

# Ethical Issues in Compensation Matters

Hon. Stacey G.C. Jernigan, U.S. Bankruptcy Court, Northern  
District of Texas

Hon. D. Michael Lynn, Bonds Ellis Eppich Schafer Jones LLP

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# The primer—what laws apply?\*

- § 327 – Employment of Professional Persons (see also § 101(14)’s definition of disinterestedness)
- § 328 – Limitation on Compensation of Professional Persons (“on any reasonable terms and conditions of employment” / unless terms “improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions”)
- § 330 – Compensation of Officers
- § 331 – Interim Compensation
- § 1103(a) – Powers and Duties of Committees
- § 1107(b) – Rights, Powers, and Duties of DIP

\* This is the *short list* of what laws apply—note that there are far more provisions than those listed here.

# The primer—what laws apply?\*

- Rule 2014 – Employment of Professional Persons
- Rule 2016 – Compensation for Services Rendered and Reimbursement of Expenses
- Texas Disc. R. Prof. Conduct 1.04(a) (fees must be reasonable).

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# Other useful info (big cases)

- USTP's Appendix B Guidelines—attorneys in large cases, which applies to attorneys in chapter 11 cases with \$50 million or more in assets *and* \$50 million or more in liabilities (aggregated for jointly administered cases)
  - For the Guidelines themselves:  
[https://www.justice.gov/sites/default/files/ust/legacy/2013/06/28/Fee\\_Guidelines.pdf](https://www.justice.gov/sites/default/files/ust/legacy/2013/06/28/Fee_Guidelines.pdf)
  - FAQs (including Qs on *ASARCO*):  
[https://www.justice.gov/ust/Prof\\_Comp/FAQ\\_Prof\\_Comp](https://www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp)

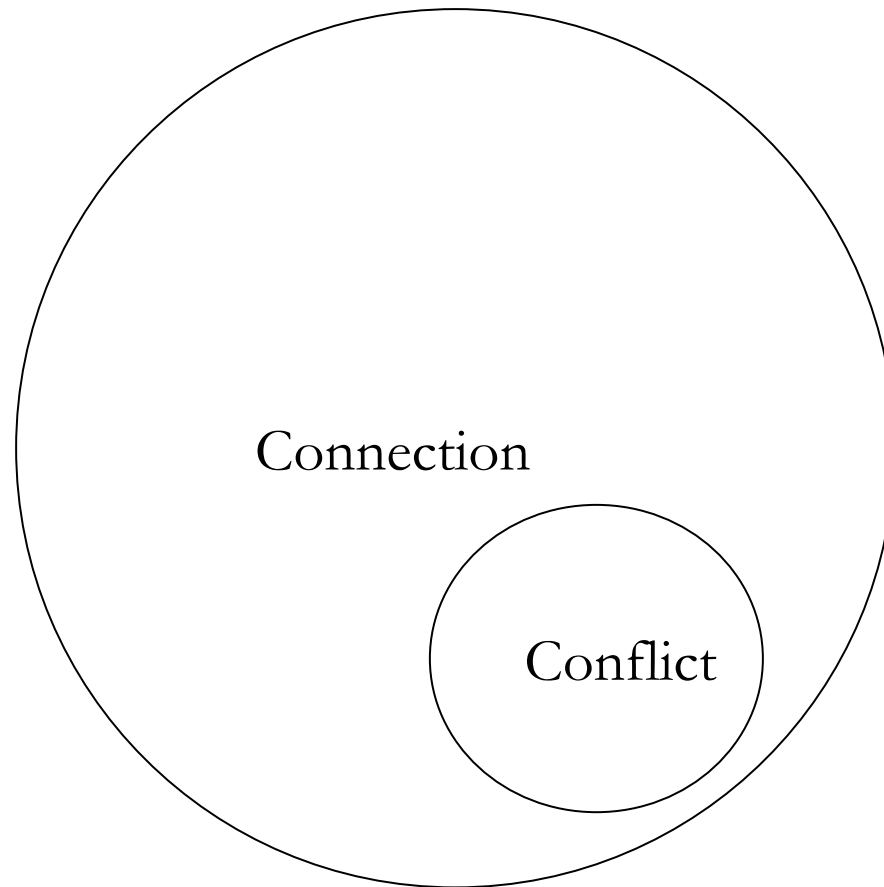
# The basics of an employment application:

- Debtor (or committee) must seek court approval to employ professionals
- Key components of an employment (also called retention) application
  - Description of qualifications and services to be provided
  - Rates to be charged
  - Disclosures of “connections” with parties in interest
    - Duty to update “connections”

# Top six issues related to compensation:

1. Not understanding the difference between “conflicts” and “connections”
2. Talking oneself into something not “counting” as a connection
3. Hot-button issues in reviewing fees and expenses
4. Fees on fees (*ASARCO* – or, here in Texas, *Baker Botts*)
5. Issues raised by flat fees (especially for non-attorney professionals)
6. No-look fees in chapter 13 cases (what’s included?)

# 1. Connection vs. conflict:



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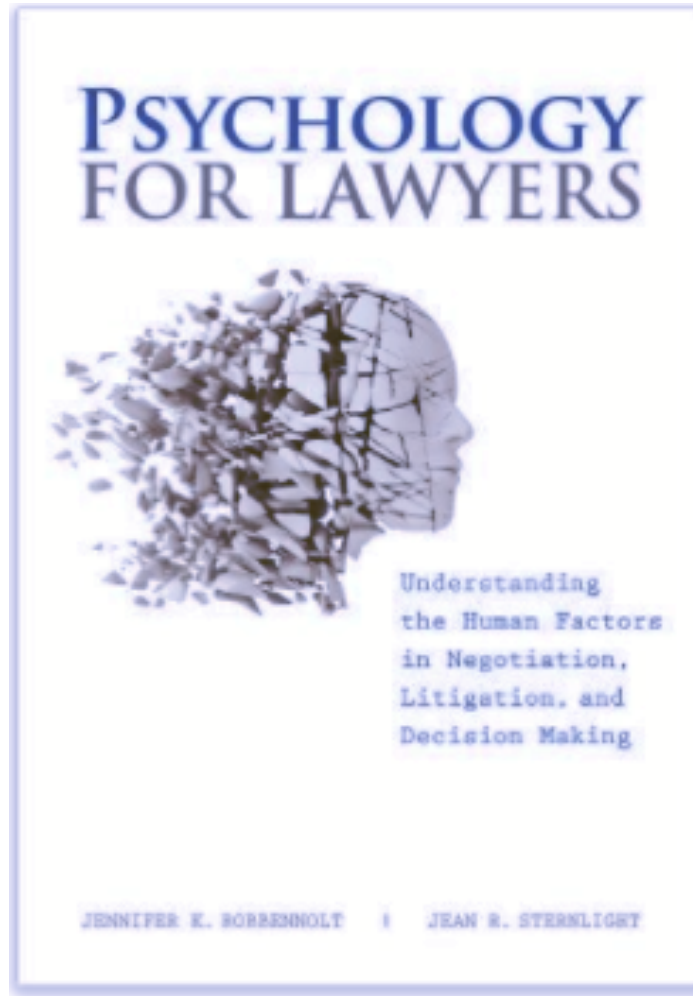
- What exactly *is* a connection? How broad is that concept?
  - Serving on boards of directors with other professionals?
  - Payment in pints of Graeter's ice cream by OUST for doing what would have been *pro bono* work (but for the ice cream)?



