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20 QUESTIONS ABOUT *BAKER BOTTS, L.L.P. V. ASARCO, LLC*: SUPREME COURT WEIGHS-IN ON BANKRUPTCY "FEE-DEFENSE" COSTS

BY: DAVID L. BURY, JR. ON JULY 16, 2015

On June 15, 2015, a 6-3 Supreme Court held in the Chapter 11 case of *Baker Botts, L.L.P. v. ASARCO, LLC* that bankruptcy professionals employed under Section 327(a) of the Bankruptcy Code may not, under Section 330(a)(1) of the Bankruptcy Code, recover as compensation fees incurred in defending their bankruptcy fee applications. Although *Baker Botts* didn't draw nearly as much attention as other, more high-profile cases that wrapped-up the term at the end of June 2015, like *Obergefell v. Hodges* (same-sex marriage) or *King v. Burwell* (Obamacare tax subsidies), it's still important, especially for professionals whose compensation depends on § 330(a)(1).

For example, take the mega Lehman Brothers Chapter 11. Our review shows that Weil Gotshal spent over 21,387 hours and over $6.4 million in fees (i.e. an average of 2100+ hours and $641,000+ per fee application) preparing and litigating its fee applications. Whereas Weil's compensation-related charges were less than 1.5% of the overall bill, it's not unusual, especially in small consumer Chapter 7 cases (where frivolous fee objections are most common) for a trustee or professional to spend 10%-20% on fee defense. And after *Baker Botts*, many of those charges aren't recoverable.

Therefore, *Baker Botts* bears emphasis for all bankruptcy professionals. We originally issued this as a 2 part blog post, covering 10 questions each about *Baker Botts*. Part 1 covered the background and the majority opinion. Part 2 emphasized the dissent, possible errors in the decision, and the potential impacts on bankruptcy practice. We've combined them here in one, easy-to-download .pdf.

[Unless noted otherwise, quotations are from the opinion. Additionally, SCOTUSblog has collected all of the briefs, with a link to Oyez for the oral argument audio.]

1. How did this matter find its way to the Supreme Court?

In 2005, ASARCO, one of the leading copper producers in the U.S., filed a free-fall Chapter 11 in the Southern District of Texas. ASARCO had everything wrong with it: cash flow issues; potentially massive environmental liabilities; corporate governance and tax problems; a striking workforce; and a litigious parent company. As the bankruptcy court pointed out in its initial fee award order (see p. 65a), the DOJ described the ASARCO case as "the largest environmental bankruptcy in U.S. history." ASARCO's CEO and board resigned and its replacement director conflicted-out. Therefore, the Bankruptcy Court approved the appointment of an independent board.

In pertinent part, ASARCO, acting through its new board and with court authorization under § 327(a) of the Code, retained Baker Botts as well as Jordan, Hyden, Womble, Culbreth & Holzer as its bankruptcy counsel. Among other things, the lawyers prosecuted a fraudulent transfer claim against

two of ASARCO's parent entities, ASARCO, Inc. and Americas Mining Corp. ("AMC"). The claim challenged ASARCO's transfer to AMC of ASARCO's controlling interest in Southern Copper Corp. ASARCO obtained a judgment against the parent worth between $7 and $10 billion. In turn, the judgment fueled a 100%, $3.56 billion payout to creditors (compared to the pennies on the dollar that most had expected at the beginning of the case). ASARCO emerged from bankruptcy 4 years later in 2009 with "$1.4 billion in cash, little debt, and resolution of its environmental liabilities."

After confirmation, the 2 law firms filed their final fee applications under § 330(a)(1). ASARCO, by then reorganized and back under the control of its parent, objected to the fee applications. Following extensive discovery and a 6-day trial, the Bankruptcy Court overruled the objections and awarded $120 million in compensation, $4.1 million as an "enhancement for exceptional performance," and $5 million in fees for defending the applications.

On appeal, the District Court affirmed the Bankruptcy Court, but the Fifth Circuit reversed. The Fifth Circuit held that (i) the American Rule (discussed below) controls absent explicit statutory authority providing reimbursement of defense fees and (ii) defense fees fall outside of § 330(a)(1)'s requirement that services are only compensable "if they are likely to benefit a debtor's estate or are necessary to case administration" because the professional, not the estate, is the "primary beneficiary of a professional fee application." For a more detailed summary of the lower court decisions, see Gregory Werkheiser's excellent Jan. 2015 ABI Journal article.

The Supreme Court then granted certiorari and heard oral argument on February 25, 2015 (transcript and audio). Aaron Streett of Baker Botts argued for Baker Botts. Brian Fletcher, Asst. to the Solicitor General, argued for the United States as *amicus curiae*. Jeffrey Oldham of Bracewell & Giuliani argued for ASARCO. [Interestingly, after ASARCO's initial Aug. 2014 brief in opposition to the petition, ASARCO added Supreme Court star Paul Clement of Bancroft (along with Jeffrey Harris) to ASARCO's Jan. 2015 brief, but neither Paul nor Jeffrey presented. Having their names on the signature block probably didn't hurt, though.]

