ATTORNEY FEES - BARRON AND THE REVERSAL OF PROSNAX ; *ASARCO* (WHAT DOES "IN DEFENSE OF" MEAN?) ARE THERE VIABLE ALTERNATIVES?

Originally Presented at the 5th Cir. Bankruptcy Bench Bar by Stephen Rosenblatt & the Hon. Craig Gargotta (Feb. 26, 2016)

Materials Prepared by Stephen Rosenblatt & Amelia Bueche

Barron and the Reversal of *Pro-Snax*

To compensate properly retained counsel under § 330(a)(1)(A), an attorney may request "compensation for actual [and] necessary services rendered." Section 330(a)(3) requires courts "consider the nature, the extent, and the value of" the legal services provided when determining the amount of reasonable compensation to award, "taking into account all relevant factors." What constitutes such reasonable compensation has proved to confound practitioners and jurists alike, particularly after the Fifth Circuit's opinion in *Pro-Snax*. After over a decade of begrudging applications of the *Pro-Snax's* retrospective "material benefit approach," in 2015, the Fifth Circuit shifted course in *Woerner*, in favor of the prospective, "Reasonable at the Time Standard." While this change has been almost universally praised, post-*Woerner* courts have cautioned that reasonable compensation remains a complex inquiry.

1. The Fifth Circuit adopts the strict "identifiable, tangible, and material benefit to the bankruptcy estate" approach.

In 1977, the Fifth Circuit announced the *Johnson* factors which were to be used to determine the amount of compensation that is reasonable for an attorney's services. Then in 1978, Congress enacted § 330(a) which essentially codified the lodestar method which required a court to engage in a two-step analysis, by first ascertaining the nature and extent of the necessary and appropriate services rendered by the professional, and then assessing the reasonable value of those service. In the Fifth Circuit, after courts determine the lodestar, it is then adjusted up or down based on the factors contained in § 330 and the *Johnson* factors as required.

> *Andrews & Kurth, L.L.C. v. Family Snacks, Inc. (In re Pro-Snax Distribus., Inc.)*, 157 F3.3 414 (5th Cir. 1998).

In 1998, the Fifth Circuit addressed the application of § 330(a), after further amendment in 1994. *Pro-Snax* began as an involuntary chapter 7, which was subsequently converted by consent to a chapter 11. Throughout the case, it was obvious to the bankruptcy court that the debtor and creditors had a hostile relationship. The creditors eventually moved to reconvert the case to chapter 7, and the bankruptcy court ultimately appointed a chapter 11 trustee to oversee the case. Since the inception of the case, Pro-Snax's counsel, A&K, provided legal services to the debtor, including services after the appointment of the chapter 11 trustee. The questions before the Fifth Circuit were therefore: (i) whether a chapter 11 debtor's attorney should be compensated for work done after the appointment of a trustee and (ii) what standard should be applied in assessing whether to compensate attorneys for work done prior to the trustee's appointment.

As to the first issue, Fifth Circuit found that based on the plain meaning of § 330(a)(1), A&K could not be compensated for services rendered to the debtor after appointment of the trustee. In a more abbreviated treatment of the second issue, the Fifth Circuit adopted a stringent test advocated by the creditors—whether A&K services resulted in an identifiable, tangible, and material benefit to the bankruptcy estate.

2. Courts throughout the Fifth Circuit struggle to apply *Pro-Snax*

Pro-Snax was subsequently interpreted as requiring that the court evaluate the benefit of the services retrospectively. Such a requirement was rejected by courts in other circuits and subject to vast criticism within the circuit. As it remained, nonetheless, binding precedent, bankruptcy courts begrudgingly applied *Pro-Snax*.

In re Gadzooks, Inc., 352 B.R. 796 (Bankr. N.D. Tex. 2006).

In *Gadzooks*, counsel to the Equity Security Holders Committee ("H&L") performed services that were objectively reasonable at the time but proved to be ultimately unsuccessful because of a poor sales season. The Liquidating Trustee did not object to any of the individual time entries nor the rates charged, but nonetheless objected to the fees under *Pro-Snax*. Judge Hale noted a seeming conflict between *Pro-Snax*'s requirement that a court look to the benefit of the estate in determining whether professional fees are reasonable and the plain language of § 330. (Section 330(a) expressly provides that "the court shall consider, the nature, the extent, and the value of such services, taking into account . . . whether the services were necessary to the administration of, or beneficial *at the time at which the service was rendered*.") Therefore, the bankruptcy court found "that professional fees are not to be judged in hindsight."

Although the district court ultimately reversed the bankruptcy court, it noted that it is difficult to evaluate *Pro-Snax*'s reasoning for the hindsight test and that many other courts rejected the Fifth Circuit's approach. The district court found that even if it were inclined to disagree with *Pro-Snax*, it nonetheless remained the law of the circuit "unless and until it is overruled."

In re Broughton Ltd. P'ship, No. 10-42327, 2012 WL 1437289 (Bankr. N.D. Tex. April 25, 2012).

Then in 2012, another Northern District of Texas bankruptcy court chipped away at *Pro-Snax*'s harsh application. In *Broughton*, the debtor was a high end residential real estate developer who located a prospective property purchaser. The debtor engaged special counsel who commenced contract negotiations with the prospective purchaser that ultimately proved to be unsuccessful. The U.S. Trustee objected to special counsel's fee application under *Pro-Snax*.

Judge Lynn outlined "The *Pro-Snax* Problem" and pointed out that much of the work bankruptcy professionals undertake does not always lead to success—like administrative matters, operational oversight—yet the chapter 11 case could not work without these functions. Ultimately, the court

held “that a professional provides an ‘identifiable, tangible and material benefit’ to a bankruptcy estate within the meaning of *Pro–Snax* through assisting the estate representative in administering an asset of the estate, whether or not the effect of administration of the asset is enhancement of the estate, so long as the professional’s services are performed at the direction of the estate representative and the estate representative is acting in accordance with the Code and its sound business judgment.”

3. *Pro-Snax’s* detractors are vindicated

In *Woerner*, Debtor Clifford Woerner’s former partner sued debtor in state court for Woerner’s misappropriation of partnership assets. Debtors retained B&N for assistance filing their voluntary chapter 11 case. B&N provided the requisite services for any debtor in bankruptcy and represented Woerner in opposing his former partner’s lift stay and dischargeability action. B&N filed several amendments to Debtors’ schedules after Debtors failed to disclose valuable personal assets, which prompted creditors to file a motion to convert Debtors’ case to chapter 7. The motion was well taken and after conversion, B&N filed their fee application to which the U.S. Trustee and creditor objected to under *Pro-Snax*. Judge Gargotta issued an oral ruling, and citing to *Pro-Snax*, found that the majority of B&N’s time was attributed to services that did not result in a material benefit to the estate.

> *Barron & Newburger, P.C. v. Texas Skyline (In re Woerner)*, 758 F.3d 693, 696 (5th Cir. 2014)

On appeal to the Fifth Circuit, the Court of Appeals found that the bankruptcy court had properly applied *Pro-Snax* but in a special concurrence authored by Judge Prado, and joined by the panel, cautioned that the *Pro-Snax* standard may be misguided. Specifically, Judge Prado noted that *Pro-Snax* runs counter to the plain language and legislative history of § 330; put the Fifth Circuit in unnecessary conflict with sister circuits; and led to confusion within the circuit. Thus, the special concurrence urged the reconsideration of the standard in *Pro-Snax* by the Fifth Circuit *en banc*.

> *Barron & Newburger, P.C. v. Texas Skyline (In re Woerner)*, 783 F.3d 266 (5th Cir. 2015)

The Fifth Circuit granted rehearing *en banc* and unanimously adopted the prospective, “reasonably likely to benefit the estate” standard. In the *en banc* opinion, the Court of Appeals echoed many jurists and practioner’s criticisms of *Pro-Snax*—particularly its reliance on *In re Melp*, which interpreted the pre-1994 version of § 330; incongruity with the plain language and legislative intent of § 330; and divergence from other circuits.

In expanding upon the reasonable at the time standard, the Fifth Circuit instructed that “if a fee applicant establishes that its services were ‘necessary to the administration’ of a bankruptcy case or ‘reasonably likely to benefit’ the bankruptcy estate ‘at the time at which [they were]

rendered,' then the services are compensable." The Court of Appeals cited to factors like the probability of success at the time the services were rendered; the reasonable costs of pursuing the action; what services a reasonable lawyer or legal firm would have performed in the same circumstances; whether the attorney's services could have been rendered by the Trustee; and any potential benefits to the estate, while noting that ultimate success is relevant but no longer dispositive. The Fifth Circuit remanded *Woerner* to the bankruptcy court out of an abundance of caution and instructed the bankruptcy court to evaluate if B&N was entitled to fees under the new standard.

4. Application of *Woerner*

In re Saldana, 534 B.R. 678 (N.D. Tex. 2015)

Before Judge Gargotta issued his Memorandum Opinion on Remand in *Woerner*, District Judge Fish noted that while *Woerner* overturned *Pro-Snax*, the new framework does not limit a court's broad discretion to award or curtail attorney fees under § 330 taking into account all relevant factors. In *Saldana*, debtors' chapter 11 counsel performed various legal services before the case was ultimately converted to chapter 7. In denying a portion of debtors' counsel's fees, the bankruptcy court noted the "'staggering' amount of attorney's fees accumulated across the three cases in light of, among other things, 'the overall results while in Chapter 11.'" Debtors' counsel argued that was an impressible application of the old retrospective standard. After reviewing the bankruptcy court's ruling, Judge Fish concluded the bankruptcy court did apply the correct prospective standard and specifically quoted the bankruptcy court's language that "at the time" certain services were rendered it was "obvious that a chapter 11 plan just no longer was reasonable."

In re Woerner, No. 10-11365, 2015 WL 5004582 (Bankr. W.D. Tex. Aug. 21, 2015)

Along similar lines, in the Memorandum Opinion on Remand in *Woerner*, Judge Gargotta found that fees related to the Disclosure Statement and Plan were not "reasonable at the time" standard. Specifically, the bankruptcy court noted hostile relationship between creditors and Woerner that was apparent through the case, as evidenced by Woerner's pre-existing misappropriation of partnership assets that precipitated the filing of the chapter 11 case, repeated misrepresentations in schedules, Debtors' lack of credibility, and the fact that no creditor opposed the motion to convert the case to chapter 7. Given this contentious relationship, the bankruptcy court found that the case could not have proceeded to confirmation and therefore, B&N's services related to the Disclosure Statement and Plan were not reasonable at the time rendered.

In re Digerati Technologies, Inc., 537 B.R. 317 (Bankr. S.D. Tex. 2015)

In a Southern District of Texas bankruptcy case, Judge Bohm reduced fees to a debtor's counsel in an "extremely acrimonious" chapter 11 case. There were disputes about the legitimacy of the board of directors and president's chapter 11 filing, which was made clear to debtor's counsel in a failed mediation. Judge Bohm noted that while *Woerner* overturned *Pro–Snax*, it did not disturb the lodestar approach used in assessing fee applications, and that bankruptcy courts may consider in its discretion, whether the resulting lodestar amount should be adjusted to account for factors not considered during the lodestar calculation.

Judge Bohm ultimately reduced counsel's compensation because various time entries were vague; impermissibly lumped; excessive; and not necessary to case administration. Recognizing *Woerner's* new standard, Judge Bohm nonetheless found that several services were not "good gambles" at the time undertaken either because of "poor preparation and paucity of relevant and convincing testimony"; "fomented further mistrust between the debtor and creditors"; or requested relief expressly contradictory to the bankruptcy code. As in *Woerner*, the bankruptcy court reduced fees in the "Plan and Disclosure Statement" category finding that the plan in *Digerati* was unreasonable and contrary to public policy.

