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SECTIONS 327 THROUGH 330: RECENT DEVELOPMENTS IN THE LAW OF EMPLOYMENT AND COMPENSATION OF BANKRUPTCY PROFESSIONALS

Steven Golden and Raff Ferraioli***

I. Introduction

Sections 327 through 330 of the Bankruptcy Code[1] provide the rules and standards that govern the employment and compensation of bankruptcy professionals. While each Code provision governs separate aspects of the employment and compensation of professionals, taken as a whole, and with certain related Federal Rules of Bankruptcy Procedures,[2] these sections comprehensively govern employment issues in bankruptcy cases. This article reviews and discusses some of the noteworthy developments in this area from 2017.

First, this article discusses some of the recent developments under section 327, particularly focusing on the scope of section 327 and "disinterestedness." Next, this article analyzes recent decisions regarding transaction fees under section 328 of the Bankruptcy Code. Lastly, this article discusses cases applying the Supreme Court's decision in *ASARCO*.

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[1]Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 11 U.S.C.A. §§ 101, et seq. (2012) (hereinafter "the Code" or "the Bankruptcy Code").

[2]See, e.g., Fed. R. Bankr. P. 2014.

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II. Section 327

Section 327 of the Bankruptcy Code[3] governs the trustee or debtor in possession's[4] ability to retain professionals. Section 327 requires both court approval of any retention and that the proposed professional is disinterested and does "not hold or represent an interest adverse to the estate . . ."[5]

A. Scope of Section 327

This section discusses the scope of section 327 of the Bankruptcy Code. Section 327 of the Bankruptcy Code governs hiring estate professionals "to represent or assist" the debtor in

[3]Section 327 reads:

> **(a)** Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.
>
> **(b)** If the trustee is authorized to operate the business of the debtor under section 721, 1202, or 1108 of this title, and if the debtor has regularly employed attorneys, accountants, or other professional persons on salary, the trustee may retain or replace such professional persons if necessary in the operation of such business.
>
> **(c)** In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
>
> **(d)** The court may authorize the trustee to act as attorney or accountant for the estate if such authorization is in the best interest of the estate.
>
> **(e)** The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.
>
> **(f)** The trustee may not employ a person that has served as an examiner in the case.

11 U.S.C.A. § 327.

[4]See 11 U.S.C § 1107(a) ("[A] debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.").

[5]See 11 U.S.C.A. § 327(a).

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carrying out its duties under the Bankruptcy Code.[6] Conventional estate professionals—such as "attorneys, accountants, appraisers, [and] auctioneers"—clearly fit this mold.[7] Section 327(b) of the Bankruptcy Code, however, carves out certain "regularly employed" professionals that may be retained or replaced in operating the debtor postpetition.[8] Recent developments highlight the importance of taking the proper steps to retain professionals, particularly in connection with fees for services rendered.

Professionals invoking the section 327(b) exception may be wise to file retention applications out of an abundance of caution, as the lines are not always clear. For example, in *In re Butterfliez Services, LLC*,[9] the debtor paid fees to an attorney and an accounting firm that had represented it in connection with normal operations without first obtaining court authorization to retain such professionals.[10] Both the debtor and the U.S. Trustee argued that the attorney and accounting firm were not "professionals" that required court approval under section 327(a) of the Bankruptcy Code because they "did not play a central role in the administration of the [d]ebtor's affairs and the bankruptcy estate . . ."[11] The Debtor also argued that the professionals fell within the section 327(b) exception.[12] The Court rejected both arguments.

First, the court found that the professionals were within the scope of section 327(a). On the record of the hearing to consider whether the professionals should be ordered to disgorge their fees, the attorney testified that he had represented the debtor with respect to normal operational issues such as handling "payment issues" with the debtor's previous employees and matters related to vendors.[13] The accountant represented to the court that it assisted the debtor with vari-

[6] See 11 U.S.C.A. § 327(a).

[7] See 11 U.S.C.A. § 327(a).

[8] See 11 U.S.C.A. § 327(b).

[9] *In re Butterfliez Services, LLC*, 563 B.R. 531, 63 Bankr. Ct. Dec. (CRR) 194, 77 Collier Bankr. Cas. 2d (MB) 299 (Bankr. S.D. Ohio 2016).

