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Office of the U.S. Trustee
20 Massachusetts Ave., N.W.,
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Washington, D.C. 20530

Gentlemen:

In December of 2011, in my capacity as Chair of the Business Bankruptcy Committee of the Business Bankruptcy Section of the American Bar Association, I appointed a working group to study the proposed Guidelines of the U.S. Trustee's Office (the "Proposed Guidelines") related to large chapter 11 cases. The attached comments reflect the comments of the members of that working group. These comments ("Comments") are submitted on behalf of certain individual members of the Business Bankruptcy Committee (the "Committee") in response to the November 8, 2011 request for comments. They have not been approved the Section of Business Law or the House of Delegates or Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments was exercised by Rafael Zahralddin-Aravena and Judith Ross of the Business Bankruptcy Committee of the ABA Section of Business Law. Contributions were made by David Posner, Kit Weitnauer, Jacob Renick, Kenneth Aaron, and Lia Allen, all of whom are members of the working group.

Although the members of the Business Bankruptcy Committee of the Business Law Section who participated in preparing these Comments may be members of firms, and may have clients who might be affected by these Comments, the Comments are those of the members themselves and should not be construed as representing the views of their firms or the American Bar Association. In addition, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Sincerely,

Patricia A. Redmond

COMMENTS ON THE U.S. TRUSTEE'S OFFICE PROPOSED FEE GUIDELINES FOR LARGE CHAPTER 11 CASES

A working group, appointed by the Chair of the Business Bankruptcy Committee, of the Business Bankruptcy Section of the American Bar Association (the "Working Group") to study the proposed Guidelines of the U.S. Trustee's Office (the "Proposed Guidelines") related to large chapter 11 cases, has completed that study and respectfully submits the comments set forth below.[1] The Working Group welcomes discussion with the U.S. Trustee's Office regarding these comments.

The Working Group believes that the Proposed Guidelines are unnecessary as the existing professional fee guidelines that are in existence adequately address issues in large cases. Further, the Working Group believes the Proposed Guidelines create ethical problems for attorneys by requiring them to comply with procedures that violate the attorney-client privilege as well as other duties of a lawyer. The Proposed Guidelines go well beyond the statutory mandate imposed by section 330 of the Bankruptcy Code and the case law, by shifting the focus away from whether the fees being charged are reasonable in comparison to other law firms in the legal community, to the issue of whether the fees being charged are reasonable in relation to the fees charged internally at that law firm. In essence, the U.S. Trustee appears to be attempting to legislate standards for approval of fees in the guise of "guidelines." Further, the Proposed Guidelines improperly require attorneys to disclose information about their internal fee and billing arrangements that may be trade secrets of those attorneys and firms. And, the information that firms must now disclose appears to be of little use as a practical matter in helping a court decide whether or not the fees are reasonable in any event. By requiring budgets, the administrative burden of handling large chapter 11 cases will be increased. While budgets are no doubt effective in assisting clients in deciding whether they want to proceed with a given legal strategy, any such budgeting needs to be flexible and certainly should not be made public due to attorney-client privilege and similar concerns. Appointment of a fee examiner should be left to the discretion of the bankruptcy court presiding over the case and not to the U.S. Trustee. Finally, at a minimum, it needs to be made clear that these Proposed Guidelines are only that -- guidelines, and that they are at all times subject to applicable law, both substantive bankruptcy law and the laws governing legal ethics and professional responsibility.

<u>No Justification is Stated for Implementing Special Guidelines in Large Cases</u>

No reason is articulated by the U.S. Trustee's office as to why the existing U.S. Trustee Guidelines on fees need to be replaced with the Proposed Guidelines. While the Working Group applauds the idea of uniformity in all jurisdictions, the Working Group notes that some portions of the Proposed Guidelines are already implemented in some form or another by local rule. In that regard then, these new Proposed Guidelines appear redundant.

[1] These comments represent the consensus reached among the members of the Working Group (who are listed on Exhibit A), but do not represent the views of 1) any individual or law firm listed thereon; 2) the American Bar Association; or 3) the Business Bankruptcy Section of the American Bar Association.

The Proposed Guidelines assume, without any explanation, that there is a need for different guidelines in cases with more than $50 million of assets and liabilities. There is no empirical data, statement or listing (let alone a judicial finding) of what circumstances exist warranting different treatment other than the magnitude of the assets and liabilities. While the Working Group has dutifully reviewed these Proposed Guidelines, and the comments on the Proposed Guidelines appear below, the Working Group views these guidelines as an unwarranted imposition on bankruptcy professionals in cases that exceed a certain arbitrary amount of assets and liabilities when, as noted above, there are already existing guidelines in place.