In re Community Home Financial Services, Inc., No. 12-01703, 2015 WL 8113699 (Bankr. S.D. Miss. Dec. 7, 2015)

In a factually similar case to *Woerner* out of the Southern District of Mississippi, Community Home Financial Services, Inc. (CFHS) entered a series of business transactions with several companies controlled by Edwards. Assisted by its properly retained counsel, CFHS filed chapter 11 petition for relief in May 2012, with Edwards being the primary creditor. The relationship between CFHS and Edwards became highly contentious, with both sides contesting each other's motions and CFHS filing an adversary proceeding against Edwards. Sometime during the chapter 11 bankruptcy, CFHS's president, without knowledge of CFHS's counsel changed the debtor's principal place of business to Panama and transferred all funds from the DIP bank accounts to banks located in Panama. The United States Trustee successfully moved for appointment of a chapter 11 trustee, and CFHS's counsel filed his fee application seeking compensation for services rendered through the appointment of the chapter 11 trustee.

Edwards specifically objected to counsel's fee application because it claimed counsel's actions did not benefit the estate, specifically that "at the time [counsel] performed services, "it was not reasonable for [counsel] to believe that the ligation activities" he was pursuing "would provide a material benefit to the estate." Noting the new standard pronounced in *Woerner*, Judge Ellington remarked that "[w]ith hindsight, it is easy to see that [the president] played [counsel] and that [counsel] had no knowledge that [the president] was plotting to the bankruptcy assets out of the country." Because counsel lacked any knowledge of the president's deleterious actions, his services were objectively reasonable at the time made and thus, compensable under § 330.

5. Going forward under *Woerner*

These cases post-*Woerner* cases emphasize that while *Pro-Snax* has been overturned; the bankruptcy court still has discretion in determining what services were reasonably likely to benefit the estate. When, at the time services are rendered, it is obvious to parties that the case has little chance of success, then courts will still find that such services are not compensable under § 330. Nonetheless, the more palatable *Woerner* standard affords counsel more latitude to make good gambles.

Panelist and litigant in *Woerner,* Steve Sather suggested the following Lessons to Be Learned from the *Woerner* remand and *Digeratti* in his popular Texas Bankruptcy Lawyer's Blog:

1. Results still matter. In the *Digerati* case, the Court said some uncomplimentary things about the lawyers but awarded them 78% of their requested fees. In the *Woerner* case, the Court had nothing bad to say about the lawyers but they only recovered 35% of their fees. The difference is that Digerati had a confirmed plan while *Woerner* had a conversion and waiver of discharge.

2. Following *Woerner*, if you find your fees challenged, be sure to explain why you thought the action you took was a good gamble. In the Digerati opinion, the Court repeatedly stated that there was no explanation of why it seemed like a good idea at the time.

3. There is a randomness to the fee application process. Judge Bohm wrote an 83 page opinion with 400 pages of supporting exhibits (thanks to his dedicated law clerks and interns). He took the time to sift through a massive fee application and document things like lumping and vague time entries. In the *Woerner* case, the U.S. Trustee appeared to take a visceral dislike of the law firm and made it their mission to say as many bad things as possible. These are both unusual cases. In the typical instance, fees are approved without objection. Thus, fee requests which could have been dramatically cut in one case pass through without objection in another.

4. In these two cases, there was no reward for exercising billing judgment. Hoover Slovacek clearly charged a below market rate in the Digerati case. If they had charged rates that were 20% higher, they would have still billed a market rate and would have recovered as much as they initially requested. In *Woerner*, Barron & Newburger aggressively no-charged time and charged a reduced rate where multiple attorneys were involved. However, in both cases, the starting point for the analysis was what the firms actually charged rather than what they could have charged. This seems to be a necessary consequence of the lodestar approach. The lesson here appears to be to bill high so that more of your fees will survive a challenge.[1]

---

[1] See Steve Sather, *After Woerner, Courts Look for "Good Gambles,"* A TEXAS BANKRUPTCY LAWYER'S BLOG (September 15, 2015), http://stevesathersbankruptcynews.blogspot.com/2015/09/after-woerner-courts-look-for-good.html (suggesting practical lessons to be learned from the Woerner remand and the Digeratti)

ASARCO (WHAT DOES "IN DEFENSE OF" MEAN?) ARE THERE VIABLE ALTERNATIVES?

In *Baker Botts LLP v. ASARCO LLC* ("***ASARCO***"),[2] the Supreme Court answered a question of great interest to bankruptcy practitioners: Does 11 U.S.C. § 330(a)(1) permit a bankruptcy court to award attorney's fees for work performed in defending a fee application? In its 6-3 opinion, the Court held that 11 U.S.C. § 330(a)(1), on its own, does not permit an award of attorney's fees for work performed in the defense of a fee application.

Although at first glance, this appears to be an issue only for professionals retained by the bankruptcy estate, *i.e.*, professionals for the Debtor or a Committee, we need to be reminded: "The Fifth Circuit applies the same standard to professionals employed by secured creditors as it does to professionals employed to represent the estate or an official committee." *In re Pan Am Gen. Hosp., LLC*, 385 B.R. 855, 868 (Bankr. W.D. Tex. 2008) (citations omitted). *See also In re: Shree Mahalaxmi, Inc.*, 522 B.R. 899, 907 (Bankr. W.D. Tex. 2014), where, in addressing to extent to which an over-secured creditor with an allowed claims was entitled to charge attorneys' fees, the bankruptcy court held:

> The reasonableness of post-petition attorneys' fees are tested under federal law. *See In re Pan Am. Gen. Hosp*., 385 B.R. at 868. In the Fifth Circuit, a three-step approach is used to determine the reasonableness of attorneys' fees for over-secured creditors: "(1) determine the nature and extent of the services supplied by the attorney with reference to the time and labor records submitted; (2) ascertain the value of the services; and (3) briefly explain the findings and the reasons upon which the award is based." *In re Pan Am. Gen. Hosp*., 385 B.R. at 868 (citing *In re Hudson Shipbuilders, Inc*., 794 F.2d 1051, 1058 (5th Cir. 1986)). Additionally, a court reviewing the reasonableness of a secured creditor's fees should consider the twelve *Johnson* factors, "the circumstances surrounding the case, the manner of its administration", and whether duplication of services occurred. *In re Pan Am. Gen. Hosp*., 385 B.R. at 869; *see also In re Cummins Utility, L.P*., 279 B.R. at 204 (quoting *Chase Manhattan Bank, N.A. v. Wonder Corp. of Am*., 82 B.R. 186, 191 (D. Conn. 1988)).

In this paper, we will address the following topics:

1. Principles with respect to compensation of bankruptcy professionals;
2. Section 330 of the Bankruptcy Code;
3. A summary of ASARCO (and its path to the Supreme Court);

[2] 135 S. Ct. 2158; 192 L. Ed. 2d 208; 2015 U.S. LEXIS 3920; 83 U.S.L.W. 4428 (2015).

4. The ruling of the Supreme Court in ASARCO;

5. Implications of ASARCO to bankruptcy professionals; and

6. How bankruptcy professionals, the Office of the United States Trustee, and courts are responding to *ASARCO*.

1. Principles of Compensation of Bankruptcy Professionals – Historical Perspective

Barron & Newburger, P.C. v. Texas Skyline, Ltd. (In re Woerner), 783 F.3d 266 (5th Cir. 2015):[3]

But "[i]n enacting section 330, Congress intended to move away from doctrines that strictly limited fee awards" and instead provide compensation "commensurate with the fees awarded for comparable services in non-bankruptcy cases." *In re UNR Indus., Inc.*, 986 F.2d 207, 208-09 (7th Cir. 1993) (citing, *inter alia*, H.R. Rep. No. 95-595, at 329-30 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6286). To that end, § 330 instructs courts to award "reasonable compensation" for "actual, necessary services" based on "the nature, the extent, and the value of such services." 11 U.S.C. § 330(a). Congress took a further step in 1994 when it "codif[ied] many of the factors previously considered by courts in awarding compensation and reimbursing expenses." 3 *Collier on Bankruptcy* ¶ 330.LH[5]; *see* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 224, 108 Stat. 4106, 4130-31 (1994).[4]

[4] For example, our circuit was among the first to conclude that the factors developed for determining reasonable attorney's fees in the non-bankruptcy context were "equally useful" in assessing bankruptcy attorney's fees. *First Colonial*, 544 F.2d at 1299 (applying factors from *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974), to a bankruptcy fee determination). Those same factors formed the foundation for the 1994 revision. *See* 3 *Collier on Bankruptcy* ¶ 330.LH[5] n.12.

In re Caplin & Drysdale Chartered v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.), 526 F.3d 824 (5th Cir. 2008)

> The bankruptcy court awarded attorney's fees pursuant to 11 U.S.C. § 330. The statute provides that the court may award "reasonable compensation for actual, necessary services, rendered by the . . . attorney." §330(a)(1)(A). The statute also provides as follows:

[3] Rather than giving a detailed factual background and a review of the rulings in various cases, for many cases, this paper simply cites relevant cases and quotes the applicable language for this topic.

In 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, including –

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

§ 330(a)(3).

> Prior to being amended in 1978, this statute [11 U.S.C. § 330] "favored economy of the estate over competitive compensation" to attorneys for the debtors. *In re Busy Beaver Bldg. Ctrs., Inc.*, 19 F.3d 833, 850 (3rd Cir. 1994). "Congress determined, it appears, that on average the gain to the estate of employing able, experienced, expert counsel would outweigh the expense to the estate of doing so, and that unless the estate paid competitive sums it could not retain such counsel on a regular basis." *Id.*; accord *In re Hillsborough Holdings*, 127 F.3d 1398, 1403 (11th Cir. 1997) (citing 124 Cong. Rec. 33,994 (daily ed. Oct. 5, 1978) (statement of Sen. DeConcini), reprinted in 1978 U.S.C.C.A.N. 6505, 6511).

In re Busy Beaver Building Centers, Inc., 19 F.3d 833, 849-50 (3rd Cir. 1994):

> The legislative history of § 330, which stems from the Bankruptcy Reform Act of 1978, P.L. No. 95-598, 92 Stat. 2549 (1978), rather than counseling a departure from the statute's plain object, amply reinforces it. The unambiguous policy inspiring § 330(a), expressed most clearly in the House Report accompanying House Bill 8200, H.R. 8200, 95th Cong., 1st Sess. (1977), is that professionals and paraprofessionals in bankruptcy cases should earn the same income as their non-bankruptcy counterparts. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 330 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6286.[22] The history nowhere speaks of

compensating professionals or paraprofessionals solely for those services which just a professional or paraprofessional can provide, but instead repeatedly refers to the billing practices of nonbankruptcy professionals, justified by the goal of retaining competent legal representation for the debtor. Congress rather clearly intended to "provide sufficient economic incentive [to lure competent bankruptcy specialists] to practice in the bankruptcy courts." In re McCombs, 751 F.2d 286, 288 (8th Cir. 1984). Congress determined, it appears, that on average the gain to the estate of employing able, experienced, expert counsel would outweigh the expense to the estate of doing so, and that unless the estate paid competitive sums it could not retain such counsel on a regular basis. With this congressional determination we are in no position to quarrel.