2. Those are the *official* Supreme Court facts. What was really going on?

Given that the majority focuses exclusively on the text of the Bankruptcy Code while ignoring "flawed and irrelevant" policy arguments, the Court's rather vanilla recitation of a hotly-contested, 7 year fee dispute is forgivable. After all, the Code either permits compensation for defending fees or it doesn't. Nevertheless, depending on who you believe, there was quite a bit more going on in *Baker Botts*--it wasn't just any old attorneys' fee dispute. In fact, the results obtained in ASARCO were so breathtaking and the core fee objections so unsuccessful, that it's astonishing that *this* case became the test case for fee-defense costs under § 330(a)(1).

Largest Judgment and Most Successful Chapter 11 Ever?

As Baker Botts pointed out in its petition, the lower courts had acknowledged that the judgment that Baker Botts obtained for ASARCO was the largest judgment "in Chapter 11 history and possibly the largest unreversed actual-damages award in American history" (compared to the $7.53 billion actual-damages *Pennzoil v. Texaco* judgment, another Baker Botts award). Further, it pointed out in its petition that (i) the Bankruptcy Court noted that the ASARCO case was "***probably the most successful Chapter 11 of any magnitude in the history of the Code***" (our emphasis); (ii) the District Court called the judgment "***a once in a lifetime result***" (ours again); and (iii) the Fifth Circuit agreed that the result was due to ASARCO's lawyers' "exemplary" performance and "creativity,

tenacity and talent." Indeed, the Fifth Circuit noted that "[w]e do not disagree with the lower courts' effusive evaluations of the results obtained." Nevertheless, ASARCO objected to the fees charged by Baker Botts. Baker Botts describes the fee fight one way; ASARCO describes it another way.

According to Baker Botts

Baker Botts pointed out that although it received 100% payment from ASARCO on 13 interim fee statements over 52 months without objection, Reorganized ASARCO still "launched a massive assault" on the final application and "attacked everything." It "stonewalled every effort at efficiently resolving its objections," "refused" to be particular about which entries were objectionable and, thus, "forc[ed] Baker Botts to self-audit thousands of pages of invoices, culminating in a 1160-page supplement." Further, "less than a month before the fee trial," it "served Baker Botts a 104-page report accompanied by a 16-foot-tall stack of schedules containing thousands of pages of individual billing entries alleged to be non-compliant."

According to Baker Botts, the "U.S. Trustee joined none of these objections, nor indeed any objections to Baker Botts' core fees" of about $113 million. ASARCO "demanded immense discovery, forcing production of every single document that hundreds of professionals created or received during the 52-month bankruptcy." Baker Botts claimed that 9 of its lawyers and their staff spent 2,440 hours reviewing hundreds of boxes of offsite documents just to protect privilege. It claimed that it ultimately "produced 2,350 boxes of hard-copy documents (nearly six million pages) and 189 GB of electronic data (approximately 325,000 documents)." In response, claims Baker Botts, ASARCO "sent just two lawyers to review the massive results of discovery" and only "copied 1% of the material" during its five day review.

To hear Baker Botts tell it, ASARCO filed a spiteful, meritless fee objection to get back at Baker Botts for having sued ASARCO's parent.

According to ASARCO

ASARCO highlighted a "substantial rise in copper prices"--something Baker Botts "cannot claim responsibility for"--as a "key factor" in ASARCO's 100% payout to creditors. ASARCO also reminded the Court that Baker Botts initially sought more than it was awarded: $120 million in core fees, over $24 million in fee enhancements, and over $8 million in fee defense costs. It generally summarized its objection categories for the Court: excessive, vague, block-billed, lumped, and/or non-compensable clerical or administrative time and expense entries. It noted that the parties had resolved some expense-related objections by agreement. ASARCO explained that it objected to the enhancements because Baker Botts "had been adequately compensated at their full hourly rates that they had set—and increased throughout the bankruptcy—and that these lodestar fees were paid without delay during the bankruptcy."

It argued that "over $8 million in fees for the five-month litigation over fees [including 191 Baker Botts timekeepers] was excessive." It disagreed with Baker Botts' claim that "every single objection was overruled" because, in fact, Baker Botts had agreed to a $112,927 and a $19,463.52 reduction in fees and expenses [for a total reduction of only 0.09%?!], respectively. It also claimed that the Bankruptcy Court had reduced the requested fee enhancement to around $20 million. ASARCO explained that the bankruptcy court found that the defense costs were "higher than were reasonable and necessary" and, thus, reduced them from $8 million to $5 million. Finally, ASARCO noted that, although the bankruptcy court overruled ASARCO's objections to the core fees ("after agreed-upon

reductions"), the court did not find that the objections were "frivolous or made in bad faith"--objections that cost ASARCO "almost $2 million in fees" to litigate.

To hear ASARCO tell it, ASARCO's objection was merely a garden variety and good faith inquiry into Baker Botts' significant fees.

