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

By Steve Golden,[*] Raff Ferraioli,[**] and Cia Mackle[***]

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 provision governs separate aspects of the employment and compensation of professionals, taken as a whole, and with certain related Federal Rules of Bankruptcy Procedure,[2] these sections comprehensively govern employment issues in bankruptcy cases. This article reviews and discusses some of the noteworthy developments in this area from 2020.

First, this article explores the Supreme Court's *per curiam* decision in *Roman Catholic Archdiocese of San Juan v. Acevedo Feliciano*[3] and subsequent bankruptcy court decisions applying its holding to professional retention and compensation under sections 327 and 330 of the Bankruptcy

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[*]Steve Golden is an associate at Pachulski Stang Ziehl & Jones LLP. Steve received his J.D. from Georgia State University and LL.M. in Bankruptcy from St. John's University School of Law.

[**]Raff Ferraioli is an associate at Morrison & Foerster LLP. Raff received his J.D. and LL.M. in Bankruptcy from St. John's University School of Law.

[***]Cia Mackle is of counsel at Pachulski Stang Ziehl & Jones LLP. Cia received her J.D. from the University of Southern California.

[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 (hereinafter the "Bankruptcy Rules").

[3]*Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano*, 140 S. Ct. 696, 206 L. Ed. 2d 1, 2020 Employee Benefits Cas. (BNA) 65393 (2020).

Code. Second, this article discusses recent developments regarding the distinction between sections 327 and 1103 of the Bankruptcy Code. Finally, this article discusses the *Freedom Communications* decision, which highlights the complexity of bankruptcy courts' approval of investment banker fees under section 328 of the Bankruptcy Code.

II. Nunc Pro Tunc Retention and Professional Compensation

For an estate professional to be compensated under section 330 of the Bankruptcy Code, they must first have had their retention approved by the bankruptcy court pursuant to section 327 (or, in the case of a statutory committee, section 1103) of the Bankruptcy Code. Because most bankruptcy courts will only grant a retention application on notice and an opportunity to object, there is necessarily a period of time—sometimes weeks—between when an estate professional has the ability to file a retention application and when the bankruptcy court enters a retention order. Accordingly, as a matter of course, bankruptcy courts have entered timely-filed retention orders under sections 327 and 1103 of the Bankruptcy Code nunc pro tunc to the date that the estate professional began providing services. That is, until the Supreme Court of the United States had the opportunity to consider the propriety of federal courts issuing nunc pro tunc orders.

Acevedo Feliciano was ostensibly presented to the Supreme Court as a case about religious liberty and the Free Exercise and Establishment Clauses of the First Amendment. In essence, the substantive central dispute in *Acevedo Feliciano* involved who could be held liable for the Pension Plan for Catholic Schools Trust's[4] termination in 2016 as among various different named defendants. The Court of First Instance (the trial court) in Puerto Rico found that only one defendant—the "Roman Catholic and Apostolic Church in Puerto Rico"—had legal personhood, with each other defendant being a division thereof. It, therefore, issued two payment orders on March 16 and 26, 2018, and a seizure order on March 27, 2018. However, on February 8, 2018, prior to the Court of First Instance issuing these payment and seizure orders, the Archdiocese of San Juan, one of the defendants, removed the case to the United States District Court for the District of

[4]The "Trust."

Puerto Rico, arguing that the 0case was sufficiently related to the Trust's (another defendant) bankruptcy proceeding.

