

New Fee Guidelines for Attorneys in Larger Chapter 11 Cases Enhance Transparency and Promote Market Forces in Billing

by:

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Introduction

On June 11, 2013, the Department of Justice (DOJ) issued new “Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under 11 U.S.C. § 330 for Attorneys in Larger Chapter 11 Cases” (Guidelines).¹ Developed by the U.S. Trustee Program (USTP or Program), these Guidelines will apply to cases filed on or after November 1, 2013, that list \$50 million or more in assets and \$50 million or more in liabilities, aggregated for jointly administered cases and excluding single asset real estate cases.²

As Acting Associate Attorney General Tony West stated in DOJ’s announcement of the Guidelines, “[a]t a time when both the public and the most sophisticated participants in the bankruptcy process say bankruptcy attorneys’ costs are rising too rapidly, these Guidelines are designed to ensure that statutory requirements limiting bankruptcy fees to market rates – not premium rates – are followed.” By providing for additional disclosures that can consistently be enforced in districts throughout the country, the Guidelines will create a more complete and efficient process to determine if fee applicants have satisfied their burden to justify fees and expenses.

While these Guidelines do not supersede statutes, rules or court orders, they do clearly communicate to professionals and the general public the criteria used by U.S. Trustees in reviewing fee applications, the USTP’s expectations of professionals, and possible bases for objections to the payment of fees and reimbursement of expenses.

Why New Guidelines Now?

The Bankruptcy Reform Act of 1994 required the USTP to promulgate uniform guidelines for its review of professional fee applications. The Program issued its original guidelines in 1996.³ Since that time, there have been significant advances in law office practice and technology, and in client-driven cost containment, which have changed the legal landscape.

¹ “Justice Department Issues New Guidelines for Payment of Attorneys’ Fees, Expenses, in Large Chapter 11 Bankruptcy Cases,” available at <http://www.justice.gov/opa/pr/2013/June/13-asg-661.html> and http://www.justice.gov/ust/eo/public_affairs/press/docs/2013/pr20130611.htm.

² “Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under 11 U.S.C. § 330 for Attorneys in Larger Chapter 11 Cases” and related materials, available at http://www.justice.gov/ust/eo/rules_regulations/guidelines/index.htm.

³ These new Guidelines are the first stage of a multi-stage effort to update the 1996 guidelines. Until the USTP adopts other superseding guidelines, the 1996 guidelines will continue in effect for the review of applications filed under section 330 in (1) larger chapter 11 cases by those seeking compensation who are not attorneys, (2) all chapter 11 cases below the larger case threshold, and (3) cases under other chapters of the Bankruptcy Code.

Beyond the goal of simply modernizing the Guidelines, the Program undertook its review guided by a number of objectives, including to: (1) ensure that fee review is subject to client-driven market forces, accountability and scrutiny; (2) enhance meaningful disclosure and transparency in billing practices; (3) decrease the administrative burden of review; (4) maintain the burden of proof on the fee proponent; and (5) increase public confidence in the integrity and soundness of the bankruptcy compensation process.

Commentary from the public and experienced participants in the bankruptcy arena reflects a clear and growing view that bankruptcy lawyers sometimes charge premiums not charged outside of bankruptcy and that discounts and other cost saving devices imposed by corporate clients are not the norm in the largest reorganization cases. In fact, in a statement delivered at a recent field hearing of the ABI Commission to Study the Reform of Chapter 11, the chief executive officer of a well-regarded turnaround firm commented that “there is little or no fee control and discipline in mega-cases.” Similar comments also have been made by the Managed Funds Association, the editorial board of the *New York Times*,⁴ and others.

The Revision Process

The final Guidelines reflect almost two years of consultation and review. The Guidelines come as close to a consensus document as one can produce without sacrificing meaningful improvements. From the beginning, the Program recognized the importance of the Guidelines to the bankruptcy system and the level of interest there would be in them. The USTP went to extraordinary lengths, beyond even what would be required for regulations under the Administrative Procedure Act, to seek input from judges, professional organizations like the National Bankruptcy Conference, practitioners, academics and the public on these important procedural guidelines.

The USTP received a diverse range of comments on its November 2011 initial draft of the Guidelines. Additional comments were gathered during and after the June 2012 public meeting, as well as following the publication of the proposed final product in November 2012. By and large, the comments provided a deep reservoir of thoughtful analysis that the Program drew upon in refining the Guidelines. By opening up the process, the USTP obtained valuable information and ended up with a markedly improved product.

