**American College of Bankruptcy**
**Friday, September 28, 2012**
**Panel 3 - 4:14 PM to 5:25 PM**
**Maintaining Ethical Standards in Bankruptcy**

Panelists:

Peter C. Blain, Partner, Reinhart Boerner Van Deuren s.c.
James M. Carr, Partner, Faegre Baker Daniels Melissa Kibler Knoll, Senior Managing Director, Mesirow Financial Consulting Nancy A. Peterman, Shareholder, Greenberg Traurig, LLP

Moderator:
Kenneth J. Malek
Senior Managing Director, Conway MacKenzie

I. United States Trustee's Proposed Fee Guidelines

A. Background/Basis for the Fee Guidelines

1. The Office of the United States Trustee ("UST") may review "in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee (which guidelines shall be applied uniformly by the United States Trustee except when circumstances warrant different treatment) applications filed for compensation and reimbursement under section 330 of title 11." 28 U.S.C. § 586(a)(3)(A).
2. The UST may also file "with the court comments with respect to such [fee] application[s] and, if the United States Trustee considers it to be appropriate, objections to such [fee] application[s.]" Id.
3. In 1996, in accordance with 28 U.S.C. § 586, the UST program set forth fee guidelines ("1996 Guidelines") which have been followed since their enactment.
4. The UST program is in the process of revising the 1996 Guidelines and submitted revised Guidelines for Reviewing Applications for Compensation & Reimbursement of Expenses Filed under 11 U.S.C. § 330 *by Attorneys* in Larger Chapter 11 Cases ("Proposed Guidelines") for public comment.

    a. The Proposed Guidelines would apply only in larger chapter 11 cases, which is defined, under the Proposed Guidelines, as a chapter 11 case with more than $50 million in combined assets and liabilities, aggregated for jointly administered cases.
    b. Upon adoption of the Proposed Guidelines, which has not yet occurred, the Proposed Guidelines would only apply to attorneys. The 1996 Guidelines will continue to apply in "(i) larger chapter 11 cases by those seeking compensation who are not attorneys, (ii) all chapter 11 cases below the $50 million threshold and (iii) cases under other chapters of the Bankruptcy Code."
    c. On November 14, 2011, the UST posted the Proposed Guidelines for comment. The comment period expired on January 31, 2012.
    d. Thirty (30) separate comments were submitted to the UST, including from the American College of Bankruptcy, AIRA, National Bankruptcy Conference, 118 law firms (who jointly submitted comments) and comments from various law firms, professors and other professionals in the restructuring field. All of these comments are available on the UST program's website. See *www.justice.gov/ust*.
    e. On June 4, 2012, the UST program held a public hearing in Washington, DC regarding the Proposed Guidelines. The transcript of this hearing is available at *www.justice.gov/ust*. As part of the public hearing process, the UST program extended the comment period for the Proposed Guidelines to May 21, 2012.

B. Overview of Proposed Guidelines[1]

1. Goals of the Proposed Guidelines: The UST's stated purposes or goals in proposing the Proposed Guidelines are as follows:

   a. "Ensure bankruptcy professional fees are subject to the same client-driven market forces, scrutiny, and accountability that apply in non-bankruptcy engagements."
   b. "Ensure adherence to the requirements of 11 U.S.C. § 330 so that all professional compensation is reasonable and necessary, particularly as compared to the market measured both by the professionals' own billing practices for bankruptcy and non-bankruptcy engagements and those of its peers."
   c. "Increase disclosure and transparency in the billing practices of professionals seeking compensation from the estate."
   d. "Increase client and constituent accountability for overseeing the fees and billing practices of their own professionals who are being paid by the estate."
   e. "Encourage the adoption of budgets and staffing plans developed between the client and professional to bring discipline, predictability, and client involvement and accountability to the bankruptcy process."
   f. "Increase the efficiency and decrease the administrative burden of the review."
   g. "Maintain the burden of proof on the professional seeking compensation to establish that fees and expenses are reasonable and necessary even absent an objection."
   h. "Increase public confidence in the integrity of the bankruptcy compensation process."

2. Section 330 Standard: In reviewing fee applications, the UST will consider the factors set forth in § 330 of the Bankruptcy Code, which are:

   a. Time spent;
   b. Rates charged;
   c. Whether services were necessary to the administration of, or beneficial towards the completion of, the case at the time they were rendered;
   d. Whether services were performed within a reasonable time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;
   e. The professional's demonstrated skill and experience in bankruptcy; and

[1] If there is an indication that any material has been quoted in Section I.B of this Article, the source is the Proposed Guidelines.

f. Whether compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under title 11.

3. Standard for Fee Review Under § 330 of the Bankruptcy Code Based Upon the Proposed Guidelines: In applying § 330 of the Bankruptcy Code to review fee applications, the UST will consider the following:

a. Comparable services standard: "whether the professional's rate in the application is reasonable, particularly as compared to the market measured both by the professional's own billing practices for bankruptcy and non-bankruptcy engagements and those of its peers and whether the applicant provided sufficient information to evaluate comparability."
b. Staffing inefficiencies: "whether there was unjustified or unjustifiable duplication of effort or services, including multiple attorney's attending hearings or meetings, or whether the seniority or skill level of the professional was commensurate with the complexity, importance, and nature of the issue or task."
c. Rate increases: "whether the application contains rates higher than those disclosed and approved on the application for retention or any supplemental application for retention or agreed to with the client."
d. Transitory attorneys: "whether a professional billed a few hours with no evidence of benefit to the estate."
e. Routine billing activities: "whether a professional billed for routine billing activities that are typically not compensable outside of bankruptcy."

i. While most attorneys do not charge clients for preparing invoices, whether detailed or not, *reasonable* charges for preparing interim and final fees applications are compensable.
ii. The UST may object to the following activities as non-compensable:

i) Redacting bills for privileged or proprietary information (since you know that bills will be publically filed, the time entries and invoices should be prepared accordingly without the need for such redaction).
ii) "Entering, preparing, reviewing or revising time records or invoices."
iii) "Preparing and issuing monthly statements in cases with a monthly compensation order."

f. Block billing or lumping: "whether the application contains entries over .5 hours without discrete tasks separately identified and billed."

g. Vague or repetitive entries: "whether the application contains insufficient information to identify the purpose of the work or the benefit to the estate." Don't use "attention to" or "review file."