Although ASARCO defends the appropriateness of its objection a little more vigorously in its second brief, it still focuses more on Baker Botts' excessive defense fees than it does on the merits of ASARCO's objection, suggesting that Baker Botts might have a point about ASARCO's possible ulterior motive in filing the objection and litigating it for 7 years. But then again, we represent debtors, so of course we read it that way.

3. How did the Justices come down?

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Majority: Justice Thomas delivered the opinion, with Justices Roberts, Scalia, Kennedy, and Alito joining, and Sotomayor joining all but part III B 2.

Dissent: Justice Breyer delivered the dissent, with Justices Ginsberg and Kagan joining.

As an aside, compliments of SCOTUSBlog, after Justice Thomas delivered the opinion, Justice Scalia announced Kerry v. Din (and in process, inadvertently referred to Justice Ginsberg as Justice "Goldberg." Hilarity ensued.

4. In one sentence, how did the majority hold?

Professionals employed under § 327(a) of the Bankruptcy Code are not entitled under § 330(a)(1) to recover fee-defense costs incurred in "defending" their own fee applications.

5. In two sentences, what was the rationale?

The American Rule (i.e., the rule that each litigant pays his own attorney's fees) is deeply rooted in the common law and, thus, is presumed to apply absent express statutory or contractual language. Given that § 327(a) and § 330(a) of the Bankruptcy Code do not expressly shift the burden of fee-defense litigation to the bankruptcy trustee, and only provide for reasonable compensation for actual, necessary services rendered to a bankruptcy trustee in a loyal and disinterested manner, it follows that Congress did not intend to depart from the American Rule with respect to fees incurred by bankruptcy professionals in defending their fees, especially given that such fees neither constitute "services" to nor benefit the estate.

6. Why is the Supreme Court so focused on the American Rule?

Without any analysis, the Court presumes that § 330(a)(1) is a statute that involves an "award of attorney's fees." Although we don't agree with the Court's application of the American Rule to § 330(a)(1) (more on that later), the Court's assumption is not without support at a basic, textual level, as § 330(a)(1) explicitly provides that the court, and we quote the statute, "may ***award*** to a trustee...or a [§ 327 or § 1103] professional . . . reasonable ***compensation*** for actual, necessary services rendered" (emphasis added). Thus, the Court's "basic point of reference" is the "American Rule" where each

"litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise" (internal quotation marks omitted).

Hence the approach: When a statute involves an award of attorneys' fees, the Court will not, "absent explicit statutory [contractual?] authority," "deviate" from the American Rule.

7. Why did the Court refuse to deviate from the American Rule with respect to §330(a)(1)?

The Court concluded that "Congress did not expressly depart from the American Rule" to permit fee-defense awards. In searching for that express departure, the Court starts with § 327(a) which provides for the employment of "disinterested" professionals "to represent or assist the trustee in carrying out the trustee's duties" under the Code. In other words, "professionals are hired to serve the administrator of the estate for the benefit of the estate."

The Court then turns to § 330(a)(1), concluding that "reasonable compensation for actual, necessary services rendered" is limited to "work done to assist the administrator of the estate." It explains that, unlike the language in other fee-shifting statutes (more on those later, too), the language in § 330(a)(1) "neither specifically nor explicitly authorizes courts to shift the costs of ***adversarial*** litigation from one side to the other" (our emphasis for later). Rather, it only permits compensation awards for "work done ***in service*** of the estate administrator" (emphasis in original); "for '***actual, necessary services rendered***'" (emphasis in original).

Adopting the Government's analysis almost verbatim and focusing on the dictionary definition of "services" ("labor performed for another"), the Court holds that time "litigating a fee application against the administrator of a bankruptcy estate cannot be fairly described" as "labor performed" much less "disinterested service" to that administrator (i.e., "client"). [As the Government states it, "it is work that the professional does on its own behalf".]

In short, if Congress had wanted to shift fee-defense costs, then it "easily could have done so," but it didn't.

The Court asserts that "other provisions of the Bankruptcy Code expressly" shift litigation costs from "one adversarial party to the other," but it only refers to one: § 110(i) (requiring petition preparers to pay debtors their "reasonable attorneys' fees and costs" for moving successfully for damages for preparer violations).

8. Does the majority agree that fee-defense is a part of the *underlying* services, though?

No. That was the Government's argument (and the dissent's take): Even though fee-defense is not, *itself*, "an independently compensable service," compensation for fee-defense is "part of the compensation ***for the underlying services*** in [a] bankruptcy proceeding" (quoting the Government's brief) (emphasis in original). The majority rejects that argument (and, thus, the dissent, which we'll cover in Part 2) because "reasonable compensation" is only available "for actual, necessary services rendered." In other words, a fee or cost is only compensable if it arises from actual and necessary services. Because fee-defense is not a service, according to the Court, it's not compensable and, thus, its reasonableness is irrelevant.

The Court would have us *first* determine whether a fee or cost is compensable and if, and only if, it's compensable, then determine its reasonableness. In fact, it appears that the Court views the reasonableness factors in § 330(a)(3) as irrelevant to the question of whether something *is* compensable, as those factors presume that the applicable fee or cost satisfies the threshold "Is it compensable?" test. We don't see it that way. See Question 16.