On March 13, 2018, prior to the Court of First Instance issuing the payment and seizure orders, the bankruptcy court dismissed the Trust's bankruptcy proceeding. The district court, however, did not remand the underlying case back to the Court of First Instance until August 20, 2018, but did so through an order stating that the remand was "effective as of March 13, 2018."[5] Pointing to 28 U.S.C.A. § 1446(d), the Supreme Court found that upon the filing of a notice of removal, a state court loses jurisdiction, cannot proceed with a case unless and until it is remanded, and that any proceedings that occur before such remand are void.[6] Importantly, the Supreme Court rejected an argument that the District Court issuing its remand order nunc pro tunc to March 13 accomplished anything. "Federal courts may issue nunc pro tunc orders, or 'now for then' orders, to reflect the reality of what has already occurred."[7] However, such retroactive orders "are not some Orwellian vehicle for revisionist history—creating 'facts' that never occurred in fact."[8] In *Acevedo Feliciano*, therefore, the District Court's retroactive remand was of no effect, and the actions taken by the Court of First Instance during the period between March and August were void.

Although not a bankruptcy case, *Acevedo Feliciano* was quickly viewed by commentators as a threat to retroactive retention of estate professionals under section 327 of the Bankruptcy Code.[9] And, less than a month after the Supreme Court issued its per curiam decision, a bankruptcy court found that nunc pro tunc retention of estate professionals is improper. In *In re Benitez*, Judge Grossman of the United States Bankruptcy Court for the Eastern District of New York found that under *Acevedo Feliciano*, "utilizing *nunc pro tunc*

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[5] 140 S.Ct. at 700.

[6] 140 S.Ct. at 700.

[7] 140 S.Ct. at 700–01 (cleaned up).

[8] 140 S.Ct. at 701 (quoting *U.S. v. Gillespie*, 666 F. Supp. 1137, 1139 (N.D. Ill. 1987)).

[9] See, e.g., "Supreme Court Bans Nunc Pro Tunc Orders," Rochelle's Daily Wire (February 26, 2020), available at https://www.abi.org/newsroom/daily-wire/supreme-court-bans-nunc-pro-tunc-orders.

orders to approve the retention of estate professionals retroactive to some date prior to the actual date of court approval is inappropriate."[10] However, the court found that retroactive approval under section 327 of the Bankruptcy Code is not a prerequisite for an estate professional to be compensated for services provided prior to the entry of a retention order pursuant to section 330 of the Bankruptcy Code.[11] "Sections 327 and 330 collectively contain a single temporal limitation. To be eligible for an award of compensation from the estate, a professional's retention must first have been approved by the court pursuant to section 327 . . . Assuming the court has approved the professional's retention under section 327 prior to an award of compensation, neither the Code nor the Rules state that the professional may not be compensated under section 330 for services provided to the estate prior to the approval of their retention."[12]

Two other bankruptcy courts have since adopted this position. In *In re Roberts*,[13] Judge Preston of the United States Bankruptcy Court for the Southern District of Ohio also stated that she will no longer enter nunc pro tunc professional retention orders because "the retroactive legal effect of a nunc pro tunc order should be reserved for those occasions when the Court has, in fact, already passed judgment that is not reflected in the record."[14] But, just as with Judge Grossman, Judge Preston reasoned that "neither the Sixth Circuit Court of Appeals nor the applicable statutes and rules require that the Court approve employment before compensable services are rendered."[15]

Similarly, Judge Jaime of the United States Bankruptcy Court for the Eastern District of California pointed to *Acevedo Feliciano* as ending the granting of orders approving retroactive employment under section 327 of the Bankruptcy Code.

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[10] 2020 WL 1272258, at *1 (Bankr. E.D.N.Y. Mar. 13, 2020).

[11] 2020 WL 1272258, at *2.

[12] 2020 WL 1272258, at *3.

[13] 618 B.R. 213 (Bankr. S.D. Ohio 2020).

[14] 618 B.R. at 217.

[15] 618 B.R. at 218.