[10] See 563 B.R. at 532.

[11] 563 B.R. at 532.

[12] See 563 B.R. at 532.

[13] See 563 B.R. at 533.

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ous accounting matters, such as preparing tax returns and other requisite filings. The court determined that the services rendered were "within the scope of a debtor in possession's duties under the Bankruptcy Code, and thus [section] 327(a) unambiguously require[d the] debtor" to obtain court approval of the professionals.[14]

Second, the court rejected the argument that the professionals fell within the 327(b) exception. In doing so, the court found that neither of the professionals were salaried employees of the debtor prepetition, nor did they replace prepetition salaried professionals.[15] The court also determined that the proposition that the section 327(b) exception can apply to professionals on retainer is in contrast to the plain language of the statute.[16]

While the court rejected the arguments that the professionals did not have to be retained under section 327(a) of the Bankruptcy Code, the court did not go so far as to require disgorgement of fees for services rendered to or for the benefit of the debtor's estate. Instead, taking a pragmatic approach, the court permitted the debtor to comply with section 327 of the Bankruptcy Code and apply for retention nunc pro tunc.[17]

Butterfliez Services serves as a reminder to debtors and their professionals that it is critical to evaluate whether court approval of the retention is necessary, no matter how minor the contemplated services may be. If the services to be rendered further the debtor's duties under the Bankruptcy Code, filing a retention application is warranted. Regardless, seeking court approval of professional retentions nunc pro tunc to the date services began, in an abundance of caution, will help avoid any issues that may arise later in the case with respect to payment for services rendered.

Aside from the scope of section 327(a) of the Bankruptcy Code, the recent decision in *In re Peterson*[18] is a reminder that timing is everything. There, in August 2012, creditors filed three uncontested involuntary petitions against the individ-

[14]See 563 B.R. at 534.

[15]See 563 B.R. at 534.

[16]See 563 B.R. at 534.

[17]See 563 B.R. at 534–35.

[18]*In re Peterson*, 566 B.R. 179 (Bankr. M.D. Tenn. 2017).

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ual debtor and two related entities.[19] After the court entered orders for relief, the Chapter 7 trustee was appointed in September 2012.[20] In October 2012, the Chapter 7 trustee filed applications in each case for her law firm to represent her, which the court approved by orders entered in November 2012.[21]

Shortly after the retention application was filed, but before the order approving retention was entered, the Chapter 7 trustee's law firm performed certain services, including filing an objection to a lift stay motion.[22] In reviewing the law firm's final fee application, the court held that certain of the services were outside the scope of employment.[23] The court specifically noted that the order approving the retention was entered on November 2, 2012, and the application contained no request for employment nunc pro tunc.[24] Considering the evidence and testimony offered,[25] the court found "no basis for granting nunc pro tunc employment to justify compensation for services provided prior to th[e] employment date."[26] *In re Peterson* is a reminder that professionals should seek approval of their employment nunc pro tunc to the precise date services began to be rendered.

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[19]See 566 B.R. at 184.

[20]See 566 B.R. at 184.

[21]See 566 B.R. at 184–85. Notably, the retention application included a list of services the law firm would render, which the court ultimately found indicated the misappropriation of the trustee's duties to her law firm. See 566 B.R. at 186. The Chapter 7 trustee eventually filed four adversary proceedings on behalf of the individual debtor and three adversary proceedings on behalf of one of the related entities. See 566 B.R. at 186. The Chapter 7 trustee later obtained court approval to hire an accounting firm, two additional law firms, and a mediator. See 566 B.R. at 185. The three cases were eventually consolidated, rendering moot certain of the adversary proceedings. See 566 B.R. at 185. Certain facts and portions of the decision not directly pertinent to this article have been omitted.

[22]See In re Peterson, 566 B.R. at 186.

[23]See 566 B.R. at 192.

[24]See 566 B.R. at 192.

[25]The court found the Chapter 7 trustee's testimony "incredibly concerning" and "downright alarming." See 566 B.R. at 188.

[26]In re Peterson, 566 B.R. at 193.

