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PERSPECTIVE

There are some limits to fees in bankruptcy cases

By David M. Reeder

The zero-intensive nature of professional fees in chapter 11 bankruptcy cases and the ongoing concern expressed by commentators bring to mind the line by the great Will Rodgers about the weather: "Everyone talks about it, but nobody does anything about it." On Monday, however, in *Baker Botts LLP v. ASARCO LLC*, the U.S. Supreme Court did something about professional fees.

The issue was whether, in addition to being compensated for services in the underlying bankruptcy case, including compensation for preparing the detailed fee applications, professionals could also be compensated for fees and costs incurred in defending their fee applications from the objections of parties to the bankruptcy case. The Supreme Court, in a 6-3 opinion, answered in the negative. It invoked the American Rule, and held that professionals defend their fee applications against objections on their own dime.

Prior to the advent of the modern bankruptcy code, which became effective in 1979, the rule regarding professional fees in bankruptcy cases was that professionals were to share the debtor's pain. Fees to employed professionals were to be awarded with an eye to the "spirit of economy." See *Levin v. Barker*, 122 F. 2d 969 (8th Cir. 1941). This meant that normal billing rates and market norms were not adhered to because, "this is bankruptcy." The result was a small and highly specialized outlier bankruptcy bar that survived on substandard billing rates and terms.

The 1979 code changed all of that. The code, and the early cases construing the professional compensation provisions, developed the policy that counsel employed in bankruptcy cases should be paid at the same rates as in the prevailing market. No more bankruptcy discount. Additionally, it was determined early on that professionals were to be compensated for the preparation of the required highly detailed interim and final fee applications.

The courts made short shrift of objections that attorneys should not be compensated for preparing their bills, due in part to the detailed and highly regulated nature of the fee application process. Congress codified this provision in 11 U.S.C. Section 330. Fee applications start with billing data, but according to the bankruptcy rules, are in fact a motion for allowance and payment of fees, with all of the attendant factual and legal support required. The allowance of payment for preparation of fee applications, and appearance at the hearing on fees, was carried over to fees generated in satellite litigation over the fees themselves.

In *Baker Botts*, the firm had represented a debtor in possession, successfully, in its chapter 11 bankruptcy case. The firm engineered large recoveries on behalf of the bankruptcy estate. A chapter 11 plan was confirmed, and creditors were paid in full. When Baker Botts filed its fee application, it sought $120 million in fees and costs, an enhancement of $4.1 million, and ultimately, another $5 million for litigating over its fees with an objecting party (who happened to be its former client, now the reorganized debtor). The bankruptcy court awarded the fees, including the $5 million for litigating over fees. On appeal, the district court affirmed. The 5th U.S. Circuit Court Appeals reversed, and the Supreme Court granted certiorari.

In a decision by Justice Clarence Thomas, the court relied on the American Rule, described as a "bed-rock" common law principal, which holds that parties to litigation bear their own legal fees and costs absent a contract, or a clear statute providing for fee shifting. The court found that no provision of the Bankruptcy Code trumps the American Rule.

Baker Botts had argued that Section 330, which provides for "reasonable compensation" for employed professionals for "actual necessary services rendered" provided "running room" for the award of fees and costs for defending fee applications. The court hit hard on the term "services," failing to find any *services* to the estate when the law firm, which is the applicant in the fee application process, litigates over its own fees. Further, the court carefully took apart Section 330(a)(1), the operative professional compensation provision, for any hint of language negating the American Rule. It found none, stating "Statutes which invade the common law are to be read with a presumption favoring the retention of long-established and familiar [legal] principals."

The law firm and the United States, as amicus curiae, argued that if professionals were not allowed to recover fees generated in litigation over professional compensation, then their fees would be diluted. This, they argued, would be at odds with the policy that professionals in bankruptcy cases are to be compensated at the same level as professionals of equal skill outside of bankruptcy. In this day of textualism, such a policy argument cannot stand up against the "show me the where the code trumps the American Rule" analysis carried out by the majority. The "fee maintenance" argument failed due to the court's determination that a fee-shifting statute must clearly shift fees. The court's look at Section 330(a)(1) showed no such clear intent to shift.

A final argument, also of the soft variety, was that to deny professionals recovery of fee litigation compensation would encourage frivolous objections. The court found this argument neither intuitive nor persuasive.

The takeaways: First, textualism is still the general rule on today's Supreme Court; and second, professional fees in bankruptcy cases do have limits.

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