Highlights of Comments and Revisions

Generally, the final Guidelines provide for:

- A showing that rates charged reflect market rates outside of bankruptcy.
- The use of budgets and staffing plans.
- The disclosure of rate increases that occur during the representation.
- The submission of billing records in an open, searchable electronic format.
- The use of fee examiners.
- The use of “efficiency” counsel.

⁴ “The Trouble With Bankruptcy Lawyers,” *New York Times*, June 9, 2012.

Though more fully addressed in the comprehensive analyses of the comments found in Exhibit F of the Guidelines, following is a summary of the key areas on which there was extensive commentary.

Comparable Compensation Disclosures

Section 330 of the Bankruptcy Code requires that courts determine “reasonable compensation” based on, among other factors, “customary compensation charged by comparably skilled practitioners in cases other than cases under title 11.” An applicant seeking to be paid by the bankruptcy estate under section 330 has an affirmative burden to prove that the compensation sought is reasonable, and the court, the U.S. Trustee and other parties in interest are entitled to the information necessary to evaluate the reasonableness.

Initially, the Program proposed that applicants disclose high, low and average rates per timekeeper category. There was considerable resistance to this proposal. Some argued that a firm’s billing information is attorney-client privileged, confidential and proprietary and that providing the data would be burdensome (if even possible). Other commenters suggested that the USTP sought to re-impose the former economy of administration standard, rather than enforce the comparable services standard.

Although the USTP firmly believes that sophisticated law firms generally maintain copious amounts of billing data that would permit them to provide such information, the USTP appreciates the need to strike the right balance between the parties’ and the court’s need for evidence of comparability and the professional’s burden of providing it. Accordingly, in line with a recommendation of the National Bankruptcy Conference, the USTP amended the Guidelines to seek the disclosure of hourly blended rates, on either an as-billed or as-collected basis, and excluding *pro bono*, charitable or firm-employee engagements from the calculation. Applicants will be asked for a concise description of the methodology used to calculate blended rates if the calculation includes other than hourly billing arrangements, and they are encouraged to supplement it as appropriate to explain how the different rate structures of various practice groups affect the blended rate. Once blended rates are disclosed, applicants will receive a limited “safe harbor” from subsequent requests from the USTP for comparability data, although this in no way limits the U.S. Trustee from seeking additional information or filing an objection based upon the facts and circumstances of any case.

Budgets and Staffing Plans

The Guidelines ask that attorneys and their clients develop budgets at the outset of a budget period and then later disclose the budget with the fee application. If the fee application materially differs from the budget, professionals should explain the reason for the variation.

Budgets are a planning and evaluation tool for disciplined case management that help to ensure that fees will be incurred in a deliberative and thoughtful manner. They are well-grounded in client expectations in other types of engagements and will provide a benchmark for the evaluation of applications for compensation.

Despite the prevalent use of budgets outside bankruptcy, many commenters asserted that bankruptcy is unique among legal engagements in that it is too unpredictable to expect meaningful budgets. The USTP addressed this concern by clarifying that budgets may be amended as the case progresses, and the USTP agreed that it would seek budgets in a particular case only by the parties' consent or by court order.

Rate Increases

When rate increases outside of bankruptcy are being restrained by clients, and there is no corresponding restraint within bankruptcy, that constitutes a bankruptcy premium not permitted by statute. In bankruptcy, annual or even more frequent rate increases have become routine and the economic consequences can be significant. For example, rate increases in the *Lehman Brothers* case alone amounted to \$90 million.

The initial draft of the Guidelines proposed that all rate increases during a case be disclosed. In response to public comments, the final Guidelines clarify that associate step increases for advancing experience do not need to be separately disclosed or justified. However, the USTP will ensure that firms do not disguise rate increases as step increases and will expect that firms that do not distinguish between the two will disclose all rate increases.

Submission of Records in an Open, Searchable Electronic Format

A key element to ensuring transparency in the bankruptcy compensation process is to make data available in an open, searchable electronic format. Currently, a firm's detailed billing records or invoices are provided in a "static" PDF document or paper copy, requiring a labor intensive and difficult manual review of often thousands of pages of detailed invoices. That is neither efficient nor effective, particularly given that firms are not only able to, but typically do, provide their clients with electronic billing data using the widely adopted Legal Electronic Data Exchange Standard (LEDES) format.