[22]We include the House Committee on the Judiciary's full explanation of § 330(a):

Section 330 authorizes compensation for services and reimbursement of officers of the estate. It also prescribes the standards on which the amount of compensation is to be determined. As noted above, the compensation allowable under this section is subject to the maxima set out in sections 326, 328, and 329. The compensation is to be reasonable, for actual necessary services rendered, based on the time, the nature, the extent, and the value of the services rendered, and on the cost of comparable services other than in a case under the bankruptcy code. The effect of the last provision is to overrule In re Beverly Crest Convalescent Hospital, Inc., 548 F.2d 817 (9th Cir. 1976, as amended 1977), which set an arbitrary limit on fees payable, based on the amount of a district judge's salary, and other, similar cases that require fees to be determined based on notions of conservation of the estate and economy of administration. If that case were allowed to stand, attorneys that could earn much higher incomes in other fields would leave the bankruptcy area. Bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, would be driven elsewhere, and the bankruptcy field would be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service. Bankruptcy fees that are lower than fees in other areas of the legal profession may operate properly when the attorneys appearing in bankruptcy cases do so intermittently, because a low fee in a small segment of a practice can be absorbed by other work. Bankruptcy specialists, however, if required to accept fees in all of their cases that are consistently lower than fees they could receive elsewhere, will not remain in the bankruptcy field.

This subsection provides for reimbursement of actual, necessary expenses. It further provides for compensation of paraprofessionals employed by professional persons employed by the estate of the debtor. The provision is included to reduce the cost of administering bankruptcy cases. In nonbankruptcy areas, attorneys are

> able to charge for a paraprofessional's time on an hourly basis, and not include it in overhead. If a similar practice does not pertain in bankruptcy cases, then the attorney will be less inclined to use paraprofessionals even where the work involved could easily be handled by an attorney's assistant, at much lower cost to the estate. This provision is designed to encourage attorneys to use paraprofessional assistance where possible, and to insure that the estate, not the attorney, will bear the cost, to the benefit of both the estate and the attorneys involved.
>
> H.R. REP. NO. 595 at 329-30, reprinted in 1978 U.S.C.C.A.N. at 6286.

In re Hillsborough Holdings Corp., 127 F.3d 1398, 1403 (11th Cir. 1997):

> Before 1978, courts applied "the spirit of economy" as a factor to be weighed in awarding attorneys' fees in bankruptcy cases. *See In the Matter of First Colonial Corp. of Am.,* 544 F.2d 1291, 1299 (5th Cir.), *cert. denied,* 431 U.S. 904, 97 S. Ct. 1696, 52 L. Ed. 2d 388 (1977); 3 *Collier on Bankruptcy,* P 330.04[3][a] (Lawrence P. King, *et al.*, eds., 15th ed.1997). Congress rejected this factor when it enacted the Bankruptcy Reform Act of 1978. Congress concluded that taking economy into account interfered too much with the policy of encouraging skilled professionals to participate in bankruptcy cases:
>
> > Attorneys' fees in bankruptcy cases can be quite large and should be closely examined by the court. However bankruptcy legal services are entitled to command the same competency of counsel as other cases. In that light, the policy of this section is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under title 11.... Notions of economy of the estate in fixing fees are outdated and have no place in a bankruptcy code.
> >
> > 124 Cong. Rec. 33,994 (daily ed. October 5, 1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6511; *see also In re Busy Beaver Bldg. Ctrs., Inc.,* 19 F.3d 833, 850 (3d Cir.1994) ("Congress determined, it appears, that on average the gain to the estate of employing able, experienced, expert counsel would outweigh the expense to the estate of doing so, and that unless the estate paid competitive sums it could not retain

such counsel on a regular basis."); 3 *Collier on Bankruptcy,* P 330.04[3][b] (Lawrence P. King, et al., eds., 15th ed. 1997) ("The economy factor was abandoned under the Bankruptcy Code in favor of the new policy that attorneys engaged in bankruptcy cases should receive compensation in parity with that received by attorneys performing services in comparable situations.").

2. Section 330 of the Bankruptcy Code – Compensation of Officers

Section 330(a)(1) of the Bankruptcy Code provides as follows:

§ 330. Compensation of officers

(a) (1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103 –

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3) In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including –

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(4) (A) Except as provided in subparagraph (B), the court shall not allow compensation for –

(i) unnecessary duplication of services; or

(ii) services that were not –

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.

(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application.

(7) In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326.

3. A summary of ASARCO (and its path to the Supreme Court)

A. The Bankruptcy Case

Originally organized in 1899 as American Smelting and Refining Company, ASARCO was one of the leading producers of copper and one of the largest nonferrous metal producers in the United States. ASARCO was a subsidiary of ASARCO Inc., itself a subsidiary of Americas Mining Corporation, which is owned by Grupo Mexico.

In August 2005, faced with recovering from a long downturn in the copper market, labor strikes at its copper-mining and smelting facilities, $490 million in bond debt and lease obligations, a recent credit downgrade, substantial federal and state environmental claims, and more than 95,000 asbestos-related personal-injury claims pending against it, ASARCO and its subsidiaries filed chapter 11 petitions. Baker Botts LLP ("Baker Botts") and Jordan, Hyden, Womble, Culbreth & Holzer ("Jordan Hyden") were retained as bankruptcy counsel pursuant to Section 327(a) of the Bankruptcy Code.

Within two months after the chapter 11 was filed, ASARCO's CEO resigned, as did all of its board members except one, who was replaced the following month due to conflicts of interest. With the new board in place, in February 2007, Baker Botts and Jordan Hyden filed fraudulent transfer claims against ASARCO's parent-related entities which ultimately resulted in a multi-billion dollar judgment against the parent, which in turn facilitated a Parent-proposed chapter 11 plan. The Parent Plan was confirmed over two competing plans – a Debtor-Plan and a creditor-sponsored Plan.

Under the confirmed Parent Plan, the Parent retained equity ownership of the Debtor. Creditors other than Asbestos Claimants received 100% of the principal on their claims in cash and interest on their claims through the date of payment in cash. The Asbestos Claimants received, through a section 524(g) trust, a $500 million cash payment at confirmation, a $280 million one-year secured, interest-bearing promissory note, plus approximately $137 million in post-petition interest, together with $27.5 million paid as an allowed administrative claim, and the right to pursue certain insurance coverage actions. The Parent waived repayment of outstanding amounts under the intercompany DIP that was provided to the Asbestos Subsidiaries. Bondholders received interest at the contract rate, as did any other claimant who was entitled to a contract rate.

Although a Plan Administrator was appointed to effectuate the confirmed chapter 11 Plan, the Parent Plan provided that the Parent had the right to appoint the directors and officers of reorganized ASARCO.

After the confirmation of the Parent Plan, Baker Botts and Jordan Hyden filed their final fee applications pursuant to Section 330(a) of the Bankruptcy Code. Jordan Hyden sought total lodestar fees of $7,009,305.05, as well as a 20% enhancement of $1,401,861.00, plus approval of

expenses of $357,100.06. Baker Botts sought final approval for $135,870,714.58 in fees and $6,046,135.06 in expenses, (which included $22,645,119.10 for a 20% additional hourly rate adjustment over the total lodestar fees), plus $8,004,920.50 in fees and $457,443.83 in expenses incurred by the Firm in preparing and defending the Fee Application.

Reorganized ASARCO, once again under the control of its parent, objected to the fee enhancement relief portion of the application of Jordan Hyden. With respect to the Baker Botts application, Reorganized ASARCO objected to: (1) the fees charged; (2) any additional compensation over and above the total lodestar fees; and (3) any fees and expenses for the preparation and defense of the fee application. The United States Trustee objected only to the fee enhancement portion of the Baker Botts application, asserting that the maximum fee enhancement should be limited to 5% of the total lodestar fee amount.

In considering the fee applications, the bankruptcy court noted where the case had started as well as its successful conclusion:

> 12. When ASARCO filed its bankruptcy case on August 9, 2005, "the prospects of reorganization were slim." "[T]he [C]ompany had essentially run out of cash and was saddled with massive environmental liability, financial debt, potential asbestos-related liability, falling copper prices, and a striking workforce." Creditors were expected to receive cents on the dollar, if anything, because ASARCO's assets were severely depleted and the claims against it were extraordinarily high. Environmental, asbestos, and toxic-tort claims alone were more than $10 billion. The history of this case is well documented in this Court's Recommendation to the District Court on plan confirmation.
>
> 13. Baker Botts faced significant hurdles from the outset of these cases. Following ASARCO's bankruptcy filing, all of the Company's prepetition directors and its chief executive officer were forced to resign. ASARCO had little cash, no debtor-in-possession financing, and no financial advisor. It also was in the midst of a labor strike. There was a significant possibility that these chapter 11 cases would be converted to chapter 7 cases and the Debtors would be forced to liquidate, placing professionals like Baker Botts at substantial risk of non-payment.

In re ASARCO, LLC, 2011 Bankr. LEXIS 5487, at [*14-15] (Bankr. S.D. Tex. 2011) (July 20, 2011).

> 11. The results obtained in these cases are nothing short of extraordinary. This Court has said that the ASARCO bankruptcy case "is probably the most successful Chapter 11 of any magnitude in the history of the Code." Baker Botts contributed significantly to the success of these cases. Baker Botts performed in an extraordinary fashion in numerous areas, but perhaps most notably in trying

and obtaining a multi-billion-dollar judgment against ASARCO's parent company, Americas Mining Corporation ("AMC," and together with ASARCO Incorporated, a Delaware corporation controlled by AMC, the "Parent"). Creditors ultimately received payment in full of all claims, plus post-petition interest and allowed attorneys' fees. Such an extraordinary result would have seemed far fetched at the outset of these cases.

14. Baker Botts acted quickly to assist ASARCO in resolving its corporate governance issues, obtaining debtor-in-possession financing, retaining a financial advisor, and settling the strike. Each of these steps was critical to save ASARCO from liquidation and put it on the path toward reorganization.

15. Over the next four years, the Debtors and Baker Botts "continuously moved this case toward the confirmation of a plan that resulted in the best possible recovery for creditors – full payment."[8] Baker Botts' outstanding achievements are described below.

[8] Amended Report and Recommendation, at 4.

16. First, Baker Botts obtained a multi-billion-dollar judgment against AMC relating to the sale of ASARCO's controlling ownership interest in Southern Copper Corporation ("SCC"). The judgment obtained by Baker Botts against AMC is likely the largest fraudulent transfer judgment in chapter 11 history.

17. Second, Baker Botts conceived, recommended, and commenced an innovative auction of the multi-billion-dollar judgment against AMC that, under the Debtors' unique plan structure, exposed the Parent to the possibility that it could both lose the Company and have to pay the judgment in full.

18. Third, Baker Botts worked closely with ASARCO and Barclays Capital Inc. ("Barclays") to develop and implement a process to auction the Debtors' assets that resulted in the selection of a plan sponsor that vigorously competed with the Parent. When, as a result of the worldwide financial crisis in September and October of 2008, that plan sponsor repudiated the parties' deal, Baker Botts worked closely with ASARCO and Barclays to renegotiate the parties' contract to maintain this critical competition for the Debtors' assets.

19. Fourth, in addition to obtaining a multi-billion-dollar judgment against AMC, Baker Botts litigated and reclaimed the Mission South Mill (the "South Mill"), a valuable and important component of ASARCO's mining operations, and prosecuted a complicated tax adversary proceeding, the result of which led to creditors receiving the benefit of an approximately $60 million tax

refund. These results increased ASARCO's profitability and made the Company far more attractive to potential buyers and ultimately more valuable to the Parent.