h. Overhead: "whether the application includes matters that should be considered part of the professional's overhead and not billed to the estate such as clerical tasks and word processing."

i. Non-working travel: "whether the application includes time for non-working travel billed at the full rates."

j. Contesting or litigating fee objections: "whether the fee application seeks compensation for defending or explaining fee applications or monthly invoices that would normally not be compensable outside of bankruptcy."

k. Geographic variations in rates: "whether the professional increased the rate based solely on the geographic location of the case."

   i. No objection from UST if: "non-forum" rates of professionals are used so long as the "non-forum" rates are based on the reasonable rates where they maintain in their primary office, even if locally prevailing rates where the case is pending are lower.

   ii. Objection from UST if: attorneys increase their rates based on the forum where the case is pending when they bill at a lower rate where they maintain their primary office.

l. Budgets and Staffing Plans: "whether budgets and staffing plans for hourly billing engagements have been agreed to between professionals and clients." The UST will consider the following:

   i. "Whether professionals have periodically updated or amended their budgets and staffing plans as a case progresses and obtained client approval of all significant or material amendments."

   ii. "Whether budget estimates track project categories used in a particular case."

   iii. "Whether the application sufficiently explains any substantial upward variations (*e.g.*, 10% or more) between the client- approved budget and the fee application."

   iv. "Whether the application sufficiently explains any substantial upward variation between the number or identity of professionals between the client-approved staffing plan and the fee application."

m. Verified and other statements: "whether a client has provided a verified statement regarding its budgeting, review, and approval

process for fees and expenses and whether the professional has made similar representations and disclosures in the retention application and application for compensation."

n. Fee enhancements: "if the application contains a request for fee enhancement, whether the applicant has identified any facts or theories that, outside of bankruptcy, would enable an attorney to compel its client to pay a fee in excess of the contractual amount due," including any request for fees incurred in preparing, seeking or defending an application for fee enhancement.

o. Summer Associates: "whether the application includes fees for summer clerks or summer associates that are more properly the firm's overhead for recruiting and training."

p. Burden of proof: "whether the applicant has provided sufficient information to satisfy its burden in the application even absent an objection."

4. Standard for Expense Review Under § 330 of the Bankruptcy Code Based Upon the Proposed Guidelines. In applying § 330 of the Bankruptcy Code to the review of expenses, the UST will consider the following:

a. Prorated expenses: if expenses are pro rated between the estate and other cases, the attorney must provide a basis for such proration.

b. Travel expenses: whether the expense is reasonable and economical (*i.e.*, coach class travel instead of first class).

c. Type of expenses: whether the expenses are customarily charged to non-bankruptcy clients.

d. Third party expenses: whether the expenses of third-parties are actual or "marked-up" by the firm.

e. Overhead: whether the expenses are or should be non-reimbursable overhead costs.

f. Actual costs: whether expenses incurred "in-house" reflect actual costs.

g. Compliance with local rules and court orders: whether the expenses charged are in compliance with any applicable local rules or orders of the court.

h. Allocation of expenses: "unusual" expenses should be allocated to specific projects within the case and contain sufficient, detailed explanations as to the nature of the expenses.

i. Receipts: larger or unusual expenses may require the submission of receipts

5. Fee Application Content Under Proposed Guidelines: Under the Proposed Guidelines, the following content and format is required for fee applications.

a. The attorney must demonstrate compliance with § 330 of the Bankruptcy Code.
b. The fee application must contain sufficient information so that the court, creditors and UST can review it without searching for relevant information in other documents.
c. Billing records should be provided in an electronic data format that is searchable.
d. The fee application must contain information about the applicant and application, including, but not limited to, (i) the name of the applicant, (ii) the name of the client, (iii) the petition date, (iv) the retention date for the attorney, (v) the date of the order approving the attorney's employment, (vi) the time period covered by the application, (vii) the terms and conditions of the attorney's employment and compensation including the source of compensation, the retainer terms, and any budgetary or other limitations on fees, (viii) whether there have been draws on the retainer, (ix) the remaining retainer balance, (x) whether the application is interim or final, (xi) why the court has allowed compensation applications more frequently than every 120 days (if applicable) and (xii) whether the attorney is seeking compensation other than under § 330 of the Bankruptcy Code.
e. For each attorney and paraprofessional working on the case, the fee application must contain (i) their name, (ii) title, (iii) primary department, (iv) date of admission to the bar (if applicable), (v) total fees included in the application, (vi) total hours included in the application, (vii) current hourly rate in the application and for all other matters, (viii) highest, lowest and average hourly rate billed in the preceding 12 months for estate-billed bankruptcy matters and all other matters and (ix) any increase in the hourly rate during the application period and number of increases since inception of the case.
f. If there are rate increases in the fee application, the application must compare the cost under the prior rate structure as compared to the new rate structure. In addition, the application must indicate who approved the rate increase.
g. If an attorney is employed by a debtor, then their fee application must contain an estimate of the fees and expenses for which approval is sought that the debtor would have incurred even absent the bankruptcy (*e.g.*, non-bankruptcy litigation, tax advice or securities compliance)

6. Time Entry and Invoice Requirements Under the Proposed Guidelines: Under the Proposed Guidelines, the attorney's time entry or invoice must comply with, among others, the following requirements.

a. Time must be in chronological order.
b. Time cannot be lumped.

c. Billing must be in tenths (.10) of an hour. "A disproportionate number of entries billed in half or whole hour increments may indicate that actions are being lumped or not accurately billed."
d. A *de minimus* amount of time can be combined or lumped if does not exceed one-half hour (.50) per day
e. There are now twenty-four (24) categories and twenty (20) sub-categories into which time must be categorized.
f. Time entries should give sufficient detail identifying the subject matter of the communication, hearing or task and any recipients or participants in such communication, hearing or task.
g. If multiple attorneys from a firm attend a hearing or conference, an explanation must be provided as to why necessary multiple attorneys were necessary.

7. Expense Description Requirements Under the Proposed Guidelines: Under the Proposed Guidelines, expense descriptions must include:

a. the amount;
b. type of expense;
c. date incurred;
d. who incurred the expense (if relevant);
e. reason for the expense; and
f. the expense must be categorized in the same manner as fees.