9. How does the Court address §330(a)(6) regarding fee app preparation?

The Government relied on § 330(a)(6) which provides that "[a]ny compensation awarded for the ***preparation*** of a fee application shall be based on the level and skill reasonably required to prepare the application" (emphasis added). However, the Court rejects the Government's argument that "because time spent preparing a fee application is compensable, time spent defending it must be too." The Court explains that, whereas fee application preparation is a service rendered to the estate administrator, "defense of that application is not." The Court relies on a strained analogy to a "car mechanic's preparation of an itemized bill": *Preparation* of the bill is a service to the customer because it helps the customer understand and even dispute its bill; however, a "subsequent court battle over the bill" is not a "part of the 'services rendered' to the customer."

Further, the Court, without naming them as such, quotes against the Government the United States Trustee Large Case Fee Guidelines. In the Guidelines, the USTP opined that fee app preparation is compensable because it's "not required for lawyers practicing in areas other than bankruptcy as a condition to getting paid" but fee app defense is not compensable because it's "for the benefit of the professional and not the estate."

Finally, the Court distinguishes its "remark" in *Commissioner, Ins. v. Jean* that "[w]e find no textual or logical argument for treating so differently a party's preparation of a fee application and its ensuing efforts to support that same application." The Court explains that "everyone agreed" that the Equal Access to Justice Act (EAJA) at issue in *Jean* "authorized court-awarded fees for fee-defense litigation" because "fees and other expenses . . . incurred . . . in any civil action" didn't support a distinction between the legal work and fees defending it. And based on the Court's narrow reading of "services rendered," the language in § 330(a)(1) "reaches only the fee-application work."

At bottom, the Court didn't view "reasonable compensation" (an "open-ended phrase") as a "specific and explicit" provision signaling a departure from the American Rule.

Admittedly, we weren't aware that the Fee Guidelines already come down so hard on post-preparation fees and costs (including explaining, defending, or litigating the application). However, *Baker Botts* takes it a step further by eliminating from the Guidelines any notion that compensation might be available if an applicant "substantially prevails" at trial in defending its application. Some suggest that, before *Baker Botts*, the "substantially prevails" approach in the Guidelines was the "majority" approach. Not anymore.

10. How does the Court address the "parity" issue regarding non-bankruptcy professionals?

"Ultimately," the Court holds, the "Government's theory rests on a flawed and irrelevant policy argument": that awarding defense fees is a "judicial exception" that is "necessary to the proper functioning of the Bankruptcy Code." Specifically, argues the Government, uncompensated fee-defense

costs "will be particularly costly" because multiples parties can object in bankruptcy versus the usual lawyer versus client dispute outside of bankruptcy.

The Court rejects the Government's argument for two reasons.

First, the Court refused to substitute "unsupported" and "policy-oriented" predictions for the "statutory text," especially given that the Government had argued the opposite view below (i.e., "requiring a professional to bear the normal litigation costs of *litigating* a *contested* request for payment . . . dilutes a bankruptcy fee award no more than any litigation over professional fees") (emphasis added).

Second, the Court figured that the threat of sanctions under Rule 9011 provides a sufficient deterrent or remedy for "frivolous" fee objections (more on that later, too).

In short, text trumps policy:

- "Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh outcome is longstanding" (quoting *Lamie v. United States Trustee*, 540 U. S. 526, 538 (2004)) (internal quotation marks omitted). "[T]hat is no less true in bankruptcy than it is elsewhere."

- "Our job is to follow the text even if doing so will supposedly 'undercut a basic objective of the statute.'"

But for the Court's June 25, 2014 ruling in *King v. Burwell*, those quotes (joined by Chief Justice Roberts) might not be surprising. However, in upholding the health insurance tax subsidies ("saving Obamacare!" as some accuse or celebrate), Chief Justice Roberts explained that "in every case we must respect the role of the Legislature, and take care not to undo what it has done. A fair reading of legislation demands a fair understanding of the legislative plan. Congress passed the Affordable Care Act to improve health insurance markets, not to destroy them. If at all possible, we must interpret the Act in a way that is consistent with the former, and avoids the latter."]

11. How did the dissent come down on the issue?

The dissent agrees with the majority that fee-defense is *not* a "service" under § 330(a)(1). However, unlike the majority, the dissent agrees with the Government that fee-defense work is simply part of the compensation for the "underlying services." Therefore, the dissent hinges on recognizing a bankruptcy court's "broad discretion" to determine "reasonable compensation" based on all "relevant factors" (including the possible need to award defense costs to maintain compensation parity between bankruptcy and non-bankruptcy professionals). For the dissent, that need is no different than other factors warranting "increased compensation" (e.g., "exceptionally protracted litigation").

The thrust of the dissent is best summarized by the dissent's fee dilution example: What if a professional has fees of $50,000, but spends another $20,000 defending them "against meritless objections"? Arguably, that *effective* payment of $30,000 is "unreasonable" and warrants *additional* compensation in the court's discretion. Indeed, wonders the dissent, how is that form of fee dilution any different than the fee dilution that the Supreme Court *rejected* in *Jean* under the Equal Access to Justice Act?