20. Fifth, Baker Botts significantly reduced the claims faced by the Debtors. The United States Department of Justice, Environment and Natural Resources Division (the "DOJ"), has described the ASARCO case in a press release as "the largest environmental bankruptcy in U.S. history." Baker Botts, through estimation and settlement resolved billions of dollars in environmental, asbestos, and toxic-tort claims, along with the claims related to the Mission Mine – all on terms favorable to the Debtors. These results liquidated the Debtors' liabilities in a substantially diminished amount and made ASARCO even more desirable to potential buyers.[9]

[9] The Debtors entered bankruptcy with over $10 billion of asserted historical debts. They exited bankruptcy under a confirmed full-payment plan of reorganization with no historical debts other than a one-year $280 million note to a section 524(g) asbestos trust, $200 million of which Reorganized ASARCO prepaid in the first quarter of 2010. Baker Botts Exhibit 71, Grupo Mexico First Quarter 2010 Results, at 5.

21. Finally, Baker Botts played a significant role in repairing the severed relationship ASARCO had with its workforce when it assisted the Company in settling the 2005 strike, negotiating a new collective bargaining agreement with the unions, and resolving a number of problems that had arisen in connection with employee benefit and pension plans.

22. During the course of these cases, ASARCO was transformed from a broke and broken company to a reorganized ASARCO, cleansed of its historical liabilities and well-positioned to compete effectively in the world of commerce. Under the guidance of Baker Botts, the Company reformed its corporate governance, dramatically improved its operations, and substantially reduced its liabilities.

23. Baker Botts' expert, retired bankruptcy lawyer Paul Wickes, explained that he is "not aware of a case in which the ultimate result was so much better than what would have been expected at commencement." The Court agrees. ASARCO's bankruptcy is truly a rags-to-riches story.

Id., at [*13–*18].

The bankruptcy court had similar praise for the work performed by Jordan Hyden in the opinion on its fee application. *See In re ASARCO, LLC*, 2011 Bankr. LEXIS 2880, at [*8 - *12] (Bankr. S.D. Tex. 2011) (July 20, 2011). The bankruptcy court awarded Jordan Hyden its expenses and its lodestar fees, but only a 10% increase in fees related to the SCC Fraudulent Transfer

Litigation, or $125,831.00, plus reasonable fees and expenses of $15,035.74 in connection with the defense of its fee application, and awarded post-judgment interest. *In re ASARCO, LLC*, 2011 Bankr. LEXIS 2880, at [*45 - *48] (Bankr. S.D. Tex. 2011) (July 20, 2011).

With respect to the Baker Botts fee application, the bankruptcy court, after extensive discovery and a six-day hearing, approved and allowed $117,613,158.44 in fees and $6,046,135.06 in expenses for services performed and expenses incurred by Baker Botts during the Application Period, which included $4,161,708.96 as an enhancement "because there are rare and extraordinary circumstances in these cases and Baker Botts' services in the SCC litigation were instrumental in producing the exceptional results that were unanticipated at case commencement." The bankruptcy court also approved $5,000,000.00 in fees and $457,443.83 in expenses incurred by Baker Botts in preparing and defending the Fee Application through July 13, 2010. Finally, the bankruptcy court found that in the event of an appeal, Baker Botts may file a supplemental fee application. *In re ASARCO, LLC*, 2011 Bankr. LEXIS 5487, at [*130 - 131] (Bankr. S.D. Tex. 2011) (July 20, 2011).

B. The District Court

Reorganized ASARCO and the office of the United States Trustee appealed these compensation orders to the District Court. The District Court viewed the primary issue as dealing with the fee enhancement awards:

> The primary question before the Court is:
>
> Should a well-compensated law firm that performed superbly in a hotly contested adversary proceeding, and whose client, the debtor, received an extremely favorable result, receive compensation in addition to its agreed upon and approved professional rates, due to the benefit the result conferred upon the estate?

ASARCO, LLC v. Baker Botts, LLP and Jordan, Hyden, Womble, Culbreth & Holzer, P.C. (In re ASARCO, LLC), 477 B.R. 661, 664 (S.D. Tex. 2012). The district court affirmed the award for the fee enhancement award, but reversed and remanded the award for the fees and expenses awarded for the preparation and defense of the fee application to the extent that Baker Botts had included in that award any fees or expenses related to Baker Botts' pursuit of either the fee enhancement or for any amounts Baker Botts had to expend to correct its own inaccurate, vague or non-compliant time records. Finally, the district court reversed the award of post-judgment interest.

In the parallel case on the appeal with respect to the Jordan, Hyden fee award, *ASARCO, LLC v. Baker Botts, LLP and Jordan, Hyden, Womble, Culbreth & Holzer, P.C. (In re ASARCO, LLC)*, 2012 U.S. Dist. LEXIS 118458 (S.D. Tex. 2012), the Court affirmed the 10% enhancement awarded by the bankruptcy court, as well as the fees and expenses awarded in connection with the preparation and defense of the fee application, but denied the award of post-interest.

C. The Fifth Circuit Court of Appeals

ASARCO appealed the district court's rulings to the Court of Appeals for the Fifth Circuit, which framed the issues as follows:

> [W]hether the bankruptcy court abused its discretion in authorizing a 20% premium to Baker Botts and 10% premium to Jordan Hyden for their unusually successful fraudulent transfer litigation; and whether the bankruptcy court was authorized, consistent with 11 U.S.C. § 330, to award attorneys' fees to the firms for defending their fee applications in court.

ASARCO, LLC v. Jordan Hyden Womble Culbreth & Holzer, P.C. (In the Matter of: ASARCO, LLC), 751 F. 3d 291, 293 (5th Cir. 2014). The Court affirmed the awards of fee enhancements for both law firms for the "rare and exceptional" results obtained in the bankruptcy case, but reversed the awards of fees for litigating the firms' fee applications on the basis that Section 330(a) of the Bankruptcy Code "does not authorize compensation for costs counsel or professionals bear to defend their fee applications." *Id.*, at 299.

The Fifth Circuit first referred to the procedure for fee approvals which requires notice and a hearing. According to the Court: "Implicit in this procedure is the possibility of fee litigation." 751 F.3d at 299. Because fees are compensable only if they are likely to benefit the bankruptcy estate or are necessary to case administration, and since the professional is the beneficiary of the fee litigation, the Court reasoned, such fees are not compensable. Further, although compensation is expressly permitted under Section 330(a)(6) for "preparation of a fee application," the defense of a fee application in a court hearing, which is entirely different, is not compensable since it was not expressly listed by the Code as being compensable.

Second, the Court held that the defense of a fee application was not a "reasonable and necessary aspect of estate administration." The Court rejected the reasoning of *In re Smith*, 317 F.3d 918 (9th Cir. 2002) and chose instead to follow the more narrow view of *Grant v. George Schumann Tire & Batt. Co.*, 908 F.2d 874 (11th Cir. 1990), which held that they were not.

The Court viewed "requiring professionals to defend fee applications as a cost of doing business is consistent with the reality of the bankruptcy process." The Court added in footnote 7: "When firms become aware that they may not be reimbursed for defending core fee applications, they can anticipate this possibility in their hourly rates and by thoroughly documenting fee applications." 751 F. 3d at 301.

Before addressing the practical concern raised by the bankruptcy court that if "fees for the defense of fees" were not permitted, there would an incentive for parties in interest to "mount objections to extract a fee reduction" and that the prospect of having to defend such objections, without any compensation for doing so, might lead to competent counsel refraining from handling bankruptcy cases, the Court voiced its concern that professionals in a bankruptcy case

share "the mutual goal of securing approval of their fees" so that they "enter into a conspiracy of silence" so as not to object to each other's fee applications. Addressing the concern that preventing a professional from being compensated for defending a fee application would encourage "tactical or ill-supported objections to fee applications," the Court stated:

> Section 330's capacious reasonableness and necessity standards shield even many unsuccessful professional actions in bankruptcy from attempts at fee reduction. We are confident that bankruptcy courts, practicing vigilance and sound case management, can thwart punitive or excessively costly attacks on professional fee applications. Where appropriate, the courts should not hesitate to implement the exception to the American Rule that allows fee shifting where an adverse party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45-46, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991); *In re Frazin, supra*, 413 B.R. at 403. (No issues falling within *Chambers* were raised in response to reorganized ASARCO's fee objections here.)

751 F. 3d at 302.

4. The ruling of the Supreme Court in *ASARCO*

The Supreme Court held that 11 U.S.C. § 330(a)(1) does not, on its own, permit a bankruptcy court to award attorney's fees for work performed in defending a fee application, at least when the objection to the fee application is filed by an estate administrator.

The Supreme Court commenced its analysis by first stating 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." Second, the Court recognized that departures from the established American Rule require "specific and explicit provisions for the allowance of attorneys' fees in selected statutes."

The majority then held that the language of § 330(a)(1) of the Bankruptcy Code is insufficient to warrant displacing use of the American Rule in fee-defense litigation. Specifically, the Court determined that the phrase in § 330(a)(1) permitting bankruptcy courts to award "reasonable compensation for actual, necessary services rendered" does not "specifically nor explicitly authorize courts to shift the costs of adversarial litigation from one side to the other." Rather, the Court held that the qualification of this phrase by the word "services" requires that the fees sought must be as "labor performed for" the client. The Court rejected the law firms' contention that the "reasonable compensation for services rendered" provision encompassed fees incurred litigating a fee application since those services were for the benefit of the law firm and not the client. Specifically, the Court concluded that "[t]ime spent litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described as … 'disinterested service to' … that administrator." Thus, the majority flatly rejected Debtor's counsel's argument that the phrase "services rendered" encompassed even "adversarial" fee-defense litigation. Specifically,

the majority noted that Debtor's counsel's reading would render even time spent on an unsuccessful fee-application defense compensable because the statute lacks any language directing fee shifting to a "prevailing party."

The majority also specifically rejected the Government's theory, which was accepted by the dissent, that although defense of a fee application does not itself qualify as a "service," it remains compensable as part of the underlying services in the bankruptcy case, or "as a component of 'reasonable compensation." The dissenting opinion, written by Justice Breyer, argues that disallowing compensation for time spent defending a fee application merely dilutes the compensation for the otherwise compensable "services rendered" in the underlying proceeding. The majority, however, dismissed this argument in favor of strict statutory interpretation and stated that reading the dilution argument into the statute would ignore § 330(a)(1)'s requirement that the services—to the client—be "actual and necessary." Because litigation in defense of a fee application is not a "service" within the meaning of §330(a)(1), the Court ruled, the contested award was not "compensation" for a "service." Further, the majority found that just because time spent preparing a fee application is compensable under § 330(a)(6) does not render the time spent defending the fee application equally compensable. Rather, the Court held that those actions are inherently different because preparation of the fee application is a service to the estate and one that non-bankruptcy professionals are not required to do; whereas, defense of a fee application is a service to the professional itself and is not ordinarily compensable even outside of bankruptcy law.

In finding that § 330(a)(1) does have the necessary "specific and explicit provision" to displace the American Rule, the Court stated that it refused "to invade the legislature's province by redistributing litigation costs here." In summary, the Court held that if Congress had wanted to allow compensation for fee-defense litigation, it could have provided for it, but Congress did not. The majority (absent J. Sotomayor) found that any policy reasons weighing in favor of allowing compensation for defense of fee applications to bankruptcy practitioners specifically are not sufficient for the Court to use "roving authority" to rewrite the statutes and directives of Congress, regardless of the statute's potentially harsh impact on bankruptcy practitioners.

As such, the Court held that labor performed in defending counsel's own fee application against an objection by the estate administrator was not a "labor performed for" or service to the client and is therefore not compensable under § 330(a)(1).