8. Budgets and Staffing Plans: Under the Proposed Guidelines, attorneys will be required to prepare and get approval of budgets and staffing plans. These budgets and staffing plans will be compared to the actual fees and staffing included in fee applications.

a. When reviewing fee applications, the UST will consider the previously submitted budgets and staffing plans.
b. Fee applications must contain a summary by project category of fees and hours budgeted for such category as compared to fees and hours actually billed for such category.
c. If the there is a variance of greater than 10% between the budgeted fees and hours and the actual fees and hours, the attorney must provide an explanation.
d. If there are attorneys who are billing time but are not on the approved staffing plan, the attorney must explain why these attorneys were not previously identified in the staffing plan.

9. Statement From Professional: A firm's fee application must answer the following questions, which may be answered simply "yes" or "no." At the attorney's option, an explanation may be provided.

a. "During the preceding 12 months, have you or your firm charged any client less than the hourly rates included in this application in

other estate-billed bankruptcy engagements? Other bankruptcy engagements? Other engagements?"

b. "During the preceding 12 months, have you or your firm charged any client more then the hourly rates included in this application in other estate-billed bankruptcy engagements? Other bankruptcy engagements? Other engagements?"

c. "Did you offer your client variations from your standard or customary billing rates, fees, or terms for services provided during the period covered by the application?"

d. "Did you agree to any variations from or alternatives to, your standard or customary billing rates, fees or terms for services provided during the period covered by the application?"

e. "Do any of the professionals included in this fee application vary their rate based on the geographic locale of the forum?"

f. "Does the fee application include time or fees related to entering, reviewing, or editing time records, invoices, and draft invoices, etc? (This is limited work involved in preparing time and billing records that would not be compensable outside of bankruptcy and does not include reasonable fees for preparing a fee application)."

g. Does this application include time or fees for reviewing time records to redact any privileged or other confidential information?

10. Statement from Client: The fee application must contain a verified statement from the client answering the following questions, which may be answered simply "yes" or "no." At the client's option, an explanation may be provided.

a. "Did you review and approve a budget and staffing plan in advance for the professional covering the time period of this application?"

b. "If the fees sought vs. the fees budgeted for the time period covered by this fee application are higher by 10% or more, did you discuss the reasons for the variation with the professional?"

c. "Did you take steps to ensure the compensation sought in this application is comparable to the compensation paid to the professional or the professional's firm for bankruptcy and non-bankruptcy engagements?"

d. "Before this application was filed, did you review the professional's compensation and expenses sought in this application to ensure that they are reasonable and are for actual and necessary services?"

e. "Did you review the application to ensure that the professional has staffed the engagement with professionals of the appropriate seniority or experience commensurate with the complexity, importance and nature of the problem, issue or task addressed?"

f. "If the application includes any rate increase since retention or the last fee application, did you review and approve those rate increases in advance?"

11. Case Status: The fee application must contain a case status covering, to the extent possible, the following topics:

a. Key steps completed in the case;
b. Key steps remaining to be completed in the case;
c. Cash on hand;
d. Amount of unpaid administrative expenses;
e. Amount of unencumbered assets; and
f. Any material changes in the case after the filing of the application should be raised at the hearing or prior to the expiration of any objection deadline.

12. Fee Application Summary Sheet: Under the Proposed Guidelines, there is a detailed summary sheet that must be submitted with each fee application.

13. Retention Applications: Under the Proposed Guidelines, there are detailed requirements for retention applications. Detailed billing data must be provided comparing billing rates for a firm's bankruptcy group to those attorneys in other departments (in the United States only), including lowest, highest and average billing rates over the last 12 months. In addition to other requirements, the following questions must be answers:

a. "Did you disclose to your client information regarding how your fees and terms for this engagement compare to other estate-billed bankruptcy engagements? Other bankruptcy engagements? Other engagements?"
b. "Did you offer your client variations from your standard or customary billing rates, fees, or terms?"
c. "Did you agree to any variations from, or alternatives to, your standard or customary billing arrangements for this engagement?"
d. "During the preceding 12 months, have you or your firm charged any client less than the hourly rates quoted for this engagement in other estate-billed bankruptcy engagements? Other bankruptcy engagements? Other engagements?"
e. "During the preceding 12 months, have you or your firm charged any client more then the hourly rates quoted for this engagement in other estate-billed bankruptcy engagements? Other bankruptcy engagements? Other engagements?"
f. "Do any of the professionals included in this engagement vary their rate based on the geographic locale of the forum?"
g. "If you or your firm has a prior or existing relationship with the client (including a member of an official committee), do the terms and conditions of the proposed post-petition retention differ in any

respect, including billing and compensation terms, from the prior retention? If so, describe the differences."

14. Fee Review Process -- Fee Examiners and Fee Committees: The Proposed Guidelines establish a procedure for the review of fees by a fee examiner or fee committee, in those cases in which fee application review will be administratively burdensome. The UST will, in its discretion, recommend the appointment of a fee committee or fee examiner to the court. It will be approved in the court's discretion.

    a. The fee examiner or fee committee is established to ensure that fees and expenses paid by the estate are reasonable, actual and necessary as required by the Bankruptcy Code.

        i. A fee committee would consist of representatives of the debtor in possession, unsecured creditors committee and UST. It could also include one independent member.
        ii. A fee examiner must be an experienced person not otherwise involved in the case.

    b. The fee examiner or fee committee would be charged with monitoring, reviewing and, where appropriate, objecting to interim and final applications for fees and expenses, including monthly compensation requests.
    c. The fee examiner or fee committee may establish other measures to assist the court and attorneys.
    d. The fee examiner or fee committee may employ professionals.
    e. The fee examiner, members of the committee and their professionals would be paid in accordance with the fee procedures of the case and the standards of the Bankruptcy Code.
    f. Any order appointing a fee examiner or fee committee should contain appropriate exculpations and indemnifications.

C. American College of Bankruptcy Comments:[2] The American College of Bankruptcy (the "College") submitted comments to the Proposed Guidelines on January 30, 2012. These comments included general observations on the Proposed Guidelines and specific comments to the provisions of the Proposed Guidelines on scope, hourly rates, non-compensable expenses and budget and staffing plans. The College's comments can be found at *www.justice.gov/ust*.