The dissent concludes that interpreting "reasonable compensation" any other way "would undercut a basic objective of the statute." Therefore, courts should retain broad discretion to award defense costs.

12. Does the dissent believe that §330(a)(1) displaces the American Rule?

Yes. The dissent claims that in *Alyeska Pipeline*, the Supreme Court "recognized that through §330(a)," Congress "displaced the American Rule."

However, rather than focusing on *how* § 330(a) displaces the American Rule, the dissent focuses on *Jean*. Specifically, it argues argues that if Court found that the Equal Access to Justice Act displaced the American Rule *even though* it doesn't explicitly mention fee-defense work, then it's inconsistent for the majority to find that § 330(a) *doesn't* displace the American Rule *simply because* it doesn't explicitly mention fee-defense work. Compare the EAJA ("fees," "prevailing party," and "civil action") to § 330(a) ("reasonable compensation for actual, necessary services rendered"). Neither explicitly mentions fee-defense, but the Court treated them differently.

Given that § 330 is arguably the most comprehensive statutory fee regime in all of federal law, we wonder whether the American Rule applies *at all*. As the amicus fee examiners explained, a "Chapter 11 reorganization proceeding is not inherently or pervasively adversarial." Thus, the "American Rule is inapposite" to fee-defense costs in bankruptcy. As they suggest, "courts exercise two very different functions" in bankruptcy: adjudication and administration. For the former, the court determines "specific rights through motions, objections, and adversary proceedings." For the latter, the court ensures that "the progression of the case" follows the Code. Finally, they explain that, unlike in a fee-shifting case, "where the award of fees is part of the litigation itself," all bankruptcy fees require court review, regardless of whether there is litigation.

In short, associating fee-defense costs with a "winning side" via the American Rule makes no sense in bankruptcy.

13. How does the dissent address §330(a)(6) regarding fee application preparation?

The dissent doesn't read § 330(a)(6) as making prep work compensable. Rather, §330(a)(6) merely clarifies how to *calculate* reasonable prep work when it's requested. Further, the dissent rejects the majority's "mechanic's invoice" analogy (see Question 9). Specifically, it criticizes the majority's argument that, because a fee app is not a condition for payment *outside* of bankruptcy, a fee app is a service *in* bankruptcy. If its status as a bankruptcy-specific requirement is what makes it compensable, then shouldn't the "time that a professional spends at a hearing defending his or her fees" *also* be compensable? Neither are required outside of bankruptcy. Therefore, both should be compensable under the majority's view.

In short, the dissent believes that "preparing for or appearing at" a fee hearing is "an integral part of fee-defense work" that should be compensable.

14. Did anyone else come to the defense of bankruptcy professionals?

12 *amicus curiae* briefs were filed: 10 in favor of Baker Botts; only 1 in favor of ASARCO; and 1 neutral.

15. That's a lot of support for an ultimately losing position. Did the Court depart from a "majority" view?

Possibly. Some suggest that the Court took the case to resolve a split between the Fifth Circuit (the case on appeal), Eleventh Circuit, and Ninth Circuit. If there was a split, then the Court resolved it in favor of the Fifth and Eleventh Circuits without saying so. In fact, it's notable that the majority cites only 2 bankruptcy cases that are even remotely close to the issue (*Alyeska* and *Laime*) and only 4 bankruptcy cases overall. After the Court's significant praise of bankruptcy court wisdom in May's *Bullard v. Blue Hills Bank*, one would think that the Court would have turned more to the lower courts for direction. Nope.

For point of reference, Robert Keach, Co-Chair of the ABI Commission, summarized the pre-*Baker Botts* views during the ABI Panel Discussion. The "majority view" was that defense costs aren't recoverable unless the applicant "substantially prevails" in defending his fees. The "minority" view was that defense costs don't benefit the bankruptcy estate and, thus, are never recoverable, *per se*.

See also United States Trustee Large Case Fee Guidelines (recognizing "substantially prevails" exception); amicus brief of Florida Bar (starting at .pdf p. 18) (collecting cases, especially in the 11th Circuit).

16. Which side got it right?

The dissent. Although we disagree with the dissent's conclusion that fee-defense is not a "service," we agree that the majority erred by adopting a *per se* prohibition on defense costs rather than leaving them to the court's discretion under § 330's comprehensive scheme.

The **first possible error** is the Court's insistence on forcing an American Rule discussion on §330--a "talk about what we know" approach; a "round hole, square peg" sort of error. The Court sidesteps that error (mostly) because, although it talks a lot about the American Rule, the Court ultimately doesn't base the holding on that rule. Rather, it construed the statute itself (albeit erroneously) by focusing on the intersection of § 327(a) (disinterested persons assisting the trustee) and § 330(a)(1) (necessary services rendered).

