REUTERS

Bankruptcy Lawyers Prep for New Disclosure Requirements

By Nick Brown | June 12, 2013

Bankruptcy lawyers will soon have to make an array of new disclosures on how they bill clients under guidelines finalized by the U.S. Department of Justice on Tuesday, the first overhaul of bankruptcy billing in 17 years.

Lawyers will have to justify any increases in their hourly rates and will be asked to provide rough budgets. Those were points of contention over the last year as the U.S. Trustee Program, the Justice Department's bankruptcy watchdog, rolled out early drafts of the proposal.

The move marks the first update to fee guidelines since 1996 as high legal costs in bankruptcy cases come under scrutiny from regulators and academics.

Lawyers were torn on the potential impact of the guidelines. Bernstein Shur's Robert Keach, a fee expert who serves as fee examiner in AMR Corp's Chapter 11, said the guidelines merely institutionalize what is already done in many large cases.

"I wouldn't characterize this as overly burdensome or unhelpful," Keach told Reuters.

But bankruptcy lawyer John Penn of Haynes & Boone said the guidelines "seem like overkill" and compared the difficulty of budgeting a bankruptcy case to anticipating hits in a football game.

"You tell me what the other side is going to do, I'll tell you what it costs," Penn said.

The guidelines, to go into effect Nov. 1, will apply to bankruptcy cases for companies with more than $50 million in assets and $50 million in liabilities. Courts are not legally obligated to implement them, but in general, most courts follow guidelines laid out by the Justice Department.

'WHEN SUPPLY EXCEEDS DEMAND'

The overhaul stems from what some industry professionals see as a disproportionate cost structure in bankruptcy billing. While many companies have looked to curb legal costs by demanding discounts from non-bankruptcy legal advisers, bankruptcy attorneys can still demand top rates - sometimes $1,000 an hour or higher - because the restructuring field is so specialized.

The issue is made even hotter by the fact that advisers of bankrupt companies and some of their creditors are paid out of the company's estate. Since legal fees are paid ahead of other creditor claims, higher legal costs mean less money for creditors.

The guidelines are meant to ensure that bankruptcy rates reflect market rates for non-bankruptcy legal work, rather than effectively creating a bankruptcy premium.

Penn, of Haynes & Boone, said that the initiative is unnecessary because the market already keeps prices competitive.

"You have seen the downturn in big cases," he said. "Well, when supply exceeds demand, rates fall."

But proponents of the plan took a more historic view, saying bankruptcy regulators have always sought to keep bankruptcy costs in line with other legal prices. The difference a generation ago, before the adoption of the 1978 federal Bankruptcy Code, was that bankruptcy lawyers were making less, not more, than their non-bankruptcy counterparts.

At the time, bankruptcy courts were authorized to enforce fee discounts to reflect the troubled state of bankrupt companies and preserve value for creditors, but the 1978 code changed that, allowing bankruptcy lawyers to charge market rate amid fears that lower prices were driving away business.

The Trustee's latest effort simply preserves that balance from the other side, Keach said.

Among the new guidelines are disclosures requiring lawyers to reveal the methodology they use to come up with certain rates, and to explain and justify rate increases.

The Trustee will also push for attorneys to provide budgets, and will ask lawyers for an explanation if those budgets are exceeded by more than 10 percent.

During a comment period late last year, large law firms complained that the overhaul would ignore market pricing and impose burdensome tasks on lawyers, with little benefit to clients.

A major sticking point was a requirement that firms calculate how much clients' bills would rise as a result of rate increases and submit statements from clients saying they agreed to the higher fees.

Law firm Foley & Lardner at the time characterized the plan as "excessive micro-management."

Marcia Goldstein, a top bankruptcy partner at Weil, Gotshal & Manges, proposed that only annual, firmwide rate increases of 10 percent or more be reported to the court.

HIKE OF 48 PERCENT

The final guidelines sustain the disclosure requirement, with one key change: rate increases tied to associates' promotions - so-called step increases - will be excluded from disclosure requirements, Clifford White, director of the Trustee Program, told reporters in a conference call on Tuesday.

"That's not a rate increase in the sense that the firm might be changing upwards its overall hourly fees," White said. "It is instead a step in a natural progression."

Not that young lawyers' rate increases are always small: It is often they who raise rates the most, as they gain experience. For instance, in Lehman Brothers' record-setting Chapter 11 case, industry superstar Harvey Miller, of Weil, increased his rate only $50 dollars over four years, from $950 to $1,000. In contrast, Candace Arthur, an associate at Weil, began work on the case in 2010 at $395 an hour, but jumped to $585 per hour, a 48 percent hike, by September of last year, according to the firm's public fee applications in the case.

It is not clear whether Arthur's increases were purely step increases. When Reuters reported on the issue in September, Weil and Arthur each declined to comment.

But the Trustee warned against rate increases that are disguised as mere step increases, saying in the guidelines that "applicants should not attempt to characterize actual rate increases … as 'step increases' in effort to thwart meaningful disclosure or billing discipline."

At first, the guidelines will apply only to lawyers, not to financial advisers and other professionals. White said new fee guidelines for investment bankers, financial advisers and accountants could be in the offing, but did not provide a time frame.

"We do want to spend some time and resources to ensure that (lawyers) understand what will be expected" from the guidelines, he said. "We want to still keep the focus for a little while on the attorneys."

The Trustee will seek to bolster the use of examiners or committees to oversee fees in big cases. Keach is serving in such a capacity in AMR's case, and says most large, complex cases already utilize fee examiners.

"In cases of this size, even the most diligent judge cannot do this alone," Keach said.

An uptick in fee examiners would pose an added cost to bankruptcy estates but would theoretically save money by regulating and supervising fees. It could also provide a business opportunity, creating one more avenue for professionals looking for a way into the business of bankruptcy.

"One might say we already have a cottage industry of fee examiners in its budding stages," Penn said.

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