The Proposed Guidelines are Inconsistent with the Statute

Section 330(a)(1)(A) broadly allows the bankruptcy judge to award "reasonable compensation for actual necessary services rendered." Section 330(a)(3), in turn, instructs courts to consider all relevant factors to "determine the amount of reasonable compensation to be awarded," including the factors outlined in the section. Further, section 330(a)(3)(F) requires courts to consider "whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in [non-bankruptcy cases]."

The Proposed Guidelines go well beyond the statutory mandate imposed by section 330 of the Bankruptcy Code and the case law by shifting the focus away from whether the fees are reasonable in comparison to other law firms and the legal community to the issue of whether the fees are reasonable in relation to fees charged internally at that law firm.

There is no requirement that the court look to see what the law firm itself charges for comparably skilled practitioners. Tests implemented by the circuit courts on the issue, including *Johnson v. Georgia Highway Express, Inc*., 488 F.2d 714, 717–19 (5th Cir. 1974) require the court to review a fee application by reviewing and considering: (1) the time and labor expended; (2) the novelty and difficulty of the question raised; (3) the skill required to properly perform the legal services rendered; (4) the attorney's opportunity cost in pressing the instant litigation; (5) the customary fee for like work; (6) the attorney's expectations at the outset of the litigation; (7) the time limitations imposed by the client or circumstances; (8) the amount in controversy and the results obtained; (9) the experience, reputation and ability of the attorney; (10) the undesirability of the case within the legal community in which that suit arose; (11) the nature and length of the professional relationship between the attorney and client; and (12) attorney's fees awarded in similar cases. This standard does not require anything but an examination of like work in similar cases in determining whether the fee is reasonable.

Before the adoption of the United States Bankruptcy Code, attorneys had to wait until the end of the case before getting paid, and were usually paid at lower rates than for corresponding non-bankruptcy representation. *See Jacobowitz v. Double Seven Corp.*, 378 F.2d 405, 407–08 (9th Cir. 1967) (discussing the spirit of economy standard for attorney compensation in bankruptcy cases under the Bankruptcy Act). Congress, in implementing section 330 of the Code, intended that the fees charged by bankruptcy practitioners mirror the fees paid by non-bankruptcy practitioners. However, the efforts of Congress to bring compensation in line with other areas of practice have only been partially successful. Inequities in compensation persist. A recent comprehensive empirical study by the American Bankruptcy Institute, funded by the ABI

Endowment Fund and the National Conference of Bankruptcy Judges documents that fees awarded in bankruptcy cases are generally lower than in other comparable areas of practice. C.R. "Chip" Bowles, *The ABI Chapter 11 Fee Study: Moving Forward Analysis* (May 2008), www.abiworld.org/committees/newsletters/profcomp/vol5num2/Fee.pdf. Professor Stephen J. Lubben is the official reporter for the study and has written several articles on the findings. *See, e.g.*, Stephen J. Lubben, *Corporate Reorganization and Professional Fees*, 82 Am. Bankr. L.J. 77 (2008). The ABI previously published a more limited empirical review of professional fees in 1991.[2] Notably, the ABI Chapter 11 Fee Study also found that almost 35 percent of the chapter 11 cases result in zero payment to the professionals. These are typically smaller cases that are often converted to chapter 7 or dismissed.

The U.S. Trustee's Office attempts to turn on its head the whole purpose of the enactment of Section 330 of the Bankruptcy Code: to now require law firms to give discounts to debtors and Creditor's Committee without regard to the difficulty or the complexity of the work at issue, and without regard to whether the work in question is deserving of a discount.

Concerns Regarding Violation of the Privilege

An attorney is required to keep communications with clients confidential.[3] There are elements of the Proposed Guidelines that put attorneys in the position of being forced to violate those confidentiality restrictions and, as such, those elements must be reconsidered. Specifically, the Working Group notes the following areas of difficulty:

- As set forth more fully in the discussion of budgets below, the requirement that budgets be made public creates significant risk that attorney-client communications will be divulged. At a minimum, there should be no requirement that the budgets be made public.

- The requirement that electronic records be filed also creates confidentiality concerns. The Proposed Guidelines appear to require any electronic records to be filed in a format that can be searched by anyone, including opponents in litigation. We reference Formal Opinion 107 of the Colorado Bar Association Ethics Committee (in the context of addressing insurance company billing guidelines) where the committee noted that a "lawyer may not reveal confidential client information contained in billing statements without the client's informed consent. A lawyer should seek the client's informed consent prior to disclosing or allowing the disclosure of confidential or privileged information to a third party, such as an auditor."[4]

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[2] *See* ABI Nat'l Report on Prof'l Comp. in Bankr. Cases (1991).

