

2017

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Recommended Citation

Jones, Sarah L., "Fixing Baker Botts: Contractual Provisions Granting an Exception to the American Rule in Bankruptcy" (2017). *Law School Student Scholarship*. Paper 883.
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Fixing *Baker Botts*: Contractual Provisions Granting an Exception to the American Rule in Bankruptcy

Sarah Jones*

I. Introduction

Two law firms have sought the Delaware Bankruptcy Court’s approval under § 328 of the Bankruptcy Code for contractual provisions in engagement letters granting attorneys fees for successfully defended fee applications.¹ The reason for such provisions takes root from the Supreme Court’s holding in *Baker Botts v. Asarco*.² In the case *Baker Botts*, the petitioner had represented ASARCO, a corporation with over \$10 billion in debt, in bankruptcy, including prosecuting ASARCO’s parent company, Grupo Mexico, for fraudulent transfer.³ *Baker Botts* accomplished what the trial court judge proclaimed “the most successful Chapter 11 of any magnitude in the history of the [Bankruptcy] Code.”⁴ *Baker Botts* obtained a judgment against Grupo Mexico worth over \$7 billion and, four years after filing bankruptcy, ASARCO found itself “with \$1.4 billion in cash, little debt, and resolution of its environmental liabilities.”⁵ *Baker Botts* filed an application requesting fees for its services under section 330 of the Bankruptcy Code.⁶

After the successful reorganization, ASARCO fell back into the control of Grupo Mexico, the parent company ASARCO had sued in *Baker Botts v. ASARCO*, for the \$7 billion. The reorganized ASARCO then began a “scorched earth campaign” to object to *Baker Botts*’ fee

* J.D. Candidate, 2017, Seton Hall University School of Law; B.S., 2013, Syracuse University. Thank you to Professor Stephen J. Lubben for his help and guidance throughout the writing of this Comment. Thank you also to my friends, family, and fellow editors.

¹ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

² *In Re Northshore Mainland Services, Inc.* No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015); *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015).

³ *In re ASARCO LLC*, No. 05-21207, 2011 WL 2974957, at *4 (Bankr. S.D. Tex. July 20, 2011), *aff’d in part, rev’d in part and remanded*, 477 B.R. 661 (S.D. Tex. 2012).

⁴ *Id.* (“Creditors were expected to receive cents on the dollar, if anything, because ASARCO’s assets were severely depleted and the claims against it were extraordinarily high.”).

⁵ *Id.*

⁶ *In re ASARCO LLC*, No. 05-21207, 2011 WL 2974957, at *4 (Bankr. S.D. Tex. July 20, 2011).

applications.⁷ After Baker Botts successfully defended itself against these objections, which the trial court held as meritless,⁸ Baker Botts requested compensation for its defense costs by an exception to the American Rule, a Bankruptcy custom accepted in the majority of jurisdictions.⁹ The district court approved the fees, but the Fifth Circuit and Supreme Court denied them on appeal.¹⁰ The Supreme Court declared that section 330 of the Bankruptcy Code did not include express language indicating an exception to the American Rule for bankruptcy attorneys; therefore, bankruptcy attorneys could not collect attorney's fees for successfully defending fee applications.¹¹

The majority of courts had previously reasoned that rewarding fees for successfully defending fee applications furthered the “market based” approach Congress adopted as the policy of section 330: to compensate bankruptcy professionals in parity with their non-bankruptcy counterparts.¹² Unlike in ordinary corporate contexts, under Chapter 11 bankruptcy law, a number of parties can object to an attorney's compensation.¹³ Each party's objection puts the bankruptcy attorney in the predicament of facing one of two losses: either cutting the fees or incurring the cost of defending the fee application.¹⁴ Despite the fact that bankruptcy professionals are fairly

⁷ Brief for Petitioners, 35–36m Baker Botts L.L.P. v. Asarco LLC, 2014 WL 6845689 (2014).

⁸ *See id.*

⁹ Timothy S. Springer, *Damned if You Do, Damned if You Don't – Current Issues for Professionals Seeking Compensation in Bankruptcy Cases Under 11 U.S.C. § 330*, 87 AM. BANKR. L.J. 525, 539 (2013).

¹⁰ Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158 (2015).

¹¹ *Id.* at 2164 (“We have recognized departures from the American Rule only in ‘specific and explicit provisions for the allowance of attorneys' fees under selected statutes’...[and] congress did not expressly depart from the American Rule to permit compensation for fee-defense litigation by professionals hired to assist trustees in bankruptcy proceedings.”) (citing *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 260 (1975)).

¹² 3-330 COLLIER ON BANKRUPTCY P 330.LH (“Attorneys and other professionals serving in a bankruptcy case are to be compensated at the same rate that would be used to compensate them for performing comparable services in nonbankruptcy cases.”). *See* Springer, *supra* note 9, at 539 (“The courts supporting the success rule follow similar policy arguments to those pre-dating the 1994 Amendments—namely, the equal pay concept that not granting defense costs would “dilute fee awards” below compensation available to attorneys generally.”).

¹³ 11 U.S.C.A. § 1109 (2005) (“A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise [a fee objection.]”).

¹⁴ Springer, *supra* note **Error! Bookmark not defined.**; Brief for Amici Curiae Bankruptcy Law Scholars in Support of Petitioners, Baker Botts L.L.P. v. Asarco LLC, 3, 2014 WL 7145500 (2014) (“Most lawyers, of course, are not in

compensated,¹⁵ fee objections are frequently litigated.¹⁶ Bankruptcy courts, wary that defense costs would dilute fee compensation below the market rate, allowed attorney compensation for successfully defending applications.¹⁷ Under the majority system, creditors and debtors were incentivized to limit objections to those with merit and professionals were compensated in a manner that furthered the policy of the statute.¹⁸

This Comment argues that *Baker Botts* does not destroy market driven compensation the way some have feared.¹⁹ The American Rule has two exceptions: by contractual provision and by statute.²⁰ This note argues that while *Baker Botts* may have denied the first option under section 330,²¹ the holding still leaves bankruptcy professionals another road to market rate compensation: contractual provisions in retention agreements made under section 328.²² While some have argued that other methods are sufficient to alleviate concerns regarding fee dilution,²³ this Comment will

the position of having to litigate the reasonableness of their fees with anyone other than the client that engaged them, much less multiple adversaries of that client.”).

¹⁵ See Stephen Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 512 (2000) (“Chapter 11 is *substantially* less expensive than other significant corporate transactions.”).

¹⁶ Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 19, 2014 WL 7145502 (2014) (citing Presentation of the Landmark ABI Fee Study: Conclusions and Ramifications 8, ¶¶ 15-16 (American Bankruptcy Institute, Winter Leadership Conference 2007); Stephen J. Lubben (Reporter), Chapter 11 Professional Fee Study 35 (American Bankruptcy Institute, 2007)).

¹⁷ See Springer, *supra* note 9.

¹⁸ *Id.*

¹⁹ David Bury, *20 Questions about Baker Botts v. ASARCO & “Fee-Defense” Costs – Part 2*, PLAN PROPONENT, (July 14, 2015), <http://www.planproponent.com/20-questions-about-baker-botts-v-asarco-fee-defense-costs-part-2/>.

²⁰ *Baker Botts*, 135 S. Ct. at 2164 (“Each litigant pays his own attorney’s fees, win or lose, unless a statute or *contract* provides otherwise.”) (emphasis added) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252–53 (2010)).

²¹ *Id.* at 2169.

²² See *In Re Northshore Mainland Services, Inc.* No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015); *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015); Stephen J. Lubben, *Problems With the Supreme Court’s Ruling on Fees*, N. Y. TIMES: DEALBOOK (Sept. 4, 2015), <http://www.nytimes.com/2015/09/04/business/dealbook/problems-with-supreme-courts-ruling-on-fees.html>; Jeffrey S. Sabin, *The Baker Botts v. Asarco Fallout Has Begun*, LAW360 (Sept. 1, 2015, 12:49 PM), <http://www.law360.com/articles/697291/the-baker-botts-v-asarco-fallout-has-begun>.

²³ See *supra* Sec. C.

demonstrate that contractual provisions are the only sufficient method to fulfill congressional policy and maintain the success of chapter 11 bankruptcy.

This note will begin in Part II by summarizing section 330's legislative history and policy, and the judicial history of defending fee applications. Next, it will explain the *Baker Botts* ruling and the American Rule. Part III will argue why court-approved defense fee provisions under section 328 comply with *Baker Botts* and why such provisions are necessary under the Code's market-based policy. Fee defense provisions not only comply with section 328, but they also are the most suitable among all of the options raised to compensate bankruptcy professionals on par with their non-bankruptcy counterparts. Finally, applying the factors applied to retention agreements drafted under section 328, courts should find fees for defense of fee provisions reasonable.

II. From the Spirit of the Economy to the Market Based Approach: The Evolution of Compensation

Two schools of thought, the market based and the spirit of the economy, chronicle bankruptcy law's philosophy.²⁴ The current Bankruptcy Code employs the market-based approach.²⁵ Under this framework, a bankruptcy attorney is paid in parity with her non-bankruptcy counterparts since she is compensated at the same rate as an attorney of comparable skill, reputation, and experience.²⁶ The Bankruptcy Act governed bankruptcy law until the Bankruptcy Code was enacted in 1978.²⁷ Under the Bankruptcy Act, courts set attorneys fees under the spirit of economy approach.²⁸ The spirit of the economy's priority was to protect the funds of the

²⁴ 3-330 COLLIER ON BANKRUPTCY P 330.LH.

²⁵ *Id.*

²⁶ *Norman v. Hous. Auth. of City of Montgomery*, 836 F.2d 1292, 1299 (11th Cir. 1988); *see id.*

²⁷ 3-330 COLLIER ON BANKRUPTCY P 330.LH.

²⁸ *Id.*

estate.²⁹ As a result, attorney fees were severely limited to the least reasonable,³⁰ if not the lowest minimum,³¹ possible.

While the spirit of the economy approach was intended to protect the estate, lawmakers grew concerned that the policy caused the opposite effect.³² If bankruptcy professionals were paid less than their non-bankruptcy counterparts, it was likely that skilled attorneys were incentivized to practice elsewhere.³³ To illustrate the pay gap, bankruptcy attorneys' fees nearly doubled after 1978 in order meet the market-based approach.³⁴ Unlike the prominent and strategic role bankruptcy practice holds today, bankruptcy professionals were locked out of the corporate world, and elite firms shunned bankruptcy practice as undignified work.³⁵ Congress, wary that the the future of the practice would only "be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service," decided to implement the market based approach under section 330.³⁶

In drafting section 330, the legislature stated that "[a]ttorneys . . . serving in a bankruptcy case are to be compensated at the same rate that would be used to compensate them for performing

²⁹ *Id.*

³⁰ *Id.*; *see, e.g.* Jacobowitz v. Double Seven Corp., 378 F.2d 405, 408 (9th Cir. 1967) (setting attorney fees "at the lower end of the spectrum for reasonableness").

