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Application: Baker Botts v. ASARCO (14-103)
[notes]

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May a Bankruptcy Court Award Fees to Debtor’s Counsel For Its Work Defending Its Fee Application?

CASE AT A GLANCE

The Bankruptcy Code authorizes the retention of lawyers and other professionals to provide necessary services to the trustee or debtor in possession. The lawyers and other professionals must submit fee applications itemizing their work for approval by the bankruptcy court, and those applications can be challenged by creditors and other parties in interest. This case asks whether a bankruptcy court has the authority to award fees to a law firm to cover its work in defending against challenges brought to its fee applications.

Baker Botts v. ASARCO
Docket No. 14-103

Argument Date: February 25, 2015
From: The Fifth Circuit

by Marshall Tracht
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INTRODUCTION

Baker Botts was appointed by the bankruptcy court as counsel for ASARCO, a multibillion dollar mining concern, in its chapter 11 proceeding. The case was extraordinarily successful from the point of view of creditors, who were repaid in full—more than \$3.6 billion—and ASARCO, which emerged as a viable reorganized company. The case was not as favorably viewed by ASARCO’s parent, which had to pay ASARCO’s creditors because Baker Botts had obtained a judgment for ASARCO against the parent company for more than \$7 billion based on the transfer of ASARCO assets to the parent company several years earlier. Baker Botts ultimately applied for more than \$113 million in fees and \$6 million in expenses for its work on the large, complex case.

Under the plan of reorganization, “Reorganized ASARCO” came back under the control of the parent company, and it promptly filed extensive objections to Baker Botts’s fee application. The result was extensive discovery and litigation, at the end of which the bankruptcy court overruled all of the objections. It then granted Baker Botts’s request for another \$5 million in fees incurred in litigating its fee application. ASARCO appealed, and the district court affirmed, but the Fifth Circuit Court of Appeals reversed, finding that the Bankruptcy Code does not authorize a court to award fees to the debtor’s counsel for the work involved in defending its fee application. This created a circuit split, which the Supreme Court must now address.

ISSUE

Does Section 330(a) of the Bankruptcy Code, which authorizes the court to award “reasonable compensation for actual, necessary services rendered” by professionals retained by the debtor with the

court’s approval, give the court discretion to award compensation to debtor’s counsel for work performed in defending its fee application?

FACTS

ASARCO, LLC (respondent), is a copper mining, smelting, and refining company that filed for chapter 11 in 2005. Copper prices were low and the company faced various environmental, labor, and tax problems, so the prospects for a successful reorganization appeared dim and creditors were expected to receive only a small percentage of their claims. With the bankruptcy court’s approval, ASARCO retained Baker Botts, LLP (petitioner) as its bankruptcy counsel. During the case, Baker Botts represented ASARCO in challenging as a fraudulent conveyance the transfer from ASARCO to its parent, two years earlier, of a controlling interest in Southern Copper Corporation (described by the trial court as ASARCO’s “crown jewel”). ASARCO prevailed, obtaining a judgment against the parent for “between \$7 billion and \$10 billion,” the largest fraudulent transfer judgment in the history of chapter 11. As a result, ASARCO’s creditors were paid in full and the company emerged from bankruptcy in 2009 with little debt, \$1.4 billion in cash, and many of its other issues resolved. However, the parent company regained control over ASARCO when ASARCO emerged from bankruptcy, and ASARCO promptly filed objections to all of Baker Botts fee requests.

Baker Botts requested approximately \$120 million in compensation for their “core” work on the bankruptcy case plus a 20 percent enhancement based on the success of the case and quality of the work performed. ASARCO raised numerous objections to the fee application and sought extensive discovery. After a six-day trial on the fee objections, the bankruptcy court rejected all of ASARCO’s

challenges, awarding approximately \$120 million in core fees, plus the 20 percent enhancement for a portion of the work (the fraudulent transfer action), which added another \$4.2 million. Baker Botts also sought more than \$8 million in compensation for litigating ASARCO's fee objections. The bankruptcy court held that Section 330(a) permits the court to award compensation for the preparation and successful defense of a fee application, but that the fees requested were unreasonably high, awarding about \$5 million.