5. Implications of *ASARCO* to Bankruptcy Professionals

The initial reaction to ASARCO among bankruptcy professionals was largely negative. The primary concerns raised are:

(1) As raised in the Fifth Circuit decision, if fees for the defense of fees are not permitted, there may be an incentive for parties in interest to "mount objections to extract a fee reduction";

(2) Because the terms “reasonable fees” or “reasonable compensation” and “the nature, the extent, and the value of such services” are rather broad and subjective, sanctions for unwarranted objections are not a sufficient deterrent;

(3) Congressional intent of compensation parity between bankruptcy and non-bankruptcy professionals is further thwarted if bankruptcy professionals are now subjected to uncompensated fee litigation resulting from non-client fee objections – unlike substantially any other area of the legal profession – since such uncompensated fee litigation, even if unsuccessful, necessarily will dilute the fees of bankruptcy professionals relative to the fees received by professionals in other practice areas; and

(4) Bankruptcy judges, who are on the front line and in the best position to apply the various factors in determining “reasonable compensation” considering “the nature, the extent, and the value of such services,” lose some discretion and flexibility in restraining the unwarranted filing and litigation of fee objections if they are not able to award compensation for the meritorious defense of a fee application.

6. **How bankruptcy professionals, the Office of the United States Trustee, and Courts are responding to *ASARCO*.**

A. Bankruptcy professionals.

(1) Modifying engagement letters to provide for the payment of fees for the defense of fee applications.

(a) *In re Boomerang Tube, LLC*, Case No. 15-11247(MFW)

(**b)** *In re Northshore Mainland Services, Inc.*, Case No. 15-11402(KJC) (sometimes referred to as “*Baha Mar, Ltd.*”)

In *Boomerang* (Dkt. # 271) and in *Northshore* (Dkt. # 284), counsel for the official committee of unsecured creditors in each case sought to be employed under Section 328(a) instead of under Section 327(a). Further, in each case, as a term and condition of their employment contract, to be indemnified and entitled to payment from the bankruptcy estate, subject to approval by the bankruptcy court, any fees, costs or expenses arising out of the successful defense of any fee application in response to any objection to its fees or expenses that may be filed in these chapter 11 cases.

These applications drew an objection from the United States Trustee in both *Boomerang* (Dkt. # 314) and in *Northshore* (Dkt. # 356), who contended:

- Section 328(a) creates no exception to the general prohibition of the American Rule against shifting fees;

- The fee defense provisions cannot be approved under Section 328(a) because they seek to pay professionals for work that is not within the scope of their employment;

- The fee defense provisions cannot be approved under Section 328(a) because they are not reasonable;

- *ASARCO* directly bars the fee defense provisions because all compensation must be approved for final payment under Section 330; and

- The parties cannot "consent" to unauthorized compensation.

In its objection in *Northshore*, the United States Trustee broke down the first point into two subcategories:

- Section 328(a) creates no exception to the general prohibition of the American Rule against shifting fees.

  - ❖ Section 328(a) is not a fee-shifting statute

  - ❖ The fee defense provisions are not a "contract"

In both *Boomerang* and *Northshore*, the bankruptcy courts approved the retention applications, but avoided having to resolve the effectiveness of the contractual workaround. In *Boomerang*, the Court expressly took the contested contractual provision under advisement (Dkt. # 391), while in *Northshore*, the Retention Order provided that "nothing in the Application shall supersede any provisions of the Bankruptcy Code during the pendency of the Debtors' chapter 11 cases; provided further, however, that to the extent the Application is inconsistent with this Order, the terms of this Order shall govern." (Dkt. # 398).

Opinion of Bankruptcy Court in *Boomerang*.

In a 22-page opinion rendered by Judge Mary Walrath on January 29, 2016 (Dkt. # 860), the court sustained the objections of the United States Trustee to the fee defense provisions of the retention applications, and ruled as follows:

- **Effect of *ASARCO***

  The Committee had asserted that *ASARCO* did not prohibit the fee defense provisions because the Supreme Court found only that section 330(a) did not contain an express statutory exception to the American Rule, but it was seeking approval of the fee-shifting provision under section 328(a), and that section 330(a) expressly provides that "subject to sections . . . 328 . . . , the court may

award . . . reasonable compensation for actual, necessary services rendered by the [professional].”

The bankruptcy acknowledged that although section 328 is an exception to section 330, section 328, 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 328 does not provide a statutory exception to the American Rule and cannot provide authority for approval of the fee defense provisions.

In re Boomerang Tube, Inc., No. 15-11247, 2016 WL 385933, at *2 (Bankr. D. Del. Jan. 29, 2016).

- **Retention Agreement as a “Contract Exception” to the American Rule.**

The Committee also contended that the Supreme Court in *ASARCO* acknowledged that, in addition to the statutory exception, there was a contract exception to the American Rule, and its retention agreement fell within that exception. The court agreed with the Committee that the contract exception was not precluded by *ASARCO*, but held that the parties cannot, by contract, violate a statutory provision of the Bankruptcy Code, but that any such contract must be consistent with the other provisions of the Bankruptcy Code. Here, the court held that the retention agreement was not a contractual exception to the American Rule because:

- ➢ It was a two-party contract (between the Committee and its counsel) and could not bind the bankruptcy estate (a third party) to pay the costs of defending their fee applications; and
- ➢ Bankruptcy courts have an independent obligation to review the terms of any contract for reasonableness and for compliance with other provisions of the Bankruptcy Code.

- **Approval under Section 328(a).**

  The UST contended that even if *ASARCO* did not directly preclude approval of the fee defense provisions, they cannot be approved because they are not "reasonable terms and conditions of employment" of a committee professional employed under section 1103 (as requires by section 328(a)) since all of the terms of employment must relate to the services to be rendered by the professionals in the representation of the committee and its interests. Adopting language from *ASARCO*, the UST argued that fee defense activates would not be a service rendered for and bon behalf of the Committee but instead would be for the committee professionals.

  The court agreed with the UST, and held that the fee-defense provisions in the retention agreement were not "reasonable terms for the employment" of counsel for the committee because they did not involve any services for the committee but rather were serves to the performed by counsel for the committee only for their own interests. Similarly, the court held that indemnification provisions also were not reasonable terms of employment. Finally, the court held that regardless of whether committee counsel defended its own fee application or incurred an "expense" in retaining outside counsel to defend the fee application was a distinction without a difference.

In a footnote at the conclusion of the opinion, presumably to give guidance to bankruptcy professionals for debtors and other parties who seek compensation from the bankruptcy estate in future cases, Judge Waldrath noted:

> 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.

Id. at *8 n.6.

Note: On the Debtor's motion, the Court dismissed the *Northshore* bankruptcy case on January 12, 2016 (Dkt. # 600). The Order of Dismissal contained the following provision:

> 4. The Debtor shall satisfy all outstanding Professional Fee Claims in amounts agreed upon between the Debtor and each professional, without

> the need for such professionals to file any further applications with the Court (including final fee applications).

Accordingly, *Northshore* will not provide any guidance on the issues related to whether that contractual "workaround" for estate professionals would be effective.

In *Samson Resources Corp.*, Judge Sontchi applied *Boomerang Tube* to debtor's counsel one week after Judge Walrath's opinion. In his letter ruling, Judge Sontchi expressly agreed with and endorses the reasoning of Judge Walrath in *Boomerang Tube*. *In re Samson Resources Corp*., Case No. 15-11934 (D. Del.) (Dkt. # 641).

(2) Increasing Rates.

(a) Overall Rates. In its opinion, the Fifth Circuit remarked that bankruptcy professionals should anticipate defending fee applications as a part of their representation and take that possibility into account when setting their hourly rates:

> In the absence of explicit statutory guidance, requiring professionals to defend their fee applications as a cost of doing business is consistent with the reality of the bankruptcy process.[7]
>
> [7] When firms become aware that they may not be reimbursed for defending core fee applications, they can anticipate this possibility in their hourly rates and by thoroughly documenting fee applications.

751 F.3d at 301.

Although the issue was raised during oral argument at the Supreme Court,[4] the Supreme Court did not address in its opinion whether bankruptcy professionals could adjust their rates to accommodate for the increased costs associated with uncompensated

---

[4] During the Government's argument on behalf of the Office of the United States Trustee, Justice Scalia suggested that debtors' attorneys could raise their rates to account for the litigation risk associated with bankruptcy fee applications:

> Scalia, J.: [. . .] I assume that the [hypothetical] lawyer's fees are set at a high enough level that it – that they take into account the fact that sometimes you will have to litigate the fees.
> Fletcher: That's true.
> Scalia, J.: And why can't bankruptcy lawyers do the same thing?

The Government responded that such a fee increase would be contrary to bankruptcy policy:

> Fletcher: Well, I think that would be contrary to the policy of the – of the bankruptcy statute and *[sic]* Section 330(a) in particular.

Transcript of Oral Argument at 23-24, *Baker Botts L.L.P. v. ASARCO LLC*, 135 S.Ct. 2158 (2015), quoted in the Retention Application of Baker Botts LLP in *In re New Gulf Resources, LLC*.

fee-application defense in bankruptcy cases. As noted herein, the office of the United States Trustee opposes such rate adjustments.

(b) Base rate / Premium Rate – *In re New Gulf Resources, LLC*, Case No. 15-12566 (BLS).

In *ASARCO*, Baker Botts stated that its standard bankruptcy rate was less than its premium rate,[5] and the bankruptcy court found that "[t]he rates charged by Baker Botts were below market rate because the Firm customarily collects premium rates or enhancements in non-bankruptcy representations."[6] In ASARCO, the fee enhancement that was sought was the time charged at the firm's "premium rate." Baker Botts requested, and the bankruptcy court granted, a fee enhancement calculated by increasing Baker Botts' standard hourly rate by 20%.[7]

In its retention application in *New Gulf Resources* (Dkt. # 54), with respect to professional compensation, Baker Botts stated that in accordance with guidance from the Supreme Court and the Fifth Circuit, it modified its postpetition fee structure to account for the uncertainties associated with payment of its fees in connection with its representation of a debtor in a bankruptcy case. Baker Botts stated that it increased its aggregate fees charged at its discounted standard rate by 10% (the "Fee Premium"), but agreed not to charge the Fee Premium under two conditions:

> First, although the Fee Premium will be earned as services are provided, no portion of the Fee Premium will be payable until and unless the Bankruptcy Court enters an order approving Baker Botts' final fee application. Second, Baker Botts will waive its right to the entire Fee Premium if, and only if, Baker Botts does not incur material fees and expenses defending against any objection with respect to an interim or final fee application. If Baker Botts incurs material fees or expenses, Baker Botts will not waive the Fee Premium regardless of the outcome of the objection. The Bankruptcy Court will make the determination as to whether any such fees and expenses are in fact material for the purposes of

---

[5] In ruling on Baker Botts' fee application, the bankruptcy court noted: "Billing and collecting premium rates is part of Baker Botts' billing practice and a material component of the Firm's revenues. While Baker Botts' average rates are at the lower end of the spectrum relative to its primary competitors, between 15% and 20% of the Firm's production is billed at a premium to standard rates (an average of approximately 16% in years 2005 to 2009). Premiums are billed and collected by Baker Botts for several reasons, but in general Baker Botts' clients agree to pay a premium because of the exceptional effort, significant result, or specialized skill of the Baker Botts lawyers involved in the representation." 2011 Bankr. LEXIS 5487, at [*55-*56].

[6] 2011 Bankr. LEXIS 5487, at [*114].

[7] 2011 Bankr. LEXIS 5487, at [*114-*115].

> the Fee Premium. The Debtors' ability to object to, dispute, or otherwise challenge Baker Botts' fees is fully preserved.

