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VIA Email
Clifford J. White III
Director
Executive Office for U.S. Trustees
20 Massachusetts Avenue, NW
Suite 8000
Washington, DC 20530

Re: Proposed Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed Under 11 U.S.C. § 330 by Attorneys in Larger Chapter 11 Cases

Dear Mr. White:

I welcome the opportunity to comment on these newly proposed fee guidelines. I am the Daniel J. Moore Professor of Law at Seton Hall University School of Law in Newark, where I specialize in chapter 11, and also teach courses on corporate governance, corporate finance and financial institutions. I have written extensively on professionals in chapter 11 cases, was the reporter for the American Bankruptcy Institute's Big Case Fee Study, the largest empirical study of chapter 11 fees to date, and wrote my dissertation on professional fees in chapter 11 cases.[1]

I also write a weekly column for the *New York Times'* Dealbook page that deals with restructuring matters. Before academia, I practiced with the restructuring department a leading New York corporate law firm. However, these comments reflect my own opinions, and not those of any current or former employer or client.

I am generally supportive of the effort to update the existing fee guidelines, which are presently out of date and unduly cumbersome. However, I do urge the Executive Office to consider a fresh approach to

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[1] Representative articles on the topic include: *Chapter 11 in Context: American and Dutch Business Bankruptcy*, 85 Am. Bankr. L.J. 63 (2011) (co-authored with O. Couwenberg); *Corporate Reorganization & Professional Fees,* 82 Am. Bankr. L.J. 77 (2008); *The Microeconomics of Chapter 11*, Part 2, 4 Int'l. Corp. Rescue 87 (2007); *The Microeconomics of Chapter 11*, Part 1, 4 Int'l. Corp. Rescue 31 (2007); *Choosing Corporate Bankruptcy Counsel*, 12 A.B.I. L. Rev. 391 (2006); *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 Am. Bankr. L.J. 509 (2000).

chapter 11 fees: in particular, an approach that focuses more on the big picture and less on after the fact inspection of fee applications.

There are a variety of reasons to think that the cost of large chapter 11 cases has increased, if not uniformly, at least in some number of high-profile cases. The reasons include the increasingly complex capital structures seen in modern corporations, which not only increase the complexity of the reorganization directly but also motivate distressed debt investors who are engaged in increasingly complex trading strategies.

Law firm structures also influence chapter 11 costs. Chapter 11 practice is increasingly integrated into large corporate law firms, in a way that means that fees charged in chapter 11 cases often inform the law firm's overall rate structure. Indeed, chapter 11 cases often provide the only publicly available information about a competitor's rates, and what the market might bear with regard to rate increases. Moreover, it is expected that the reorganization practice will provide just as much to the firm's bottom line as any other practice group.

Boards increasingly approach chapter 11 as they would any other fundamental corporate transaction. At such a point in the corporation's existence, there is little harm in hiring the best possible professionals that money can buy, and board members can only lose by underinvesting in this area.

And professional work in chapter 11 cases is becoming increasingly specialized, which results in greater numbers of firms, and professionals within firms, working on cases. The more cooks in the kitchen, the more likelihood inefficiencies will result as professionals engage in duplicative work and, more benignly, a greater number of professionals spend time getting "up to speed."

All of these factors will tend to push the cost of chapter 11 cases upward, but focusing on the details of retention or fee applications is not apt to yield substantial results with regard to any of them.

I suggest that real effects on overall chapter 11 costs could be achieved by consideration of the retention choices made by corporate debtors, and by better division of duties among professionals and law firms once retained. For example, big corporate law firms can bring real value to a chapter 11 case in matters requiring great speed or involving great complexity. They do not bring real value to the estate in handling common bankruptcy matters such as small preference actions, contract rejections, and simple claims objections. And it surely is not efficient for these firms to have partners make court appearances on such mundane matters.