The **second possible error** is the Court's refusal to use § 330(a)(6) to make defense costs recoverable. At first, it appears that the Court held that defense costs aren't recoverable because § 330(a)(6) explicitly references fee preparation, but not fee-defense. After all, many of the briefs addressed whether § 330(a)(6) *authorizes* prep work or merely clarifies how to *calculate* reasonable prep work when it's requested. However, the Court dodges those arguments altogether, holding, correctly, that § 330(a)(6) "does not presuppose that courts are free to award compensation based on work that does not qualify as a service to the estate administrator" (i.e., § 330(a)(6) is neither here nor there on compensability).

That gets us to the **heart of the Court's error**: It splits § 330 into separate analytical parts rather than recognizing that § 330 works as a whole to calculate reasonable compensation. In the process, the Court adopts a *per se* prohibition on defense costs that robs courts of the discretion to

determine when they benefit the bankruptcy case and/or are necessary for its administration. Thus, the Court ends-up sanctioning the very form of fee dilution that it rejected in *Jean*.

Specifically, the Court appears to treat § 330 as requiring 2 steps: (1) a threshold § 330(a)(1) determination of whether something is a compensable "service" and (2) a follow-up § 330(a)(3) determination of whether the professional charged the compensable service reasonably. However, we believe that § 330(a)(3) and § 330(a)(4) actually inform the threshold "compensable service" determination under § 330(a)(1):

- § 330(a)(3)(C) emphasizes "whether the services were ***necessary to the administration*** of, or ***beneficial…toward the completion*** of" the bankruptcy case.

- § 330(a)(4) emphasizes only paying for services that were (i) "reasonably likely to ***benefit the debtor's estate***" or "***necessary to the administration of the case***."

And by focusing so much on (a)(1) and so little, if at all, on (a)(3) and (a)(4), the Court commits ***3 real errors***.

Error #1: Court adopts an overly narrow, mutually exclusive view of "benefit."

The Court adopts an overly narrow, mutually exclusive view of "benefit." The Court's view is too narrow because it focuses only on the relationship between the trustee and the professional. For example, the Court recognized that fee preparation is a "service" to the administrator because it "allows the ***customer*** to understand--and, if necessary, dispute his expense." If one looks just at § 330(a)(1), then one might conclude that the administrator is the sole customer. However, (a)(3) and (a)(4) suggest that the "customer" is, in fact, the administrator, the United States Trustee, the constituencies who have claim against the estate, the constituencies that have an obligation to help administer the estate (e.g., committees, fee examiners, etc.), and the court itself.

The Court views "benefit" in a mutually exclusive manner because it doesn't recognize that a service can benefit the professional *and* other constituencies without forfeiting disinterestedness. In fact, the compensation process contemplates a certain level of self-interest because it has the estate bearing a professional's reasonable compensation. For example, preparing a fee application benefits the professional because it's a condition for payment; it benefits other constituencies because it permits them to satisfy their duty to the estate to "understand" and even "dispute" fee applications. How is *fee-defense* any different? The Court doesn't tell us.

Error #2: Court fails to consider if fee-defense is necessary for case administration.

The Court also ignores the **alternative basis for compensation**: whether a service is "necessary to the administration" or "completion of" the bankruptcy case. After all, the Code *requires* a detailed and itemized fee application that's unknown outside of bankruptcy. It requires notice to the United States Trustee and other parties-in-interest. At a minimum, the court must review the application for compliance with § 330. Finally, the trustee can't satisfy its duty to complete the case until there's a ***resolution*** (not just an assertion) of all claims against the estate, including §503(b)(2) administrative claims for compensation. And with limited exceptions, such resolution is impossible without a hearing. As Baker Botts argued, "fee-defense litigation is necessary to a case's completion because it is an indivisible part of a complex fee-assessment process that the Code specifically mandates."

If "compensability" is the sole province of § 330(a)(1), then it makes no sense for § 330(a)(1) to require that services be "necessary" (and for the Court to read "benefit" into the term "services") ***and*** for (a)(3) and (a)(4) to ***also*** emphasize benefit and necessity. In other words, if (a)(1), (a)(3), and (a)(4) *don't* work together as a whole, then (a)(3) and (a)(4) are superfluous.

Error #3: Court flip-flops on fee parity and fee dilution.

Eventually, *Jean* comes back to haunt the Court. It's not the language that the majority quotes from *Jean* (i.e., "We find no textual or logical argument for treating so differently a party's preparation of a fee application and its ensuing efforts to support that same application."). After all, there was no doubt in *Jean* that the EAJA extended to core fees and fee-defense. Rather, it's the language from *Jean* that the majority *doesn't* quote: "Denying attorneys' fees for time spent in obtaining them would dilute the value of a fees award by forcing attorneys into extensive, uncompensated litigation in order to gain any fees."

That brings us to the **bottom line**: Almost all of the parties argued extensively that a *per se* prohibition on defense work, without regard to whether the defense is meritorious, could dilute compensation and, thus, contravene Congress' intent that there be compensation parity between bankruptcy and non-bankruptcy professionals. The parties even screamed that argument from the roof-tops in at least 16 separate briefs. Nevertheless, the Court wasn't buying it. Relying on its flawed invoice analogy and unsupported assertions about what motivates attorneys, the Court simply dismissed the dilution argument as a "flawed and irrelevant policy argument." Unfortunately, that's that.