Baker Botts asserted that this proposed fee structure fairly compensates Baker Botts for the litigation risk associated with collection of its fees incurred as Debtors' counsel and comports with the Supreme Court's recent ruling in *Baker Botts L.L.P. v. ASARCO LLC*, 135 S.Ct. 2158 (2015), which, Baker Botts asserts held only that the Bankruptcy Code prohibited debtors' counsel from seeking reimbursement of fees incurred defending fee applications, but did not prohibit debtors' attorneys from taking into account the possibility of fee litigation when setting rates for a bankruptcy case.

The office of the United States Trustee objected to the Baker Botts retention application (Dkt. # 116) on the following grounds:

- The Fee Premium violates the Bankruptcy Code's comparability standard;
- The Fee Premium is a direct attack on *ASARCO*, repackaged; and
- The Fee Premium is a windfall for Baker Botts and chills the rights of parties to litigate fees in good faith.

The bankruptcy court approved the retention application (Dkt. # 173), but with this reservation:

> 5. Consideration, authorization and approval of the provisions authorizing the Fee Premium, if any, are subject in all respects to further order of the Court after notice and a hearing, and all rights of the Ad Hoc Committee, the Debtors, the U.S. Trustee, and Baker Botts, with respect to the Fee Premium – whether in opposition to or support of – on any grounds are fully reserved." (Dkt. # 173).

On January 19, 2016, the court entered an order approving the retention of Baker Botts and providing that "approval of the provisions authorizing the Fee Premium, if any, are subject in all respects to further order of the court after notice and hearing." Thus, the court reserved the issue for later determination.

On February 1, 2016, the court issued a letter to counsel indicating that it had withheld its ruling on the fee premium because the issue was fully briefed and pending before another court in the district. Then on March 16, 2016, the court issued a Letter Ruling in which Judge Shannon stood by his earlier determination that such a fee structure runs afoul of the holdings in *Asarco* and *Boomerang*. (Dkt. # 395).

After Judge Shannon's letter ruling, now three Delaware bankruptcy judges have rejected attempts to work around *ASARCO*. Since these decisions came out of Delaware, a venue with a reputation for being friendly to complex restructurings, it sends a strong signal that *ASARCO* will be strictly enforced.[8]

(3) Retention Application filed pursuant to Section 328(a) instead of Section 327(a).

Section 328(a) provides as follows:

> The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, 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. *Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.*

11 U.S.C. § 328(a) (emphasis added). As set forth in *ASARCO, LLC v. Barclays Capital, Inc. (In the Matter of: ASARCO, LLC)*, 702 F.3d 250 (5th Cir. 2012), courts face a "high hurdle" to modify, after the fact, the terms of a retention agreement previously approved by the bankruptcy court:

> We have repeatedly interpreted § 328(a) as meaning precisely what it says: A professional may be retained on any reasonable terms; but, once those terms have been approved pursuant to § 328(a), the court may not stray from them at the end of the engagement unless developments subsequent to the original approval that were incapable of being anticipated render the terms improvident. *See Coho Energy*, 395 F.3d at 204-05; *In re Barron*, 325 F.3d 690, 693 (5th Cir. 2003) (*Barron II*); *Barron I*, 225 F.3d at 586 (admonishing the bankruptcy court for failing to rely "upon the plain language of" § 328(a)); *see also In re Nucentrix Broadband Networks, Inc.*, 314 B.R. 574, 580 (Bankr. N.D. Tex. 2004) ("As taught by the Fifth Circuit, the bankruptcy court must honor the plain meaning of Section 328."). Section 328(a) therefore creates a "high hurdle" for a movant seeking to revise the terms governing a

[8] Steve Sather, *Creative Lawyers Thwarted in ASARCO Workaround Attempts*, A TEXAS BANKRUPTCY LAWYER'S BLOG (February 27, 2016), http://stevesathersbankruptcynews.blogspot.com/2016/02/creative-lawyers-thwarted-in-asarco.html.

> professional's compensation *ex post facto. In re Smart World Techs., LLC*, 552 F.3d 228, 234-35 (2d Cir. 2009) ("Surprisingly few cases have construed [§ 328(a)'s] language, but those that have make it evident that it is a high hurdle to clear."); *see also Coho Energy*, 395 F.3d at 205 (commenting that § 328(a) sets a "high standard"). Such a movant must show not merely that a compensation adjustment is appropriate in light of subsequent developments that were previously unforeseen or unanticipated by the parties; instead, the movant is tasked with the weightier burden of proving that the subsequent developments were incapable of being anticipated at the time the engagement was approved. *See Barron II*, 325 F.3d at 693 ("[T]he intervening circumstances must have been *incapable* of anticipation, not merely unanticipated."); *Barron I*, 225 F.3d at 586 ("It is not enough that the developments were simply unforeseen."); *Smart World*, 552 F.3d at 235 ("[S]imply because the size and scope of a settlement had not actually been anticipated, it does not follow that it was *incapable of anticipation*."). Likewise, before a court may revise a compensation agreement, it must explain with specificity why the subsequent developments were "incapable of being foreseen." *Barron II*, 325 F.3d at 693; *see also* 3 Collier on Bankruptcy § 328.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009) ("A failure by the bankruptcy court to make a record establishing that the approval was improvident and *setting out with specificity (not conclusory statements)* the development that could not have been anticipated at the time of approval will be insufficient to comply with the requirements of section 328.") (emphasis added); *cf. In re Evangeline Ref. Co.*, 890 F.2d 1312, 1327-28 (5th Cir. 1989) ("If a court awards fees but fails to explain why compensation was awarded at the level it was given, it is difficult, if not impossible, for an appellate court to engage in meaningful review of a fee award.").

702 F.3d at 257–58. For this reason, most bankruptcy courts are reluctant to approve attorneys' retentions under Section 328(a) to the extent such retention would approve hourly rates or other key components in determining "reasonable compensation for actual, necessary services" under Section 330(a).

See also subsection 1 above, where the Retention Applications were filed pursuant to Section 328(a) instead of Section 327(a).

(4) Sanctions as a deterrent for frivolous or tactical fee objections.

(a) Rule 11 / Bankruptcy Rule 9011.

Because Bankruptcy Rule 9011 is substantially identical to Rule 11 of the Federal Rule of Civil Procedure 11, a court considering Rule 9011 sanctions may also take into account Rule 11 jurisprudence. *Cadle Co. v. Pratt (In re Pratt)*, 524 F. 3d 580, 586 (5th Cir. 2008).

In summary, Bankruptcy Rule 9011, which is substantially similar to Rule 11 of the Federal Rules of Civil Procedure, provides, in summary, that the signature of an attorney or party constitutes a certificate that the attorney or party has read the document; that to the best of the attorney's or party's knowledge, information, and belief formed after reasonable inquiry that it is well-grounded in fact and is warranted by existing law or a good faith argument for the extension of existing law; and that it is not interposed for any improper purpose. If the document is signed and filed in violation of this rule, the court, either pursuant to a motion filed by another party or on its own motion, shall impose an appropriate sanction.

In *First Bank of Marietta v. Hartford Underwriters Insurance Company*, 307 F.3d 501, 517 (6th Cir. 2002), the Court discussed the characteristics and uses of Rule 11 sanctions and the differences between Rule 11 sanctions and those in which the court exercised its inherent authority:

> Further, as noted in *Chambers*, there are significant differences between Rule 11 sanctions and inherent power sanctions. Rule 11 applies primarily to pleading and papers. *Byrne v. Nezhat*, 261 F.3d 1075, 1106 (11th Cir. 2001). Another principal difference is that the imposition of Rule 11 sanctions requires a showing of "objectively unreasonable conduct," *United States v. Kouri-Perez*, 187 F.3d 1, 8 (1st Cir. 1999). In contrast, the imposition of inherent power sanctions requires a finding of bad faith. "A court may impose sanctions pursuant to its inherent powers only when it finds the action in question was taken in bad faith," *Lockary v. Kayfetz*, 974 F.2d 1166, 1174 (9th Cir. 1992) (citing *Chambers*, 501 U.S. at 50), or conduct that is "tantamount to bad faith." *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 767, 65 L. Ed. 2d 488, 100 S. Ct. 2455 (1980). Moreover, a Rule 11 monetary sanction is limited to "only those expenses directly caused by the [offending] filer." *Cooter & Gell v. Hartmarx Corp.,* 496 U.S. 384, 406-07, 110 L. Ed. 2d 359, 110 S. Ct. 2447 (1990). Where, as here, the offending party's conduct extends through the proceedings, Rule 11 remedies would not address the injury that the district court sought to remedy that included withholding evidence, the consequences of the withholding, violating discovery orders and extending the proceedings.

See also In re: Dobbs, 535 B.R. 675, 686-87 (Bankr. N.D. Miss. 2015), where the bankruptcy court addressed the requirements for the imposition of sanctions under Bankruptcy Rule 9011:

> "In determining whether a party has violated Rule 9011, the court need not find that a party who makes a false representation to the court acted in bad faith. 'The imposition of Rule 11 sanctions ... requires only a showing of objectively unreasonable conduct.'" *In re Taylor*, 655 F.3d 274, 282 (3d Cir. 2011) (quoting *Fellheimer, Eichen & Braverman, P.C. v. Charter Tech., Inc.*, 57 F.3d 1215, 1225 (3d Cir.1995)). The standard to be applied is "reasonableness under the circumstances." *Bus. Guides, Inc. v. Chromatic Commc'ns Enterprises, Inc.*, 498 U.S. 533, 551, 111 S. Ct. 922, 933, 112 L. Ed. 2d 1140 (1991). Reasonableness is defined as an "objective knowledge or belief at the time of the filing of a challenged paper" that the claim was well-grounded in law and fact. *Jones v. Pittsburgh Nat. Corp.*, 899 F.2d 1350, 1359 (3d Cir. 1990).

(b) 28 U.S.C. §1927

Section 1927 provides as follows:

> § 1927. Counsel's liability for excessive costs
>
> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

In *Citizens Bank & Trust Co. v. Case (In re Case)*, 937 F.2d 1014, 1023 (5th Cir. 1991), the Fifth Circuit held that bankruptcy courts have the ability to impose sanctions under 28 U.S.C. § 1927 for actions taken in a bankruptcy case.

The Fifth Circuit has interpreted 28 U.S.C. § 1927 as requiring evidence of bad faith, improper motive, or reckless disregard of the duty owed to the court. *See Edwards v. Gen. Motors Corp.*, 153 F.3d 242, 246 (5th Cir. 1998). ("The adverbs being in the conjunctive, sanctions under § 1927 must be predicated on actions that are both 'unreasonable' *and* 'vexatious.' This requires that there be evidence of bad faith, improper motive, or reckless disregard of the duty owed to the court. Because of the punitive nature of § 1927 sanctions, and in order not to chill legitimate advocacy, the provision must be strictly construed." (original emphasis) (citations omitted).

Moreover, the Fifth Circuit noted in *FDIC v. Calhoun*, 34 F.3d 1291, 1297 (5th Cir. 1994) that punishment under 28 U.S.C. § 1927 should be "sparingly applied" and '"except when the entire course of proceedings were unwarranted and should neither have been commenced nor persisted in, an award under 28 U.S.C. § 1927 may not shift the entire financial burden of an action's defense.' We therefore require a detailed finding that the proceedings were both 'unreasonable' and 'vexatious.'" *Id.* (citations omitted). Because the Fifth Circuit find there was "no rule 11 basis to impose sanctions for instituting suit for an improper purpose, we necessarily also hold that the imposition of sanctions under § 1927 was error." *Id.*, at 1300.