Just as in *Benitez* and *Roberts*, the court in *In re Miller*[16] found that the granting of retroactive retention orders under section 327 of the Bankruptcy Code "create[s] facts or rewrite[s] history" in contravention of *Acevedo Feliciano*.[17] The court did, however, make clear that grants of retroactive compensation under section 330 of the Bankruptcy Code remain proper. "Implied retroactive authority reposes in Bankruptcy Code provisions that require court approval but that do not mandate that such approval actually precede the statutory activity."[18] So long as a court does not "need to create facts or rewrite history with a nunc pro tunc order," retroactive relief is not improper.[19] Under both Ninth Circuit precedent and the Bankruptcy Rules, Judge Jaime found that section 330 of the Bankruptcy Code contains such implied retroactive authority.[20]

Although three bankruptcy judges have stopped issuing retroactive professional retention orders, the practice of nunc pro tunc retention remains commonplace in the majority of bankruptcy courtrooms, even after *Acevedo Feliciano*.

III. Disinterestedness and Committee Professionals

Section 327 of the Bankruptcy Code[21] governs the trustee or

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[16] 620 B.R. 637 (Bankr. E.D. Cal. 2020).

[17] 620 B.R. at 641.

[18] 618 B.R. at 641.

[19] 618 B.R. at 641.

[20] 618 B.R. at 642–43.

[21] 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

debtor in possession's[22] ability to retain professionals. Section 327 requires both court approval of any retention and that the proposed professional is disinterested[23] and does "not hold or represent an interest adverse to the estate . . ."[24] Courts exercise their discretion when evaluating a proposed retention, taking into account "the particular facts and circumstances surrounding each case and the proposed retention before making a decision."[25]

Official committees[26] appointed in a bankruptcy case are also authorized, on court approval under Bankruptcy Code section 1103, to employ "one or more attorneys, accountants,

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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.

[22]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.").

[23]Pursuant to 11 U.S.C.A. § 101(14), a disinterested person "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.A. § 101(14).

[24]See 11 U.S.C.A. § 327(a); see also *In re WorldCom, Inc.*, 311 B.R. 151, 163, 43 Bankr. Ct. Dec. (CRR) 61 (Bankr. S.D. N.Y. 2004); see also *In re Project Orange Associates, LLC*, 431 B.R. 363, 370, 53 Bankr. Ct. Dec. (CRR) 114 (Bankr. S.D. N.Y. 2010) (citing *In re AroChem Corp.*, 176 F.3d 610, 622–23, 41 Collier Bankr. Cas. 2d (MB) 1647, Bankr. L. Rep. (CCH) P 77933 (2d Cir. 1999); *In re Innomed Labs, LLC*, 2008 WL 276490, at *2 (S.D. N.Y. 2008); *In re Granite Partners, L.P.*, 219 B.R. 22, 33, 32 Bankr. Ct. Dec. (CRR) 331 (Bankr. S.D. N.Y. 1998)).

[25]Arochem, 176 F.3d at 621 (internal quotation and citation omitted).

[26]The terms "committee" and "official committee" as used herein refer to committees appointed under section 1102 of the Bankruptcy Code.

or other agents, to represent or perform services for such committee."[27] Under section 1103(b) of the Bankruptcy Code, "[a]n attorney or accountant employed to represent a[n official] committee appointed under section 1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case."[28]

A subtle, yet important distinction is evident after parsing the language of sections 327 and 1103 of the Bankruptcy Code. Like section 327 of the Bankruptcy Code, section 1103(b) prohibits an "attorney or accountant" retained by a committee from representing any other entity holding an adverse interest in connection with the case. However, unlike section 1103(b), section 327 of the Bankruptcy Code prohibits employment if the professional holds an adverse interest or is not a "disinterested person" under section 101(14) of the Bankruptcy Code. Thus, a professional that holds an adverse interest or is not a "disinterested person" will not be *per se* precluded from representing a committee under section 1103(b) of the Bankruptcy Code, especially with respect to matters unrelated to the bankruptcy case.[29]

A recent example in *Bingham Greenebaum Doll, LLP v. Glenview Health Care Facility, Inc. (In re Glenview Health Care Facility, Inc.)*[30] highlights the importance of this distinction in practice. The debtor in *Glenview Health Care Facility* operated a nursing home facility in Kentucky.[31] For over 30 years, Kay Bush and Lisa Howlett jointly owned the debtor in equal shares. After the debtor filed for chapter 11 protection,

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[27] 11 U.S.C.A. § 1103(a).