³¹ 3-330 COLLIER ON BANKRUPTCY P 330.LH.; *see, e.g.* In re Lng, 127 F. 755, 757 (W.D. Tex. 1904) (reducing fees to the "lowest minimum possible").

³² H.R. REP. 95-595, 30, 1978 U.S.C.C.A.N. 5963, 6286; 24 Cong. Rec. H11,091-2 (Sept. 28, 1978); *reprinted in* App. Pt. 4(f)(i) *infra*; 124 Cong. Rec. S17,408 (Oct. 6, 1978), *reprinted in* App. Pt. 4(f)(iii) *infra*.

³³ *Id.*

³⁴ Elliot D. Lee, "Bankruptcy Lawyers Gain Status, Wider Role in Corporate Strategy," WALL ST. J., July 9, 1987, at 31.

³⁵ *Id.*; KAREN GROSS, FAILURE AND FORGIVENESS 152 (1997) ("Indeed, most professionals wish to avoid a return to the time when bankruptcy law practice was not well regarded and was considered by most firms as unseemly, like family law or criminal law. The quality and professionalism of the bankruptcy bar have risen since then.") (citing Lynn M. LoPucki, "The Demographics of Bankruptcy Practice," 63 AM. BANKR. L.J. 289 (1989)).

³⁶ 11 U.S.C.A. § 330 (1978); H.R. REP. 95-595, 30, 1978 U.S.C.C.A.N. 5963, 6286; *see also* 124 Cong. Rec. 32, 394 (1978) ("[T]he policy of [the section] is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services[.];"); 3-330 COLLIER ON BANKRUPTCY P 330.LH; Lee, *supra* note 34, at 31 ("We intended to make it easier for companies to file for reorganization and easier for the bankruptcy bar to attract better-qualified lawyers[.]") (Frank R. Kennedy) (executive director of the federal commission that recommended most of the changes adopted in the 1978 Act).

comparable services in non-bankruptcy cases.”³⁷ The new market-based approach, combined with the other changes of the Code, such as increased accessibility to bankruptcy protection, allowed bankruptcy professionals to gain status and a wider role in corporate decisionmaking.³⁸ They became corporations’ special advisors and strategists for “life or death situation[s].”³⁹ By 1987, bankruptcy attorneys had shed their “dirty collar” reputation and joined some of the nation’s most elite law firms.⁴⁰ The new system has proven to be fruitful for debtors, creditors, and attorneys alike, evidenced by the fact that modern bankruptcy attorneys have orchestrated some of the most successful reorganizations in bankruptcy’s history.⁴¹

The Bankruptcy Code and section 330 have been modified over time, but the market-based approach has continued to be documented within its statutes.⁴² The 1978 version of section 330(a) stated that compensation is “based on the nature, the extent, and the value of such services, the time spent on such services, and *the cost of comparable services other than in a case under [the Code].*”⁴³ In 1994, the legislature also added the *Johnson* factors to aid courts in determining reasonable compensation, finalizing section 330(a) to the version it is today.⁴⁴ The Johnson Factors entail: (a) time spent on services; (b) rates charged for such services; (c) whether the

³⁷ 3-330 COLLIER ON BANKRUPTCY P 330.LH; *see also* 124 Cong. Rec. 32, 394 (1978) (“[T]he policy of [the section] is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services[.]”).

³⁸ Lee, *supra* note 34, at 31; *see also* Richard I. Aaron, *The Bankruptcy Bench*, 89 COM. L.J. 47, 47 (1984) (“Insolvency practice enjoys a prestige marked by contrast to that of a few years ago. Firms which disdained the work now eagerly seek the business.”).

³⁹ Lee, *supra* note 34, at 31.

⁴⁰ Lee, *supra* note 34, at 31; GROSS, *supra* note 35, at 152.

⁴¹ Stewart Bishop, *Lehman Brothers Creditors Getting \$2.2B Payout*, LAW360, (Feb. 19, 2015, 6:42 PM), <http://www.law360.com/articles/623015/lehman-brothers-creditors-getting-2-2b-payout>; Trefis Team, *Relaunching American Airlines's Coverage: Exiting Bankruptcy Into A Successful Turnaround Has Added Value*, FORBES (May 12, 2014, 01:36 PM), <http://www.forbes.com/sites/greatspeculations/2014/05/12/relaunching-american-airlines-coverage-exiting-bankruptcy-into-a-successful-turnaround-has-added-value/#2f8814104b81>; *see also* In re ASARCO LLC, No. 05-21207, 2011 WL 2974957, at *4 (Bankr. S.D. Tex. July 20, 2011) (calling the case “the most successful Chapter 11 of any magnitude in the history of the [Bankruptcy] Code.”).

⁴² 3-330 COLLIER ON BANKRUPTCY P 330.LH.

⁴³ 11 U.S.C. § 330(a) (1978) (emphasis added).

⁴⁴ 3-330 COLLIER ON BANKRUPTCY P 330.LH.

services were necessary or beneficial to the case at the time they were rendered; (d) whether the services were completed within a reasonable period of time given the importance, complexity, and nature of the problem; (e) whether the person has bankruptcy skills and experience; and (f) “*whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.*”⁴⁵

A. Actual and Necessary Services

Under section 330, attorneys may receive compensation for “actual, necessary services” that are found reasonable under the Johnson Factors.⁴⁶ Actual and necessary services are “those services that aid the professional's client in fulfilling its duties under the Code.”⁴⁷ For example, if an attorney represents the committee, his services may aid the client in investigating the debtor’s conditions and plans, formulating plans, and other duties proscribed under the Code.⁴⁸ An attorney representing the trustee may aid the client in investigating the financial affairs of the debtor, monitoring the business if it is still in operation, and ensuring the debtor performs all duties proscribed under the Code.⁴⁹ While it comported with common sense that assisting clients in their duties classified as “actual, necessary” services payable under section 330, other services, such as preparing fee applications or defending such fee applications, were frequently disputed.⁵⁰

A fee application is a thorough statement of a bankruptcy attorney’s rates and time spent on services for a given case.⁵¹ Courts were split on whether preparing fee applications, no less

⁴⁵ 11 U.S.C. § 330 (1994) (emphasis added).

⁴⁶ 11 U.S.C. § 330(a)(1)(A) (1994).

⁴⁷ *In re Lifschultz Fast Freight, Inc.*, 140 B.R. 482, 485 (Bankr. N.D. Ill. 1992).

⁴⁸ 11 U.S.C. § 1103(c) (1984).

⁴⁹ 11 U.S.C. § 502(a) (2010).

⁵⁰ *See, e.g.* *In re Nucorp Energy, Inc.*, 764 F.2d 655 (9th Cir. 1985) (allowing compensation for preparing and defending fee applications); *In re Jessee*, 77 B.R. 59 (Bankr. W.D. Va. 1987) (declining to award compensation for defending fee applications); *In re Courson*, 138 B.R. 928 (Bankr. N.D. Iowa 1992) (declining to allow compensation for preparing and defending fee applications).

⁵¹ *See* Fed. R. Bankr. P. 2016(a).

defending such applications, were necessary services under section 330.⁵² Applications require a great deal of care and detail because the attorney must prove that the compensation is a fair market rate.⁵³ In the 1994 amendment, Congress partially addressed these issues by adding subsection (a)(6) to 330, which orders that “compensation awarded for the preparation of a fee application [shall] be based on the level and skill reasonably required to prepare the application.”⁵⁴ This provision demonstrated that preparing fee applications was a necessary service for the purposes of the statute, but remained silent as to the defense of such fee applications.⁵⁵

Courts were split as to whether defending fee application were actual and necessary services under section 330.⁵⁶ The majority, led by the Ninth Circuit, held that such litigation fees should be payable if the attorney was successful in defending the fee application.⁵⁷ The minority held that the estate should never pay for defense fees.⁵⁸

B. The Majority Approach

⁵² See *In re Nucorp Energy, Inc.*, 764 F.2d 655 (allowing compensation for preparing and defending fee applications); *In re Jessee*, 77 B.R. 59 (declining to award compensation for defending fee applications); *In re Courson*, 138 B.R. 928 (declining to allow compensation for preparing and defending fee applications).

⁵³ See *Bankruptcy Fee Applications: Compensable Service or Cost of Doing Business*, 58 FORDHAM L. REV. 1327, 1327 n. 7 (1990); see also Butenas, *Establishing Attorney's Fees Under the New Bankruptcy Code*, 37 Bus. Law. 77, 83 (1981) (advising attorneys to extensively document every hour of work and to be prepared that compensation and services may be objected).

⁵⁴ 11 U.S.C. §330(a)(6) (1994); GRANT W. NEWTON, BANKRUPTCY AND INSOLVENCY ACCOUNTING, PRACTICE AND PROCEDURE 454 (7th ed., Volume 1, 2009).

⁵⁵ See generally 11 U.S.C. §330 (1994).

⁵⁶ Springer, *supra* note 9, at 535, n. 69–70 (citing *In re Manoa Fin.*, 853 F.2d 687, 692 (9th Cir. 1987) (allowing compensation); *Frazin v. Haynes & Boone, LLP* (*In re Frazin*), 413 B.R. 378, 402–03 (Bankr. N.D. Tex. 2009) (denying compensation), *aff'd in part, rev'd in part on other grounds, and remanded*, 723 F.3d 313 (5th Cir. 2013) (denying compensation); *In re Hers Cosmetics Corp.*, 114 B.R. 240, 244 (Bankr. C.D. Cal. 1990) (allowing compensation); *In re DN Assocs.*, 165 B.R. 344, 354–55 (Bankr. D. Me. 1994) (denying compensation); *Boyd v. Engman*, 404 B.R. 467, 483 (W.D. Mich. 2009) (allowing compensation); *In re Teraforce Tech. Corp.*, 347 B.R. 838, 866–67 (Bankr. N.D. Tex. 2006) (denying compensation); *In re JNS Aviation, LLC*, No. 04-21055-RLJ-7, 2009 WL 80202, at *9 (Bankr. N.D. Tex. Jan. 9, 2009) (denying compensation); *ASARCO LLC v. Baker Botts, L.L.P.* (*In re ASARCO LLC*), 477 B.R. 661, 675 (S.D. Tex. 2012) (allowing compensation); *Nunley v. Jessee*, 92 B.R. 152, 154 (W.D. Va. 1988) (allowing compensation)).