On appeal, ASARCO dropped its objections to the core fees, but challenged the award of fees incurred defending the fee application (the "fees on fees") and the 20 percent enhancement for the fraudulent transfer work. The district court largely affirmed, noting that "[a] seven billion dollar judgment, which is recoverable, which saves a company, and funds a 100% recovery for all concerned is a once in a lifetime result." It held that petitioner was entitled to the fees for defending its core fees, though it was not entitled to fees incurred in seeking the enhancement or correcting any deficiencies in the original fee application. On remand, the bankruptcy court reaffirmed the \$5 million in fees, saying none were attributable to the prohibited matters.

The Fifth Circuit affirmed the fee enhancement but reversed the award for petitioner's fee defense, holding that "Section 330(a) does not authorize compensation for the costs counsel or professionals bear to defend their fee applications." The court relied on Section 330(a)(4), which states that professional services are compensable only if they are either "reasonably likely to benefit the debtor's estate" or "necessary to the administration of the case." The court held that the defense of a fee application does not satisfy either criterion because "[t]he primary beneficiary of a professional fee application ... is the professional" rather than the estate. The court also relied on Section 330(a)(6), which permits compensation for "the preparation of a fee application," but does not mention the defense of a fee application.

CASE ANALYSIS

Under the old Bankruptcy Act, compensation for professionals retained in the bankruptcy case "emphasized economy of administration and conservation of the estate," and the view was that bankruptcy professionals should be compensated at the low end of the range of fees charged by comparable professionals in other contexts. When Congress passed the Bankruptcy Code in 1978, it abandoned this view, adopting the position that it was necessary to pay market rates to attract high-quality practitioners; otherwise, the bankruptcy system would be less efficient, undermining reorganizations and reducing recoveries for creditors. While the fees of bankruptcy professionals would be scrutinized by the court, the policy was to compensate attorneys and other professionals at the same rate they earn for comparable services to other clients.

Professionals are appointed under Section 327 of the Code, which provides that a bankruptcy trustee (or debtor in possession in a chapter 11) may, with court approval, employ professionals "that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee [or DIP] in carrying out [its] duties under this title." Under Section 328(a), the retention may be on "any reasonable terms and conditions of

employment," but the court may award different compensation "after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." The court may also deny compensation "if, at any time during" the employment, "such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed."

Section 330(a) provides that after notice to parties in interest and to the United States Trustee, and a hearing, "the court may award ... (A) reasonable compensation for actual, necessary services rendered ... and (B) reimbursement for actual, necessary expenses." It also provides factors for determining the amount of compensation, directing the court to "consider the nature, the extent, and the value of such services, taking into account all relevant factors, including" the time spent, the rates charged, whether the services were "necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title," the professional's skills and qualifications, and the compensation charged by similar practitioners in nonbankruptcy settings. Finally, Section 330(a)(4) precludes compensation for "(i) unnecessary duplication of services; or (ii) services that were not (I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the case."

Under this system, a professional retained by the estate must file detailed fee applications, which can then be scrutinized and objected to by the U.S. Trustee and any other parties in the case, before the court rules on the amount of compensation to be awarded. Thus, the preparation of detailed billing documents is part of the process, as is the need to respond in a judicial hearing to any objections to the fees asserted.

Petitioner argues that the 1978 Bankruptcy Code intended to provide professionals with compensation equivalent to that they would receive in other contexts, but in other contexts their bills are not subject to challenge by third parties and do not have to be defended before a judge. If the costs of defending a fee application from such challenges are not compensable, the compensation of bankruptcy professionals will be "diluted" compared with compensation in other contexts. The Code grants a great deal of discretion to the bankruptcy judge in determining fee awards, and the goal of parity, petitioner argues, requires that the court be allowed to award "fees on fees" in appropriate cases.

