NOTES FOR REMARKS BY

CLIFFORD J. WHITE III
DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES

BEFORE THE

NATIONAL BANKRUPTCY CONFERENCE

WASHINGTON, D.C.
NOVEMBER 10, 2011

Introduction

Thank you for allowing me to speak with you about a topic that is so central to the proper functioning of the bankruptcy system: professional compensation. All of us have an enormous stake in advancing a system for the award of professional compensation that promotes proper remuneration, encourages the very best professionals to work in the bankruptcy system, and creates confidence that the bankruptcy system operates for the public interest and not just for a small group of bankruptcy insiders.

I appreciate the invitation you extend each year for me and others from the United States Trustee Program to attend your annual meeting. We learn a great deal and, perhaps, from time to time, we have been able to offer a fact or perspective that has assisted you during the course of your deliberations. I know I speak for all of my colleagues in the USTP when I tell you that we, as public servants, have enormous respect and admiration for those of you in private life who put aside your own interests in order to come together to grapple with important bankruptcy issues. You endeavor to come up with solutions to complex problems that serve the broader public interest. That is why this organization is so important and the contributions you make are so valuable.

This is the second time you have invited me to provide luncheon remarks. The last time was five years ago in 2006. My topic back then was the bankruptcy reform law and how the United States Trustee Program was implementing the new means test, approving credit counselors, conducting debtor audits, and carrying out many of the other changes to chapters 7, 11, and 13. As I recall, the bankruptcy reform law was somewhat controversial within the NBC. And I suspect that the notion of changing the professional fee guidelines likewise may be somewhat controversial within this esteemed group. So, even though this is not the easiest topic to address, I am grateful that my colleagues and I have been given an opportunity to discuss with you a matter of such importance to the bankruptcy community.

When the United States Trustee Program decided some months ago to update the professional fee guidelines that were issued back in 1996, we knew that we would want and we would need a great deal of input from practitioners, judges, and other experts. Naturally, one of the first places we looked was the National Bankruptcy Conference. I want to thank Don Bernstein and Rich Levin, in particular, for the time they personally have given to us to discuss fee issues. They also were helpful in identifying several other NBC members who were available to talk with us along the way. A special thank you to those members – David Lander, Michael St. Patrick Baxter, Jane Vris, Marcia Goldstein, John Shaffer, and Brady Williamson – who collectively shared their thoughts with us as well.

Purpose and Goals of Revising the Professional Fee Guidelines

United States Trustees have an express statutory responsibility to review applications for professional compensation in bankruptcy cases. Congress further amended that obligation in the Bankruptcy Reform Act of 1994 by imposing a mandate on the United States Trustee Program to establish uniform guidelines for reviewing fee and expense applications. The guidelines were

not to change substantive law or statutory standards for awarding fees. Rather, they were intended to foster uniformity in the fee application preparation and review process.

In early 1996, we published our Fee Guidelines and I submit that those Guidelines satisfied their statutory objective. Although the Guidelines are not mandatory by law, they have been adopted in whole or in part by the courts in many jurisdictions and are followed with various degrees of rigor in districts throughout the country. Among the reforms achieved through the Guidelines were threshold disclosure requirements, task-based billing, and standards for reimbursement for certain expenses.

But, like most things, the Guidelines are not immutable and they can become out-of-date. Although I think the Guidelines have retained their essential validity, changes in billing practices, office technology, and other aspects of bankruptcy practice have rendered the Guidelines in need of updating and even a bit of re-thinking. As chapter 11 increasingly is accepted as a means for businesses to move forward during times of economic distress, and as large companies employ chapter 11 to alter their obligations to customers, employees, and pensioners, it is especially important to ensure that the professionals engaged to manage the bankruptcy process be paid in accordance with statutory standards.

I assembled a group of colleagues within the United States Trustee Program to tackle the job of revising the professional fee guidelines. Although we received input from many throughout the Program, our core group is with me today. It includes General Counsel Ramona Elliott; Deputy General Counsel Lisa Tracy; Associate General Counsel and the day-to-day director of this project, Nan Eitel; and United States Trustees Tracy Hope Davis and Roberta DeAngelis. United States Trustee Bill Harrington is also an integral member of the group, but unfortunately, his flight in today was cancelled.

Based on the collective wisdom of my United States Trustee Program colleagues, we identified several objectives, including the following:

- ensure that fee review is subject to client-driven market forces, accountability, and scrutiny;

- enhance meaningful disclosure and transparency in the fee application process;

- decrease the administrative burden of review;

- maintain the burden of proof on the fee proponent and not allow the fee review process to shift that burden to the objecting party; and

- increase public confidence in the integrity and soundness of the bankruptcy system.