[28] 11 U.S.C.A. § 1103(b). Section 1103(b) of the Bankruptcy Code further provides that "[r]epresentation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest."

[29] See *In re Pilgrim Medical Center, Inc.*, 574 B.R. 523, 530 (Bankr. D. N.J. 2017) (counsel's representation of secured creditors of the debtor in matters wholly unrelated to the bankruptcy did not disqualify counsel from representing an official committee).

[30] *In re Glenview Health Care Facility, Inc.*, 620 B.R. 582 (B.A.P. 6th Cir. 2020).

[31] See 620 B.R. at 586.

an official committee of unsecured creditors[32] was formed.[33] The Committee subsequently filed an application to retain Dentons Bingham Greenebaum LLP[34] as counsel.[35] In its retention papers, DBG disclosed that prior to the chapter 11 case it had represented Lisa Howlett in estate planning matters that were unrelated to the debtor's bankruptcy.[36] The representation occurred three years before the petition date.[37]

The debtor—but not Lisa Howlett—filed an objection to the Committee's retention of DBG.[38] The debtor asserted that the firm "was more directly involved with [the debtor, and] assisted Glenview and Lisa Howlett with the preparation of a buy-sell agreement for the purchase and sale of Glenview and all its assets."[39] In support of its objection, the debtor offered an invoice from DBG for services rendered in the pre-bankruptcy period, which demonstrated that DBG provided estate-planning advice to Howlett.[40] The invoice included entries relating to a "buy-sell agreement for Glenview Health," but DBG asserted that no such agreement was ever consummated.[41]

The bankruptcy court heard arguments and issued an opinion and order denying the Committee's application to retain DBG.[42] On appeal before the United States Bankruptcy

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[32]The "Committee."

[33]See Glenview Health Care Facility, Inc., 620 B.R. at 586.

[34]"DBG."

[35]See Glenview Health Care Facility, Inc., 620 B.R. at 586.

[36]See 620 B.R. at 586

[37]See 620 B.R. at 587.

[38]See 620 B.R. at 586.

[39]620 B.R. at 586 (quotations and citation omitted).

[40]See 620 B.R. at 586

[41]Glenview Health Care Facility, Inc., 620 B.R. at 586.

[42]See 620 B.R. at 586 Shortly after the bankruptcy court denied the retention application, the Committee was disbanded. See In re Glenview Health Care Facility, Inc., Case No. 19-10795 (JAL) (Bankr. W.D. Ky. Dec. 26, 2019) [Docket No. 95]. The Panel decided that the issue on appeal was not moot, however, and was "satisfied that the 'collateral consequences' of the bankruptcy court's retention order on the Appellant's ability to seek compensation for pre-dissolution work under § 330 supply a sufficient 'case or controversy' to warrant appellate review under Article III of the

Appellate Panel for the Sixth Circuit,[43] DBG argued that it satisfied the requirements in section 1103(b) because it did not represent Lisa Howlett while it was employed by the Committee.[44] DBG maintained that section 1103(b) is the only statutory provision governing a committee's retention of counsel, and based on the text of the statute, "proposed committee counsel should not be disqualified for its prior representation of a party holding an adverse interest so long as that representation has concluded prior to its appointment."[45] The debtor acknowledged that section 1103 lacks a disinterestedness requirement (unlike section 327 of the Bankruptcy Code), and did not assert that DBG concurrently represented the Committee and another client with an adverse interest.[46] However, the debtor argued that the provision of the Bankruptcy Code "governing actual payment to employed professionals does impose a disinterested requirement."[47]