## 2. Talking oneself into something not “counting” as a connection

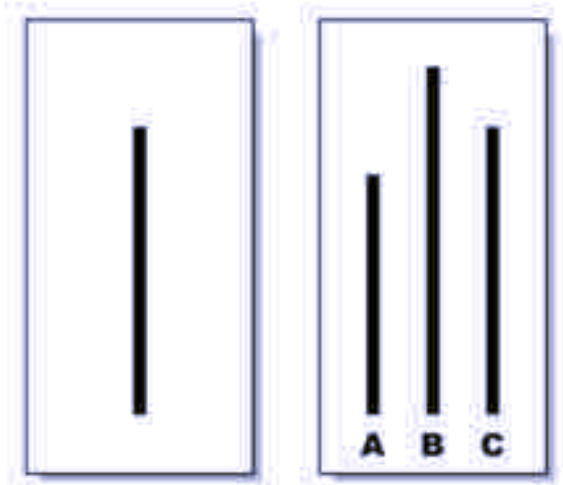
- Mesirow’s connection in Caesars bk.
- John Gellene’s connection in Bucyrus-Erie bk. (*see* U.S. v. Gellene, 182 F.3d 578 (7<sup>th</sup> Cir. 1999)).
- Countless other examples.
- So why do smart people sometimes fail to disclose connections?

# Disclosures and social science:



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- Cognitive dissonance (Milgram experiments).
- Diffusion of responsibility.
- Social pressure (Asch experiments).



- And the list goes on....

### 3. Hot-button issues / red flags

- How to handle disclosure of work by contract attorneys:
  - Where to disclose?
  - How to categorize?

### 3. Hot-button issues / red flags

- Don't assume that the judge has lived the entire case with you the way that you have—EXPLAIN unusual fees/expenses.
  - “Analyze strategies and tactics” and the reasonableness requirement of § 330.
  - Vague time entries / block-billed entries
  - Staffing inefficiencies, i.e., multiple billers on same project w/o explanation; top-heavy billers
  - Overhead expenses charged to the estate
  - Billing 0.1 hours for “reading each entry” on a day's docket, or several people reviewing the docket for the same reason
  - Not following local rules for expenses like car services, meals, travel time
  - Abnormally high airfare or hotel rates
  - Unusual hourly rate increases or increases that did not receive prior client approval

### 3. Hot-button issues / red flags

- We kid you not:
  - \$425,000 conflicts check
  - Tens of thousands of dollars to make charts (presumably from Excel data)
  - Cell phone purchases charged to the estate
  - \$140 shirt billed to the estate
  - In-room movies
  - Dinners at fancy restaurants

## 4. Fees on fees

- *Baker Botts, L.L.P. v. ASARCO, L.L.C.*, 135 S. Ct. 2158 (2015)
  - Defense of a fee application is not necessary to the administration of the bankruptcy case and, therefore, not compensable under § 330.
  - Bankruptcy judges *do not* have discretion on this issue and cannot award compensation for the defense of a fee application.
  - The Court relied on the American rule (each litigant pays for his or her own attorney's fees, win or lose, unless a statute or contract provides otherwise)

## 4. Fees on fees

- Attempted “work-arounds” post-*ASARCO* have been rejected by courts:
  - *See, e.g., In re Boomerang Tube, Inc.*, Case No. 15-11247, 2016 WL 385933 (Bankr. D. Del. Jan. 29, 2016)
- The difference between explaining a fee / expense in response to a fee examiner’s questions and defending a fee application in court.
- **COULD** a court, in the employment order, allow for the payment of the debtor’s attorney fees (as part of approving the engagement letter) if there’s a challenge to the fee application?



## 5. Flat fees

- What is “success”?
- What about those months in which no activity at all occurs?
- Tone-deafness on certain types of expenses

## 6. No-look fees and what they include

- Take a look at [N.D. Tex. Gen'l Order 2013-01](#) as an example (setting forth \$3,500 as the Standard Fee and listing what actions that \$3,500 should cover; “Level 2” business case fee is \$4,000).
- How do we ensure that the clients know what’s covered?

# Compensation: key takeaways

- Vague descriptions, i.e., “attention to,” and block billing are not acceptable under the Guidelines
- Advise non-bankruptcy practitioners who are working on the case of need for compliance
- Ensure appropriate staffing and division of labor, especially when multiple firms retained
- Check local rules and guidelines to ensure expenses are compliant