⁵⁷ *Id.*

⁵⁸ *Id.*

Prior to *Baker Botts*,⁵⁹ the majority of courts held that successfully defending fee applications were actual and necessary services under section 330.⁶⁰ The reasoning behind the majority view can be traced to opinions long before the 1994 amendment to the code, such as *In re Nucorp Energy*.⁶¹ Following the 1994 amendment, courts determined that, as a matter of fairness and in furtherance of section 330's market-based policy, successful defense costs were necessary to the bankruptcy system as a whole.⁶²

In 1985, *In re Nucorp* set forth the majority's policy perspective regarding defense fees.⁶³ The Ninth Circuit first determined which services are comparable to bankruptcy counsels' for purposes of the statute.⁶⁴ If the services were comparable to services with fees expressly provided for by statute, the compensation should have been allowed.⁶⁵ For policy reasons, statutory fee award provisions are read to approve compensation for defending fees. However, if the services were comparable to situations in which the attorneys benefit the entire class of litigants through a common fund, then compensation would not be allowed under the "fund doctrine."⁶⁶

The court found that, given the special nature of the source of fees in bankruptcy, bankruptcy was not directly comparable to either of the categories.⁶⁷ However, the policies underlying bankruptcy and other statutory fee provisions were so similar that compensation was fairly warranted.⁶⁸ The issue with the common fund comparison was the fact that, while attorney

⁵⁹ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

⁶⁰ See Springer, *supra* note 9, at 535.

⁶¹ 764 F.2d 655 (9th Cir. 1985).

⁶² Springer, *supra* note 56, at 538–41.

⁶³ See *In re Smith*, 305 F.3d 1078, 1088 (9th Cir. 2002) (citing *In Re Nucorp*, 764 F.2d at 660–61).

⁶⁴ *In re Nucorp Energy, Inc.*, 764 F.2d 655, 655–61 (9th Cir. 1985).

⁶⁵ *Id.* at 659–61.

⁶⁶ *Id.* at 661 (citing *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 257 (1975); *City of Detroit v. Grinnell Corp.*, 560 F.2d 1094, 1098 (2d Cir. 1977); *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp.*, 540 F.2d 102, 110 (3d Cir. 1976) (en banc)).

⁶⁷ *Id.* at 662.

⁶⁸ *Id.*

fees are derived from the common pool of the estate, this was not a common fund created by the attorney and benefiting the entire class. The estate existed as the source of compensation to begin with. While the source of fees in bankruptcy cases is not the same as in statutory fee cases either, the underlying policy concerns are similar. Bankruptcy and other statutory fee provisions share two common policies: maintaining fair market rates for services, which may be affected by dilution, and encouraging attorneys to practice in the field, which may be affected by decreased rates. Dilution is the concern that “the attorney’s effective rate for all the hours expended on the case will be correspondingly decreased.”⁶⁹ The court reasoned, if attorney fees are diluted, then attorneys will not take bankruptcy cases, thus defeating the Code’s goal to encourage representation.⁷⁰

The courts that followed *In Re Nucrop*’s reasoning sought to protect bankruptcy fees, and thus protect the quality of bankruptcy work, by counteracting the fee dilution created by fee objections.⁷¹ Despite the fact that bankruptcy professionals are fairly compensated,⁷² fee objections are frequently litigated.⁷³ Every time a party objects, the bankruptcy attorney is forced to either cut her fees or incur the cost of defending a fee application; either way her fees are effectively diluted.⁷⁴ To counteract fee dilution, the majority of bankruptcy courts awarded

⁶⁹ *Id.* at 660 (citing *Prandini v. Nat’l Tea Co.*, 585 F.2d 47, 53 (3d Cir. 1978)).

⁷⁰ *Id.*

⁷¹ *In re Nucorp Energy, Inc.*, 764 F.2d 655 (9th Cir. 1985).

⁷² Stephen Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 512 (2000) (“Chapter 11 is *substantially* less expensive than other significant corporate transactions.”).

⁷³ Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, 19, *Baker Botts L.L.P. v. Asarco LLC*, 2014 WL 7145502 (2014) (citing Presentation of the Landmark ABI Fee Study: Conclusions and Ramifications 8, ¶¶ 15–16 (American Bankruptcy Institute, Winter Leadership Conference 2007); Stephen J. Lubben (Reporter), Chapter 11 Professional Fee Study 35 (American Bankruptcy Institute, 2007)).

⁷⁴ Springer, *supra* note 56; Brief for Amici Curiae Bankruptcy Law Scholars in Support of Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 3, 2014 WL 7145500 (2014) (“Most lawyers, of course, are not in the position of having to litigate the reasonableness of their fees with anyone other than the client that engaged them, much less multiple adversaries of that client.”).

attorneys compensation for successfully defending applications.⁷⁵ Under such a system, creditors and debtors were incentivized to limit objections to those with merit, and professionals were compensated in a manner that furthered the policy of the statute.⁷⁶

The Ninth Circuit further articulated the majority approach in 2002.⁷⁷ *In Re Smith* held that a court did not err in err in granting attorneys fees for successfully defending a fee application.⁷⁸ The court held that the express language of section 330 did not prohibit granting such attorneys fees, and granting compensation for defense fees would in fact comport with section 330's requirements.⁷⁹ The court recognized that if it were to deny the plaintiff "reasonable compensation for *successfully* defending its fee awards would dilute its compensation for 'actual and necessary services.'"⁸⁰ Thus, for the purposes of section 330(a), the defense fees were necessary to the bankruptcy system as a whole, and consequentially to the case at hand.⁸¹ Some courts grew concerned that compensation would encourage meritless fee requests and subsequent litigation fees when such requests were objected.⁸² However, because the *In Re Smith* holding was limited to *successful* fee defenses, the Ninth Circuit held that meritless fee requests would not be an issue.⁸³

B. *Baker Botts* and the American Rule

In 2015, the Supreme Court overruled the majority approach by holding that, due the American Rule, section 330 did not recognize defense fees. The American Rule is the "bedrock

⁷⁵ See Springer, *supra* note 56, at 539.

⁷⁶ See Springer *supra* note 56, at 539–40.

⁷⁷ *Smith v. Edwards & Hale, Ltd.* (In re *Smith*), 317 F.3d 918 (9th Cir. 2002), *abrogated on other grounds* by *Lamie v. U.S. Tr.*, 540 U.S. 526, 531–39 (2004).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.* at 929.

⁸¹ *Id.*

⁸² *In re Riverside-Linden Inv. Co.*, 945 F.2d 320, 323 (9th Cir. 1991) (quoting *In re Riverside-Linden Inv. Co.*, 111 B.R. 298, 301 (B.A.P. 9th Cir. 1990)).

⁸³ *Id.*

principle” which requires that: “[e]ach litigant pays his own attorney’s fees, win or lose, unless a statute or contract provides otherwise.”⁸⁴ In the case, Baker Botts did not have a contract expressly granting defense fees, but applied for the court to approve its fees under section 330. The Court took a textualist approach: Congress included no express provision for bankruptcy fees in section 330, such as it had done for preparing fee applications, therefore no exception could be inferred.⁸⁵ In dicta, the Court questioned the market-based policy supporting defense fees, but ultimately held that even if the decision would “undercut a basic objective of the statute,” the absence of express language ruled the day.⁸⁶ An array of bankruptcy experts, including scholars, judges, neutral fee examiners, and professional organizations, supported Baker Botts as Amici Curiae.⁸⁷ They all agreed that, based on the market-based approach, denying compensation for fee applications would be an unfit dilution of fees below the general market value.⁸⁸

In *Baker Botts*, the Supreme Court declined to follow the majority rule. Applying the American Rule to Section 330, the Court determined that, because section 330 did not contain an express provision granting defense fees, such fees may not be granted.⁸⁹ The Court held that defense fees are not statutorily granted under section 330 of the Bankruptcy Code, and thus do not fall within the express statute or contract exception to the American Rule.⁹⁰ The court reasoned

⁸⁴ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164 (2015) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U. S. 242, 252–53 (2010)).

⁸⁵ *Id.* at 2169.

⁸⁶ *Id.*; see also Stephen J. Lubben, *Problems With the Supreme Court’s Ruling on Fees*, N. Y. TIMES: DEALBOOK (Sept. 4, 2015, time?), <http://www.nytimes.com/2015/09/04/business/dealbook/problems-with-supreme-courts-ruling-on-fees.html> (“[T]he opinion does suggest that the Supreme Court does not really understand the dynamics of large Chapter 11 cases.”).

⁸⁷ Brief for Neutral Fee Examiners in Support of Petitioners, *Baker Botts*, 2014 WL 6845689 (2014); Brief For Amici Curiae Bankruptcy Law Scholars in Support of Petitioners, *Baker Botts*, 2014 WL 6845689; Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts*, 2014 WL 7166533; Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, *Baker Botts*, 2014 WL 7145502.

⁸⁸ *Id.*

⁸⁹ *Baker Botts*, 135 S. Ct. at 2169.

⁹⁰ *Id.*

that under the American Rule, “[e]ach litigant pays his own attorney’s fees, win or lose, unless a statute or contract provides otherwise.”⁹¹ Baker Botts, supported by a lengthy list of amici curiae including bankruptcy scholars, judges, neutral fee examiners, and professional organizations, argued that the policy and purpose of the current Bankruptcy Code is to compensate bankruptcy attorneys on par with other attorneys performing comparable services, and that such a ruling would dilute bankruptcy attorneys’ fees below the general market value.⁹² The Court, emphasizing its strict adherence to the traditional application of the American Rule, ruled that section 330 does not create an express exception to the American Rule, thus the defense awards would not be granted “even if doing so [would] . . . ‘undercut a basic objective of the statute.’”⁹³

III. Court Approved Fee Defense Provisions Under Section 328

A number of bankruptcy practices have responded to *Baker Botts* by incorporating fee defense provisions in their retention agreements with creditors and debtors alike.⁹⁴ Under the Bankruptcy Code, professionals may make fee requests with the court *quantum meruit* at the end of the case under section 330, or they may alternatively have the court preapprove retention agreements under an entirely separate section, section 328.⁹⁵ Firms make the argument that, while

⁹¹ *Id.* at 2164 (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U. S. 242, 252–53 (2010)).

⁹² Brief for Petitioners at 35–36, *Baker Botts*, 2014 WL 6845689.

⁹³ *Id.* at 2169; *see also* Lubben, *Problems With the Supreme Court’s Ruling on Fees*, *supra* note 86 (“[T]he opinion does suggest that the Supreme Court does not really understand the dynamics of large Chapter 11 cases.”).

⁹⁴ *In Re Northshore Mainland Services, Inc.*, No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015) (representing official committee of creditors); Supplemental Brief In Support of the Application of the Official Committee of Unsecured Creditors, *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015); Fola Akinnibi, *Kirkland Ch. 11 Fee Bid 'Unreasonable,' US Trustee Says*, LAW360 (Nov. 24, 2015, 5:42 PM), <http://www.law360.com/articles/730906/kirkland-ch-11-fee-bid-unreasonable-us-trustee-says> (representing debtors); Scott Flaherty, *Baker Botts Angles to Shield Future Fees After Asarco Ruling*, AM. LAWYER (Dec. 31, 2015), <http://www.americanlawyer.com/id=1202746109263/Baker-Botts-Angles-to-Shield-Future-Fees-After-Asarco-Ruling?slreturn=20160024212227> (representing debtors).