In *Prosser v. Gerber (In re Prosser)*, 777 F.3d 155 (3d Cir. 2015), in addressing sanctions under 28 U.S.C. § 1927, the Court of Appeals for the Third Circuit stated:

> Such "sanctions are intended to deter an attorney from intentionally and unnecessarily delaying judicial proceedings, and they are limited to the costs that result from such delay." *LaSalle*, 287 F.3d at 288 (emphasis omitted). "[C]ourts should exercise this sanctioning power only in instances of a serious and studied disregard for the orderly process of justice." *Id.* (internal quotation marks and alteration omitted).
>
> The language and purpose of the statute reflect that these sanctions are aimed at deterring lawyers' bad faith conduct that disrupts the administration of justice by multiplying proceedings in "any court of the United States." 28 U.S.C. § 1927. A bankruptcy court is a unit of a district court, and as a result, it may impose § 1927 sanctions. *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 105 (3d Cir. 2008). In the bankruptcy context, the proceedings include adjudication of both the bankruptcy petition and adversary proceedings, which are "essentially ... self-contained trial[s] -- still within the original bankruptcy case." *In re Mansaray-Ruffin*, 530 F.3d 230, 234 (3d Cir. 2008); *see also In re TCI Ltd.*, 769 F.2d 441, 442-44, 449-50 (7th Cir. 1985) (affirming § 1927 sanctions for filing of baseless amended complaint in adversary action during bankruptcy). Thus, the filing of an adversary complaint may multiply the proceedings in a bankruptcy case, as it can increase the cost of the entire bankruptcy proceeding of which it is a part.

777 F.3d at 161–62. Addressing the proof required before imposing sanctions under 28 U.S.C. § 1927, the Court held:

> To impose § 1927 sanctions, a court must "find an attorney has (1) multiplied proceedings; (2) in an unreasonable and vexatious manner; (3) thereby increasing the cost of the proceedings; and (4) doing so in bad

> faith or by intentional misconduct." *Prudential*, 278 F.3d at 188. A court imposing § 1927 sanctions must find bad faith, but that finding need not be made explicitly. *Id.* at 189 ("An implicit finding of bad faith will support sanctions just as well so long as it is not an abuse of discretion, not based upon clearly erroneous factual findings, and not based upon an error of law."); *see also Baker Indus., Inc. v. Cerberus Ltd.*, 764 F.2d 204, 209 (3d Cir. 1985) (finding bad faith standard was met "in light of the entire record and the expressions of the district court judge, who employed the very words of the statute"). "Indications of ... bad faith are findings that the claims advanced were meritless, that counsel knew or should have known this, and that the motive for filing the suit was for an improper purpose such as harassment." *Prudential*, 278 F.3d at 188 (internal quotation marks omitted).

Id., at 162. Under the clearly erroneous standard of review, the Court of Appeals found that the record supported the bankruptcy court's finding that the counsel had unreasonably and vexatiously multiplied and increased the cost of the proceedings in bad faith.

Query: If the bankruptcy estate is not responsible for the payment of fees for defending a fee application, do the actions of a party asserting a bad-faith objection to a fee application "increase the cost of the proceedings" if the bankruptcy estate is not liable for the payment of attorneys' fee for fee-defense costs so that 28 U.S.C. § 1927 can be used to recover attorneys' fees. Are there indirect, non-monetary costs, such as delays in the administration of the bankruptcy estate that would be deemed to "increase the cost of the proceedings"?

(c) Court's Inherent Power to Impose Sanctions / Section 105(a).

The Fifth Circuit, in its *ASARCO* opinion, noted the bankruptcy court's inherent power to prevent abusive or frivolous objections to fee applications:

> We are confident that bankruptcy courts, practicing vigilance and sound case management, can thwart punitive or excessively costly attacks on professional fee applications. Where appropriate, the courts should not hesitate to implement the exception to the American Rule that allows fee shifting where an adverse party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45-46, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991); *In re Frazin, supra*, 413 B.R. at 403. (No issues falling within *Chambers* were raised in response to reorganized ASARCO's fee objections here.)

751 F. 3d at 302.

The leading case on the court's equitable powers for sanctions is *Chambers v. NASCO, Inc*., 501 U.S. 32, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991). In *Chambers*, the Supreme Court restricted the use of the court's inherent powers to those situations where a statute or the federal rules did not cover the conduct: "Furthermore, when there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules, the court ordinarily should rely on the Rules rather than the inherent power. But if in the informed discretion of the court, neither the statute nor the Rules are up to the task, the court may safely rely on its inherent power." 501 U.S. at 50, 111 S. Ct. at 2136, 115 L. Ed. 2d at 49.

Chambers sets forth three categories in which it will permit a deviation from the "American Rule" and permit fee shifting:

1. The "common fund exception," which allows a court to award attorney's fees to a party whose litigation efforts directly benefit others;

2. As a sanction for the "willful disobedience of a court order" in which the court has discretion to determine "the degree of punishment for contempt" and impose as part of the fine attorney's fees representing the entire cost of the litigation; and

3. When a party has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons." Under this category, if the court finds "that fraud has been practiced upon it, or that the very temple of justice has been defiled, "it may assess attorney's fees against the responsible party as it may when a party "shows bad faith by delaying or disrupting the litigation or by hampering enforcement of a court order, …" The imposition of sanctions under this third category "transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of "vindicating judicial authority without resort to the more drastic sanctions available for contempt of court and making the prevailing party whole for expenses caused by his opponent's obstinacy."

501 U.S. at 50, 111 S. Ct. at 2136, 115 L. Ed. 2d at 49 (citations omitted).

While bankruptcy courts have such inherent powers, the threshold for a court's invoking those powers is high. In *Boland Marine & Mfg. Co. v. Rihner*, 41 F.3d 997, 1005 (5th Cir. 1995) (*citing Chambers*, 501 U.S. at 46, 111 S. Ct. at 2133), the Fifth Circuit held that a court "should invoke its inherent power to award attorney's fees only when it finds that "fraud has been practiced upon it, or that the very temple of justice has been defiled."

Although *Chambers* involved a district court, the Fifth Circuit Court of Appeals, in *In re Case*, 937 F.2d 1014 (5th Cir. 1991), acknowledged:

> The power to assess attorneys [sic] fees, like other inherent powers possessed by the district court, is based on the need to control court proceeding and necessity of protecting the exercise of judicial authority in connection with those proceedings. These principles are equally applicable to the bankruptcy court.

937 F.2d at 1023.

In *Galveston County Navigation Dist. No. 1, v. Hopson Towing Co., Inc.*, 92 F.3d 353, 358 (5th Cir. 1996), the Fifth Circuit held that the conduct required to invoke the exception to the American Rule and impose sanctions must be "callous and recalcitrant, arbitrary, and capricious, or willful, callous, and persistent."

Two bankruptcy court decisions address the various options available to a bankruptcy court for sanctions for improper conduct.

1. In *In re Pastron*, 462 B.R. 201 (Bankr. N.D. Tex. 2011), Judge Jernigan addressed the debtor's requested relief against two mortgage loan servicers and the law firm that represented them under: (1) 28 U.S.C. § 1927; (2) Section 105(a); and (3) the court's inherent powers. No relief was sought under either Rule 11 or Bankruptcy Rule 9011. Although Judge Jernigan found that the work of the mortgage loan servicers "was sloppy and bad form (which justified denying stay relief), this, in and of itself, did not rise to the level of bad faith or vexatious litigation that would legitimize fee shifting." 462 B.R. at 212. In her opinion, Judge Jernigan covered the basic requirements for each basis of sanctions, even Rule 11 and Bankruptcy Rule 9011. Addressing the bankruptcy court's authority to impose sanctions under Section 105(a), Judge Jernigan wrote:

   > Similarly, a bankruptcy court's authority under Section 105(a) of the Bankruptcy Code also comports with its inherent power to sanction, and some courts have found that such powers are essentially coterminous. *Caldwell v. Unified Capital Corp. (In re Rainbow Magazine, Inc.)*, 77 F.3d 278, 284 (9th Cir. 1996) ("By providing that bankruptcy courts could issue orders necessary 'to prevent an abuse of process,' Congress impliedly recognized that bankruptcy courts have the inherent power to sanction that *Chambers* recognized within Article III courts."); *Jones v. Bank of Santa Fe (In re Courtesy Inns, Ltd., Inc.),* 40 F.3d 1084, 1089 (10th Cir. 1994) ("We believe, and hold, that § 105 intended to imbue the bankruptcy courts with the inherent power recognized by the Supreme court in *Chambers*); *but see Ginsberg v. Evergreen Sec. Ltd. (In re Evergreen Sec., Ltd.)*, 570 F.3d 1257, 1273 (11th

> Cir. 2009); *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178, 1196 (9th Cir. 2003); *In re Rimsat, Ltd.*, 212 F.3d 1039, 1049 (7th Cir. 2000). Section 105(a) of the Bankruptcy Code states that:
>
> > The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making the determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.
>
> Several courts have concluded that Section 105(a) provides a basis for a bankruptcy court to make an award of attorney's fees under certain circumstances. *In re Paige,* 365 B.R. 632, 637-40 (Bankr. N.D. Tex. 2007); *In re Brown*, 444 B.R. 691, 695 (Bankr. E.D. Tex. 2009); *In re Gorshtein*, 285 B.R. 118, 124 (Bankr. S.D.N.Y. 2002). However, regardless of whether a bankruptcy court chooses to impose sanctions under its inherent authority or under Section 105(a) of the Bankruptcy Code, it still must make a "specific finding of bad faith." *In re Parsley*, 384 B.R. 138, 179 (Bankr. S.D. Tex. 2008); *Gorshtein*, 285 B.R. at 124.

462 B.R. at 212.

2. In *In re Dobbs*, 535 B.R. 675 (Bankr. N.D. Miss. 2015), the court found that the debtor's counsel had "put the Debtor in bankruptcy without the Debtor's authorization or knowledge, forged the Debtor's signature, had the Debtor's estranged wife take a credit counseling course in place of the Debtor, and then filed fabricated documents with the Court." Before holding that counsel should be disbarred from the practice of law in the Bankruptcy Court in that district, the court addressed sanctions available under Bankruptcy Rule 9011, Section 105(a), and the inherent power of the bankruptcy court, among others.

With respect to the statutory authority of the bankruptcy court to impose sanctions pursuant to its equitable powers, the court noted:

> Pursuant to 11 U.S.C. § 105, "[a] bankruptcy court has statutory authority to 'issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code.'" *Law v. Siegel*, 134 S. Ct. 1188, 1194, 188 L.

> Ed. 2d 146 (2014). “The clear language of 11 U.S.C. § 105(a) grants this Court significant equitable powers as well as latitude in framing the relief necessary to carry out both the specific provisions of the statute as well as its philosophical underpinnings.” *In re Ludwick*, 185 B.R. at 245.

535 B.R. at 690-91.

With respect to the inherent power of the court to impose sanctions, Judge Woodard noted:

> Although 11 U.S.C. §§ 105 and 526, Federal Rule 9011(c), and Local Rule 1001-1(g) all provide possible avenues for sanction, a court’s inherent power “can be invoked even if procedural rules exist which sanction the same conduct, for these rules are not substitutes for the inherent power.” *In re Mroz*, 65 F.3d 1567, 1575 (11th Cir. 1995). Rather, a court’s “‘inherent power extends to a full range of litigation abuses’ and ‘must continue to exist to fill in the interstices.’” *Peer v. Lewis*, 606 F.3d 1306, 1314 (11th Cir. 2010) (quoting *Chambers*, 501 U.S. at 46). “A specific finding of bad faith, however, must ‘precede any sanction under the court’s inherent powers.’” *United States v. Stoneberger*, 805 F.2d 1391, 1393 (9th Cir. 1986)(quoting *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 767, 100 S.Ct. 2455, 2465, 65 L.Ed.2d 488 (1980)). Further, “a decision to invoke the inherent power to sanction requires a finding of ‘bad faith or willful abuse of the judicial process....’” *Moore*, 739 F.3d at 729. For the reasons explained at length above, the Court finds that clear and convincing evidence shows such bad faith and abuse of the judicial process, thereby enabling it to invoke its inherent powers as described in *Chambers*.