The Panel noted the different standards in sections 327 and 1103 of the Bankruptcy Code, reasoning that the distinction "probably reflect[s] the different duties of representatives for committees and estate fiduciaries."[48] Indeed, because a trustee must be a "disinterested person," it is reasonable that its court-approved agents and professionals must also be disinterested.[49] On the other hand, a creditor "can never qualify as a 'disinterested person' under the Bankruptcy Code so it comes as no surprise, as the statute recognizes, that a professional who represents a group of creditors (the committee) need not qualify as a disinterested person, either."[50] And, unlike a trustee or debtor in possession, a creditors' commit-

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Constitution." Glenview Health Care Facility, Inc., 620 B.R. at 585. As of the date hereof, DBG had not sought compensation for the pre-dissolution work.

[43] The "Panel."

[44] See Glenview Health Care Facility, Inc., 620 B.R. at 587.

[45] See 620 B.R. at 587. (citations omitted).

[46] See 620 B.R. at 587.

[47] Glenview Health Care Facility, Inc., 620 B.R. at 587 (citation and quotation omitted).

[48] 620 B.R. at 587.

[49] See 620 B.R. at 587.

[50] 620 B.R. at 587.

tee "is, by design, a 'partisan representative,' not a detached fiduciary."[51]

The Panel then addressed the debtor's argument regarding the disinterestedness requirement in the provisions of the Bankruptcy Code governing compensation. Section 328(c) provides that the court may deny allowance of compensation or reimbursement of expenses of a professional "employed under section 327 or 1103 . . . if, at any time during such professional person's employment . . . such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed."[52] DBG was not seeking compensation; instead, the Committee was seeking approval of the retention of its counsel.[53] Although the Panel did not fault the bankruptcy court "for forecasting its concerns about DBG's ultimate right to compensation," it ultimately held that the bankruptcy court "erred by withholding its approval of DBG as committee counsel under [section] 1103 by engrafting into that statute the term 'disinterested person' where it nowhere appears."[54] Indeed, conflating sections 327 and 1103 as if section 1103 contained the same disinterested requirement as section 327 was an abuse of discretion.[55]

Aside from the distinction between sections 327 and 1103 of the Bankruptcy Code, *Glenview Health Care Facility* also demonstrates the applicability of state law rules of professional conduct in bankruptcy cases. There, the bankruptcy court effectively viewed the debtor's objection to the Committee's retention application as a motion to disqualify counsel and sought guidance from the Kentucky Rules of Professional Conduct. On appeal, the Panel noted that it was appropriate for the bankruptcy court to consider state rules governing professional responsibility to the extent put in issue by the

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[51] 620 B.R. at 587. (quoting *In re National Liquidators, Inc.*, 182 B.R. 186, 191 (S.D. Ohio 1995)).

[52] 11 U.S.C.A. § 328(c).

[53] See Glenview Health Care Facility, Inc., 620 B.R. at 587.

[54] 620 B.R. at 587.

[55] See 620 B.R. at 587.

parties and adopted by federal court.[56] The Panel reasoned that "[s]ection 1103 addresses the employment of one or more 'attorneys,' a term the Bankruptcy Code defines by reference to the authorization to practice law under 'applicable law.' "[57] Moreover, the federal district court previously made the Kentucky Rules of Professional Conduct applicable in the relevant district.[58] For these reasons, the Panel determined that it was appropriate to look to state law rules of professional responsibility for guidance in determining whether to approve a retention application under section 1103(b) that was contested on state law grounds (*i.e.*, conflicts).[59]

Glenview Health Care Facility is a reminder to prospective committee professionals and other parties in interest that the difference between sections 327 and 1103 of the Bankruptcy Code—namely, the "disinterestedness requirement"—is rooted in underlying bankruptcy policy. Therefore, it is improper to conflate the two provisions to require committee professionals to satisfy the adverse interest and disinterestedness standards in section 327 of the Bankruptcy Code. *Glenview Health Care Facility* makes clear that it is improper to foreshadow potential compensation issues at the retention stage given the disinterestedness requirement in section 328(c) of the Bankruptcy Code. Moreover, attorneys should be mindful that the applicable rules of professional conduct can serve as a useful guide for courts in determining whether to approve a contested retention application.