⁹⁵ 11 U.S.C. §§ 328, 330 (2005); *see generally*, ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY, ¶ 330.03 (16th ed. 2015)

(“Under the Bankruptcy Act, compensation was awarded only upon a *quantum meruit* basis as determined by the court. Thus, the trustee did not have the power to enter into compensation arrangements with professionals employed by the trustee. Section 328(a) gives to the trustee authority to agree to any reasonable compensation arrangements with professional persons.”).

section 330 does not include language consenting to fees for defense of fees, section 328 allows attorneys to draft contracts with fee defense provisions.⁹⁶ So long as the court approves the contracts as reasonable, they are valid.⁹⁷ Under the Supreme Court's holding in *Baker Botts*, contractual arrangements are an exception to the American Rule.⁹⁸

The bankruptcy firms' stance has been met with some opposition.⁹⁹ The U.S. Trustee, Andrew Vara, has taken the opposing position that such provisions are strictly precluded under *Baker Botts*.¹⁰⁰ Furthermore, in the recent opinion for *In Re Boomerang*, one bankruptcy court for the District of Delaware recently determined that *Baker Botts* forbids such provisions as well.¹⁰¹ The arguments proclaimed by both the U.S. Trustee and the bankruptcy court for the District of Delaware misinterpret both the statutes and precedent, and ignore the market-based policy underlying the Code.¹⁰²

This Comment argues that courts may approve retention agreements with fee defense provisions in compliance with Section 328 and *Baker Botts*, and that such provisions are

⁹⁶ See, e.g., Supplemental Brief In Support of the Application of the Official Committee of Unsecured Creditors, In Re Boomerang Tube, LLC, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015).

⁹⁷ *Asarco, L.L.C. v. Barclays Capital, Inc. (In re Asarco, L.L.C.)*, 702 F.3d 250, 258 (5th Cir. 2012) (asserting that contracts approved by the court will be honored unless within a "narrow improvident exception"); COLLIER ON BANKRUPTCY, *supra* note 95, at ¶ 382.02 ("[W]ith court approval, professional persons may be employed on any reasonable terms and conditions.").

⁹⁸ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164 (2015) ("Our basic point of reference when considering the award of attorney's fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise." (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U. S. 242, 252–53 (2010))).

⁹⁹ See, Akinnibi, *supra* note 94; Jim Christie, *Judge Rejects 'Fees on Fees' in Bankruptcy in Wake of Asarco*, REUTERS (Feb. 2, 2016 6:42 AM), <http://www.reuters.com/article/idUSL2N15H0M4>.

¹⁰⁰ United States Trustee's Supplemental Brief Objecting to Applications For Orders Authorizing the Retention of As Co-Counsel For The Official Committee of Unsecured Creditors, In Re Boomerang Tube, LLC, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015); Akinnibi, *supra* note 94.

¹⁰¹ *In Re Boomerang Tube, LLC*, No. 15-11247-MFW (Bankr. D. Del. Jan. 29, 2016).

¹⁰² See generally, 11 U.S.C. § 328, 330 (2005) (representing section 330 and 328 as separate sections, and that section 330 is subject to 328); *Baker Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015) (holding that statute or contract is an exception to the American Rule); 124 Cong. Rec. 32, 394 (1978) ("[T]he policy of [the section] is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services[.]").

imperative to maintaining a market-based bankruptcy system.¹⁰³ By denying fees for successful defense of fees, courts heighten the risk that bankruptcy attorneys' fees will be diluted, and that attorneys will be paid less than non-bankruptcy attorneys in comparable fields.¹⁰⁴ Opposing counsel will strategically object to fees knowing that the attorneys are in a "no-win" situation.¹⁰⁵ Fee defense provisions under section 328 will guard bankruptcy professionals from fee dilution and maintain a fair and just system through court oversight.¹⁰⁶ Furthermore, while other solutions have been proposed, such as raising fees in general or imposing sanctions on frivolous objections, fee defense provisions are the only feasible option under the current bankruptcy system.¹⁰⁷

A. Fee Defense Provisions Under Section 328 Comply with *Baker Botts*

1. *Baker Botts* Does Not Effect Section 328

Section 328 is not subject to the Supreme Court's ruling on section 330. The court's ruling in *Baker Botts* was strictly limited to section 330, and nowhere in the opinion was section 328 mentioned.¹⁰⁸ Furthermore, because section 330 does not bind section 328, the opinion has no control over contracts made under section 328.¹⁰⁹ Prior to the enactment of the Bankruptcy Code and the introduction of section 328, private payment agreements were not permissible.¹¹⁰ Since, section 328 and section 330 have existed as separate methods of compensation.¹¹¹ If a court approves retention under section 328, fees may not be later altered under section 330 (absent

¹⁰³ Stephen J. Lubben, *Problems With the Supreme Court's Ruling on Fees*, *supra* note 86.

¹⁰⁴ Brief for Brief For Amici Curiae Bankruptcy Law Scholars in Support of Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 3-4, 36, 2014 WL 6845689 (U.S., 2014); Springer, *supra*, note 56 at 539; *Lawyers React to Justices' Ruling in Baker Botts Fee Case*, LAW360 (June 15, 2015 7:25 PM), <http://www.law360.com/articles/667772/lawyers-react-to-justices-ruling-in-baker-botts-fees-case>.

¹⁰⁵ Springer, *supra* note 56 at 539.

¹⁰⁶ *See infra* § II D.

¹⁰⁷ *See infra* § II C.

¹⁰⁸ *Baker Botts*, 2014 WL 6845689.

¹⁰⁹ Bruce A. Markell, *Loser's Lament: Caulkett and ASARCO*, 35 No. 8 BANKRUPTCY LAW LETTER NL 1 (2015).

¹¹⁰ 3-328 COLLIER ON BANKRUPTCY P 328.LH (16th ed.).

¹¹¹ *Id.*; 3-330 COLLIER ON BANKRUPTCY P 330.LH (16th ed.).

unforeseen circumstances).¹¹² In fact, the language of section 330 directly states that it is *subject* to section 328, and any mention that section 328 is bound to section 330 is absent from both statutes.¹¹³

2. Court Approved Retainer Agreements Are Binding Contracts

Retainer agreements are contracts.¹¹⁴ However, the U.S. Trustee has argued that a retainer agreement made under section 328 is not a contract because it is subject to court approval, and therefore cannot serve as an exception to the American Rule.¹¹⁵ This is not accurate. Under section 328, an attorney may be employed, with court approval, “on any reasonable terms and conditions of employment, including on a retainer.”¹¹⁶ By definition, a retainer agreement is a *contract* setting forth the amount an attorney is to be paid for a certain period of time or certain tasks.¹¹⁷ In fact, in recognizing section 328’s binding nature, courts, including the court in *In Re Boomerang*,¹¹⁸ have identified that court-approved retainer agreements remain contracts.¹¹⁹ In fact, there are other circumstances under the Bankruptcy Code in which agreements may be unilaterally modified or approved by courts while still remaining binding contracts.¹²⁰ Similar to retainer agreements,

¹¹² *In re Reimers*, 972 F.2d 1127 (9th Cir. 1992); *In re Confections by Sandra, Inc.*, 83 B.R. 729 (B.A.P. 9th Cir. 1987); *In re Westbrook*, 202 B.R. 520 (Bankr. N.D. Ala. 1996).

¹¹³ 11 U.S.C. §§ 328, 330 (2005).

¹¹⁴ 7 Am. Jur. 2d Attorneys at Law § 249, (citing *McQueen, Rains & Tresch, LLP v. Citgo Petroleum Corp.*, 195 P.3d 35, 41 (Okla. 2008)) (“A “general *retainer agreement*” is a *contract* pursuant to which the client agrees to pay the attorney a fixed sum in exchange for an agreed price to cover all legal services arising during a specified period.”) (emphasis added).

¹¹⁵ United States Trustee’s Supplemental Brief Objecting to Applications For Orders Authorizing the Retention of As Co-Counsel For The Official Committee of Unsecured Creditors, 4–7, *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015).

¹¹⁶ 11 U.S.C. § 328(a) (2005).

¹¹⁷ *See* Am. Jur., *supra* note 114.

¹¹⁸ *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, 10 (Bankr. D. Del. Jan. 29, 2016).

¹¹⁹ *In re Merced Falls Ranch, LLC*, 2012 WL 8255520, at *4 (Bankr. E.D. Cal. Oct. 16, 2012) (“Once § 328(a) is invoked, the bankruptcy court has limited discretion to vary the contractual terms of that employment.”); *U.S. Trustee v. Newmark Retail Fin. Advisors LLC (In re Joan & David Helpen, Inc.)*, No. 00 CIV. 3601 (JSM), 2000 WL 1800690, at *1 (S.D.N.Y. Dec. 6, 2000).

¹²⁰ *Direct Press Modern Litho, Inc.*, 328 NLRB 860, 865 (1999); *In re Trump Entm't Resorts, Inc.*, 519 B.R. 76, 84 (Bankr. D. Del. 2014), *aff'd sub nom. In re Trump Entm't Resorts Unite Here Local 54*, No. 14-4807, 2016 WL 191926 (3d Cir. Jan. 15, 2016); *In Re Garofalo's Finer Foods, Inc.*, 117 B.R. 363, 368–70 (Bkrcty. N.D. Ill. 1990).

bankruptcy courts may alter collective bargaining agreements¹²¹ if modifications are found necessary and appropriate under the balance of the equities.¹²²

3. Contracts Under 328 Are Exceptions to the American Rule

Baker Botts holds that contracts are an exception to the American Rule,¹²³ and if retainer agreements are contracts, it naturally follows that they are an exception to the rule.¹²⁴ Nevertheless, the *In Re Boomerang* court held that a retainer agreement between counsel and the official committee of creditors, despite being a valid contract, was not an exception to the American Rule because it bound the estate, a third party, to pay.¹²⁵ The court also asserted that a contract cannot bind a non-signing third party.¹²⁶

The Delaware bankruptcy court's holding is weak for two reasons. The first issue is the fact that it has one-sided implications. The estate, which is the entity that funds attorneys' fees and other expenses,¹²⁷ is still able to contract with its counsel for fee defense provisions.¹²⁸ It would not comport with fairness to allow debtors to reimburse counsel for defense of fee applications, but not creditors.¹²⁹ Second, although a contract cannot bind a non-signing third party, the court's contention will not prohibit fee defense provisions in general; it will only cause modifications.¹³⁰ Given the fact that debtors and creditors alike have sought to include fees for defense of fees provisions in their retainer agreements, the simple work-around this opinion is to

¹²¹ *Collective-Bargaining Agreement*, BLACK'S LAW DICTIONARY (10th ed. 2014) (defining a collective bargaining agreement as a "contract between an employer and a labor union regulating employment conditions, wages, benefits, and grievances").

¹²² *Direct Press Modern Litho, Inc.*, 328 NLRB at 865; *see In re Trump Entm't Resorts, Inc.*, 519 B.R. at 84 (approving court modifications); *In Re Garofalo's Finer Foods, Inc.*, 117 B.R. at 368–70 (same).

¹²³ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164 (2015) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U. S. 242, 252–53 (2010)).