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B. Disinterestedness

This section discusses the substantive "disinterestedness" requirement of section 327 of the Bankruptcy Code. Aside from the scope of section 327 of the Bankruptcy Code, section 327(a)'s requirement that professionals "do not hold or represent an interest adverse to the estate" and "are disinterested" is the foundation to the Bankruptcy Code's treatment of professionals. Indeed, at least one court has noted that "section 327(a) is designed to limit even appearances of impropriety to the extent reasonably practicable . . ."[27] While the Bankruptcy Code defines a "disinterested person,"[28] applying the definition in practice is not always clear. Recent developments discuss this requirement, and their addition to the jurisprudence in this area is noteworthy.

In *In re Blue Jet, Inc.*[29] the court held that the debtor's proposed counsel's attempt to obtain a charging lien on postpetition accounts receivable and cash rendered counsel interested under section 327(a) of the Bankruptcy Code. There, the debtor entered into a prepetition retainer agreement with counsel which provided, in part, that counsel "specifically reserves a contractual right to enforce an attorney's charging lien against any client's judgement, award, or recovery [and the] charging lien . . . will take priority over any other set-off or judgment."[30] The U.S. Trustee objected to counsel's retention application, arguing that the charging lien created a security interest, thus disqualifying counsel from retention because it was a secured creditor with an interest

[27] *Rome v. Braunstein*, 19 F.3d 54, 60, 25 Bankr. Ct. Dec. (CRR) 695, 30 Collier Bankr. Cas. 2d (MB) 1346, Bankr. L. Rep. (CCH) P 75773 (1st Cir. 1994).

[28] Section 101(14) provides that a "disinterested person" means a person that—

> (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S. C. § 101(14).

[29] *In re Blue Jet, Inc.*, 63 Bankr. Ct. Dec. (CRR) 220, 2017 WL 785606 (Bankr. D. N.M. 2017).

[30] 2017 WL 785606 at *1.

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adverse to the estate.[31] At a hearing on the issue, counsel represented that it would only seek to enforce the charging lien if the case converted to Chapter 7 in order to ensure its fees were paid ahead of Chapter 7 administrative expenses.[32] Counsel also represented that it would waive its right if the court determined the right to assert the charging lien would disqualify counsel from employment.[33]

In framing the issue, the court asked whether "[d]ebtor's counsel [could] obtain, pre-petition, collateral to secure payment of its chapter 11 fees and still qualify for retention under [section] 327" and stated that "[t]he answer is a definite maybe."[34] The court first looked to section 328 of the Bankruptcy Code, noting that courts have held that, under section 328(a), counsel can remain disinterested even if it obtained a prepetition retainer.[35] However, with respect to other collateral, the court noted that while courts are skeptical, "there is no per se bar," and disinterestedness is determined on a case-by-case basis.[36]

Relying on state law, the court noted that questions surrounded whether the charging lien would ever attach to the collateral. Generally, the court pointed out, charging liens arise in suits to recover money, and in such instances, "success results in a specific fund of money, generated by the attorney's efforts."[37] In Chapter 11, however, counsel to the debtor will not create an analogous fund so "[i]t is quite the stretch to argue that by helping [the d]ebtor operate post-petition, the accounts receivable and cash are a judgment or 'fund' resulting from [c]ounsel's services."[38]

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[31] See 2017 WL 785606 at *1.

[32] See 2017 WL 785606 at *1–*2.

[33] See 2017 WL 785606 at *2.

[34] 2017 WL 785606 at *2.

[35] 2017 WL 785606 at *2.

[36] See 2017 WL 785606 at *2.

[37] See 2017 WL 785606 at *5 (citation omitted).

[38] 2017 WL 785606 at *5.

