of fee size (such as the complexity or contentiousness of a particular case), but that they might themselves be the determinants. To put it bluntly in terms that will resonate with a non-statistician, they conclude that professionals might be billing more in large, long and professional-heavy cases simply because they can.[22]

What is lost in these analyses is the comparison between bankruptcy and non-bankruptcy practitioners. Section 330(a)(3)(F) requires the court to consider "whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title." The abrogation of the economy of administration standard guaranteed that highly skilled bankruptcy practitioners could take their well-deserved place with other highly skilled professionals. But it was not designed to enable them to command

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[19]*E.g., In re Enron Corp*. (S.D.N.Y. Case No. 01-16034) (Order 4/23/2002).

[20]Stephen J. Lubben, "Corporate Reorganization and Professional Fees," 82 Am. Bankr. L.J. 77 (2008).

[21]Lynn M. LoPucki & Joseph W. Doherty, "Professional Overcharging in Large Bankruptcy Reorganization Cases," 5 Journal of Empirical Legal Studies 983, 1010-11 (2008).

[22]*Id.* at 1011.

a premium at the proverbial "front of the line." We suspect that this is precisely what has happened.

"Big firms" reinhabited the reorganization bar in the years following the adoption of the Bankruptcy Code, and their increasing prevalence in chapter 11 cases has created upward pressure on professional fees. One recent study by the Corporate Executive Board found that the size of the firm where an attorney practices is a primary driver of hourly rates for lawyers in all practice areas.[23] In recent years, increases in hourly rates have far outpaced inflation. Indeed, during the most recent recession, approximately 75 percent of lawyers increased their hourly rates charged to corporate clients and nearly 20 percent increased their hourly rates by $100 or more.[24] The top rates of the top lawyers at the most prestigious firms become the top rates of many practitioners with less experience, expertise and overhead. This leads to an inexorable rise in rates unrelated to the quality of the services being rendered.

But the rise in hourly rates is only part of the professional fee story. Corporate America has rebelled and demanded better value from its lawyers through alternative billing arrangements. A recent study confirmed that "78% of timekeepers bill different rates to clients for similar work."[25] That same study noted that various alternative fee arrangements increased by 47 percent between 2007 and 2009.[26] Almost 20 years ago, the Third Circuit optimistically predicted that alternative fee arrangements would become common in bankruptcy "once comfortably established in the realm of comparable non-bankruptcy legal services."[27]

Despite this optimism, there is no evidence to suggest that value-based or alternative billing arrangements "percolate[d] up"[28] into the bankruptcy fee process in any meaningful or systematic way. Rather, the lodestar approach remains the benchmark in bankruptcy.

Thus, fees in bankruptcy may not reflect what firms earn in non-bankruptcy engagements. Every fee application lists the professionals and their regular billing rates. No doubt these are the rates that the firms would like to charge their clients. But there is an entire body of literature and substantial evidence showing how corporate counsel can and do negotiate with outside counsel to lower the cost of representation.[29] We suspect that a corporate client's

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[23]The Real Rate Report™ (reviewing actual invoices reflecting $4 billion in actual charges by 100,000 professionals and para-professionals for the years 2007-2009 to corporate clients) available at http://www.executiveboard.com/real-rate-report/index.html.

[24]*Id.*

[25]*Id.*

[26]*Id.*

[27]*Busy Beaver Bldg. Centers*, 19 F.3d at 856.

[28]*Id*.

[29]*See, e.g.*, *The Association of Corporate Counsel Value Challenge*, available at www.acc.com/valuechallenge.

regular negotiation and control of fees outside bankruptcy often break down when retaining reorganization professionals because, among other reasons, a potential debtor is not in a strong negotiating posture when engaging bankruptcy counsel. If every large firm is quoting essentially the same fee structure, deciding who to retain will likely turn on factors other than fees. This is particularly true where the debtor will not have post-confirmation operations that would benefit from lower fees.