¹²⁴ *Id.*

¹²⁵ *In Re Boomerang Tube, LLC*, No. 15-11247-MFW, 4–5 (Bankr. D. Del. Jan. 29, 2016).

¹²⁶ Markell, *supra* note 109.

¹²⁷ *In Re Boomerang Tube, LLC*, No. 15-11247-MFW at 4–5

¹²⁸ *Id.* (excluding the debtor or estate from its reasoning).

¹²⁹ *Id.*

¹³⁰ *Id.* (neglecting to consider that debtors and creditors counsel alike will prefer fees for defense of fees).

have both parties agree to such contractual provision.¹³¹ As further support for the general acceptance of fee provision, it should be noted that neither the creditors nor debtors have objected to each others' fee defense provisions, but it is rather the U.S. Trustee who has taken on this role.¹³²

B. Maintaining a Market Based Bankruptcy Code: Fee Objections and the No-Win Situation

Under the U.S. Trustee's interpretation of *Baker Botts*,¹³³ bankruptcy professionals "are now being asked to be the volunteer firefighters of the bankruptcy world. Debtors [and creditors] will say, 'Please send the jaws of life, but staff it with volunteers.'"¹³⁴ Increased fee objections and the threat of such objections in negotiations will dilute fees by putting professionals in a no-win situation: either defend their fees and eat the costs, or lower their fees to avoid litigation.¹³⁵ Skilled bankruptcy professionals will make the rational choice to work in other areas of law, and once such skilled bankruptcy professionals have left the practice, the bankruptcy system and the market in general will suffer the consequences.¹³⁶ Highly successful bankruptcy cases would not exist without the talented attorneys who coordinate such reorganizations.¹³⁷

¹³¹ In Re Northshore Mainland Services, Inc., No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015) (representing official committee of creditors); Supplemental Brief In Support of the Application of the Official Committee of Unsecured Creditors, In Re Boomerang Tube, LLC, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015); Fola Akinnibi, *supra* note 94 (representing debtors); Flaherty, *supra* note 94 (representing debtors).

¹³² In Re Northshore Mainland Services, Inc., No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015) (objecting U.S. Trustee) Supplemental Brief In Support of the Application of the Official Committee of Unsecured Creditors, In Re Boomerang Tube, LLC, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015) (objecting U.S. Trustee); Akinnibi, *supra*, note 94 (objecting U.S. Trustee); Scott Flaherty, *supra* note 94 (objecting U.S. Trustee).

¹³³ *Id.*

¹³⁴ *Lawyers React To Justices' Ruling In Baker Botts Fees Case*, *supra* note 104.

¹³⁵ See Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts L.L.P. v. ASARCO LLC*, 2014 WL 7166533 (U.S.), 13 (U.S., 2014); *Chambers v. NASCO, Inc.*, 501 U.S. 32, 53 (1991).

¹³⁶ Brief For Amici Curiae Bankruptcy Law Scholars in Support of Petitioners, *Baker Botts*, 2014 WL 6845689; Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts*, 2014 WL 7166533; Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, *Baker Botts*, 2014 WL 7145502.

¹³⁷ See, e.g., Harvey R. Miller & Maurice Horwitz, Weil, Gotshal & Manges LLP, The Lehman Brothers Saga: International Issues and Conflicts, http://www.stern.nyu.edu/sites/default/files/assets/documents/con_041232.pdf.

Increased fee objections will dilute the fees of bankruptcy professionals.¹³⁸ Bankruptcy professional fees are frequently litigated,¹³⁹ and if bankruptcy professionals receive no exceptions to the American Rule, objections and any subsequent litigation will only increase.¹⁴⁰ In a 2004 based study conducted by the American Bankruptcy Institute, parties objected to the lead debtor attorney fees in 10% of chapter 11 cases.¹⁴¹ In large chapter 11 cases, party objections doubled to 20%.¹⁴² As will be discussed *infra*, bad faith sanctions such as Rule 9011 and § 1927 have little to no deterrence on unmeritorious fee objections. Disgruntled creditors and debtors alike will use this as an opportunity to commence scorched earth campaigns against professionals under the false guise of good faith.¹⁴³

Fee dilution is not limited to the bankruptcy profession and exceptions to the American Rule have been commonly recognized in other areas of law as well.¹⁴⁴ The Ninth Circuit, fearing fee dilution for bankruptcy professionals, compared the situation to other statutorily authorized fees.¹⁴⁵ If an attorney is required to spend time litigating fee applications at self-cost, the attorney's effective rate for the hours spent on the case will shrink, and as a result attorneys will take less cases with statutorily authorized fees, such as Title VII, civil rights cases, or bankruptcy cases.¹⁴⁶ In addition, the effective rate for bankruptcy professionals is at even greater risk than civil rights

¹³⁸ *Id.*

¹³⁹ Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 19 n. 18, 2014 WL 7145502 (2014).

¹⁴⁰ *Id.* at 18–21.

¹⁴¹ *Id.* at 20–21.

¹⁴² *Id.*

¹⁴³ Robert J. Keach, *Bankruptcy Experts Discuss Supreme Court's Ruling in Baker Botts LLP v. ASARCO LLC and the Impact on Professional Fees, Bankruptcy Litigation*, AM. BANKRUPTCY INSTITUTE (June 18, 2015), <http://www.abi.org/educational-brief/bankruptcy-experts-discuss-supreme-courts-ruling-in-baker-botts-llp-v-asarco-llc>; *see, e.g.* *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742 (Bankr. N.D. Tex. 1988) (engaging in a scorched earth campaign).

¹⁴⁴ *In re Nucorp Energy, Inc.*, 764 F.2d 655, 660 (9th Cir. 1985).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

attorneys because a longer list of parties may object to bankruptcy fees.¹⁴⁷ The debtor, a trustee, a creditor, an equity security holder, any indenture trustee, or any other party of interest may contest a debtor or creditor’s attorney fees—or, in the case of *Baker Botts*, even a scorned parent company that the law firm sued on behalf of the debtor.”¹⁴⁸

The license to make threats of objections may be an even stronger source of fee dilution than the objections themselves.¹⁴⁹ The intimidation of the court’s oversight may sometimes hinder bad faith or unmeritorious objections in court, but court oversight does not extend to objections in negotiations.¹⁵⁰ Robert Keach, co-chair of the Chapter 11 Reform Commission, explains that an objector, such as ASARCO, can make a law firm, such as Baker Botts, “spend in excess of its bonus to defend its bonus. It’s a powerful threat to make—whether it is from creditors or debtors.”¹⁵¹ The power of the threats will come from their newfound credibility.¹⁵² If an objection is made, it is now more than likely that the bankruptcy professional will eat the cost of defending the objection.¹⁵³ As the District of Delaware court recognized, “creditors could negotiate reductions in these fee awards knowing full well that the attorney is in a no-win situation. Even if the attorney prevails, he or she will in effect have financed the litigation without any hope of surviving it whole.”¹⁵⁴

¹⁴⁷ 11 USC §1109.

¹⁴⁸ 11 USC §1109; Brief for Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 2014 WL 6845689 (U.S.), 8–13 (U.S., 2014).

¹⁴⁹ See Lubben, *Problems With Supreme Court’s Ruling on Fees*, *supra* note 86; Robert J. Keach, Bankruptcy Experts Discuss Supreme Court’s Ruling in *Baker Botts LLP v. ASARCO LLC* and the Impact on Professional Fees, Bankruptcy Litigation, AM. BANKRUPTCY INSTITUTE (June 18, 2015), <http://www.abi.org/educational-brief/bankruptcy-experts-discuss-supreme-courts-ruling-in-baker-botts-llp-v-asarco-llc>.

¹⁵⁰ *Id.*

¹⁵¹ Keach, *supra* note 149.

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *In re Worldwide Direct Inc.*, 334 B.R. 108, 111 (D. Del. 2005) (quoting *In re Big Rivers Electric Corp.*, 252 B.R. 670, 675 (W.D. Ky. 2000)).

As Congress feared, if bankruptcy professionals are paid less than their non-bankruptcy counterparts, there will be less incentive to engage in bankruptcy practice.¹⁵⁵ Currently, almost every elite law firm has a bankruptcy practice.¹⁵⁶ But there was a time, when bankruptcy professionals were compensated based on the economy of the estate, “when bankruptcy law practice was not well regarded and was considered by most firms as unseemly.”¹⁵⁷ Under such a system, skilled attorneys had no interest in joining the bankruptcy practice because “no money could be made without very hard labor, and it [was] only by volume of work that one may [have] hope[d] to acquire a competence.”¹⁵⁸ Bankruptcy was, and still is, a very complicated system, so talented young attorneys will have little incentive to join such a difficult practice if they know they will be more fairly compensated in another corporate area.¹⁵⁹

“Compensation is the lubricant which makes the bankruptcy machinery work,”¹⁶⁰ but if bankruptcy professionals are not compensated at market rate, the machinery may no longer work.¹⁶¹ Skilled bankruptcy professionals have benefited creditors and debtors alike by finding ways to decrease losses to the estate, save jobs, and pay creditors.¹⁶² If bankruptcy is left to “those

¹⁵⁵ 11 U.S.C.A. § 330 (1978); H.R. REP. 95-595, 30, 1978 U.S.C.C.A.N. 5963, 6286; *see also* 124 Cong. Rec. 32, 394 (1978) (“[T]he policy of [the section] is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services[.]”); 3-330 COLLIER ON BANKRUPTCY P 330.LH; Lee, *supra* note 34, at 31 (“We intended to make it easier for companies to file for reorganization and easier for the bankruptcy bar to attract better-qualified lawyers[.]”) (Frank R. Kennedy) (executive director of the federal commission that recommended most of the changes adopted in the 1978 Act).

¹⁵⁶ DAVID A. SKEEL, *DEBT’S DOMINION* 122 (2014) (stating that, in 2001, “49 of the 50 largest New York law firms now claim to have a bankruptcy practice”).

¹⁵⁷ GROSS, *supra* note 35 at 152; *see, e.g.*, Lynn M. LoPucki, *The Demographics of Bankruptcy Practice*, 63 AM. BANKR. L.J. 289 (1989); *Bankruptcy Lawyers Gain Status, Wider Role in Corporate Strategy*, WALL ST. J., July 9, 1987, at 31.

¹⁵⁸ Reuben G. Hunt, *A Defense of Attorneys’ Fees in Bankruptcy Proceedings*, v.35 issue 10 Commercial Law Journal 630, 631 (Oct. 1930).

¹⁵⁹ *See Problems With Supreme Court’s Ruling on Fees*, *supra* note 86.

¹⁶⁰ *Matter of King Res. Co.*, 651 F.2d 1349, 1352 (10th Cir. 1981).

¹⁶¹ Stephen J. Lubben, *Review Essay: Chapter 11 as Intrigue-- Professional Fees in Corporate Bankruptcies: Data, Analysis, and Evaluation* Lynn M. LoPucki & Joseph W. Doherty, 28 B.F.L.R. 171, 185 (Nov. 2012).