17. After *Baker Botts*, which fees and costs are reimbursable and not reimbursable?

The way we read *Baker Botts*, the "reimbursable v. non-reimbursable" debate is resolved this way:

Employment Applications/Compensation Procedure Motions

There's nothing in *Baker Botts* suggesting that fees related to prosecuting § 327 employment applications aren't reimbursable. A professional benefits from employment matters, but it's difficult to argue that employment matters aren't "actual, necessary services." At bottom, employment applications are the first services rendered to a trustee. That rationale also applies to compensation procedure motions under § 331, as such motions establish a review process that benefits all constituencies and promotes administration.

However, that's not to say that someone will not try to use *Baker Botts* to challenge typical "first day" employment or compensation procedure matters.

Fee Statements and Fee Applications

For purposes of *Baker Botts*, interim fee *statements* that are served under a procedures order should be treated like interim and final fee *applications*. Therefore, *Baker Botts* likely impacts statements and applications as follows: (i) under § 330(a)(6), the cost of preparing, serving, and filing them (as applicable) are recoverable; but (ii) the cost of correcting them and of reviewing and

responding to information requests or objections are not recoverable because such costs are in the prohibited "defending" category.

Non-preparation fees and expenses likely amount to "defending" the applicant's fees and, thus, are not recoverable. They include fee-related corrections, explanations, negotiations, research, and responses occurring after a fee application is served.

Hearings on Compensation Requests

We can argue about whether "after notice and a hearing" requires a hearing when no objection is filed, but our judges, at least, tend to require a hearing unless, under Rule 2002(a)(6), the requested compensation doesn't exceed $1,000. Under Rule 9014, those hearings fall into 2 categories: (i) uncontested hearings without objections and (ii) contested hearings with objections. Under *Baker Botts,* preparing for, traveling to, or participating in any contested ("adversarial") fee hearing is not recoverable.

However, do uncontested hearings fall outside of *Baker Botts'* prohibitions? Can the court award compensation for defense costs related to a *court-ordered* fee hearing as long as the applicant merely *presents* his application, *summarizes* his fees, and the answers questions to establish a record? We hope so, but probably not.

Baker Botts is not clear. On the one hand, the dissent asserted that the "majority does not believe that preparing for or appearing at [an uncontested hearing]--an integral part of fee-defense work--is compensable." On the other hand, Robert Keach pointed out that "[u]nder the majority opinion, apparently you can now *attend* the hearing, but if you do any *defending* while you're there, you can't be paid for that time." Ultimately, the majority speaks for itself: A court can't award fees "for work performed in defending a fee application in court." Therefore, we don't see a *definitive* basis for treating uncontested hearings differently (but see Question 18 re: limiting *Baker Botts*).

Arguing about *Baker Botts*

Under the Court's "benefit theory," applicants will likely bear the expense of obtaining answers to any questions that *Baker Botts* leaves unanswered.

18.That's an awfully strict reading of *Baker Botts*. Can we work around it?

Limiting *Baker Botts* to its Facts

We might be able to limit *Baker Botts* to adversarial litigation between the applicant and the debtor (based on the following language that we've emphasized):

- The court can't "shift the costs of ***adversarial litigation*** from one side to the other" (i.e., from "***attorneys***" to the "***administrator***").
- "Time spent ***litigating*** a fee application against the ***administrator***" isn't "labor performed" for or "disinterested service to" the administrator.
- The term "services" doesn't "encompass ***adversarial*** fee defense ***litigation***."

- Even in the mechanic's invoice analogy, the Court speaks only of a "***battle***" over a bill.

In other words, the Court emphasizes (1) adversarial litigation (2) between two sides (3) where one side (the applicant) is seeking to have the other side (the applicant's client) pay its defense fees. That only occurs when the *debtor* or *trustee* objects because the shifting of fees, if any, can only be to the debtor or the trustee. Compare that to a dispute between an applicant and a creditor: The applicant is not seeking to transfer the fees to the creditor--the estate bears them or it doesn't.

Therefore, we might limit *Baker Botts* in 2 ways, such that the prohibition on defense costs only applies:

1. When the applicant's client (i.e., the debtor) objects; or

2. When an objection leads to litigation (regardless of who objects).

In the former, a pretty aggressive limitation, the "substantially prevails" standard would still apply to non-debtor objections.

In the latter, a less aggressive limitation, uncontested fee hearings would be compensable.

Implementing Contractual Workarounds

Two problematic reactions to *Baker Botts* might be "I'll just increase my hourly rate" or "I'll just get the debtor to agree to pay fee-defense costs."

Increasing Rates. Although the Supreme Court didn't mention it, the Fifth Circuit made the rather incredible suggestion that bankruptcy professionals can address fee dilution by "anticipat[ing]" it "in their hourly rates." As the amicus judges explain, this "rate-padding scheme will make the fee award process less transparent." Worse, the suggestion should fail the reasonableness test out of the gate.