1. The College's General Observations:

    a. The College notes that "the present fee and expense reimbursement regime, consisting of Bankruptcy Code § 330, applicable Federal Rules of Bankruptcy Procedure, applicable rules and fee orders

[2] If there is an indication that any material has been quoted in Section I.C of this Article, the source is the comments of the American College of Bankruptcy.

promulgated by each court, the 1996 Guidelines and constantly developing case law, has been largely successful in ensuring transparency, efficiency and reasonableness in the fee and expense review process."

b. The College notes that the Proposed Guidelines may "go beyond or conflict with the Bankruptcy Code or applicable case law."

c. The College's comments highlight that the Bankruptcy Court is the "ultimate decision-maker with respect to compensation and expense issues."

d. The College concludes that "the 1996 Guidelines and other tools at the Bankruptcy Court's disposal" are sufficient. The Proposed Guidelines "would introduce extraneous and misleading information or seek to limit the Bankruptcy Court's authority over the allowance process and, thus, are beyond the scope of the U.S. Trustee's assigned role in the fee application process."

2. Scope of the Proposed Guidelines:

a. The College suggests that the Proposed Guidelines should only apply to cases of a particular *asset size* requirement. The College does not suggest the appropriate threshold.

i. The College notes that compliance with the Proposed Guidelines is burdensome and expensive. Therefore, the Proposed Guidelines should only be applied in cases that merit compliance.

ii. If the threshold is based on asset size, the petition could determine whether compliance with the Proposed Guidelines is required.

b. The Proposed Guidelines should not apply to ordinary course attorneys or attorneys employed under § 327(e) of the Bankruptcy Code "so long as (i) the attorney is compensated in accordance with the pre-bankruptcy course of dealing between the attorney and the debtor and (ii) the attorney's fees and expenses are not of a sufficient magnitude to justify the burdens and costs imposed by the Proposed Guidelines."

3. Hourly Rate Issues under the Proposed Guidelines:

a. A stated purpose of the Proposed Guidelines "is to '[e]nsure bankruptcy professionals fees are subject to the same client-driven market forces, scrutiny and accountability that apply in non-bankruptcy engagements.'"

b. The College notes that professional fees, including hourly rates, are based on market forces. "No potential client is without choices

and the ability shop, compare and negotiate. In our experience, they do so."

c. As drafted, the Proposed Guidelines would allow the UST to second guess these market results and the judgment of the debtor and its board in selecting professionals.

d. "It is the Bankruptcy Court, not the U.S. Trustee, that is the ultimate decision-maker regarding fees, and the issue under the Bankruptcy Code § 330 is not whether the estate is being charged the lowest possible rate, but rather whether the compensation requested is reasonable within the context of the specific circumstances of the case."

4. Additional Specific Comments to the Proposed Guidelines:

a. Fee Enhancements: The College notes that outside of bankruptcy, there is "rarely, if ever, a basis to 'compel' professional fees in excess of a contractual amount." Both inside and outside of bankruptcy, the standard for a bonus should be as follows: "the appropriateness of a bonus should be determined in the first instance between the client and the professional, subject, of course, to the Bankruptcy Court's determination of the reasonableness of the bonus under Bankruptcy Code § 330."

b. Summer Associates and Non-Working Travel Time: The College notes that the statement in the Proposed Guidelines that summer associate time is firm overhead and non-working travel time should not be billed a full rates is not market based.

c. Telephone Charges: Under the Proposed Guidelines, all telephone charges are overhead. Again, the College notes that this statement is not market based and that the 1996 Guidelines get it right. "Reasonable long distance and multi-party or conference calls charges that are client specific should be reimbursed."

d. Disclosures Regarding Rates in Other Matters: The Proposed Guidelines seem to require an attorney to disclose the billing rate actually collected for each attorney's services "in every matter in which he or she billed time." This requirement likely is difficult, if not impossible, to comply with for certain firms with many attorneys or multiple offices. In addition, there are ethical concerns (such as obtaining client consent for such disclosures). The College notes that there are many reasons an attorney may agree to discounts, billing reductions, contingency billing or the like based upon the specific facts and circumstances of the case and/or the client. This is market driven and has little relevance to the billing rates for the case at hand.

e. Redaction of Bills: The College takes the position that redacting bills for privileged or confidential information should be compensable. It is not reasonable to expect every attorney working on a case to prepare time entries without such privileged

or confidential information. Moreover, debtors or committees may want more detailed time entry with this privileged or confidential information included, with the understanding that it would be redacted in the public filing.

f. Contesting or Litigating Fee Applications: The Proposed Guidelines indicate that "professionals should be denied compensation for defending or explaining their fee applications or monthly invoices when such fees would not be compensable outside of bankruptcy." The College notes that "outside of bankruptcy, professional fees are not usually subject to review and objection by third parties." The College notes that the fees should be reimbursable if reasonable in accordance with § 330 of the Bankruptcy Code. Moreover, the College notes the importance of this standard to "discourage insubstantial or vexatious objections."

5. Budget and Staffing Plans:

a. Budgeting should not be mandatory in every case. It is not clear whether the Proposed Guidelines are requiring budgeting in every case.

b. The College notes that outside of bankruptcy, budgeting usually occurs in connection with lawsuits or transactions involving two or three parties. Large chapter 11 cases "usually involve multiple parties with differing agendas, and much of the legal cost that debtors or official committees incur depends on the conduct of potential adversaries, which may be unanticipated or unpredictable." The College questions the usefulness of budgeting but notes, if it does occur, "(i) it should be limited only to transactions or contested matters or adversary proceedings that are discrete and predictable; (ii) it should be for a limited period such as three months . . . and (iii) professionals should be permitted to update budgets as they obtain additional information."

c. The client should determine whether a budget will be required, not the UST. The UST should only be allowed to object to the lack of a budget if a debtor would normally have required one.

d. If required, budgets should remain confidential. They should only "be disclosed to the client and not to other third parties or even to the Bankruptcy Court without safeguards being in place." "Budgets inherently contain privileged or confidential information that would be valuable to an adversary . . ."

e. The Proposed Guidelines seem to imply that attorneys will be paid for the preparation of budget and staffing plans. The College notes that this is appropriate.

D. Law Firm Response:[3] On January 31, 2012, 119 law firms submitted their collective comments to the Proposed Guidelines. On April 16, 2012, 118 of these firms submitted specific changes to the Proposed Guidelines, including commentary and a mark-up of the Proposed Guidelines. On May 18, 2012, these firms submitted a short amendment to the April 16, 23012 submission. The three referenced comments can be found at *www.justice.gov/ust* and the highlights are summarized below.