¹⁶² Stewart Bishop, *Lehman Brothers Creditors Getting \$2.2B Payout*, LAW360, (Feb. 19, 2015, 6:42 PM), <http://www.law360.com/articles/623015/lehman-brothers-creditors-getting-2-2b-payout>; Trefis Team, *Relaunching American Airlines’s Coverage: Exiting Bankruptcy Into A Successful Turnaround Has Added Value*, FORBES (May

who could not find other work and those who practice bankruptcy only occasionally almost as a public service,”¹⁶³ the new rank of attorneys representing debtors and creditors may mistakenly take action, or not take action, in such a way that is damning to the estate.¹⁶⁴ Creditors will realize that the likelihood of receiving recoveries from a bankrupt estate has dwindled, and will consequently raise borrowing costs.¹⁶⁵

C. Rejecting Alternatives: Why Section 328 Fee Defense Provisions Are Superior to Other Options

The additional solutions have been proposed to fix the fee dilution problem: (1) Rule 9011 sanctions against offending attorneys, firms, or parties who bring an fee objection that is frivolous or improper;¹⁶⁶ (2) §1927 sanctions against attorneys for vexatious or improper conduct in bringing a fee objection;¹⁶⁷ and (3) fee padding.¹⁶⁸ One may also argue that this is a problem best dealt with by Congress, but given the current state of affairs, the reality of the situation has tapped the judiciary with responsibility.¹⁶⁹ The remainder of this Comment will analyze the three possible

12, 2014, 01:36 PM), <http://www.forbes.com/sites/greatspeculations/2014/05/12/relaunching-american-airlines-coverage-exiting-bankruptcy-into-a-successful-turnaround-has-added-value/#2f8814104b81>; *see also* In re ASARCO LLC, No. 05-21207, 2011 WL 2974957, at *4 (Bankr. S.D. Tex. July 20, 2011) (calling the case “the most successful Chapter 11 of any magnitude in the history of the [Bankruptcy] Code”).

¹⁶³ H.R. REP. 95-595, 330, 1978 U.S.C.C.A.N. 5963, 6286.

¹⁶⁴ See Lubben, *Review Essay*, *supra* note 161, at 185.

¹⁶⁵ *Id.*

¹⁶⁶ Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158, 2168 n. 4 (2015).

¹⁶⁷ Keach, *supra* note 149.

¹⁶⁸ Louis R. Robin, *Three Recent Supreme Court Cases--None Concerning Jurisdiction*, CLLA BANKRUPTCY BLOG, <http://clla-ba.blogspot.com/2015/09/three-recent-supreme-court-cases-none.html>.

¹⁶⁹ The Baker Botts v. Asarco Fallout Has Begun, LAW360 (Sep. 1, 2015 2:59 PM), <http://www.law360.com/articles/697291/the-baker-botts-v-asarco-fallout-has-begun>

(“Bankruptcy practitioners trying to ensure undiluted payment of debtors’ counsel may seek to return to the pre-Asarco fee structure by lobbying Congress to insert into Section 330(a) express language authorizing payment of fees incurred in resolving fee disputes. This request could be framed as a follow-up to the recent American Bankruptcy Institute Commission Report, which did not address this particular issue. The problem with this approach is that Congress, which has yet to act on the ABI Commission Report and is not likely to undertake much needed reform of the code anytime soon, is almost certain to do nothing in response.”);

but see *Lawyers React to Justices’ Ruling in Baker Botts Fee Case*, *supra* note 104 (“Of course, if Congress wanted to clarify that the Bankruptcy Court has the discretion to award compensation for the defense of a fee application, it would be easy to amend Section 330 to expressly so provide.”).

alternatives to section 328, and will prove that contractual provisions are the best-suited solution for bankruptcy law.

1. Fee Padding

Some professionals have suggested that the proper way to counteract fee dilution caused by meritless fees objections is to set attorneys fees at a higher price.¹⁷⁰ Aside from the fact that a rate padding scheme would put the cost of meritless fee objections posed by the few on the whole, such a scheme is not possible under the Code's transparency requirements,¹⁷¹ current case law,¹⁷² or the U.S. Trustee Guidelines.¹⁷³

Bankruptcy courts hold that “the hourly rates of bankruptcy practitioners must be commensurate with the hourly rates charged by their peers in other practice areas.”¹⁷⁴ If a firm were to raise its hourly rate for bankruptcy work, then the bankruptcy court would compare such fees to its work in non-bankruptcy proceedings, note that the bankruptcy rate is higher, and hold that that the bankruptcy rate does not comply with the code.¹⁷⁵ In addition, the U.S. Trustee does not allow attorneys to engage in rate padding.¹⁷⁶ Despite concerns regarding fee dilution, the U.S. Trustee has maintained the guideline requirement that firms be paid the general hourly rate charged

¹⁷⁰ Transcript of Oral Argument at 23, (No. 14-103) *Baker Botts L.L.P. v. ASARCO LLC*, (Justice Scalia) (suggesting that “lawyer's fees are set at a high enough level...that they take into account the fact that sometimes you will have to litigate to get the fees”).

¹⁷¹ Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, at 18.

¹⁷² *In re Fleming Companies, Inc.*, 304 B.R. 85, 93 (Bankr. D. Del. 2003).

¹⁷³ Appendix B Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases, 78 Fed. Reg. 116, 36248–36276 (June 17, 2013).

¹⁷⁴ *In re Fleming Companies, Inc.*, 304 B.R. at 93.

¹⁷⁵ See *id.*; Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, 11–12, *Baker Botts L.L.P. v. ASARCO LLC*, 2014 WL 7166533 (U.S. 2014)

¹⁷⁶ Appendix B Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed Under United States Code by Attorneys in Larger Chapter 11 Cases, 78 Fed. Reg. 116, 36248–36276 (June 17, 2013); Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, 18, *Baker Botts L.L.P. v. Asarco LLC*, 2014 WL 7145502 (U.S., 2014) (citing 78 F.R. 36248-02, 2013 WL 2902995 (F.R.), at *36255 (June 17, 2013) (“[S]uch risk-adjusted higher fees may well run afoul of the recently implemented United States Trustee Guidelines that require evidence that rates charged are not higher merely because the case arose in bankruptcy.”)).

for non-bankruptcy proceedings.¹⁷⁷ The bankruptcy system requires fee applications to be transparent and detailed breakdowns of rates.¹⁷⁸ If rates are padded, the system will be undermined because attorneys cannot honestly account for the generally increased fees when the number of fee defenses will vary from case to case.¹⁷⁹

2. Rule 9011

The majority opinion in *Bakers Botts* suggests that Rule 9011, the bankruptcy version of Federal Rule of Civil Procedure 11, will provide a sufficient deterrent against frivolous claims.¹⁸⁰ Rule 9011 sanctions attorneys for bad faith litigation conduct, including attorney's fees that occurred as a result of the conduct.¹⁸¹ Rule 9011 may protect against frivolous objections in theory, but in practicality, it will be an insufficient guard against fee dilution because it is rarely brought up and executed.¹⁸²

Rule 9011 is rarely used in bankruptcy courts, and even when raised, its standard is too high to make any real impact on fee dilution.¹⁸³ Courts demand “exceptional circumstances where a claim is patently unmeritorious or frivolous”¹⁸⁴ so that the “very temple of justice has been defiled.”¹⁸⁵ If courts must exercise “restraint” and “discretion” at the level the law demands,¹⁸⁶

¹⁷⁷ Appendix B Guidelines, *supra* note 176, at 36251–53, 66.

¹⁷⁸ Amicus Curiae Brief of the State Bar of Texas Bankruptcy Law Section in Support of Petitioners, 18, *Baker Botts L.L.P. v. ASARCO LLC*, 2014 WL 7166533 (U.S. 2014).

¹⁷⁹ *Id.*

¹⁸⁰ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2168 (2015).

¹⁸¹ Fed. R. Bankr. P. 9011 (1997).

¹⁸² Lubben, *Problems With Supreme Court's Ruling on Fees*, *supra* note 86 (“There is a good deal of space between and objection that is made in bad faith and one that is actually ‘sanctionable’ under the rules.”).

¹⁸³ Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts L.L.P. v. ASARCO LLC*, 13, 2014 WL 7166533 (U.S. 2014) (“The standard for imposing sanctions is too high for bankruptcy judges to prevent dilution with that *rarely* used cudgel.”) (emphasis added).

¹⁸⁴ *In re 15375 Mem'l Corp.*, 430 B.R. 142, 150 (Bankr. D. Del. 2010)

¹⁸⁵ *Chambers v. NASCO, Inc.*, 501 U.S. 32, 46 (1991).

¹⁸⁶ *Id.* at 44.

even the list of meritless objections in *Baker Botts* would not meet such a criteria.¹⁸⁷ Thus, the patent bad faith necessary for rule 9011 sanctions will hardly meet most meritless fee objections.

The first case published since *Baker Botts* illustrates that Rule 9011 is a useless tool against fee dilution. In *In re River Rd. Hotel Partners, LLC*, the Bankruptcy Court of the Northern District of Illinois determined that, despite a “scorched earth campaign” of objections against the fee application,¹⁸⁸ which was met to no avail both in the trial court and on appeal,¹⁸⁹ attorney fee sanctions were not warranted.¹⁹⁰ The court stated that “[t]he standards for bad faith are necessarily stringent, and [a] party should not be penalized for maintaining an aggressive litigation posture.”¹⁹¹ The court furthermore reasoned that the objector “acted to protect its interests,” and given the fees at stake, “did not commit a fraud upon the Court, nor did it defile the “very temple of justice.”¹⁹² It must be reminded that in large bankruptcy cases, fees will always come with a price because of the case’s inherent size and complexity.¹⁹³ Objectors will continue to object in self-interest, whether it is by a scorched earth campaign or a justified pursuit, but it is in the interest of the profession and estates to minimize fee dilution.¹⁹⁴

In addition to objections by parties, fee applications are also subject to objections by the court itself. In such instances, Rule 9011 provides no instrument to combat fee dilution at all.¹⁹⁵ Take this hypothetical, proposed by former Bankruptcy Judges Clark and Fitzgerald, for example:

¹⁸⁷ *In re ASARCO LLC*, No. 05-21207, 2011 WL 2974957 (Bankr. S.D. Tex. July 20, 2011) *aff’d in part, rev’d in part and remanded*, 477 B.R. 661 (S.D. Tex. 2012).

¹⁸⁸ *In re River Rd. Hotel Partners, LLC*, 536 B.R. 228, 243 (Bankr. N.D. Ill. 2015)

¹⁸⁹ *In re River Rd. Partners, LLC*, No. 09 B 30029, 2012 WL 6585506, at *2 (Bankr. N.D. Ill. Dec. 17, 2012) *aff’d in part, rev’d in part sub nom. FBR Capital Markets & Co. v. Bletchley Hotel at O’Hare LLC*, No. 09 B 30029, 2013 WL 5408848 (N.D. Ill. Sept. 24, 2013) *remand to In re River Rd. Partners, LLC*, 520 B.R. 691 (Bankr. N.D. Ill. 2014) *reconsideration denied*, 536 B.R. 228 (Bankr. N.D. Ill. 2015).