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The court relied on a leading case, *In re Martin*,[39] and cited the following factors as set forth in *In re Watson*:[40]

1. The reasonableness of the arrangement and whether it was negotiated in good faith;
2. Whether the security demanded was commensurate with the predictable magnitude and value of the foreseeable services;
3. Whether it was a needed means of ensuring the engagement of competent counsel;
4. Whether or not there are telltale signs of overreaching;
5. The nature and extent of any conflict arising from the taking of a security interest as well as the likelihood that a potential conflict might turn into an actual one;
6. The influence the putative conflict may have in subsequent decision making;
7. How the matter likely appears to creditors and to other parties in legitimate interest, given the importance of perceptions by the creditor body and the problem at large;
8. Whether the existence of the security interest threatens to hinder or to delay the effectuation of a plan;
9. Whether the security interest granted is (or could be perceived as) an impediment to reorganization;
10. Whether the fundamental fairness of the proceedings might be unduly jeopardized either by the actuality of the arrangement or by the reasonable public perception of it.[41]

The court determined that the *Martin/Watson* factors weigh against approval of the charging lien. Specifically, with respect to the first factor, the court held that while the arrangement may have been negotiated in good faith, it is not reasonable for counsel to argue that it recovered all postpetition

[39] *In re Martin*, 817 F.2d 175, 179, 16 Bankr. Ct. Dec. (CRR) 112, 16 Collier Bankr. Cas. 2d (MB) 672, Bankr. L. Rep. (CCH) P 71759 (1st Cir. 1987).

[40] *In re Watson*, 94 B.R. 111 (Bankr. S.D. Ohio 1988).

[41] See *In re Blue Jet, Inc.*, 63 Bankr. Ct. Dec. (CRR) 220, 2017 WL 785606, *4 (Bankr. D. N.M. 2017) (quoting *In re Watson*, 94 B.R. 111, 115 (Bankr. S.D. Ohio 1988).

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liquid assets.[42] The court also found that the second and third factors weighed against approving the charging lien because it is not commensurate with the value and magnitude of services that may be rendered, and a charging lien in favor of debtor's counsel is uncommon.[43] With respect to the fourth, fifth, sixth, seventh, and tenth factors, the court ruled that a charging lien on all cash and accounts receivable appears to be overreaching and unfair, there is potential for a conflict of interest (as payment of any administrative expenses would deplete cash collateral, and counsel would be in conflict with any creditor with rights in cash collateral), and asserting such a lien would seem unfair to creditors.[44]

Thus, counsel to the debtor could not be disinterested if it could assert a charging lien against postpetition assets, and the court would not approve retention unless the charging lien was waived.[45] The court, however, left open whether such an arrangement would be permissible in adversary proceedings,[46] a determination that would depend on circumstances such as the nature of the adversary proceeding and whether counsel is retained separately and solely in connection with such adversary proceeding.

C. Transaction Fees and Section 328 of the Bankruptcy Code

This section discusses recent developments regarding transaction fees under section 328 of the Bankruptcy Code. While a professional's involvement in a case may begin with retention, the rules governing compensation for services rendered are essential. Assuming section 327 of the Bankruptcy Code governs, section 328 of the Bankruptcy Code sets forth certain parameters by which professionals may be compensated. Indeed, section 328(a) of the Bankruptcy Code provides for the retention of professionals with court approval "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or per-

[42] See 2017 WL 785606 at *5.

[43] See 2017 WL 785606 at *5.

[44] See 2017 WL 785606 at *5–6.

[45] See 2017 WL 785606 at *6.

[46] See 2017 WL 785606 at *6.

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centage fee basis, or on a contingent fee basis."[47] The section further provides, "[n]otwithstanding such terms and conditions, the court may allow compensation different . . . 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."[48] When professionals, such as investment bankers, seek to be compensated for services rendered, there may be tension between section 328 and section 330, of the Bankruptcy Code, the latter of which imposes a separate "reasonableness" standard on fees.[49]

1. Section 330 Should Not Govern Compensation Approved Under Section 328

The strife between sections 328 and 330 of the Bankruptcy Code was recently analyzed in *In re Relativity Fashion, LLC*.[50] There, two investment banking firms were retained, and the underlying retention agreements provided for a fee structure "common to most investment banker retentions, both within and outside bankruptcy."[51] Specifically, the investment bankers were to receive a monthly fee, and if a restructuring transaction was consummated, subject to certain conditions, they would also receive a transaction fee.[52] Both investment banks sought approval of their transaction fees, and the fee examiner and a secured creditor objected on several grounds, including the applicable standard for approving the final fee applications.[53] Specifically, they argued that the court should review the final fee applications under the reasonableness standard set forth in section 330 of the Bankruptcy Code, as opposed to section 328 of the Bankruptcy Code, and neither

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[47] 11 U.S.C § 328(a).