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[56] See 620 B.R. at 589.

[57] 620 B.R. at 589 (citing 11 U.S.C.A. § 101(4)).

[58] See 620 B.R. at 589 (citation omitted).

[59] See Glenview Health Care Facility, Inc., 620 B.R. at 590. The Panel, like the bankruptcy court, analyzed the test in the Sixth Circuit governing disqualification: "(1) a past attorney-client relationship existed between the party seeking disqualification and the attorney it seeks to disqualify; (2) the subject matter of those relationships was/is substantially related; and (3) the attorney acquired confidential information from the party seeking disqualification." Glenview Health Care Facility, Inc., 620 B.R. at 590 (citing *Dana Corp. v. Blue Cross & Blue Shield Mut. of Northern Ohio*, 900 F.2d 882, 889, R.I.C.O. Bus. Disp. Guide (CCH) P 7439 (6th Cir. 1990)). The Panel, however, did not find disqualification was warranted based on the applicable test. The Panel also rejected imputed disqualification, and the bankruptcy court's failure to apply KRPC 1.10 which rejects imputed disqualification. See Glenview Health Care Facility, Inc., 620 B.R. at 593.

IV. Reasonableness of Investment Bankers' Fees Under Section 328

Section 330 of the Bankruptcy Code lists factors for evaluating the reasonableness of a request for compensation of a professional employed under section 327(a) of the Bankruptcy Code.[60] Ultimately, applications for compensation are heard at the end of the case when the court has a record of what the professional achieved and the context in which the professional worked, even if interim approval of fees is obtained throughout a case on an interim basis.

In contrast, professionals employed under section 328(a) of the Bankruptcy Code are subject to a substantially circumscribed judicial review of compensation at the end of the case;[61] the reasonableness of their compensation is assessed at the time of employment.[62] While employment under section

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[60] 11 U.S.C.A. § 330(a)(1)(A).

[61] Once approved on specific terms and conditions, a professional's compensation may only be altered at the time of fee allowance under limited circumstances. Specifically, section 328(a) provides that:

> [N]otwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C.A. § 328(a). If a professional is retained on terms that are approved under § 328(a), "the court cannot on the submission of the final fee application instead approve a reasonable fee under § 330(a), unless [it] finds that the original arrangement was improvident due to unanticipated circumstances as required by § 328(a)." *In re Texas Securities, Inc.*, 218 F.3d 443, 445–46, 36 Bankr. Ct. Dec. (CRR) 94, 44 Collier Bankr. Cas. 2d (MB) 625 (5th Cir. 2000). Under this standard, the circumstances must not only have been "unanticipated," but "not capable of anticipation." *In re Smart World Technologies, LLC*, 383 B.R. 869, 877 (S.D. N.Y. 2008), judgment aff'd, 552 F.3d 228, 51 Bankr. Ct. Dec. (CRR) 1, 60 Collier Bankr. Cas. 2d (MB) 1722, Bankr. L. Rep. (CCH) P 81387 (2d Cir. 2009).

[62] Under section 328(a), a debtor-in-possession, with the court's approval, may employ a professional person:

> on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C.A. § 328(a).

328(a) may work well for a simple contingency fee arrangement for a particular litigation, courts have considerably more difficulty assessing the reasonableness of a compensation package for investment bankers who have "a whole suite of capabilities, such as valuation, negotiation, M&A, and the raising of debt or equity capital either during the case or as part of an exit facility, and the difficulty of whose future work might range from fairly simple to really hard" and which are not easily tested against a market.[63]

This is precisely the issue Judge Drain confronted when asked to approve the retention of Evercore Group LLC as the investment banker and financial advisor to the debtors in *Frontier Communications*. As the bankruptcy court noted, the "market driven" approach adopted by the most circuits[64] requires a clear market rate for services.[65] While task-based, as opposed to hourly-based, compensation for investment bankers is a normal fee structure outside of bankruptcy cases, discerning whether proposed compensation terms for a prospective set of transaction-related services of investment bankers in a restructuring are reasonable has proved challenging for courts. That problem is compounded by the fact that there is no clear non-bankruptcy market analog to a "restructuring fee" on top of a financing fee or an M&A fee, which raises the possibility that "market data" for restructuring services may turn into an echo chamber in which a small group of investment bankers establish the parameters of their market in bankruptcy cases with little input from others.