[3] *See* Model Code of Prof'l Responsibility R. 1.6 (2010).

[4] *See* Colo. State Bar Assoc. Ethics Comm., Formal Op. 107 (1999).

Proprietary Information

The Proposed Guidelines improperly require attorneys to disclose information about their internal fee and billing arrangements that are proprietary trade secrets or confidential research, development, or commercial information of those attorneys which is protected under 11 U.S.C. § 107. Law firms do not routinely disclose to their clients or their competition the fees that they charge their other clients.

Putting aside the issue of whether or not a firm's information about what it charges its clients is "protected confidential information," requiring professionals to disclose what they charge other clients in non-bankruptcy matters with the apparent goal of forcing the law firm to provide discounts to the estate makes little or no sense in the bankruptcy context. Typically, law firms give discounts if they are being assured a specific volume of business that constitutes repeat business. Neither bankruptcy debtor clients nor Creditors' Committee clients give firms "repeat business." As a result, it is difficult to understand how the disclosure of the information requested about internal rates charged by law firms to other clients has any relevance. Moreover, the fact that a law firm charges one client a discount has no relevance unless the information is put into context: it may be that the firm only discounts a small percentage of its work. It does not logically follow that just because one client receives a discount that all clients should receive a discount. It would be more logical to focus inquiry on the complexity of the work being performed or the routine or complex nature of tasks being performed. Indeed, in many of the larger cases where there is local co-counsel or conflicts counsel retained under Section 327(a) of the Code, routine tasks are performed by the local firm and that brings down overall costs. The inquiry should not be about discounts but whether the work was assigned to the appropriate counsel to perform the task based upon the complexity, importance, and nature of the problem, issue, or task addressed, and whether one of the firms can do routine tasks more economically. The Bankruptcy Code gives the bankruptcy court sufficient discretion to make that determination.

Increased Administrative Burden

The Working Group also notes that many of the U.S. Trustee's proposed changes increase administrative burdens in a case without providing a corresponding benefit:

- The Proposed Guidelines object to the use of transitory professionals. Very often, the few hours billed by the transitory professional in a case end up being the most productive hours spent. In any event, if a lawyer, in his or her professional judgment, believes that a short consultation with a lawyer in another practice area is beneficial to the representation of the client, that professional judgment should not be second guessed.[5]

- If the U.S. Trustee's office is going to require more burdensome details and bills, then redaction of those bills or invoices for privileged or proprietary information should be compensable by the law firm. Congress's goal in enacting the Bankruptcy Code was to make bankruptcy work as attractive as non-bankruptcy

[5] *See* Model Code of Prof'l Responsibility R. 2.1 (2010).

work for practitioners. That goal is harmed by increasing the administrative burden to attorneys and not compensating for them for that increased administrative burden.

- The Working Group questions the efficacy of increased categories and subcategories as described in Exhibit A of the Proposed Guidelines. Different professionals will categorize matters in different ways, and the more categories there are the more confusing it is going to be and the more expensive it is to make time entries consistent with one another. Moreover, standardizing categories for large chapter 11 cases ignores the reality that complex issues arising in these chapter 11 cases will vary from case to case requiring categories specifically tailored to that case.

- The section related to applications for employment suggest that professionals be required to disclose information about the lowest hourly rates billed within the firm in the last 12 months and the average and highest rates billed in the last 12 months. This information really does not convey anything that is of any help to the court or to the U.S. Trustee's Office. It may well be that a law firm has charged a very low hourly rate for 1% of the work done by its law firm. And in most law firms, pro bono work is done for free. What does this information tell the Court or the U.S. Trustee that is of relevance to whether the fees charged were reasonable in comparison to other practitioners? Unless the rates are for the same type of work and there is an opportunity for explanation of any variances, simply reporting rates does nothing to inform the inquiry as to whether the work was reasonably charged to the estate.

- Precluding compensation of law firms for preparing monthly fee statements is inappropriate. Filing those fee statements is far more complicated than billing a client and, subject to a reasonableness standard, should be compensable.

- Precluding compensation of law firms for defending and explaining fee applications and monthly invoices is also inappropriate. Very often, the party objecting to the fees is the U.S. Trustee's office (which is part of their job, of course). It should be recognized that providing explanations of and defense of fee applications are part of the process and should be compensable.

Fee Examiners

Finally, with respect to the special fee review procedures proposed, the Working Group would note the following:

- Some bankruptcy courts believe that fee examiners are helpful. Others do not. The only reason for the appointment of a fee examiner should be whether or not it will aid the court. If the U.S. Trustee's Office is in need of help to review fees, then that cost should be borne by the federal government, not by debtors in a chapter 11 bankruptcy case.