The Guidelines ask that firms provide this same electronic data with fee applications to materially enhance the ability of the court, the U.S. Trustee and interested parties to filter, sort and query the data, thereby providing for a more substantive and meaningful review that is all but impossible now in the largest cases. Few commenters objected to disclosing data electronically, although some were concerned that open data required investment in proprietary software and others raised confidentiality and compliance concerns.

The USTP clarified that a firm can provide electronic data in the same format in which it maintains it and need not modify existing billing software. As to confidentiality concerns, they are annulled since no new data is being requested. The change simply is that the information be provided in an electronic, searchable format.

Greater Use of Fee Examiners

Fee applications in large reorganizations cases are voluminous, and it is daunting for the court, the U.S. Trustee and interested parties to review those applications with the necessary detailed care. The Guidelines encourage greater use of fee examiners to help evaluate technical compliance (e.g., lumping tasks into a single time entry) and assess the reasonableness of a fee request. A fee examiner is guided by the court order establishing the examiner's duties and

powers. The fee examiner typically should be a bankruptcy expert who is qualified to make judgments about the costs, benefits and efficiency of the applicant's work.

The USTP has successfully proposed fee examiners in several large cases, including *Lehman Brothers*, *General Motors* and *American Airlines*.⁵ The fee examiners in those cases brought much value to the fee review process. In *General Motors*, for instance, the fee examiner presented a series of important legal issues for resolution, such as the proof required to justify billing rate increases and the appropriateness of charging fees incurred in contesting objections to the professional's own fee application. The former issue was consensually resolved and the latter issue elicited a thoughtful decision and opinion by the bankruptcy court that is sure to guide other courts in the future.⁶

Greater Use of Efficiency Counsel

Though not included in the initial draft, a recommendation to consider greater use of efficiency counsel developed out of the USTP's process in drafting the Guidelines. Several commenters suggested that the USTP should encourage the use of co-counsel to handle the more routine or "commoditized" work of a bankruptcy case, such as preference actions and claims objections. In many ways, this reflects common practice in the District of Delaware where local counsel typically handles such matters.

Recognizing the potential efficiencies that such counsel could bring to a case, the USTP agreed that applicants should consider how to assign and staff more routine work and whether lower cost co-counsel should be retained for discrete types of work. Thus, the final Guidelines incorporate principles for the effective use of co-counsel with a caution that multiple section 327(a) bankruptcy counsel must not be used to mask disqualifying conflicts and connections and that co-counsel must avoid duplication of services.

Next Steps

By applying the Guidelines to cases filed on or after November 1, 2013, the USTP is affording time for law firms to study the Guidelines and prepare for the USTP's implementation. Over the next several months, the USTP will conduct outreach to ensure that practitioners understand the expected disclosures and other provisions of the Guidelines, with the goal of fostering compliance and avoiding the necessity of filing objections in court. In addition, the Program will work closely with the courts to encourage them to adopt the Guidelines as local rules or administrative orders, as many have done with the 1996 guidelines. Finally, the Program will publish fillable forms prior to the November 1 effective date as a resource for practitioners.

Once the Guidelines take effect, the USTP will enforce them prudently, but vigorously. The Program will be judicious and demonstrate reasonable flexibility, but it is important that the Guidelines be applied as national Guidelines. Undoubtedly, some will challenge the Guidelines by asking the court not to follow them. The Program will be prepared for those challenges and

⁵ The *Lehman Brothers* case involved a fee committee with an independent chair, which functioned essentially like a fee examiner.

⁶ *In re Motors Liquidation Co.*, No. 09-50026, Bench Decision on Pending Fee Issues, at 2 (Bankr. S.D.N.Y. Nov. 23, 2010) (ECF No. 7896).

will defend the Guidelines in bankruptcy court and, as appropriate, will take disputes up the appellate chain. The USTP believes these Guidelines are correct as a matter of law and advance sound public policy as articulated by Congress in the Bankruptcy Code.

Conclusion

The public and commentators will be watching the bankruptcy community to see if the new Guidelines are followed or if they are met with resistance and unproductive litigation. They will expect bankruptcy lawyers to exhibit the same restraint in billing practices that is afforded to clients outside bankruptcy, and that the fee process will become more transparent and effective.

The new Guidelines can make the fee review process more efficient for the courts, U.S. Trustees and interested parties. If everyone works together to implement the Guidelines in a reasonable and consistent manner, public confidence in the integrity of the bankruptcy compensation process can be restored.