In *Frontier Communications*, the bankruptcy court was guided by the following factors: Do the proposed terms reflect the marketplace for these types of services? Did the parties engage in arms-length negotiations to derive the terms? Is the retention as proposed in the best interests of the estate? Do creditors oppose the retention or the proposed fees? And, lastly, is the projected amount of fees reasonable given the

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[63] *In re Frontier Communications Corporation*, 623 B.R. 358, 362 (Bankr. S.D. N.Y. 2020).

[64] 623 B.R. at 362 (noting that the "market driven" approach is the view in circuits other than perhaps the Fifth Circuit).

[65] 623 B.R. at 363.

size and circumstances of the case?[66] The bankruptcy court found the first factor largely determinative, noting that the other factors "can be seen as indirect ways to establish whether the modified engagement letter is at market, or not."[67]

In assessing whether the terms proposed were market, Judge Drain noted that only a few firms engage in investment banking services in large chapter 11 cases[68] and that the paucity of representations "helps explain bankruptcy judges' continued discomfort with contested investment banker retentions."[69] The bankruptcy court first determined that the work undertaken and proposed to be undertaken did not warrant a bonus above market-driven compensation in other comparable arrangements.[70]

Noting the wide array of issues investment bankers work on in large chapter 11 cases under the rubric of "restructuring advice" and covered by a "restructuring fee" (which may include addressing valuation issues, providing litigation support, valuation analyses, developing an optimum post-emergence capital structure, raising new money in the form of DIP financing and/or exit financing, managing an auction or sale process, financial analyses, and negotiation), the bankruptcy court turned to information from "mega" chapter 11 cases for guidance.[71]

First, the court determined that, despite appearing in most investment banker restructuring engagement letters, there is no level-set or level measure against which to compare one fee cap, including the caps proposed in Evercore's modified proposal, against another because fee caps in these types of

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[66] 623 B.R. at 363–64 (citing *In re Energy Partners, Ltd.*, 409 B.R. 211, 226, 51 Bankr. Ct. Dec. (CRR) 270 (Bankr. S.D. Tex. 2009); *In re High Voltage Engineering Corp.*, 311 B.R. 320, 333, 52 Collier Bankr. Cas. 2d (MB) 967 (Bankr. D. Mass. 2004); *In re Insilco Technologies, Inc.*, 291 B.R. 628, 633, 41 Bankr. Ct. Dec. (CRR) 52, 49 Collier Bankr. Cas. 2d (MB) 1686 (Bankr. D. Del. 2003)).

[67] 623 B.R. at 364.

[68] "It is a highly specialized field, and there are barriers to entry because of that specialization and the resources that need to be employed." 623 B.R. at 365.

[69] 623 B.R. at 365.

[70] 623 B.R. at 366.