[48] 11 U.S.C § 328(a).

[49] Section 330 of the Bankruptcy Code, and recent developments thereunder, are discussed in more detail below.

[50] *In re Relativity Fashion, LLC*, 2016 WL 8607005 (Bankr. S.D. N.Y. 2016).

[51] See 2016 WL 8607005 at *1, *3.

[52] See 2016 WL 8607005 at *1.

[53] See 2016 WL 8607005 at *1.

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investment bank's transaction fee could satisfy the reasonableness standard.[54]

The court began by commenting on the difference between sections 328 and 330 of the Bankruptcy Code. The court noted that "[d]ifferent standards apply to the review of fee applications depending on whether or not the terms of employment have been approved under [s]ection 328(a)" of the Bankruptcy Code.[55] Under section 328 of the Bankruptcy Code, approved fees are payable, "unless the approved terms and conditions 'prove to have been improvident in light of developments not capable of being anticipated' " when the terms were fixed.[56] Thus, under section 328 of the Bankruptcy Code, "reasonableness is judged in advance, and the issue is not revisited except in the very narrow circumstance permitted by the statute."[57]

The court further reasoned that absent approval under section 328 of the Bankruptcy Code, "[s]ection 330 calls for review of reasonableness that, to some extent, is made after-the-fact," by reviewing relevant factors including whether the services were necessary and beneficial, and whether the compensation sought is reasonable.[58] The court relied on the reasoning in *In re National Gypsum Co.*,[59] and noted that underlying section 328(a) of the Bankruptcy Code is "the view that professionals are entitled to know what they are likely to be paid for their work."[60] So, if a professional is retained on an agreed upon fee structure, the parties can take comfort that they will be paid in that manner, free from a court imposing different terms on the parties after the work has been performed.[61]

Aside from commenting on sections 328 and 330 of the Bankruptcy Code, the court also addressed references made

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[54]See 2016 WL 8607005 at *1.

[55]2016 WL 8607005 at *2.

[56]2016 WL 8607005 at *2. (quoting 11 U.S.C. § 328(a)).

[57]2016 WL 8607005 at *2.

[58]2016 WL 8607005 at *2.

[59]*Matter of National Gypsum Co.*, 123 F.3d 861, 31 Bankr. Ct. Dec. (CRR) 750, Bankr. L. Rep. (CCH) P 77528 (5th Cir. 1997).

[60]*In re Relativity Fashion, LLC*, 2016 WL 8607005, *3 (Bankr. S.D. N.Y. 2016).

[61]See 2016 WL 8607005 at *3.

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by the parties to the Blackstone Protocol.[62] The court explained that the Blackstone Protocol "represents a negotiated truce between" the U.S. Trustee for the Southern District of New York and investment banks, under which parties are bound by section 328(a) of the Bankruptcy Code, except for the U.S. Trustee, who retains the right—which is rarely invoked—to object to professional compensation under section 330 of the Bankruptcy Code despite approval under section 328 of the Bankruptcy Code.[63] The court noted that the Blackstone Protocol creates, in effect, a "hybrid situation in which the court must [or may] apply . . . the section 330 standards to an objection made by the U.S. Trustee, but otherwise must apply [s]ection 328(a)," and questioned whether this approach was intended by Congress when it enacted section 328 of the Bankruptcy Code.[64]

The court further explained that the Blackstone Protocol reserves the U.S. Trustee's rights to object under the reasonableness standard, and noted it would be improper for a court to change the standards to apply to objections after the fact.[65] Indeed, the court stated that "[i]t would completely undermine Section 328(a) if all a court needed to do after approving a section 328(a) retention was to appoint a new party with standing to object and to give that new party the right to make objections on grounds other than [s]ection 328(a)."[66] In questioning the fairness of the Blackstone Protocol, the court suggested that any issues with retention should be raised at the time of retention, and not after the fact.[67]

While the court in *Relativity* may have put the Blackstone Protocol in question, it did not need to rule on it, as both investment bankers' retention applications provided that the U.S. Trustee's rights to object under section 330 of the Bankruptcy Code were reserved, even though they were both ap-

[62] See 2016 WL 8607005 at *5.