¹⁹⁰ *Id.* at 244

¹⁹¹ *In re River Rd. Hotel Partners, LLC*, 536 B.R. 228, 244 (Bankr. N.D. Ill. 2015) (citing *Fortune v. Taylor Fortune Grp., L.L.C.*, No. 15-60009, 2015 WL 4624211, at *3 (5th Cir. Aug. 4, 2015)).

¹⁹² *Id.* at 244 (quoting *Chambers v. NASCO, Inc.*, 501 U.S. 32, 42 (1991)).

¹⁹³ KAREN GROSS, *FAILURE AND FORGIVENESS* 152 (1997).

¹⁹⁴ *See id.*

¹⁹⁵ Fed. R. Bankr. P. 9011 (1997) (sanctioning attorneys’ fees on attorneys, not the courts).

Suppose the bankruptcy judge, acting sua sponte under Section 330(a)(2), flags a perceived problem with the professional's fee application. The professional prepares a response, at some nontrivial cost, and the bankruptcy judge is ultimately persuaded to award fees as originally requested by the application. Nobody has done anything wrong here. To the contrary, the process is precisely what the Bankruptcy Code requires The bankruptcy judge certainly will not sanction himself, so . . . the professional [will be forced] to bear the bankruptcy-specific cost of defending her successful application. That cannot be right[.]¹⁹⁶

Rule 9011, while an available tool, is not a sufficient solution to fee dilution on its own. If it were, fee objections would increase given the lack of consequences imposed by rule 9011, and attorneys would be disincentivized to practice in bankruptcy, leaving the estates to the lack of skilled workforce from days past.¹⁹⁷

3. Section 1927

It has been suggested that Section 1927 will provide a more adequate solution to the fee dilution problem.¹⁹⁸ However, Section 1927, just like Rule 9011, will not solve the fee dilution problem. Section 1927 declares that any attorney who “multiplies the proceedings in any case *unreasonably and vexatiously* may be required by the court to satisfy personally the . . . *attorneys’ fees* reasonably incurred because of such conduct.”¹⁹⁹ While the statute would theoretically sanction attorneys fees for “unreasonable and vexatious” objections, in practical application, the statute will not be effective or even applicable to bankruptcy proceedings.²⁰⁰

The primary issue with Section 1927 is the fact that circuits are split on whether bankruptcy courts may even impose the sanctions at all.²⁰¹ Even if a bankruptcy court allows for 1927

¹⁹⁶ Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts L.L.P. v. ASARCO LLC*, 2014 WL 7166533 (U.S.), 14 (2014).

¹⁹⁷ See Richard I. Aaron, *The Bankruptcy Bench*, 89 COM. L.J. 47, 47 (1984); see also Harold Lavien, *Fees As Seen From The Bankruptcy Bench*, 89 COM. L.J. 136, 136 (1984).

¹⁹⁸ Robert J. Keach, Bankruptcy Experts Discuss Supreme Court's Ruling in *Baker Botts LLP v. ASARCO LLC*.

¹⁹⁹ 28 U.S.C.A. § 1927 (West).

²⁰⁰ See *supra*, page 24–26 (discussing problems with Rule 9011).

²⁰¹ Compare *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90 (3d Cir. 2008) (holding a bankruptcy court has the power to impose sanctions under 28 U.S.C. § 1927), with *In re Courtesy Inns, Ltd., Inc.*, 40 F.3d 1084, 1086 (10th Cir. 1994) (“A bankruptcy court is not a “court of the United States” and therefore cannot impose sanctions under 28

sanctions, the standard of persuasion is just as high, if not higher, than what is necessary for Rule 9011 sanctions.²⁰² As the bankruptcy court reminded in *In Re River*, “[s]anctions, under any authority, are the exception, not the norm, and should not be imposed lightly, ‘even in the face of aggressive litigation tactics and strategy.’”²⁰³ In addition, scholars have suggested that the burden of proof under 1927 is more demanding than the burden of proof under 9011(a).²⁰⁴ In some jurisdictions, such as the Second Circuit, sanctions are declined “absent both ‘clear evidence’ that the challenged actions ‘are entirely without color, and [are taken] for reasons of harassment or delay or for other improper purposes’” and “a high degree of specificity in the factual findings of [the] lower courts.”²⁰⁵ Thus, Section 1927 is just as, if not more, unreliable and inefficient as a tool against fee dilution as Rule 9011.

D. The Viable Option: Fee Defense Provisions Are Reasonable Under Section 328

Attorney Fee provisions are reasonable under 328, and should therefore be granted by courts. The bankruptcy court of the District of Delaware and the Third Circuit have listed five non-limiting factors to determine the reasonableness of terms and conditions under § 328: (1) whether the terms of the retention agreement reflect normal business terms; (2) the relationship between the debtors and the professionals; (3) whether the retention agreement is in the best interest of the estate; (4) whether the creditor opposes the retention agreement; (5) the reasonability

U.S.C. § 1927.”); *In re Sandoval*, 186 B.R. 490 (B.A.P. 9th Cir. 1995) (holding bankruptcy court is not “court of the United States.”), *Matter of Volpert*, 110 F.3d 494, 499 (7th Cir. 1997) (declining to determine if bankruptcy courts can impose sanctions under 28 U.S.C. §1927).

²⁰² Carlos J. Cuevas, *Vexatious Tactics Judicial Code 1927 and Bankruptcy Attorneys Part I*, ABI JOURNAL (Aug. 1998), <http://www.abi.org/abi-journal/vexatious-tactics-judicial-code-1927-and-bankruptcy-attorneyspart-i>.

²⁰³ *In re River Rd. Hotel Partners, LLC*, 536 B.R. 228, 243 (Bankr. N.D. Ill. 2015) (citing *Kramer v. Mahia* (In re Khan), 488 B.R. 515, 528 (Bankr.E.D.N.Y.2013), *aff’d sub nom. Dahiya v. Kramer*, No. 13–CV–3079 (DLI), 2014 WL 1278131 (E.D.N.Y. Mar. 27, 2014), *aff’d*, 593 Fed.Appx. 83 (2d Cir. 2015).

²⁰⁴ Cuevas, *supra* note 202.

²⁰⁵ *Oliveri v. Thompson*, 803 F.2d 1265, 1272 (2d Cir. 1986) (citing *Dow Chemical Pacific Ltd.*, 782 F.2d at 344); *see also In re Smith*, BR 896-80189-478, 2011 WL 222146, at *3 (E.D.N.Y. Jan. 21, 2011) (sanctions were a “close call” but the court declined to sanction under 28 U.S.C. §1927 where it could not “state with certainty that Appellants acted in bad faith”).

of the price and level of risk minimization.²⁰⁶ The fifth factor, reasonability of the price, can be supplemented by the Johnson factors from section 330—most notably, “whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.”²⁰⁷ This section will demonstrate why engagement agreements granting compensation for successfully defending fee applications meet all five factors of the Delaware test.

1. Defense Fees Are Part of the Normal Market Place

The provision would reflect normal business terms in the market place because it would maintain the way the modern bankruptcy system has operated itself and would replicate accepted practice in other fields of law. In the bankruptcy market, the majority of courts have allowed for compensation for successful fee defenses.²⁰⁸ In fact, courts in nineteen states have awarded

²⁰⁶ *In re Insilco Technologies, Inc.*, 291 B.R. 628, 634 (Bankr. D. Del. 2003) (citing *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 238 n. 4 (3d Cir. 2003)).

²⁰⁷ 11 U.S.C. § 330 (1994) (emphasis added).

²⁰⁸ Supplemental Brief In Support of the Application of the Official Committee of Unsecured Creditors, *In Re Boomerang Tube, LLC*, no. 15-11247-MFW (Bankr. D. Del. Aug. 17, 2015) (listing, “California: *See In re GFI Commercial Mortg. LLP*, 2013 WL 4647300 (N.D. Cal. Aug. 29, 2013); *In re DIMAS, LLC*, 357 B.R. 563 (Bankr. N.D. Cal. 2006), *aff’d in part, rev’d in part*, 2009 WL 7809032 (B.A.P. 9th Cir. Feb. 25, 2009); *In re Merced Falls Ranch, LLC*, 2013 WL 3155448 (Bankr. E.D. Cal. June 20, 2013); *In re Shalan Enters., LLC*, 2012 WL 1345328 (Bankr. C.D. Cal. Apr. 17, 2012); *In re Schneider*, 2008 WL 4447092 (Bankr. N.D. Cal. Sept. 26, 2008); *In re Buckridge*, 367 B.R. 191 (Bankr. C.D. Cal. 2007); *In re Walters*, 2006 WL 6589027 (Bankr. S.D. Cal. May 30, 2006). Colorado: *In re Chavez*, 157 B.R. 30, 33 (D. Colo.) *aff’d*, 13 F.3d 404 (10th Cir. 1993). Connecticut: *See In re Ahead Commc’ns Sys., Inc.*, 2006 WL 2711752 (Bankr. D. Conn. Sept. 21, 2006). Georgia: *See In re Concrete Prods., Inc.*, 1993 WL 13726054 (Bankr. S.D. Ga. July 27, 1993). Hawaii: *See In re Kahuku Hosp.*, 2011 WL 5884144 (Bankr. D. Haw. Nov. 23, 2011). Illinois: *See In re Churchfield Mgmt. & Inv. Corp.*, 98 B.R. 838 (Bankr. N.D. Ill. 1989); *In re Chicago Lutheran Hosp. Ass’n*, 89 B.R. 719 (Bankr. N.D. Ill. 1988). Kentucky: *See Big Rivers Elec. Corp. v. Schilling (In re Big Rivers Elec. Corp.)*, 252 B.R. 670 (W.D. Ky. 2000); *In re Atwell*, 148 B.R. 483 (Bankr. W.D. Ky. 1993). Massachusetts: *See In re Lupo*, 2012 WL 1682571 (Bankr. D. Mass. May 14, 2012). Michigan: *See In re Wiczorek*, 2013 WL 1120019 (E.D. Mich. Mar. 17, 2013); *Boyd v. Engman*, 404 B.R. 467 (W.D. Mich. 2009); *In re Moss*, 320 B.R. 143 (Bankr. E.D. Mich. 2005). New Mexico: *See In re First State Bancorporation*, 2014 WL 1203141 (Bankr. D.N.M. Mar. 24, 2014). New York: *See In re Quigley Co., Inc.*, 500 B.R. 347 (Bankr. S.D.N.Y. 2013); *In re CCT Commc’ns, Inc.*, 2010 WL 3386947 (Bankr. S.D.N.Y. Aug. 24, 2010). North Carolina: *See In re Downs & Assocs., Ltd.*, 2002 WL 32139302 (Bankr. W.D.N.C. Dec. 11, 2002). Oklahoma: *See In re Millennium Multiple Emp’r Welfare Benefit Plan*, 470 B.R. 203 (Bankr. W.D. Okla. 2012). Oregon: *See In re Smith*, 2008 WL 2852263 (Bankr. D. Or. July 23, 2008). Pennsylvania: *See In re Bible Deliverance Evangelistic Church*, 39 B.R. 768 (Bankr. E.D. Pa. 1984). Utah: *See In re Ricci Inv. Co., Inc.*, 217 B.R. 901 (D. Utah 1998); *In re CF & I Fabricators of Utah, Inc.*, 131 B.R. 474 (Bankr. D. Utah 1991). Vermont: *See In re S.T.N. Enters. Inc.*, 70 B.R. 823 (Bankr. D. Vt. 1987). Virginia: *See Goodbar v. Beskin*, 2013 WL 1249124 (W.D. Va. Mar. 26, 2013); *Nunley v. Jessee*, 92 B.R. 152 (W.D. Va. 1988). Wisconsin: *See In re Hutter Constr. Co.*, 126 B.R. 1005 (Bankr. E.D. Wis. 1991).” Supplemental Brief In Support of

