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Should An Estate Professional Be **Paid** For **Defending Fees?**

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BIGSTOCK

Baker Botts, an international law firm of almost 700 attorneys, recently served as debtors' counsel in the Asarco bankruptcy case. In connection with its role, the bankruptcy court showered Baker Botts with the following praise:

> Throughout these bankruptcy cases, Baker Botts lawyers conducted themselves with the utmost professionalism and commitment, addressing an array of challenging legal issues with sophistication, creativity, and skill. Few firms in the country have the breadth and depth of experience in different disciplines necessary to handle these cases with the skill demonstrated by Baker Botts. Baker Botts performed at an exemplary level in a wide spectrum of legal specialties.
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> 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 [ ]. 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.[1]

To date, neither the bankruptcy court nor any appellate court has made findings that question Baker Botts' efforts or performance during the case, and Baker Botts was awarded more than $113 million for its work as debtors' counsel.

During the case, Baker Botts incurred millions in fees in defending its fee applications before the bankruptcy court. No court questioned the reasonableness of the fees that Baker Botts incurred in defending its fee requests, and its underlying fees were largely approved. Yet, the U.S. Court of Appeals for the Fifth Circuit

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reversed the lower courts' determinations that a bankruptcy estate professional's fees incurred in connection with defending its fee applications are compensable under the Bankruptcy Code. The Fifth Circuit's ruling was based on the finding that Baker Botts' defense of its fee applications was not likely to benefit the Asarco debtors' bankruptcy estate and was not necessary to the administration of their estate. This decision ran contrary to precedent from the Court of Appeals for the Ninth Circuit that could have allowed Baker Botts to be compensated for defending its fee applications. Given the circuit split, and the significance of the underlying bankruptcy issue, on Oct. 2, 2014, the U.S. Supreme Court granted certiorari in *Baker Botts v. Asarco*, No. 14-103.

Given the importance of this appeal before the Supreme Court, this article will focus on §330 of the Bankruptcy Code, the section under which Baker Botts sought compensation as a bankruptcy estate professional, and the methods courts employ when evaluating §330 fee applications. This article also will examine the circuit split that gave rise to this appeal before the Supreme Court, and will focus on the practical effects the case will have on bankruptcy practitioners and their roles as estate professionals in future bankruptcy cases.

Section 330 of the Bankruptcy Code

Section 330(a)(1) of the Bankruptcy Code provides for "reasonable compensation for actual, necessary services" of attorneys and other professionals who are paid from the bankruptcy estate. To receive compensation, professionals must submit detailed fee applications, which are subject to challenge by interested parties, including the U.S. Trustee. Compensation awarded to estate professionals under §330 is an administrative expense under §503(b)(2) and given second priority in the distribution of estate assets under §507(a)(2). Generally speaking, fee applications are approved on a final basis at the conclusion of a bankruptcy case.

When reviewing fee applications, §330(a)(3) provides that bankruptcy courts must consider "the nature, the extent, and the value of such services, taking into account all relevant factors," including the following six explicit factors: (1) the time spent on such services; (2) the rates charged for such services; (3) whether the services were necessary or beneficial; (4) whether the services were performed in a timely manner; (5) the qualifications and experience of the professional; and (6) the rates charged by comparably skilled practitioners in non-bankruptcy fields. Although courts must consider these factors, they are not exhaustive in determining what constitutes reasonable compensation. In addition to providing guidance regarding reasonableness, §330(a)(4)(A) also includes two prohibitions on compensation for: (1) unnecessary duplication of services and (2) services that were neither reasonably likely to benefit the debtor's estate nor necessary to the administration of the case.