[63] See 2016 WL 8607005 at *5.

[64] 2016 WL 8607005 at *6.

[65] See 2016 WL 8607005 at *6.

[66] 2016 WL 8607005 at *7.

[67] See 2016 WL 8607005 at *7.

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proved under section 328(a) of the Bankruptcy Code.[68] The U.S. Trustee did not object, however.[69] The court approved the fee applications under section 328 of the Bankruptcy Code.

To avoid litigation surrounding the applicable standard in reviewing fee applications, parties can agree that section 330 of the Bankruptcy Code will not apply. For example, in *In re NephroGenex, Inc.*,[70] the order approving retention of the debtor's investment banker explicitly stated that the investment banker's fees "pursuant to the [e]ngagement [a]greement shall be subject to review pursuant to the standards set forth in [s]ection 328(a) of the Bankruptcy Code and shall not be subject to the standards set forth in section 330 of the Bankruptcy Code . . ."[71] While such a provision will not avoid any litigation over compensation, it is likely to prevent parties from fighting over which standard the court should apply.

2. *"Improvidence" Under Section 328*

In re NephroGenex, Inc. is a noteworthy decision under section 328(a) of the Bankruptcy Code, separate and apart from the issues raised in *Relativity*. In *NephroGenex*, the court reviewed an investment banker's fee application under section 328(a) of the Bankruptcy Code, noting that it had the authority to change the terms of the agreed-upon compensation under the improvidence standard.[72] There, the debtor retained an investment bank to market and sell its assets, and the investment bank was entitled to a transaction fee equal to the greater of $500,000 or 3.5% of the sale price.[73] The investment bank marketed the debtor's assets to over

[68]See 2016 WL 8607005 at *7. The Official Committee of Unsecured Creditors also retained the right to object under section 330 of the Bankruptcy Code with respect to one of the investment bankers. See 2016 WL 8607005 at *7.

[69]See 2016 WL 8607005 at *8. Similarly, the Official Committee of Unsecured Creditors did not file an objection. See id.

[70]*In re NephroGenex, Inc.*, 64 Bankr. Ct. Dec. (CRR) 119, 2017 WL 3189861 (Bankr. D. Del. 2017).

[71]2017 WL 3189861 at *3.

[72]See 2017 WL 3189861 at *3.

[73]See 2017 WL 3189861 at *2.

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275 potential purchasers,[74] during which the investment bank was instructed not to communicate with Medpace, Inc. ("Medpace"), as the debtor's attorneys were working with Medpace.[75] The Medpace transaction panned out, and the investment bank performed certain advisory services in connection with that transaction.[76]

The reorganized debtor, Medpace, and other entities objected to the investment banker's transaction fee, arguing that payment would be improvident.[77] Specifically, the objecting parties argued that the investment bank was entitled to the transaction fee only if a sale occurred, the purpose for which it was retained.[78] Instead of a sale, the debtor filed a liquidating plan and Medpace "staved off liquidation by exchanging its large claim . . . for a distribution of new common stock."[79] This, the objecting parties argued, was not a sale, and did not fall under the definition of "Sales Transaction" as set forth in the investment bank's engagement letter.[80]

In deciding the issue, the court looked to the terms of the engagement agreement, which defined "Sales Transaction" to include (1) " 'an acquisition, merger, consolidation, or other business combination' combining the [d]ebtor, 'directly or indirectly' with another company;"[81] (2) "the acquisition . . . of equity interests . . . constituting a majority of the then outstanding economic interests in . . . or possessing a majority of the then outstanding voting power of the" debtor;[82] and (3) " 'any other purchase or acquisition, directly or indirectly, by a buyer or buyers of any assets, securities or other interests

[74] See 2017 WL 3189861 at *3.

[75] *In re NephroGenex, Inc.*, 64 Bankr. Ct. Dec. (CRR) 119, 2017 WL 3189861, *3 (Bankr. D. Del. 2017).

[76] See 2017 WL 3189861 at *3.

[77] See 2017 WL 3189861 at *3.