1. Budget and Staffing Process: "The Proposed Guidelines impose a substantive requirement on debtors, creditors' committees and their professionals that they should prepare and approve fee budgets [and] staffing plans . . . The cost of preparing such materials would be large and consume scarce time and resources needed to stabilize the debtor in the early stages of a case. Further, such budgets, plans and estimates would be, by their nature, inherently unreliable. Moreover, they have no bearing on whether the compensation requested by a professionals is reasonable for the work that was actually required to be performed in the case."

    a. The budgeting and staffing process will add significant cost to the case.
    b. The budgeting and staffing process could force disclosure of privileged or confidential information or strategic information.
    c. The process itself could lead to litigation and "mischief" among various constituencies.
    d. The UST is not authorized to impose new requirements on debtors, committees or professionals based on the language of 28 U.S.C. § 586. This budgeting and staffing process does just that.
    e. By comparing budgeted to actual fees in determining the appropriateness of fee applications, the UST is altering the standard on which fee applications are approved.
    f. Preparing an accurate, useful budget in a complex chapter 11 case is virtually impossible.

2. Hourly Rate Comparisons: "The Proposed Guidelines regarding the comparison of hourly rates seek to apply an arbitrary and irrelevant evidentiary requirement that is inconsistent with public policy governing the compensation of professionals."

    a. The Proposed Guidelines' requirement to provide highest, lowest and average hourly rates billed in estate matters and other private matters over the last 12 months is an evidentiary requirement. The UST is not authorized to establish such an evidentiary standard.

[3] If there is an indication that any material has been quoted in Section I.D of this Article, the source is the comments of the 119 (or 118) law firms.

b. The Proposed Guidelines' search for the lowest rate charged over the past 12 months appears to be a return to the "economy of administration" standard.
c. The hourly rate data required by the Proposed Guidelines in not useful or relevant to the process of evaluating fee applications under § 330 of the Bankruptcy Code.

3. Establishment of Evidentiary Presumptions: "The Proposed Guidelines apply several arbitrary evidentiary presumptions that are neither rational, consistent with the standard of compensation set forth in § 330 of the Bankruptcy Code, nor authorized by the UST enabling statue, 28 U.S.C. § 586."

a. The Proposed Guidelines incorporate provisions based upon the "economy of administration" standard rejected by Congress.
b. For example, the Proposed Guidelines create a presumption that "compensation should be denied for the attendance of more than one professional at court hearings."
c. The Proposed Guidelines improperly deny compensation for the review of time detail to conform to the unique requirements of billing in bankruptcy cases, including the need to redact time entry.
d. The Proposed Guidelines improperly deny compensation for the defense of fee applications and monthly statements.
e. The Proposed Guidelines improperly create the presumption that the fees of any professional billing less than 15 hours during a 120 day time period should be denied.

4. Retention Applications: The Proposed Guidelines improperly contain provisions concerning retention applications. This is outside the scope of the UST's authority to promulgate guidelines relating to fee applications.
5. Definition of Larger Chapter 11 Cases: The definition of larger chapter 11 cases should be modified as noted below.

a. A larger chapter 11 case should be a case involving a debtor, or group of debtors whose cases are jointly administered, who show, on the initial schedules of assets and liabilities filed in the case(s):

i. Assets exceeding $250 million;
ii. Unencumbered assets (including the scheduled value of assets in excess of secured claims against them) exceeding $50 million;
iii. At least 100 pre-petition unsecured creditors, excluding employees and former employees, holding more than $100 million in general unsecured claims; and
iv. Outstanding pre-petition debt for borrowed money in excess of $50 million that is:

i) held by three or more creditors, and
ii) subject to a common loan or credit agreement, purchase agreement, trust indenture or other similar agreement setting forth common terms and conditions singularly applicable to at least $50 million of such debt.

b. For purposes of determining whether the thresholds above been satisfied, the schedules of assets and liabilities filed by the debtor(s) shall be determinative, including the value of encumbered and unencumbered assets as set forth on such schedules.

6. Geographic Variations in Rates: A national case is likely to be staffed by attorneys from multiple offices billing at national (as opposed to regional) rates. The Proposed Guidelines must be revised to reflect this reality.
7. Overhead: The definition of overhead expenses included in the 1996 Guidelines should continue to be used. Certain expenses, such as after hours lighting, heat or air conditioning, should be reimbursable when incurred specifically due to the case at hand.
8. Case Status: The case status information required by the Proposed Guidelines is within the control of the debtor. The Proposed Guidelines should require primary counsel to the debtor to gather this information and include it in their fee application.
9. Threshold for Justifying Individual Expenses: The law firms propose increasing the threshold at which individual expenses must be explained to $500. If there is a much lower threshold, nearly all expenses will have to be explained at a cost to the estate.
10. Special Fee Review Procedures: The Bankruptcy Court must have more flexibility to determine the appropriate fee review process, if any, for a case. Moreover, if a fee review process is in place and it is a process to which the UST has agreed, the UST must be bound to the outcome of that process and cannot separately object to a fee application.
11. Project Categories: The firms' comments include continued use of the task categories currently in use, with the ability to increase those categories based upon the specific case. The firms recommend eliminating the sub-categories.
12. Revised Fee Guidelines: The firms submitted a revised form of fee guidelines.

    a. The revised guidelines were prepared with the following objectives:

        i. "To recognize the exclusive statutory role of the bankruptcy courts in deciding compensation for professionals in bankruptcy cases and related evidentiary requirements, while also providing the UST and any

professional or committee appointed to review and comment on fees with the information requires to do so."

ii. "To follow and implement the statutory standard that professionals in bankruptcy should be compensated at their customary hourly rates for comparable non-bankruptcy work."

iii. "To suggest practical and feasible procedures with respect to attorney fee applications in larger chapter cases that are (a) cost effective, taking into consideration the cost and expense to the estate of providing various information against its relevance and value and (b) within the capabilities of current law firm accounting and record-keeping practices and related technology that is available at reasonable cost to both small and large law firms."

b. Some of the proposed modification to the Proposed Guidelines are noted below:

i. Removal from fee application requirements the need to provide the highest, lowest and average hourly rate billed in preceding 12 months.