Most courts agree with the Ninth Circuit's analysis that **compensating bankruptcy professionals** for the preparation of and the successful defense of their fee applications is **necessary to avoid dilution of their fees.**

Although courts remain split over whether attorneys may recover fees and expenses incurred in defending their fee applications, §330(a)(6) provides for compensation in connection with the preparation of fee applications. Compensation under §330(a)(6) is subject to the other requirements of §330, including not being duplicative under §330(a)(4). While not addressed by the Bankruptcy Code, some courts have limited recovery for the preparation of fee applications.[2]

The six factors contained in §330(a)(3) were not part of the Bankruptcy Code until 1994, when Congress substantially amended §330 in the Bankruptcy Reform Act of 1994. Prior to these amendments, courts generally looked to a combination of: (1) various factors set forth by the Fifth Circuit Court of Appeals known as the *Johnson*[3] factors and (2) a formula approach developed by the Court of Appeals for the Third Circuit known as the lodestar method.[4] Although Congress codified some of the *Johnson* factors in the 1994 Amendments, bankruptcy courts continued to apply the lodestar method and *Johnson* factors. As stated by a bankruptcy court in the Central District of Illinois, "although the *Johnson* factors, the 'lodestar' approach and §330 are not identically termed, there is a sense of harmony between [sic] them and a court need not pick one over the others."[5]

The Split Giving Rise to Certiorari

On the one hand, the Ninth Circuit Court of Appeals has supported the discretion of bankruptcy judges to award fees for essential services, which, in its view, includes the successful defense of fee applications.[6] It has held that the Bankruptcy Code's text and policy accepts defense fees under appropriate circumstances, and denying counsel reasonable compensation for successfully defending its fee applications would reduce its compensation for actual and necessary services.[7] The Ninth Circuit has explained that the availability of compensation for successful fee award defense is necessary to prevent the dilution that would result if attorneys were forced to absorb the time devoted to successfully litigating a fee award, which, in the Ninth Circuit's judgment, would be contrary to Congressional intent against fee award dilution.[8]

On the other hand, the Fifth Circuit Court of Appeals held that §330(a) does not authorize compensation for the costs estate professionals bear to defend their fee applications.[9] The Fifth Circuit inter-

preted §330(a) not to include fees for defense of fees either as reasonable, necessary costs of case administration or to prevent dilution of the professional firm's core fees, in essence holding that defending fee applications never benefits the estate.[10] Therefore, presumably defense fees are not available in the Fifth Circuit as a matter of law, yet within the Ninth Circuit, courts have discretion to award them when deemed reasonable and necessary.

The conflict among the Ninth and Fifth Circuits is illustrative of the disagreement among the lower courts on this question. Most courts agree with the Ninth Circuit's analysis that compensating bankruptcy professionals for the preparation of and the successful defense of their fee applications is necessary to avoid dilution of their fees. When those courts deny defense fees, it is ordinarily a matter of discretion, rather than perceived legal preclusion. For example, courts deny defense fees when the fee application defense was unsuccessful or if some other reason did not warrant compensation.[11] In contrast, at least two bankruptcy courts (the Northern District of Texas and the Western District of New York) consistently deny defense fees as a matter of law since the enactment of the Bankruptcy Reform Act of 1994.[12] Accordingly, the pending *Asarco* decision before the Supreme Court should clarify existing splits both among the circuits and the lower courts.

Consequences of the Forthcoming Decision

Commentators have widely speculated about the possible effects of the Supreme Court decision in *Asarco*, no matter how the court rules. Conventional wisdom suggests that should Baker Botts prevail, this could deter meritless objections to fee applications and ensure firms are fairly compensated for their bankruptcy work. Should the Fifth Circuit be upheld, bankruptcy lawyers could have to dilute their recovery by spending their own money defending objections to their fee requests. Valid objections to fee applications are an essential part of the bankruptcy process and firms that file invalid fee applications should not be compensated for the time defending those requests. Yet, an affirmance of the Fifth Circuit's ruling arguably encourages other parties to lob endless risk-free objections at fee applications. If counsel can never get fees for defending their applications, it gives a free pass to objectors to raise any and all objections so long as they are not frivolous, without the objecting parties being forced to bear the cost their complaints impose on the firm seeking to be paid for its work.

While the Fifth Circuit opined that Baker Botts' fees were not necessary to the administration of the *Asarco* bankruptcy estate, and therefore prohibited under §330(a)(4)(A), the Bankruptcy Code, could, in fact, be interpreted such that defending fee applications falls within the general concept that fees are recoverable so long as they are necessary to administration of the estate. Because a court can not finalize a bankruptcy proceeding without addressing fees, resolving fee litigation like the one before the *Asarco* court is necessary to administration of the case, and, thus, arguably Congress did provide for compensation to defend fee applications.