Finally, how is it fair or loyal to burden *all* clients with padded fees that are otherwise not compensable just because a *few* clients *might* embroil the professional in fee litigation? The New York Bar stated it best: "It would be an odd system indeed that allowed professionals to be compensated for defending fee applications indirectly through their hourly rates instead of directly through compensation for reasonable actual defense fees."

Modifying Engagement Letters. The Court held that the American Rule applies "unless a statute ***or contract*** provides otherwise" (emphasis added). Therefore, can having debtors agree to pay for defense costs displace the American Rule *as a matter of contract*? Probably not. **First**, does an attorney have an ethical duty on the front-end to disclose *Baker Botts*? How would that conversation go? "The Supreme Court just held that you aren't required to pay for defense costs, but I'd like you to pay them anyway." **Second**, even if the debtor agrees to pay for defense costs, wouldn't the attorney simply be setting himself up for a § 327 employment objection when he discloses the terms to the court?

Freedom of contract is important, but we aren't sure how it can trump the Code on compensation limitations and reasonableness.

Applying for Employment under Section 328

Some, including those on the ABI Panel Discussion, have wondered whether § 328(a) provides a workaround. Under § 328(a), a court may approve in advance "***reasonable terms and conditions of employment***" for a professional. A § 328(a) compensation arrangement cannot be altered after the conclusion of the employment unless it proves "improvident in light of developments not capable of being anticipated." Typically, § 328 issues arise with investment bankers and the like, and the reasonableness of their retainers.

We also don't see how § 328 helps. After all, the court still has a duty to determine whether the terms are "reasonable." We'd think that *Baker Botts* will bear on that determination. Such an arrangement might also be an improper attempt to contract around § 328(a)'s disinterestedness requirement.

Of course, if (and it's a big "if"), the court approves payment of fee-defense costs on the front-end, then § 328 likely *is* a solution.

Seeking Sanctions under Rule 11

The majority remarked that if the "United States harbors any concern about the possibility of frivolous objections to fee applications," then Rule 9011 "authorizes the court to impose sanctions for bad-faith litigation conduct." However, as the amicus judges explained, the "standard for imposing sanctions is too high for bankruptcy judges to prevent dilution with that rarely used cudgel" (citing a Delaware bankruptcy case holding that the "stringent" Rule 9011 standard demands "exceptional circumstances" where a claim is "patently unmeritorious or frivolous"). Even ASARCO's objections weren't *patently* frivolous. Finally, even a successful Rule 9011 movant will be lucky to break-even on the cost and burden of litigating Rule 9011.

19. Does *Baker Botts* impact the award of "fee enhancements"?

No. The issue of enhancements was a big issue below, but the parties didn't take it up. Some might say that the lower court decisions advance the cause for fee enhancements. Others might say that a fee enhancement from "probably the most successful Chapter 11 of any magnitude in the history of the Code" is hardly helpful precedent in (surely) more humble cases.

20. What are others saying about *Baker Botts*? Have courts gotten involved yet?

What Others are Saying

Law360 collected various reactions to *Baker Botts* here, including one from **Dechert's Eric Brunstad Jr.** (a Supreme Court bankruptcy star in his own right):

> Bankruptcy is a highly specialized context, and reliance on general fee-shifting principles is at odds with the purpose, policy, and reality behind the supervision and award of fees in Chapter 11 cases. Unfortunately, this decision will create problems in the administration of Chapter 11 matters.

Similarly, **Prof. Stephen Lubben**, one of the amici and a frequent Credit Slips contributor, observed that:

> The majority seems to be totally out of touch with the reality of bankruptcy practice, and its opinion seems to be an open invitation for bomb throwers who stop just short of Rule 11.

You can find additional commentary by listening to the excellent ABI Panel Discussion.

What the Courts are Saying

So far, 6 courts have cited *Baker Botts*, but not on the fee-defense issue. As an aside, we couldn't help but notice that one of our S.D.G.A. judges cited it on the general issue of statutory interpretation. We'll keep our eyes on other cases.

CONCLUSION

Our knee-jerk reaction to *Baker Botts* was that it represents another example of the Supreme Court's disdain for bankruptcy practice. Perhaps we've been recovering fee-defense costs for so long that we can't imagine bankruptcy practice any other way. Nevertheless, Baker *Botts* is now controlling law. The most that we can probably hope for is that lower courts will limit *Baker Botts* to fee litigation rather than fee presentation, such that the cost of court-ordered, *uncontested* fee hearings is still compensable.

About Stone & Baxter, LLP

Stone & Baxter is a boutique business litigation firm with a special emphasis on financial restructuring and bankruptcy. With its strategic location in Macon, Georgia, Stone & Baxter readily serves debtors and other restructuring constituencies all over the State. The firm also has robust transactional and regulatory practices. Stone & Baxter publishes Plan Proponent: A Bankruptcy Confirmation Blog, a blog which focuses on confirmation issues arising in business, municipal, and other restructuring cases.

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