ii. Removal from fee application requirements the need to provide a comparison of actual to originally approved hourly rates.

iii. Removal from fee application requirements the debtor-only requirement to provide an estimate of fees and expenses that the debtor would have incurred absent the bankruptcy.

iv. Removal of the concept that actions are considered lumped or inaccurately billed if there are a disproportionate number of time entries in one-half (.50) or one (1) hour increments.

v. Allow professions to bill continuous tasks as a single time entry when the activity involves a series of connected continuous tasks that are not meaningful segmented (such as drafting of motion, declaration and order).

vi. Removal of the requirement for attorneys to explain the need for multiple attendees at hearings or conferences.

vii. Removal of the budget and staffing plan process and the benchmarking of such budgets and staffing plans in fee applications.

viii. Removal of the required "Statement from Professional."

ix. Removal of the Verified "Statement from Client."

x. Modification of the special fee review procedures involving the appointment of a fee committee or fee examiner as follows:

i) The bankruptcy court should decide whether a fee committee or fee examiner should be appointed in a case.

ii) If there is a fee committee or fee examiner, the UST cannot object to an application for compensation that has been approved by the fee committee or fee examiner

iii) If the UST is going to recommend the use of a fee committee or fee examiner, the UST should make such recommendation as early as possible in the case.

iv) The purposes, scope, authority, functions and amount and manner of compensation of a fee examiner or fee committee are for the court to decide as appropriate for each case.

v) The UST will not object to the inclusion in the order appointing a the fee committee or fee examiner appropriate provisions exculpation and indemnifications for the members of the fee committee (including the independent member) or the Fee Examiner.

II. Issues on Disinterestedness

A. Prepetition Claims—*In re SBMC Healthcare, LLC*, 473 B.R. 871 (Bankr. S.D. Tx. 2012).

1. Facts.

a. Johnson DeLuca Kurisky & Gould, P.C. filed an application to be appointed general bankruptcy counsel to represent the Debtor, which owned a hospital facility on 20 acres of land located in northwest Houston, Texas. In its application, the firm disclosed that it was owed $128,000 prepetition and further disclosed that it had been paid $50,000 for prepetition work.

b. The U.S. Trustee objected to the application. In response, the firm filed an amended application seeking appointment as special counsel to the Debtor and also seeking the appointment of a solo practitioner with thirty years of bankruptcy experience as general bankruptcy counsel. In its amended application, the firm indicated that general bankruptcy counsel would draft the plan, disclosure statement, as well as any necessary pleadings, including without limitation, motions to recover avoidable preference. However, special counsel would provide assistance to general bankruptcy counsel as necessary because of size and complexity of the case, which was too large for a solo practitioner to handle alone.

c. In its amended application, the firm also disclosed to the court that it waived its unsecured claim against the estate, but retained its claim against one of the principals of the Debtor who signed the firm's engagement letter personally. The firm agreed not to sue the principal for the 180 days. The firm also took an assignment of the principal's claim which provided that the firm would receive any distribution to which the principal was entitled up to the amount of the firm's prepetition claim, but only after payment of all other creditors of the estate.

d. The U.S. trustee renewed its objection, arguing that although the firm was not a direct creditor of the estate after the waiver of its claim, it was an indirect creditor because of the assignment of the claim against the principal. The firm was therefore not disinterested under section 327(a) of the Code because of the indirect claim and the potential preference. The U.S. Trustee also argued that the firm was in a position to unduly influence the principal in decisions made with respect to the estate because of the potential claim it held against him.

2. Court Opinion.

a. The court noted that in a case dealing with the retention of a law firm which was paid a retainer by a non-debtor third party, the Fifth Circuit rejected the per se rule with respect to disinterestedness and adopted a "totality of the circumstances" test to determine whether a disqualifying conflict existed. *See, Waldron v. Adams & Reese, LLP (In re Am. Int'l Refinery, Inc.),* 676 F3d. 455 (5th Cir. 2012).

b. The court applied the totality of circumstances test to the present case and articulated a non-exclusive list of 14 factors the court should consider when determining whether a conflict was disqualifying:

i. Does the prepetition claim arise from an ordinary employment relationship with the Debtor?

ii. Is the attorney who has applied to represent the estate also an insider of the Debtor?

iii. Does the attorney who has applied to represent the estate hold a mortgage or other type of lien on property of the Debtor to secure the prepetition claim?

iv. Even if the attorney holds no lien on property of the estate, does the attorney hold any other type of interest, direct or indirect, on property of the estate?

v. Does the attorney who has applied to represent the estate not only hold a prepetition claim against the Debtor, but also represent a third party creditor of the estate?

vi. Does the attorney who has applied to represent the estate have a loan outstanding that is owed to the debtor?
vii. Does the attorney who has applied to represent the estate have a direct prepetition claim for services rendered prior to the filing of the petition?
viii. Is the attorney who holds a prepetition claim and who has applied to represent the estate going to serve as general bankruptcy counsel?
ix. Is the attorney who holds a prepetition claim and who has applied to represent the estate going to serve as special bankruptcy counsel?
x. Does the attorney now, or has he ever, served on the Debtor's board?
xi. Is there an undisclosed relationship pursuant to Federal Rule of Bankruptcy Procedure 2014?
xii. Has the attorney received potential preferential payments?
xiii. Is some individual or entity, in addition to the Debtor, liable to the attorney who has applied to represent the estate on the prepetition claim? If so, is this individual or entity an insider?
xiv. How badly does the Debtor really need to employ the attorney who has applied to represent the estate?

c. After applying the factors, the court found that only three, (Nos. 4, 12 and 13), disfavored the retention and the remainder favored the retention. The court thereupon authorized that the firm be retained. In its discussion, the court seemed the apply equal weight to each of the factors.

d. The court concluded by noting that while it was approving the retention, it had significant concerns regarding potential conflicts. However, it placed great weight on the fact that there would be experienced independent general bankruptcy counsel appointed to prevent the firm from pressuring the principal to take actions in the firm's interest rather than the interests of the estate and to examine the potential preferential transfer. The court ordered monthly status conferences to revisit the firm's continuing retention.