Prognosticators that have defended the Fifth Circuit's decision opine that the allowance of fees for fee defense could increase the administrative costs of bankruptcy, which could negatively impact creditors, as well as debtors attempting to restructure. These costs can become substantial, costly and time-consuming. Furthermore, a Supreme Court decision running contrary to the Fifth Circuit also would conflict with the principle that each party to a litigation should bear its own legal costs (the American Rule), which is the general rule in our legal system, absent clear statutory authority or certain other circumstances (e.g., where a party has acted in bad faith).[13] An adoption of the Ninth Circuit's allowance of fees for fee defense, and burdening a debtor and its estate with such costs, would conflict with the normal practice outside of bankruptcy where practitioners typically receive no compensation for litigating a fee dispute.

Regardless of its ruling, the Supreme Court's decision should provide estate professionals the needed guidance whether they can request and expect payment of fees incurred defending fee applications. Settling the split among the circuits will allow for uniform law across all bankruptcy courts and will allow estate professionals to better make informed decisions when taking on engagements in bankruptcy cases.

1. *In re Asarco*, Case No. 05-21207, 2011 Bankr. LEXIS 5487, at *12-14 (Bankr. S.D. Tex. July 20, 2011).
2. *In re Borders Grp.*, 456 B.R. 195, 212 (Bankr. S.D.N.Y. 2011) (limiting recovery of fees for preparation of fee applications to three to 5 percent of the total fees and expenses requested).
3. *Johnson v. Georgia Highway Express*, 488 F.2d 714 (5th Cir. 1974). While *Johnson* was not a bankruptcy decision per se, its factors were later adopted by bankruptcy courts in analyzing estate professionals' fee requests. See *Am. Benefit Life Ins. Co. v. Baddock (In re First Colonial of Am.)*, 544 F.2d 1291 (5th Cir. 1977).
4. *Lindy Bros. Builders v. Am. Radiator & Sanitary*, 487 F.2d 161 (3d Cir. 1973).
5. *In re E. Peoria Hotel*, 145 B.R. 956, 962 (Bankr. C.D. Ill. 1991).
6. *Smith v. Hale (In re Smith)*, 317 F.3d 918 (9th Cir. 2002) (abrogated in part on other grounds by *Lamie v. U.S. Trustee*, 540 U.S. 526, 531-39 (2004)).
7. *Smith*, 317 F.3d at 929.
8. *N. Sports v. Knupfer (In re Wind N'Wave)*, 509 F.3d 938, 945-46 (9th Cir. 2007) (explaining that the Bankruptcy Code intended to avoid dilution of the effective rate for bankruptcy counsel that would result if fees incurred in successfully obtaining or defending an award were not compensated).
9. *Asarco v. Jordan Hyden Womble Culbreth & Holzer, P.C. (In re Asarco)*, 751 F.3d 291 (5th Cir. 2014). Along with Baker Botts, Jordan Hyden acted as co-counsel to the debtors in Asarco.
10. Id.; see also *Andrews & Kurth v. Family Snacks, Inc. (In re Pro-Snax Distribs.)*, 157 F.3d 414, 418 n.7 (5th Cir. 1998) (indicating that §330 states twice, in both positive and negative terms, that professional services are compensable only if they are likely to benefit a debtor's estate or are necessary to case administration).
11. See *In re Wireless Telecomms.*, 449 B.R. 228, 238 (Bankr. M.D. Pa. 2011) (denying compensation for defense fees because the court "can articulate no benefit to the estate or necessity as it relates to the unsecured creditors"); *In re Erewhon*, 21 B.R. 79, 89-90 (Bankr. D. Mass. 1982) (denying compensation "for time spent by counsel seeking to justify its own request for an excessive fee").
12. See *In re Teraforce Tech.*, 347 B.R. 838, 867 (Bankr. N.D. Tex. 2006) (observing that "counsel should not normally be able to recover fees for defending a fee application in the bankruptcy court"); *In re St. Rita's Assocs. Private Placement, L.P.*, 260 B.R. 650, 652 (Bankr. W.D.N.Y. 2001) (not awarding compensation for the defense of a fee application where the objections were filed in good faith and ultimately resulted in a partial disallowance of the requested fees).
13. See, e.g., id.