<u>Budgets and other Restrictions on Ethical Duties of a Lawyer</u>

Budgets can be effective tools for clients to use in keeping the expenses associated with a bankruptcy proceeding from becoming too large. However, while most budgets are no doubt effective in assisting clients in deciding whether they want to proceed with a given legal strategy, any such budgeting needs to be flexible and it certainly should not be made public due to attorney-client privilege concerns. When budgets are prepared for the typical client, they provide some detail about the types of work that is going to be done, which if viewed by an opponent can hurt the case being prosecuted by the client. Accordingly, while the Working Group does not oppose the Proposed Guidelines encouraging Committees and Debtors to require budgets, those budgets should never be made public.

Moreover, the Working Group believes that in the large Chapter 11 case, the secured lenders are already imposing budgets upon the Creditors' Committee and Debtors' counsel when they negotiate the carve-out for professionals handling the bankruptcy case. Secured lenders are highly motivated to keep legal fees to a minimum in such circumstances and are effective in addressing such issues. Further, before the secured lenders even get to the negotiating table to talk about a budget, clients have already negotiated with the law firm regarding the legal fees to be charged. Bottom line, the Working Group believes that there are sufficient pressures in place in a large bankruptcy case which will ensure that fees are kept reasonable without requiring lawyers to spend valuable time in drafting and re-drafting ever-changing budgets.

The Working Group notes further that in a recent article, the Director of the U.S. Trustee's Office questioned the usefulness of budgets noting, "Occasionally a budget will flag potential duplication of effort before it occurs. On balance, however, the budgeting process does not impose significant billing discipline." *See* Clifford J. White & Walter W. Theus, Jr., *Professional Fees under the Bankruptcy Code: Where Have We Been and Where are We Going?*, 29-JAN Am. Bankr. Inst. J. 22, 78 (Dec./Jan. 2011). If the Director of the U.S. Trustee's Office does not believe budgeting imposes billing discipline on professionals, then it is difficult to understand why that same office is recommending that budgets be part of the Proposed Guidelines.

Effective representation of Debtors and Creditors' Committees requires crisis management skills on the part of the firms handling such work. Typically, it is impossible to predict with certainty every single issue that will arise in a case. But, a law firm representing a Debtor or Creditors' Committee must have the ability to act consistent with its ethical duties regardless of whether a budget is ignored. As the Disciplinary Board of the Hawai`i Supreme Court noted: "Provisions [in fee guidelines] which prohibit activity which, in the lawyer's professional judgment, are necessary in the representation of the client or provisions which provide a [disincentive] to perform those tasks are **ethically unacceptable**."[6]

Further, the Colorado Bar Association Ethics Committee has noted with respect to the topic of billing guidelines imposed by insurance companies, if there is any billing guideline that unreasonably interferes with the lawyer's independent professional judgment, the lawyer must

[6] *See* Disciplinary Bd., Haw. Sup. Ct., Formal Op. 37, at *2 (1999).

either (1) obtain permission not to comply with the guideline; (2) refuse to abide by the guideline and withdraw; or (3) obtain permission from the client to comply with the guideline.[7]

The Working Group notes that provisions of the Proposed Guidelines imposing restrictions on reasonable communications between members of the team on a day to day basis, or which seek to dictate the number of personnel that should be used to perform a particular task absolutely impact a lawyer's professional judgment. As the Legal Ethics Committee of the Indiana Bar Association recently noted: "Such provisions, even though intended merely to achieve cost efficiency infringe upon the independent judgment of counsel, and tend to induce violations of ethical rules."[8]

In summary, to the extent the Proposed Guidelines prevent lawyers and their firms from exercising their independent judgment about what needs to be done in a case, those Proposed Guidelines are ethically unacceptable and should not be implemented. The Working Group absolutely opposes any guideline that demands slavish adherence to budgets without regard to the needs of the client or the situation as such adherence can easily (and is indeed, likely) to adversely impact a lawyer's independent obligation to act in the best interest of the client.

Impact of Proposed Guidelines

At a minimum, if these Proposed Guidelines are adopted, it needs to be made clear that (1) these guidelines are not being implemented pursuant to any rule making authority granted to the U.S. Trustee's Office; (2) that they are merely suggestions; and (3) that they are subject to all applicable laws, including the United States Bankruptcy Code, and any applicable professional rules of conduct governing lawyers.

[7] *See* Colo. State Bar Assoc. Ethics Comm., Formal Op. 107 (1999).

[8] *See* Ind. State Bar Assoc. Ethics Comm., Formal Op. 3, at *8 (1998).

EXHIBIT A

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