B. Conflicts Counsel—*In re Project Orange Associates, LLC*, 431 B.R. 363 (Bankr. S.D.N.Y 2010).

1. Facts.

a. DLA Piper US represented the Debtor, which operated a steam and electricity cogeneration plant located on the Syracuse University campus. In its application to be appointed as general bankruptcy counsel, DLA disclosed that prepetition, it had represented a number of the Debtor's creditors on unrelated matters, including

GE which held a secured claim and the largest unsecured claim and which had sued the Debtor pre-petition (collectively, "Conflict Parties").

b. The declarations supporting the application disclosed that the Conflict Parties other than GE accounted for less than one percent of the firm's annual revenues, and that GE accounted for slightly over one percent when averaged over three years. DLA indicated that it would not sue certain Conflict Parties and proposed the retention of Conflict Counsel to deal with conflict issues, including matters related to GE.

c. In addition, the firm obtained a special conflict letter from GE which permitted it to negotiate with GE on all matters, and in which the parties agreed that Conflict Counsel would represent the Debtor in any adversary proceeding or contested matter against GE.

d. Additionally, the Debtor had filed a motion and a stipulation to approve a settlement of GE's secured claim, which was based on an artisan lien for certain services undertaken in connection with the repair of one of the facilities turbines. DLA indicated that stipulation and motion resolved issues with respect to GE.

e. The U.S. Trustee objected to DLA's retention arguing that DLA was not disinterested as required by section 327(a).

2. Court Opinion.

a. The court noted that a professional's representation of a creditor in another case does not automatically disqualify it from being retained under section 327.

b. However, the court noted that section 327(a) requires that the firm be disinterested, which is defined in section 101(14)(c) as the firm not having an interest materially adverse to the interests of the estate or any class of creditors. The court indicated that requirements of section 327(a) and the definition found in section 101(14)(c) creates a single test for the court---the professional must not hold or represent an interest adverse to the estate.

c. The court noted that the Second Circuit has defined "holding or representing an interest adverse to the estate" as (1) possessing or asserting an economic interest that would tend to lessen the value of the bankruptcy estate or that would create an actual or potential dispute in which the estate has a rival claim; or (2) possessing a predisposition under circumstances that render such a bias against the estate. *In re AroChem Corp*, 176 F. 3d 610 (2d. Cir. 1999).

d. The determination of whether an adverse exists is to be done on a case by case basis.

e. In addition, the court said that DLA's conflict letter with GE did not obviate the potential conflict. Because the firm was unable to

sue GE, the ability to effectively negotiate with GE was too severely circumscribed because it lacked the ability to even hint at the possibility of litigation.

f. Contrary to DLA's assertion that the settlement of GE's secured claim resolved matters with GE, the court noted that although there was a stipulation GE's secured claim was not approved by the court and required material performance by the Debtor's insurers.

g. The court also noted that the parties apparently believed resolving issues with GE was essential to successfully concluding the case because Conflict Counsel was proposed to be retained co-counsel under section 327(a) and not as special counsel under section 327(e).

h. The court denied DLA's application concluding that approving the retention of a firm who has a conflict with the largest creditor in the case who is critical to its successful resolution is not appropriate. In its decision, however, the court noted that there is surprisingly little precedent on this point.

C. Preference and Conflicts Counsel—*In re Enron Corp.*, *No-01-16034*, 2002 W L 32034346 (Bankr. S.D.N.Y. 2002).

1. Facts.

a. Milbank Tweed Hadley and McCloy LLP was retained as counsel to represent the creditor's committee in the case. In its application, the firm disclosed that it represented, among other prepetition creditors, two members of the committee, Citibank and JPMorgan Chase. Citibank and Chase had been qualified bidders in the UBS sale process which partially predated the filing of Milbank's application and supporting affidavit. Milbank also disclosed that it participated in several prepetition transactions and had been paid $449,000 prepetition.

b. Three months after the application was filed and Milbank was appointed, a large creditor, Exco Resources, Inc., joined by five other creditors filed an objection to Milbank's fee application and asked that the firm be disqualified. The creditor argued that Milbank did not adequately disclose its various connections to various debtors and creditors, that it had received a $449,000 preference, that it had been significantly involved in several of the Debtor's prepetition transactions, and finally that Milbank conspired with Citibank and Chase to suppress the release of information to preclude equitable subordination of their claims. For these reasons, the creditor argued that Milbank should be disqualified under Sections 327(a), 328 and 1103.

c. Interestingly, the U.S. Trustee filed a response to Exco's motion indicating that it would not be appropriate to disqualify Milbank.

d. The court began by noting the complexity of the case and the fact that there had been more than 3,800 docket entries and almost 500 orders entered by the date of the hearing on Exco's motion to disqualify.

e. The court observed that Exco had been actively involved since the beginning of the case, but had waited three months to file its initial objection and deferred a hearing on the objection for an additional two months. The court noted that the delay itself would be sufficient grounds to deny the motion to disqualify. However, because of the seriousness of the allegations, the court decided not to deny the motion as untimely.

f. The court noted that a Debtor's choice of counsel is entitled to great deference.

g. Addressing Exco's claim that Milbank had failed to disclose qualifications, the court found that the disclosure had been meaningful, forthright, continuous and sufficiently detailed to fulfill Milbank's obligations under Rule 2014. The court said an applicant for retention is required to disclose all relevant connections but is not required to disclose every conceivable interpretation of its connections and possible consequence resulting from the connections or to predict the outcome of any litigation that may result from, or be related to the referenced connection.

h. The court then noted the differences between the requirements of section 1103 and section 327(a), observing that unlike section 327(a), 1103(b) does not require the disqualification of a professional from representing a committee solely because the professional holds an interest adverse to the estate or because the professional is is not disinterested under section 101(14). However, the court noted that section 328(c) permits the court to deny compensation and reimbursement of expenses of any professional appointed under section 327 or section 1103 who is not disinterested or who represents an interest adverse to the estate. The court indicated that it did not need to reconcile the contours of sections 1103(b) and 328(c) because it concluded that Milbank met the higher standard imposed by section 327(a).

i. After examining a number of documents filed under seal, the court concluded that it was confident that Conflicts Counsel would adequately examine the prepetition transactions about which Exco complained. In addition, the application indicated that Milbank would not participate in the investigation of structured transactions in which it was involved prepetition. Those investigations would be undertaken by Conflicts Counsel and the court appointed Examiner.

j. With respect to the alleged preference, Milbank waived its right to litigate the preference and agreed to be bound by the Examiner's

determination of avoidability and further agreed to waive any claim arising from the recovery of any property. The court also indicated that collectability would be resolved by holding back an amount equal to the alleged preference from Milbank's interim fee request.

k. On the basis of the foregoing, the court denied the motion to disqualify.