attorney's fees for successfully defending fee applications.²⁰⁹ Furthermore, despite the fact that 328 provisions were not necessary for successful defense costs under section 330, some courts approved such provisions regardless.²¹⁰ Even outside of sections 330 and 328, courts have awarded defense fees in debtor-in-possession financing orders.²¹¹ Even outside of bankruptcy law, where attorneys are not subject to as much fee dilution, engagement agreements with provisions contracting for similar attorneys fees have been approved.²¹² Thus, fees for defense of fees provision would reflect normal business terms both in and outside of bankruptcy.

2. Sophisticated Parties

The relationship between the debtors and professionals generally indicate that retention agreements are reasonable because both parties to the agreements tend to be sophisticated with equal bargaining power.²¹³ This will be especially true in large Chapter 11 bankruptcy cases in

the Application of the Official Committee of Unsecured Creditors, *In Re Boomerang Tube, LLC*, no. 15-11247-MFW (Bankr. D. Del. Aug. 17, 2015).

²⁰⁹ *Id.*

²¹⁰ *See, e.g.*, *In re Potter*, 377 B.R. 305, 308 (Bankr. D.N.M. 2007).

²¹¹ Motion for Leave to File Committee Reply to UST Objection, *In Re Northshore Mainland Services, Inc.*, No. 15-11402 (Aug. 14, 2015) (citing *In re Signal Int'l, Inc.*, Case No. 15-11498(MFW) (Bankr. D. Del. July 14, 2015) (Docket No. 78; order granting approval of DIP financing and providing the Court with the ability to review reasonableness of lenders' professionals' fees in the event of a dispute); *In re Alsip Acquisition, LLC*, Case No. 14-12596(KJC) (Bankr. D. Del. Nov. 26, 2014) (Docket No. 70); *In re AWI Delaware, Inc.*, Case No. 14-12092(KJC) (Bankr. D. Del. Sept. 10, 2014) (Docket No. 58).

²¹² Supplemental Brief in Support of Committee Retention Apps, *Boomerang Tube LLC*, No. 14-11247 (Aug. 17, 2015) (citing *Calvo Fisher & Jacob LLP v. Lujan*, 184 Cal. Rptr. 3d 225 (Cal. Ct. App. 2015)); *Lockton v. O'Rourke*, 109 Cal. Rptr. 392 (Cal. Ct. App. 2010); Opinion 2009-2 of the Delaware State Bar Association Committee on Professional Ethics at 4.10 ("The Committee sees no legal impediment to a fee shifting provision in an engagement or retainer letter. Further, the Committee is of the opinion that there is no professional ethical impediment to a valid fee shifting provision in the client agreement."); Opinion 310 of the District Of Columbia's Bar Legal Ethics Committee, http://www.dcbare.org/for_lawyers/ethics/legal_ethics/opinions/opinion310.cfm (permitting engagement letters with costs of collection provisions); *see Carey Rodriguez Greenberg & Paul, LLP v. Arminak*, 583 F. Supp. 2d 1288 (S.D. Fla. 2008); *Gossett & Gossett, PA v. Mervolion*, 941 So. 2d 1207 (Fla. Dist. Ct. App. 2006); *Berryer v. Hertz*, 522 So. 2d 510 (Fla. Dist. Ct. App. 1988); *see Burds v. Hipes*, 763 S.E.2d 887 (Ga. Ct. App. 2014); *Timothy Whelan Law Associates, Ltd. v. Kruppe*, 947 N.E.2d 366, 370 (Ill. App. Ct. 2011); *Payne Broder & Fossee, P.C., v. Shefman*, 2014 WL 3612699 (Mich. Ct. App. July 22, 2014); Order Authorizing Employment and Retention of Arent Fox PLLC as Counsel for the Debtors, 240 Church Street Operating Co. II, LLC, No. 04-14388 (RDD) (Bankr. S.D.N.Y. July 30, 2004), D.I. 62, *supra*; *King & Ballow v. MaineToday Media, Inc.*, 2012 WL 4192522 (M.D. Tenn. Sept. 19, 2012); Virginia Legal Ethics Opinion No. 1667 (permits engagement letters with costs of collection provisions); *Leen v. Demopolis*, 815 P.2d 269, 276 (Wash. Ct. App. 1991)).

²¹³ *Id.*

which creditors and debtors are sizeable and sophisticated organizations with their own in-house counsel.²¹⁴

3. Fee Defense Provisions Are in the Best Interest of Estates

The retention agreements will be in the best interest of estates under the same market based policy reasoning the majority of courts maintained for section 330 prior to *Baker Botts*.²¹⁵ While it may be argued that *Baker Botts* eliminated any such policy arguments,²¹⁶ *Baker Botts* was decided based on the statutory text, which does not negate the importance of the market-based approach.²¹⁷ Similar to courts granting defense fees, retention agreements will minimize fee dilution and will ensure that bankruptcy cases will be handled by skilled professionals, ultimately protecting estates from higher costs.²¹⁸ When professionals, without the security of defense fees, face objections to their fee applications, they are put in a no-win situation for which there is no viable solution.²¹⁹ If professionals are not granted attorney's fees for successfully defending fee applications, there is a risk that attorney's fees in general will rise, adding unnecessary costs to the estate.²²⁰ If such costs do not rise, then the highly skilled professionals who make the system work will not be compensated in parity with their non-bankruptcy counterparts.²²¹ Bankruptcy attorneys will be forced to join practice elsewhere, leaving the fate of the estate to volunteers and those who

²¹⁴ See, e.g., In Re Northshore Mainland Services, Inc. No. 15-11402-KJC (Bankr. D. Del. Aug. 14, 2015); In Re Boomerang Tube, LLC, No. 15-11247-MFW (Bankr. D. Del. June 19, 2015).

²¹⁵ See *supra* ?, at 9–11.

²¹⁶ See U.S. Trustee's Supplemental Brief Objecting to Application, In Re Boomerang Tube, LLC, No. 15-11247-MFW, (Bankr. D. Del. June 19, 2015).

²¹⁷ *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

²¹⁸ See *supra* page 9–11.

²¹⁹ Springer, *supra* note 56, at 539.

²²⁰ Transcript of Oral Argument at 23, (No. 14-103) *Baker Botts L.L.P. v. ASARCO LLC* (Justice Scalia) (suggesting that “lawyer’s fees are set at a high enough level...that they take into account the fact that sometimes you will have to litigate to get the fees”).

²²¹ See Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts L.L.P. v. ASARCO LLC*, 13, 2014 WL 7166533 (U.S., 2014); *Chambers v. NASCO, Inc.*, 501 U.S. 32, 53 (1991).

could not otherwise find employment.²²² Ultimately, all parties will suffer from a lack of skilled representation.²²³

4. Creditors Will Not Oppose the Provision

Creditor opposition will be of little issue in regards to defense fee provisions because creditors are just as likely as debtors to apply for fee defense provisions.²²⁴ The effects of such agreements are mutually beneficial for both parties, so it is unlikely that either parties' defense fee provisions will be objected by anyone other than the U.S. Trustee or the court.²²⁵

5. Reasonable Fees with Built-In Risk Minimization

Lastly, the provision is reasonable and provides the correct level of risk minimization. Under the Johnson Factors, it is the general policy of the Code to compensate attorneys in parity with their non-bankruptcy counterparts. As discussed above, professionals' fees will be diluted to the point where they are compensated less than other attorneys in similar circumstances. Under the pre-2015 bankruptcy system, which generally included defense fees, bankruptcy attorneys were paid the same as, if not less than, other corporate attorneys.²²⁶ If fees are generally diluted, then they, as a whole, will be paid even less. As demonstrated above, Rule 9011 and Section 1927 are inadequate barriers to fee dilution, and fee padding is impermissible under the law. The fee defense provisions are further reasonable because of court oversight, which mitigates the risk of attorneys filing frivolous fee requests under the expectation that they will be objected to, adding

²²² H.R. REP. 95-595, 30, 1978 U.S.C.C.A.N. 5963, 6286.

²²³ See *supra* page 4–7.

²²⁴ See *supra* page 18.

²²⁵ See *supra* page 18.

²²⁶ Stephen Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 512 (2000) (finding that “the costs of professionals in large chapter 11 cases is “substantially less expensive than other significant corporate transactions”); Oscar Couwenberg & Stephen J. Lubben, *The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy*, 85 AM. BANKR. L.J. 63, 63 (2011) (comparing the costs of American bankruptcy professionals to the international bankruptcy market and finding that the costs are the same).

up defense fees to charge the estate.²²⁷ Courts have the power to modify the terms of the agreement and limit fees to successful defenses and reasonable amounts.²²⁸

²²⁷ See 11 U.S.C. §328 (2005) (requiring court oversight).

²²⁸ *In re Riverside-Linden Inv. Co.*, 945 F.2d 320, 323 (9th Cir. 1991) (quoting *In re Riverside-Linden Inv. Co.*, 111 B.R. 298, 301 (B.A.P. 9th Cir. 1990); Brief for Former Bankruptcy Judges Leif M. Clark and Judith K. Fitzgerald as Amici Curiae in Support of Petitioners, *Baker Botts L.L.P. v. Asarco LLC*, 11-12, 2014 WL 7166533 (U.S., 2014) (“A bankruptcy judge who has discretion to award reasonable defense fees is not bound to do so at the request of a professional with ‘perverse incentives.’ The bankruptcy judge can always say no.”) (citing *Comm’r v. Jean*, 496 U.S. 154, 163 (1990) (“Exorbitant, unfounded, or procedurally defective fee applications . . . are matters that the [judge] can recognize and discount.”); *In re S. Cal. Sunbelt Developers, Inc.*, 608 F.3d 456, 463 n.2 (9th Cir. 2010) (“[W]e reject [the] contention that permitting recovery of fees on fees fosters a ‘lottery mentality’ and invites debtors to engage in excessive fee litigation.”)).