[78] See 2017 WL 3189861 at *3. The objecting parties also argued that there were no "proceeds," as that term is used in the engagement agreement, from which the investment bank could receive the transaction fee. See 2017 WL 3189861 at *7. The court rejected this argument. See 2017 WL 3189861 at *7.

[79] 2017 WL 3189861 at *3.

[80] 2017 WL 3189861 at *3.

[81] See 2017 WL 3189861 at *3.

[82] 2017 WL 3189861 at *4.

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of this" debtor.[83] The court found that because Medpace owned all of the equity in the reorganized debtor, the transaction was a "combination, 'direct or indirect' between the [d]ebtor and Medpace,"[84] and because Medpace acquired all of the debtor's equity in the transaction, it was a "Sales Transaction" under the engagement agreement.[85] The court ultimately approved the investment banker's success fee.[86]

In re NephroGenex, Inc. teaches that even if a transaction does not come to light as initially contemplated, investment bankers may still be entitled to transaction fees under the controlling provisions of an engagement agreement. Furthermore, *In re NephroGenex, Inc.* reinforces the rationale behind the decision in *In re Relativity Fashion, LLC*. These decisions demonstrate that courts will preserve previously approved agreements between the parties, absent facts that rise to the level of improvidence. Indeed, professionals should expect to be compensated on the agreed terms approved under section 328(a) of the Bankruptcy Code, so long as they are not improvident. Respecting the approved agreements of the parties, courts will not rewrite the terms of engagement in hindsight, absent an objection meeting a relatively high standard.

III. Section 330—Continued Developments After *ASARCO*

This section discusses decisions that have applied the Supreme Court's holding in *ASARCO* over the past year. By way of background, in *Baker Botts LLP v. ASARCO LLC*,[87] the Supreme Court decided whether, under sections 327 and 330 of the Bankruptcy Code, a law firm could be compensated from a debtor's estate for the time it expended defending its own fee application. Holding that such compensation was impermissible, the Supreme Court held that "Congress did not expressly depart from the American Rule to permit

[83] 2017 WL 3189861 at *4.

[84] 2017 WL 3189861 at *3.

[85] See 2017 WL 3189861 at *4.

[86] See 2017 WL 3189861 at *4.

[87] *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 192 L. Ed. 2d 208, 61 Bankr. Ct. Dec. (CRR) 41, 73 C.B.C. 1017, Bankr. L. Rep. (CCH) P 82811 (2015).

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compensation for fee-defense litigation by professionals hired to assist trustees in bankruptcy proceedings."[88] The American Rule, a "bedrock principle," provides that "[e]ach litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise."[89] The Supreme Court's decision in *ASARCO* focused on Congress' use of the word "services" in section 330(a)(1)(A), finding that litigating a contested fee request is not a "service" rendered to the bankruptcy estate under such Code section, a prerequisite to compensation.[90]

A. *In re Hungry Horse, LLC*, 574 B.R. 740, 64 Bankr. Ct. Dec. (CRR) 172 (Bankr. D. N.M. 2017)

In *In re Hungry Horse, LLC*,[91] the court held that a provision that provides for payment of fees incurred in defending a fee application may be approved under section 328 of the Bankruptcy Code.[92] In *Hungry Horse*, the Unsecured Creditors' Committee objected to a provision in the Debtor's application to employ counsel providing that the Debtor must pay all of its counsel's reasonable fees incurred defending its fee applications. The Committee argued that this provision, which the Debtor sought to approve pursuant to section 328(a) of the Bankruptcy Code, contravened the Supreme Court's decision in *ASARCO*. The bankruptcy court reviewed the *ASARCO* decision, noting that "[n]o party argued the 'contract exception' to the American Rule" in that case.[93] Further, the bankruptcy court stated that *ASARCO* "was not focused on whether the fee charged was 'reasonable,' but instead on whether it was for 'services' rendered to the estate."[94]

The Committee argued that based on *In re Boomerang*

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[88] 135 S. Ct. at 2164.

[89] 135 S. Ct. at 2164, citing *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252–53, 130 S. Ct. 2149, 176 L. Ed. 2d 998, 49 Employee Benefits Cas. (BNA) 1001 (2010).