Process for Developing Professional Fee Guidelines

Early in the project we decided we would solicit input from knowledgeable professionals. Visiting with members of the NBC was a top order of business. We also spoke with many judges, attorneys, and non-attorney professionals. In fact, we were extremely gratified that groups of judges in both the Southern District of New York and in the District of Delaware were generous in sharing their time and perspectives with us. Supported by that outreach, we drafted the Guidelines that are before you today.

Please note that these are draft Guidelines. On Friday, November 4th, we posted them on our Web site and are seeking public comment for 90 days. We hope the draft is somewhat provocative because we want thoughtful comments that we will seriously consider. Ultimately, the final Guidelines will be published in the Federal Register along with our analysis of the comments received. Because the intra-Executive Branch process for publishing in the Federal Register is often quite lengthy, I am not able to provide a firm date on which the final Guidelines will be promulgated in 2012. For now, we seek your thoughts on the Guidelines at this meeting and invite you to submit written comments through our Web site at www.justice.gov/ust during the public comment period.

Let me add that, two days ago, I participated in an Inn of Court meeting in Dallas where one member raised a very good point that we should consider, that is excluding single asset real estate cases from the mega-case guidelines. He made a good point worthy of consideration. That example shows why we so much want commentary from thoughtful members of the bankruptcy community.

Scope of the Guidelines

After meeting with many bankruptcy experts, we decided that the revised Guidelines needed to make distinctions between larger and smaller cases, and between attorneys and other professionals. As a result, we have not rewritten the Guidelines to cover all cases. Instead, we have proposed revisions to the Guidelines that would apply only to chapter 11 cases with combined assets and liabilities of at least $50 million, and to the professional fees of attorneys only. These tend to be the cases that have engendered the most commentary from both inside and outside the United States Trustee Program.

We will address cases filed under other chapters of the Code, smaller cases, and fees sought by accountants, investment bankers, and others, in later iterations of the Guidelines. That means that Nan Eitel will continue to direct this project, in phases, well into next year.

Legal Policies Reflected in the Guidelines

The Guidelines reflect certain United States Trustee Program legal policy positions that practitioners can expect we will pursue in all districts. Let me describe a few, but by no means all, of those policies. First, the Guidelines make clear that the United States Trustee will not seek to impose local hourly rates on out-of-town law firms. We recognize that bankruptcy has become a national, and even an international, practice. It is not our role to limit the ability of a

national law firm to charge its rates in cases around the country. Not all large cases are filed in the District of Delaware or the Southern District of New York. When large cases are filed in other districts, there should not be an artificial limit imposed on the professional's customary rate. Conversely, however, we will object to a lawyer charging rates that are above his or her customary rates even if the case is filed in a jurisdiction where higher rates are allowed for other law firms and lawyers.

Second, the United States Trustee will object if law firms in mega-chapter 11 cases charge a bankruptcy rate above that charged for comparable services outside of bankruptcy. Prior to the 1978 Act, bankruptcy lawyers were paid under an economy standard predicated upon the assumption that creditors were not being paid in full, so neither should the professionals. Sensibly enough, the draftspeople of the 1978 Code found that the economy standard deprived the bankruptcy practice of some of the best lawyers who would ply their trade in areas of the law where they could be paid their full worth.

The economy standard was replaced by a comparable services standard under the 1978 rewrite of the bankruptcy law. Under the comparable services standard, a professional may be paid under section 330 based on the "customary compensation charged by comparably skilled practitioners in cases" outside bankruptcy.

In recent years, private industry has imposed major cost controls on outside counsel. Budgets, discounts, and other cost saving measures are required under many retention agreements. But in bankruptcy, budgets are rare and charging anything other than the full hourly fee often is considered unfair by the bankruptcy bar.

We are concerned that the economy standard that was changed by law in favor of a comparable services standard has transformed into a bankruptcy premium standard whereby the bankruptcy professionals are allowed to charge rates above what they charge non-bankruptcy clients. By seeking additional disclosures, the revised Guidelines are designed to ensure adherence to the statutorily-based comparable services standard.

The third and final policy I will highlight is our continued policy not to object to lawyers charging full hourly rates for preparing fee applications. Some restraint is expected, however. We believe that much of the work can be performed by less senior professionals and by paralegals. When the law firm amends deficient time entries, unsuccessfully defends fee applications, or redacts privileged information, the professional generally should not be compensated by the estate.