535 B.R. at 691-92 (footnote omitted).

5. Argument – Limiting ASARCO to its particular facts: ASARCO is not applicable to a fee defense related to an objection from a party other than the Debtor or a representative of the bankruptcy estate.

a. The fees incurred that are related to a fee objection that is resolved amiably and without extensive litigation are compensable because they are not within the scope of “adversarial fee defense litigation” as discussed in *ASARCO*.

b. Fee-defense litigation is a part of the bankruptcy administration and is within the scope of "services" rendered for the trustee in the bankruptcy case, where:

(1) The litigation is not brought by or is against the estate – it is pursuant to the objection of a creditor (instead of the Debtor, a reorganized Debtor, a Trustee, a Plan Administrator, or some other representative of the bankruptcy estate).

(2) The fee-defense litigation is not impermissible "fee shifting" or a deviation from the American Rule since it is not seeking to recover fees from the other party to the litigation, especially if the professional is the "prevailing party."

(3) Where the professional is not the "prevailing party" in fee-dispute litigation, the Court can deny fees by finding that fees were not "reasonable compensation" for "actual, necessary services" based on "the nature, the extent, and the value of such services." 11 U.S.C. § 330(a).

c. Fee-defense litigation with respect to an objection by one other than the estate administrator constitutes "services" for the bankruptcy estate which are a part of bankruptcy administration since it is not "adversarial litigation" against the "bankruptcy administrator" to the extent that the court finds that such fees are "reasonable compensation" for "actual, necessary services" based on "the nature, the extent, and the value of such services." 11 U.S.C. § 330(a). ("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."), 135 S. Ct. at 2165; 192 L. Ed. 2d at 216; 2015 U.S. LEXIS 3920 at [***12].

6. Congressional Action – Amend Sections 327(a) and/or 330(a).

Another "possible" (but not very probable) workaround to ASARCO would be for Congress to amend Sections 327 or 330 to provide expressly for the payment of fees for the successful defense of an objection to a fee application of a bankruptcy professional. No one has seriously raised this as a likely course of action that would be pursued.

B. Office of the United States Trustee. The Office of the United States Trustee has provided guidance with respect to its position on ASARCO and possible "workarounds" as reflected on its website in a section entitled "Frequently Asked Questions (FAQS) – Professional Compensation," the link to which is:

http://www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp

C. Subsequent Court Decisions.

Since *ASARCO* was decided on June 15, 2015, there have been a few bankruptcy courts that have addressed the "fee for fee-defense" issue:

1. *In re Huepenbecker*, 2015 Bankr. Lexis 2352 (Bankr. W.D. Mich. 2015). In a decision rendered less than a month after *ASARCO*, the bankruptcy court, in ruling on an objection by the counsel for the debtors [Mr. Budzynski] to a fee application for counsel to the chapter 12 trustee [Mr. Davidoff] pointed out some of the practical consequences of ASARCO. Although stating that it was making no findings on this issue because the trustee had not "pressed the point," the bankruptcy court found that the tenor of the objection tended to corroborate the trustee's suggestion that it was filed "out of spite." The court noted that it could not award fees for defending the fee application, and concluded with this remark:

> The court cannot turn a blind eye to the impact that *Baker Botts* will have on the members of the bar whose livelihood depends on approval of fees under § 330. Today's decision, and Mr. Davidoff's unhappy experience with Mr. Budzynski, presents a telling example of the hardship to estate professionals (and debtors' counsel in chapter 12 and 13 cases) whose fee petitions draw objection. Mr. Davidoff has spent at least $1,925.00 of his own (non-compensable) time seeking $6,625.00 in fees for [re]presenting his client. Constrained by *Baker Botts*, the court will approve fees in a reduced amount, totaling only $4,700.00 for the first and second applications. This means that Mr. Davidoff will net only $2,781.00, resulting in an effective rate of approximately $146.00 per hour. The result, though dictated by recent precedent, undermines important policies affecting administration of estates.

2015 Bankr. Lexis 2352, at [*9].

2. *In re: River Road Hotel Partners, LLC*, 536 B.R. 228 (Bankr. N.D. Ill. 2015). The debtor's financial advisor ("FBR") requested a restructuring fee of approximately $2.5 million, to which the plan transferee under the confirmed plan ("Bletchley") objected. The bankruptcy court, after briefing and a bench trial, awarded the requested restructuring fee. FBR then filed an amended fee application in which it sought, in addition to the $2.5 million restructuring fee, an additional $1.8 million in expense reimbursement, the majority of which was incurred for attorneys' fees in defense of the FBR fee request.

The bankruptcy court denied the expense reimbursement request, citing *ASARCO*. FBR contended the ASARCO was not applicable and it should recover its attorneys' fees because (1) both the Engagement Letter and the Retention Order provide for them; and

(2) because FBR was entitled to reasonable compensation under Section 330(a)(1). The court noted that the Supreme Court in *ASARCO* explicitly held that Section 330(a)(1) does not permit a bankruptcy court to award attorneys' fees for work performed in defense of fee requests, and there was no distinction between fees incurred by debtor's counsel and those incurred by a third party's counsel when the fees are to be reviewed under Section 330.

The Court also held that FBR's contract-based argument also failed because its legal fees were not incurred "in connection with the services provided" under the Engagement Letter and were not reasonably likely to benefit the bankruptcy estate or necessary for the administration of the case, but were incurred primarily for FBR's benefit in connection with FBR's fee-defense litigation against the bankruptcy estate.

The bankruptcy court also rejected FBR's fee-shifting argument that attorneys' fees should be awarded for Bletchley's bad faith litigation for its "scorched earth tactics" which drove up FBR's litigation costs. FBR sought this relief, not under Bankruptcy Rule 9011, but under Section 105(a) and the inherent power of the court. The bankruptcy court declined to grant FBR relief under Section 105(a) because "[s]anctions, under any authority, are the exception, not the norm, and should not be imposed lightly, 'even in the face of aggressive litigation tactics and strategy.'" 536 B.R. at 243. The bankruptcy court also denied FBR relief under the inherent power of the court after finding: (1) Bletchley's aggressive pursuit of its objections did not constitute "abusive litigation tactics"; (2) Bletchley did not commit a fraud upon the court; and (3) Bletchley did not "defile the 'very temple of justice.'" 536 B.R. at 244.

3. In *In re: MACCO Properties, Inc.*, 2015 Bankr. LEXIS 3921 (Bankr. W.D. Okla. 2015), the bankruptcy court addressed objections by the former equity owner ("Price") and her husband ("McGinnis") to the fee applications of the Chapter 11 trustee ("Trustee"), counsel for the trustee ("Counsel"), and the accountant and financial consultant to the trustee ("MED"). Price and McGinnis contended that *ASARCO*, the court was required to disallow all fees requested by any of Movants for a litigation of their fee applications. Judge Rasure distinguished *ASARCO* from the facts of *MACCO*, overruled the objections, and allowed the fees related to the defense of the fee applications on the following grounds:

> (1) In *ASARCO*, the Reorganized Debtor, as the estate administrator, opposed the requested fees, but in *MACCO*, the Trustee, as the estate administrator, fully supported the requested fees in order to complete the administration of the bankruptcy estates. In *ASARCO*, the fee dispute was between the bankruptcy estate and the estate professionals, but in *MACCO*, the fee dispute was between the estate professionals and third parties. Consequently, the facts were quite unlike *ASARCO* where the Supreme Court held that the fees

sought were not "reasonable compensation for services rendered" for the client because "[t]ime 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." (*citing ASARCO*, 135 S.Ct. at 2165 (emphasis added by Judge Rasure).

(2) Although acknowledging that the Supreme Court rejected the Government's positon that "uncompensated fee litigation in bankruptcy will be particularly costly because multiple parties in interest may object to fee applications, whereas nonbankruptcy fee litigation typically involves just a lawyer and his client." (citing *ASARCO*, 135 S.Ct. at 2168), the bankruptcy court noted:

> Because ASARCO itself, the proposed payor of the fees, objected to Baker Botts' compensation application, comments concerning objections by other parties in interest are pure dicta, and the Court declines to draw any inference that the American Rule (precluding fee shifting between the litigating parties) precludes professionals from being paid *from the estate* for defending against claims and objections asserted by a party *other than* a duly appointed representative of the estate.

2015 Bankr. LEXIS at [*234] (emphasis added by Judge Rasure).

(3) Because the objectors to the fee applications also asserted tort claims against the estate professionals, and it was proper for the bankruptcy estate to pay for the defense of claims asserted against the Trustee and MED as services to the administrator of the estate, as well as legal fees for the defense of the fee application of Counsel, because all such administrative expense claims needed to be resolved in order to complete the administration of the estate, and this was "work done in the service of the estate administrator" (*citing ASARCO*, 135 S.Ct. at 2164, *quoting Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252-53. 130 S.Ct. 2149, 176 L. Ed. 2d 998 (2010) 2015 Bankr. LEXIS at [*234].

(4) The bankruptcy court found that Counsel was "defending itself, and its fees, from baseless claims of malfeasance asserted by Price and McGinnis …." The bankruptcy court also noted that "Counsel is stuck in this litigation simply because it has diligently, loyally, and professionally performed services for Trustee and the estate." 2015 Bankr. LEXIS at [*233].

(5) The bankruptcy court also concluded that the relief sought by Price and McGinnis should be denied under the equitable doctrine of "unclean hands" and pursuant to Section 105:

> Section 105 permits courts to *sua sponte* exercise equitable powers not contrary to the Bankruptcy Code in order to carry out the provisions of the Code. And when facts warranting the application of the unclean hands doctrine come to a court's attention, the court should "close[] the doors," and refuse to award any remedy to the party with unclean hands, in order to protect the integrity of the court.

2015 Bankr. LEXIS at [*258-59].

4. In *In re Divine Ripe, L.L.C.*, 538 B.R. 300 (S.D. Tex. 2015), the issue did not involve attorneys' fees with respect to the defense of a fee application, but whether attorneys' fees should be awarded pursuant to either 28 U.S.C. § 1927 or Rule 9011. In *Divine Ripe*, the Debtor moved to extend the automatic stay to a third party in a pre-petition lawsuit filed against them by Tomver. Tomver opposed the motion and sought attorneys' fees against the Debtor on the grounds that the motion was frivolous. The bankruptcy denied the motion to extend the stay, and also, citing *ASARCO*, denied Tomvar's motion for attorneys' fees:

> The Supreme Court recently discussed the issue of the recovery of fees and costs by parties, in an application of the "American Rule" in circumstances where statutory authorization is not explicitly provided for. *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164, 192 L. Ed. 2d 208 (2015). The American Rule, as applied here, requires that Frescos Tomver be responsible for their legal costs unless there is a provision in the Code to provide for attorney's fees and costs.

538 B.R. at 313–14 (footnote deleted).

The bankruptcy court declined to grant relief under 28 U.S.C. § 1927 because Tomver failed to establish that the Debtor's seeking to assert its rights under the Bankruptcy Code did not meet the standard of "unreasonable and [vexatious]" as required by § 1927. The court also found that Tomvar's request did not comply with the requirements of Rule 9011(c)(1) by filing a motion for sanctions separate from any other motion or request, serving that motion on the opposing party, and giving the opposing party 21 days to respond by withdrawal, correction, or if no wrongdoing has been committed then no action is required.