A basic requirement that work be allocated to the professional who can handle it most efficiently would go much further than many, more detailed application requirements. The debtor and its professionals should be charged with such a duty at the outset of the case.

Moreover, the US Trustees should focus on the overall package of professionals retained in a case, and demand that the debtor explain how tasks will be allocated among these professionals and within the hierarchy of any particular professional. Too often both courts and Trustees seem content to abide boilerplate discussions of such matters.

Indeed, modern retention and fee applications are long on boilerplate and short on actual substance. There is no real reason why such a retention application need exceed the few pages needed to state that the professional (a) meets the requirements of §327(a) – the proof is in the attached declaration, (b) intends to charge its usual hourly rates, and (b) will perform a defined set of tasks for the debtor.

My specific comments follow.

Section A.2

The proposed guidelines are to apply to debtors with assets of $50 million or more. In a paper published in 2010, I demonstrated how the relationship between chapter 11 cost and debtor size seemed to change

dramatically at the point where the debtor's assets passed $60 million.[2] That study was based on cases filed in 2004. If anything, I would assume that the tipping point is now even higher.

I suggest that these new guidelines should be limited to debtors with at least $100 million of assets. Anything lower and the guidelines will be overinclusive, a problem that will only get worse as time goes by.

Sections B.4.h. and 5.e.

I am surprised that here and elsewhere in the proposed guidelines the Executive Office seeks to reopen the old "overhead" can of worms, which, despite its inclusion in the 1996 Guidelines, has largely faded from view. In a world where clients are increasingly unwilling to subsidize some other client's representation, there is a strong incentive for law firms to charge items to the specific client that used the service in question. The fact that a particular item was historically treated as overhead – such as word processing, an item expressly mentioned at this point in the guidelines – should have no bearing on whether it is properly charged to the debtor.

Section C.5.c.

The suggestion that billing in even hour or half-hour increments is somehow suspect may have damaging effects, as it provides an incentive to add one tenth of an hour to such time entrees.

Section C.6.

While the idea of budgeting early in the case makes a lot of sense, this section seems somewhat unworkable when applied to interim fee applications. For example, how will the applicant or the Trustee know if the application deviates from the budget?

Section C.8.

If the client had no relationship with the professional firm in question before the onset of financial distress, the client will have no ability to answer some of these questions. For example, how will the client know what the firm's non-bankruptcy rates are?

Section C.10.

Stating the reason for every expense seems rather impractical and not apt to yield useful data. The Executive Office might consider what reason they would give each time they use the photocopier, send an overnight package, etc.

Section E

While I understand the motivation of this section, I do think the Executive Office needs to think very carefully about potential unintended consequences for bankruptcy costs and the larger market for corporate legal services. In the securities area, it is widely believed that rule changes that mandated disclosure of top executive's compensation resulted in upward pressure on executive compensation.

After the change, boards could easily calculate what CEOs in their industry were making, and what board would have the temerity to offer an incoming CEO below-average compensation? Of course, once everyone begins to receive above-average compensation, the average moves and the process begins anew. I have some fear that the disclosures the Executive Office contemplates in this section might have a similar effect on hourly rates generally, especially once the economy recovers and law firms regain some degree of pricing power with respect to their clients.

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[2] *The Types of Chapter 11 Cases,* 84 Am. Bankr. L.J 233 (2010).

I would also note some ambiguity with regard to the average hourly rates in this section – are these averages to be weighted by the number of hours that the professionals billed in any particular year? Or are they to be calculated as the sum off all hourly rates divided by the number of professionals in a particular category? The second, although easier to calculate, is apt to produce rather skewed and therefore unhelpful results, especially in broad categories like "associate."

In a somewhat related vein, it would seem helpful to know if any of the hourly rates to be disclosed under this section of the guidelines were actually charged in more than a token number of instances.

Thank you for considering these comments. Please do not hesitate to contact me if I can be of further assistance.

Very truly yours,

/s/ Stephen J. Lubben
Daniel J. Moore Professor of Law