Major Features of the Guidelines

Let me now address what I consider to be the most significant changes in the revised Guidelines. They are not presented here in any particular order of importance.

I will start with an easy change: all attorney fee applications should be submitted in an open electronic data format that is searchable. All major law firms use sophisticated billing

software packages. We also know that large law firms extract data so they can analyze their own fees, as well as the fees of other law firms in their market.

Under the new Guidelines, fee applications would be submitted so that we, the court (if it wishes), and others may download the fee applications into a software package of their own choosing to conduct an automated review. This will facilitate the identification of common issues, such as the sending of an excess number of lawyers to a hearing, and help perform other analyses. After speaking with an array of judges and lawyers, we think the open electronic data requirement will aid everyone while imposing little or no additional burden to the applicant.

Moving on to another rather technical change: the number of categories included under task-based billing would be expanded. We believe the routinization of task-based billing has been essential to efficient fee review and to performing a cost-benefit analysis on discrete portions of a bankruptcy case. In our experience – and in the experience of some of those with whom we consulted – additional categories and subcategories will be helpful in larger cases. The Guidelines would add a number of new project categories to the existing categories to more precisely capture key actions in bankruptcy. The proposed Guidelines also would add activity-based sub-categories that are similar to activity codes, counseling codes, and litigation codes commonly used by law firms under the Uniform Task-Based Management System.

Now to what is perhaps a more provocative change in the Guidelines: new attorney and client certification requirements. In a departure from the original Guidelines, some of these attestations pertain not only to applications filed under sections 330 and 331, but also to retention applications filed under section 327. Among other things, we propose that the law firm applicant certify that it provided information to the client about its rates in non-bankruptcy cases; state whether more favorable rates have been offered to other clients; and, if the firm had a prior relationship with the client, disclose whether it charged the client, including members of the Official Committee, different rates in its other engagements with them.

We also propose that the client verify whether the client reviewed the fee request and compared it to the budget; whether the lawyer and client discussed comparative billing rates and terms; and whether the client gave prior approval for rate increases, if any. We hope that these certifications will focus both the attorney and client on the important questions that will help promote client control and establish joint accountability for controlling legal costs.

Moving to a slightly more controversial change: budgets should be submitted in cases meeting the $50 million threshold for both the debtor's attorney and the official committee's legal fees. While the budgets would not be binding and could be changed simply by submitting revisions, they would provide a benchmark and cause the applicant to explain any significant deviations from the budget targets.

In most cases outside of bankruptcy, clients obtain a budget as part of the engagement process. With this Guideline change, budgets would become the norm in bankruptcy and they would be available for all parties to see. We understand that unanticipated litigation may lead to significant deviations, but we hope that budgets will bring greater discipline to the fee application

process, help maintain the burden of proof with the applicant, and ensure greater client control and accountability.

Continuing with our potentially more controversial provisions, the Guidelines also provide for significant new disclosures. Many of the disclosures are a natural consequence of the new budgeting guidelines and certification of customary billing rates. Other disclosures relate to some of the policy positions that will guide the United States Trustee's review of fee applications.

In many ways these new disclosures not only will add greater transparency to the fee approval process, but the disclosures also will achieve greater efficiency for the court and all parties. By providing necessary information on the record earlier in the process, we may obviate the need for follow-up questions by reviewers, or even depositions and document production requests, that otherwise may be necessary in order to ensure that the fees requested are reasonable and in accordance with statutory standards.

Some of the more significant disclosures called for in the proposed Guidelines are as follows:

– Identify and explain differences between fees budgeted and fees sought.

– Indicate the number of professionals included in the application, including which professionals were not disclosed in the budget staffing plan.

– Summarize each professional's billing practices by disclosing the professional's highest, lowest, and average hourly billed rate over the past 12 months in estate-paid bankruptcy and in all other engagements.

– Disclose the amount of fees attributable to billing rate increases. The United States Trustee will urge courts to require that billing increases be noticed to the parties with an opportunity to object. In some cases, the rate increases during the course of the case may constitute a sizable percentage of the attorney's entire bill. We believe that fact should be known to the parties and to the court.