The problem persists throughout the bankruptcy process. Outside bankruptcy, a unitary corporate actor, driven by its business objectives, realizes all of the value from both its professionals' work and its own efforts at controlling professional fees. In bankruptcy, those functions–retention, invoice review and payment approval–are divided among the court and various actors with different responsibilities and incentives. Furthermore, any savings from controlling professional fees do not necessarily inure to the benefit of the debtor but are more likely to benefit the unsecured creditors. The debtor, therefore, does not have the same incentive in bankruptcy to control professional fees as it does outside.

The creditors' committee is in a slightly different posture than the debtor. The committee's constituency stands to lose if professional fees are exorbitant. But the committee is often under extreme pressure to engage counsel quickly in a major case. The committee has often just been formed, so the members might not know one another. This hardly sets the stage for a fruitful negotiation. Creditors' committees also frequently fail to review and object to the fees of other estate professionals. As the *Busy Beaver* court noted, committee professionals do not object to fee applications out of either professional courtesy or fear of retaliation.[30] More than two decades ago, the Fifth Circuit stated its belief that bankruptcy professionals engage in a "conspiracy of silence"on fees.[31]

Moreover, whether and how much to pay professionals ultimately rests with the court. If the bankruptcy court does not exercise the type of billing control that clients do in analogous non-bankruptcy engagements, bankruptcy practitioners are effectively being compensated at higher rates than non-bankruptcy practitioners in contravention of § 330.[32]

Bankruptcy professionals raise a number of common arguments in response to concerns over burgeoning fees in large chapter 11 cases, including the risk of non-payment because of administrative insolvency or that only repeat clients qualify for alternative billing. These arguments distort the analysis. The firm's compensation should be based on what comparably skilled professionals in non-bankruptcy practice receive for their work.[33] If non-bankruptcy practitioners receive less than bankruptcy professionals seek, this should be a factor in determining a reasonable fee.

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[30] *Busy Beaver Bldg. Centers*, 19 F.3d at 843.

[31] *In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1255 (5th Cir. 1986).

[32] *See Busy Beaver Bldg. Centers*, 19 F.3d at 855-56.

[33] *Id*. at 853.

What Is Really Going On Here?

To the best of our knowledge, despite bearing the burden, professional firms have not litigated whether their bankruptcy billing practices are comparable to the billing practices of similarly skilled non-bankruptcy practitioners. It might be necessary to dedicate a team of USTP attorneys to conduct discovery in major cases. In the absence of a contested matter, examination of debtor's management and professionals should be available under Fed. R. Bankr. P. 2004. The permissible scope of examination in a chapter 11 case extends to "any other matter relevant to the case," which is certainly broad enough to include whether the estate is being unreasonably billed.

We are also considering modifications to the guidelines to require additional disclosure in fee applications. One of the Code's core values is transparency and disclosure sufficient to enable all constituents to evaluate transactions, decisions and value. This transparency should extend to the rate structure and billing practices of professionals paid from funds otherwise available for distribution to unsecured creditors. At least one court has suggested that disclosure of both bankruptcy and non-bankruptcy billing practices should be part of the retention process for bankruptcy professionals.[34] Accordingly, we may require professional firms to disclose effective billing rates for professionals with similar experience in corporate and litigation departments as well as other information about alternative or value-based billing actually used in non-bankruptcy engagements.

Conclusion

The concern that fees are "too big" is not new: by the late 1980s complaints had arisen over the size of fee requests. Not only have efforts by the USTP, fee examiners and fee committees to rein in fees been met with righteous indignation, those efforts also have been largely unavailing. Few professionals and, sadly, few courts have shown the inclination to exercise meaningful restraint on professional compensation.

Although the USTP will continue to exercise its statutory responsibility to review and comment on fee applications, professionals should step back and evaluate their billing practices in light of the current economic climate. If the public at large, which already harbors an historical mistrust for the legal profession, becomes convinced that professionals are "feeding at the trough" while creditors and investors are "going hungry," they might call upon their representatives to develop a legislative solution. Any such solution would likely be more painful than what professionals could attain by self-policing their billing practices to align them with their non-bankruptcy billing practices.

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[34] *Id*. at 854-55.