D. Different Standards in Different Courts?

1. Do courts in smaller jurisdictions apply the disinterested standards of section 327(a) differently than the courts in Delaware or New York?
2. For an interesting discussion of the differences between jurisdictions *see generally* Michael C. Regan, *Eat What You Kill* 333-335 (2004), which describes the circumstances surrounding the successful criminal prosecution of a Milbank partner for failing to disclose conflicts of interest in a Milwaukee Chapter 11.

III. Addressing Conflicts and Causes of Action Involving Professionals

A. The Barton Doctrine allows suits in a forum other than the U.S. bankruptcy court against a bankruptcy trustee or other officer appointed by the bankruptcy court for acts done the officer's official capacity, only if the plaintiff first obtains leave of the bankruptcy court to pursue the suit. Barton v. Barbour, 104 U.S. 126, 26 L. Ed 672 (1881)

B. Barton v. Barbour, 104 U.S. 126, 26 L. Ed 672 (1881), arose from a state railroad receivership. Frances Barton was thrown from a sleeping car. She sought to sue the state court appointed receiver for the railroad. The Supreme Court established the principle, now known as the "Barton Doctrine", that a party seeking to sue a court-appointed receiver (or as later expanded a bankruptcy trustee or other officers or professionals appointed or employed with court approval in a bankruptcy case) must first seek and obtain leave of the "appointing" court before commencing an action. The Supreme Court explained:

C. "The evident purpose of a suitor who brings his action against a receiver without leave is to obtain some advantage over the other claimants upon the assets in the receiver's hands."

D. In response to the Barton case, Congress enacted 28 U.S.C. § 959(a) ("§ 959") (enacted 6/25/1948 and amended 11/6/1978) which provides:

> (a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice, but this shall not deprive a litigant of his right to trial

by jury.

E. Notwithstanding § 959, the "Barton Doctrine" was expanded and refined over the years to protect other "bankruptcy-court-appointed officers", including counsel and other professionals employed by a trustee (or presumably a debtor-in-possession), Lawrence v. Goldberg, 573 F.3d 1265, 1269 - 1270 (11th Cir. 2009), and recently, a lawyer serving as chair for the creditors committee in a former client's chapter 11 case, Blixeth v. Brown, 470 B.R. 562 (D. Mon. 2012).

F. Matter of Linton, 136 F.3d 544 (7th Cir. 1998) is the leading 7th Circuit authority on the "Barton Doctrine". In that case, Judge Posner explained:

> "Just like an equity receiver, a trustee in bankruptcy is working in effect for the court that appointed or approved him, administering property that has come under the court's control by virtue of the Bankruptcy Code. If he is burdened with having to defend against suits by litigants disappointed by his actions on the court's behalf, his work for the court will be impeded.
>
> This concern is most acute when suit is brought against the trustee while the bankruptcy proceeding is still going on. The threat of his being distracted or intimidated is then very great…Without the [*Barton* Doctrine], trusteeship will become a more irksome duty, and so it will be harder for courts to find competent people to appoint as trustees. Trustees will have to pay higher malpractice premiums, and this will make the administration of the bankruptcy laws more expensive (and the expense of bankruptcy is already a source of considerable concern). Furthermore, requiring that leave to sue be sought enables bankruptcy judges to monitor the work of the trustees more effectively. It does this by compelling suits growing out of that work to be as it were prefiled before the bankruptcy judge that made the appointment; this helps the judge decide whether to approve this trustee in a subsequent case. *Matter of Linton*, 136 F.3d 544, 545 (7th Cir. 1998).

G. In re Vista Care Group LLC, 678 F.3d 218 (3rd Cir. 2012) recently revisited and reaffirmed the vitality of the Barton Doctrine notwithstanding the enactment of § 959.

1. Facts.

   a. A disgruntled purchaser of real estate from a chapter 7 trustee sought to sue the trustee in state court based on claims related to actions of the trustee taken in his official capacity.

   b. Schwab, the chapter 7 trustee, administered a bankruptcy estate that included a 12-acre parcel subdivided into 45 lots. A

retirement home was located on one of the lots. The remaining lots were zoned for mobile home sites. However, the subdivision plan prohibited the sale of the lots to owners of the mobile homes. The trustee entered into an agreement with the zoning authority to abrogate the prohibition and sold sites to mobile home owners. The owner of the retirement home (the "Owner") sought leave of the bankruptcy court to sue the trustee (Schwab) arguing that removal of the prohibition and sale of sites to mobile homes damages the retirement home.

2. Court Opinion.

a. The bankruptcy court expressed doubt regarding the continuing vitality of the Barton Doctrine in 3rd Circuit following the enactment of § 959. The bankruptcy court opined that Barton was "antiquated and probably not controlling in the Third Circuit". Nevertheless, the bankruptcy court granted leave to the Owner to sue the trustee in state court. The trustee appealed and the 3rd Circuit affirmed. However, the 3rd Circuit held that the Barton Doctrine is alive and vibrant in the 3rd Circuit and that obtaining the bankruptcy court's permission to bring the suit against the trustee was a prerequisite for the Owner's action against Schwab. Because pre-petition Vista Care was not in the business of buying and selling lots, § 959 did not apply.

b. The 3rd Circuit explained that without the protection of the Barton Doctrine 1) litigants could obtain advantages over other bankruptcy claimants, and 2) litigation would impede the trustee's administrative efforts. The 3rd Circuit further held that Barton applies even though the UST (and not the bankruptcy court) appointed the bankruptcy trustee. The 3rd Circuit also held that the provision of Bankruptcy Code § 323(b) that a bankruptcy trustee may "sue and be sued" does not imply reversal of the Barton Doctrine.

H. In re Herrera, 472 B.R. 839 (Bank. Ct. D.N.M. 2012) upheld the Barton Doctrine and required bankruptcy court permission to sue even though the state court action (filed without leave of the bankruptcy court) had later been removed to the bankruptcy court. Herrera declined to follow contrary 9th Circuit authority, In re Harris 590 F.3d (9th Cir. 2009).