– Provide an estimate of the amount of fees sought that would have been incurred irrespective of bankruptcy. Many commentators have noted that fee applications may mislead reviewers and the public into thinking that all of the applied for fees are a cost that would not have been borne by the company absent a chapter 11 filing. We know, however, that some professional services subject to section 327 retention and section 330 review would have been performed by the company irrespective of chapter 11. An estimate of the magnitude of the fees and expenses that would have been incurred even without the filing of a bankruptcy petition will be useful in evaluating the reasonableness of fees and the cost-benefit to the estate. It also should strengthen public confidence in the integrity of the bankruptcy compensation process by better delineating what costs are attributable solely to bankruptcy.

The Guidelines include model forms for use by applicants in providing these additional disclosures, which will ease the administrative burden of review and ensure that the requested information is provided clearly.

Special Fee Review Procedures

The final Guidelines topic I will address this afternoon is special fee review procedures. This subject generated much discussion in our meetings with various constituencies. Our recent experience with fee committees, bolstered by the views of many commentators, led the United States Trustee Program to be favorably inclined to move for the establishment of fee committees in larger cases.

It is a myth to believe that any party – including the court or United States Trustee – can timely and carefully evaluate every time entry in a large chapter 11 case. Neither the court nor the United States Trustee is privy to every deposition, negotiation, and other critical aspect of a large, complex case. It is a daunting task, therefore, to make trenchant analyses of the cost and benefits of discrete aspects of a case.

Often, the objections we file tend to be on more technical grounds – such as lumping and overstaffing hearings – and the amount of money saved is modest in comparison to the aggregate amount of professional fees. Law firms usually are willing to negotiate these smaller objections. If we file more significant objections, however, the large law firms often are less willing to compromise and they sometimes seek to denigrate the fee reviewer as not understanding the demands of the case. In fact, I think it fair to say that, generally, significant objections are sustained in only two scenarios: where the law firms failed to adequately disclose a material connection or conflict, and where the case spiraled downward into administrative insolvency.

We suggest that these facts militate in favor of special fee review procedures in the largest and most complex cases. In recent years, there has been an increased use of fee auditors, fee committees, and fee examiners. In the District of Delaware, for example, more than one judge requires that the debtor employ a fee auditing firm to review professional billing records in cases with assets and liabilities reaching $100 million or more. Given the rising complexity of cases, the United States Trustee Program encourages through these proposed Guidelines the establishment of special fee review procedures and sets forth some model principles governing such procedures.

There are three different models for fee review committees. Over time, the United States Trustee Program expects to develop model orders that it will propose to courts in cases requiring special procedures. We do not provide any specific thresholds that should trigger a United States Trustee request, but we think most cases that are subject to these revised Guidelines should be seriously evaluated as likely candidates for such special fee review mechanisms.

In the revised Guidelines, we describe three special fee review mechanisms:

(1) A fee review committee consisting of a representative of the debtor, each official committee, and the United States Trustee. Such committees are of some, but often limited,

utility. They tend to be more effective if they hire a fee auditing firm. These committees centralize the fee review process, attempt to negotiate the resolution of disputes, and file reports with the court evaluating the fee applications. Neither the United States Trustee nor any other party forfeits its right to file objections independent of the committee.

Although the committee may create greater efficiency in fee review, in many cases, the members reflect the same lack of market-based tension that plagues the general fee review process in bankruptcy cases. It is critical that the members of the fee committee not be the lawyers whose fees are subject to review.

(2) A potentially superior variation to the fee review committee is to add a chair who is independent of the parties and the case. The chair, with the consent of the committee, should be able to depose witnesses, conduct Rule 2004 examinations, and object to applications. It is probably advisable to allow the chair to employ not only a fee auditor, but also other professionals to assist the committee in carrying out its responsibilities.

(3) A third alternative is a single fee examiner appointed by the United States Trustee under section 1104 or by the court. In the General Motors case, Bankruptcy Judge Gerber commented on the record that he has found the work of the fee examiner to be extremely helpful. It is critical that the examiner be a seasoned professional who will exercise independent judgment. The fee examiner not only should identify technical flaws in the fee application – for example, lumping or overstaffing depositions – but also conduct a cost-benefit analysis of staffing patterns and time devoted to discrete tasks. The result is a report that has credibility.

It will be interesting over the next year to be able to compare the effectiveness of these varying models that have been employed in several large cases that are on-going, but that may be wrapped up in 2012.

Conclusion

On that note, I conclude my summary of the proposed revisions to the Professional Fee Guidelines. My colleagues and I welcome a discussion with you during our remaining time here and also through written comments you may wish to submit through the formal public comment process.

The members of the National Bankruptcy Conference are a key constituency for these Guidelines so we will eagerly await your thoughtful commentaries on our proposal.

Thank you.

# # # # #