[71] 623 B.R. at 366–67.

engagements are often "bespoke" in the light of an overall negotiation that takes into account the facts and circumstances of the case.[72] In comparable engagements to Evercore's retention in *Freedom Communications*, several had fee caps, but not total fee caps; some carved out M&A fees from the fee cap; others carved out monthly fees from the fee cap; certain engagements carved out subsets of those fees; and at least one case capped only the restructuring fee. In those recent engagements where a cap had not been imposed, the uncapped fees at times were also carved out of the section 328(a) retention and, therefore, subjected to the section 330 standard, which gave all parties the flexibility to review a particular transaction after it took place to determine what was reasonable.[73]

At issue in *Freedom Communications* was whether the proposed fee cap of $52 million needed to include the $22 million sale fee. The bankruptcy court found that the sale fee should be viewed as standing on its own separate from Evercore's other services, which were much more tied to the debtors' restructuring, and concluded that the $22 million sale fee was reasonable because of Evercore's experience, the complexity of the transaction, the success of the sale and benefit to the estates, and crediting of the sale fee against the restructuring fee.[74]

Nonetheless, the bankruptcy court found that certain components of the proposed retention were not reasonable. Specifically, although the proposal purported to provide for crediting of 50 percent of finance fees and monthly fees against the restructuring fee, the bankruptcy court found that it really did not do so because it then imposed a cap on the 50 percent crediting.[75] In addition, the court found that the proposed revised fee for financing transactions was unreasonable, whether looking at the market generally or the nature of the work to be performed.[76] Finally, the court determined that the restructuring fee of 0.16 percent of the funded debt

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[72]623 B.R. at 367.

[73]623 B.R. at 367.

[74]623 B.R. at 368.

[75]623 B.R. at 369.

[76]623 B.R. at 369. The court noted that financings already had been arranged in these cases. Under the Evercore proposal, the so-called DIP-to-

to be restructured required modification to be at market. Looking at comparable cases, the court noted that the average ratio of the restructuring fee to debt was between 0.10 to 0.11 percent.[77] The court concluded that a reasonable restructuring fee, where the debt to be restructured in approximately $17.5 billion, would be 0.14 percent of such debt, before crediting.[78] Judge Drain noted that there is some dispute as to whether a court can impose compensation terms under section 328(a) of the Bankruptcy Code,[79] but stated that this issue was largely academic because if Evercore chose not to be retained on those terms under section 328(a), its compensation would be governed by the Court's views of reasonableness under Section 330 of the Bankruptcy Code.

The decision in *Frontier Communications* highlights the inherent difficulties courts face in approving the terms of investment bankers' compensation given the wide variety of services and paucity of cases to use as a valid point of comparison.

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exit facility, under which Evercore's revised proposal Evercore would be paid at one percent of the outstanding amount, would also apply under its proposal to any future additional exit financing, which with the $49 million fee cap proposed by Evercore would add another roughly $2 million of fees if in fact the financing occurred.

[77]623 B.R. at 370. The court further noted that this included two cases where the percentage was substantially lower, namely Caesars and Hertz. Caesars' low percentage was explicable in part because the investment banker came in only postpetition and arguably, therefore, could be said to have less to do, although Caesars also appears to have been a contentious case. Hertz may be an artificially low percentage depending on the amount of debt upon which the fee ratio is based.

[78]623 B.R. at 371.

[79]Compare In re Energy Partners, 409 B.R. at 232 ("[U]nder § 328(a), bankruptcy courts have the discretion to tailor the fees in the applications if the court is dissatisfied with the terms proposed in the applications"), citing *In re Federal Mogul-Global, Inc.*, 348 F.3d 390, 403, 42 Bankr. Ct. Dec. (CRR) 34 (3d Cir. 2003), with In re Fansteel Foundry Corp., 2018 Bankr. LEXIS 4168, at *19 (Bankr. S.D. Iowa Nov. 27, 2018) ("Under 11 U.S.C. § 328(a) a court approves or rejects the employment of a professional based upon the stated compensation terms. The court's role does not extend to changing or dictating the terms"), citing *In re Farmland Industries, Inc.*, 296 B.R. 188, 191, 41 Bankr. Ct. Dec. (CRR) 187, Bankr. L. Rep. (CCH) P 78893 (B.A.P. 8th Cir. 2003), order aff'd, 397 F.3d 647, 44 Bankr. Ct. Dec. (CRR) 69, Bankr. L. Rep. (CCH) P 80238 (8th Cir. 2005).