Petitioner also points out that in 1994, the Code was amended to include in Section 330, among the factors to be considered in determining reasonable compensation, whether the services were "necessary for the administration of, or beneficial ... toward the completion of, a case under this title," a standard much broader than whether the services directly benefit the estate. Hearings to determine the compensation of professionals retained by the estate, which are administrative expenses that must be paid for any plan of reorganization to be confirmed, are a necessary part of "administration of ... the case" and "complet[ing] a case under this title," and the fees incurred in those hearing are thus compensable.

ASARCO argues, however, that Section 330 provides standards for compensating professionals retained under Section 327 “to assist the trustee in carrying out the trustee’s duties under this title,” but defending a fee application does nothing to assist the trustee in carrying out its duties, which run to the estate, not to the professional. Thus, respondent argues, Section 330 does not permit the court to award fees on fees because they are not within the scope of a professional’s retention under Section 327. Moreover, respondent argues, Section 330 only authorizes compensation for “necessary services rendered by” a professional, but defending the professional’s own fee application is not “necessary” to the bankruptcy estate or case, helping only the professional itself. Nor can work the professional does on its own behalf be considered “services rendered.”

In fact, respondent argues, fee litigation goes beyond not assisting the trustee; it is directly contrary to the interests of the trustee and the bankruptcy estate because fees diminish the estate, reducing the assets available to pay other creditors. Section 328(c) says that the court may deny compensation to a professional if “at any time during such professional person’s employment” the professional “holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.” In litigating its fees, respondent argues, a professional “holds an adverse interest to the estate,” and must be denied compensation.

Respondent also argues that Section 330 expressly addresses fees for work spent *preparing* a fee application, and by not mentioning fee litigation, it implicitly denies that such litigation is compensable. Petitioner responds that this misreads the provision, which *limits* the compensation for preparing fee applications to that “based on the level and skills reasonably necessary” to prepare the application; the authority to compensate for this work exists under the general standards of Sections 327 and 330, which, petitioner argues, also authorize compensation for fee litigation—and Congress did not limit compensation for such litigation, as it did compensation for the preparation of the application itself.

ASARCO argues that petitioner’s position is an attempt to impose fee shifting, in place of the American rule under which litigants bear their own costs and fees, despite the absence of a statute expressly providing for fee shifting. They concede that such fees could be awarded as a sanction in the event of bad faith or frivolous objections, but no such argument was made in this case, and without such justification or an express fee-shifting provision, the intent of the statute must have been to retain the default rule that parties bear their own litigation costs.

The United States filed an amicus brief supporting petitioner, arguing that the Fifth Circuit’s ruling, by categorically precluding fees on fees, would dilute the compensation of bankruptcy professionals, but making a slightly different argument from that of petitioner. Petitioner argues that the fee litigation itself is “services rendered” for which it is entitled to reasonable compensation. The United States argues that “services rendered” more naturally refers to work for a client, not efforts to recover its fees. However, such fee litigation should be considered part of the underlying work for the trustee or debtor because the statute requires the fee approval process in order for the professional to be retained and perform that underlying work, and compensating for that litigation may be

appropriate and necessary to ensure that the professional receive “reasonable” compensation for the underlying work. (Although the briefs do not make this point, this is consistent with fact that most retainer agreements used by professionals outside of bankruptcy contain express provisions entitling the professional to recover costs and fees should it have to sue to collect its fees.)

SIGNIFICANCE

The Fifth Circuit acknowledged that if fees on fees are denied, the compensation of professionals will be diluted, but reasoned that permitting fees on fees would encourage fee litigation, to the detriment of the estate and its creditors. This essentially rejected the bankruptcy court’s reasoning that to deny fees on fees might encourage parties to challenge the debtor’s counsel’s fee requests simply to extract concessions or use the prospect of such challenges to pressure the debtor and its counsel. The bankruptcy court would seem to have the better of this argument because if Baker Botts prevails, that does not establish a right for professionals always to collect the costs of fee litigation; it merely recognizes that the bankruptcy court has the discretion to make such an award in appropriate cases. This should discourage fee challenges that lack a sound foundation. If fees on fees are categorically barred, professionals may well have to settle questionable claims to avoid litigation, giving a tool to those parties who oppose the work being done by the debtor’s professionals.

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PREVIEW of United States Supreme Court Cases, pages 191–194.
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