[90] 135 S. Ct. at 2167.

[91] *In re Hungry Horse, LLC*, 574 B.R. 740, 64 Bankr. Ct. Dec. (CRR) 172 (Bankr. D. N.M. 2017).

[92] See 574 B.R. at 747–48.

[93] 574 B.R. at 743.

[94] 574 B.R. at 744.

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Tube, Inc.,[95] which held that the proposed counsel to the unsecured creditors' committee could not include a term in its retention agreement that provided for payment of expenses incurred defending counsel's fee applications under *ASARCO*, a similar provision in the debtor's counsel's retention agreement could not be approved. *Hungry Horse* noted three primary holdings from *Boomerang Tube*: (1) section 328(a) is not a statutory exception to the American Rule; (2) the retention agreement between the Committee and its counsel could not come within the contract exception to the American Rule; and (3) the fee defense provisions could not be approved under section 328 because they could never be considered "reasonable."[96] The *Hungry Horse* court, however, disagreed with the last holding from *Boomerang Tube*, namely that a fee defense provision in a retention agreement could never be a reasonable term under section 328(a).

The *Hungry Horse* court stated that *ASARCO* stands for the fact that section 330 of the Bankruptcy Code limits an attorney to compensation for services rendered to its client and, accordingly, an attorney cannot be awarded even "reasonable" compensation under section 330 if the services rendered are not rendered to its client.[97] The court further found that *ASARCO* "does not hold that a fee defense provision can never be a 'reasonable term' under § 328(a)."[98] Indeed, the *Hungry Horse* court listed numerous employment terms that, while "reasonable," provided no benefit to a bankruptcy estate, including retainer requirements, prompt payment of monthly bills, and returned check fees.[99]

Thus, the *Hungry Horse* court found that "a properly drafted fee defense provision could be a 'reasonable term' under § 328(a)" if it: (1) is agreed to by the estate; (2) allows the bankruptcy court to review and approve the reasonableness of defense fees sought; (3) provides a similar benefit to

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[95] *In re Boomerang Tube, Inc.*, 548 B.R. 69, 62 Bankr. Ct. Dec. (CRR) 28 (Bankr. D. Del. 2016).

[96] Hungry Horse, 574 B.R. at 744–45.

[97] 574 B.R. at 747.

[98] 574 B.R. at 747.

[99] 574 B.R. at 747.

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committee counsel; and (4) provides that no fees will be allowed for unsuccessful fee defense work.[100]

There may be a pragmatic limitation to *Hungry Horse*, however. The bankruptcy court itself noted that "[i]n jurisdictions such as New Mexico, which typically have smaller bankruptcy cases with smaller fees, fee defense can be a sizeable percentage of the total fees billed."[101] Accordingly, in such jurisdictions, if estate counsel had to bear its own costs in defending its fees, net compensation would be substantially reduced. Therefore, *Hungry Horse* concluded there was "no need to change the system," particularly because it did not read *ASARCO* as requiring a different result.[102]

B. *In re Nortel Networks Inc.*, 2017 WL 932947 (Bankr. D. Del. 2017)

In *In re Nortel Networks Inc.*,[103] the Delaware bankruptcy court considered whether counsel to an indenture trustee was entitled to fees for defending its fees under *ASARCO*. There, the indenture in question provided that the Debtors were responsible for paying the indenture trustee's attorney's fees incurred in a fee dispute. *Nortel* focused on *Boomerang Tube*, supra, a case also decided by a Delaware bankruptcy court, which found that a retention agreement "was not a bilateral agreement" but rather "was a contract between the creditors' committee and its attorneys providing that the estate, a third party [although not a party to the agreement], would pay the defense costs even if the estate was not the objecting party."[104] Given that the indenture was a contract made by the debtor with the indenture trustee, the bankruptcy court easily concluded that it was outside the holding of *Boomerang Tube* and was covered as an exception to the American Rule recognized by ASARCO.

[100] 574 B.R. at 747–48.

[101] 574 B.R. at 747.

[102] 574 B.R. at 747.

[103] *In re Nortel Networks Inc.*, 2017 WL 932947 (Bankr. D. Del. 2017).

[104] 2017 WL 932947 at *9.