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Article

***485** COMPENSATION OF INVESTMENT BANKERS IN BANKRUPTCY PROCEEDINGS: JUST OR UNJUST ENRICHMENT?

James W. Giddens [a1]

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I. Introduction

As the worlds of investment banking and bankruptcy increasingly intersect, it is desirable for the judicial system to develop standards for evaluating and fairly compensating financial advisors for their ***486** contributions to a bankruptcy reorganization. An advisor's work may include financial advisory services, restructuring advice, sales of assets, and financings. Compensation

usually includes a fixed monthly advisory fee and transaction fees payable as a percentage of the consideration received by a debtor upon the successful completion of a transaction. [1]

Over the years the courts have struggled with the issue of investment banks' compensation, often disallowing compensation agreed to and reflected in an engagement letter between the debtor and its bankers that had been previously approved by the same bankruptcy court. In general, the courts have treated investment bankers in the same fashion as they have treated lawyers, accountants, and other professionals, requiring detailed fee applications based on hourly rates. Since investment bankers traditionally have neither maintained detailed timerecords nor worked on an hourly basis, this has often created a conflict when courts review the application and assess compensation. [2]

The theses of this article are: (i) the Bankruptcy Code ("Code") authorizes the retention and compensation of investment bankers on terms and conditions consistent with current industry-wide practice outside the reorganization context; (ii) the Code does not, nor should the courts, require a financial advisor's performance to be measured by the standards applicable to lawyers or accountants; and (iii) the contract approved by the court at the commencement of the engagement should be honored absent exceptional circumstances because such a practice is in the best interests of an efficient, fair, and orderly reorganization process.

***487** This article will examine in sequence the relevant provisions of the Code, the underlying legislative history and case law, and assess how courts have applied the Code's requirements to investment bankers. While Part II of this article sets forth the Bankruptcy Code's requirements for professional service providers, Part III addresses the legislative history behind relevant sections of the Code. Part IV describes standard practices in the investment banking industry. In Part V, the article provides a survey of case law in which courts attempt to apply bankruptcy standards to investment bankers. The survey of case law demonstrates both how courts are continuing to struggle with the issue, and also the progression of the courts' views from outright hostility to some intelligent accommodation to industry practices. This accommodation is reflected, for example, in the bankruptcy court's approach in the Enron case. [3] Part VI attempts to reconcile industry practices with the Bankruptcy Code's requirements and existing case law, concluding with the author's suggestions as to how courts should interpret the Code to provide reasonable compensation for investment bankers.

II. Bankruptcy Code Requirements for Advisors' Compensation

The principal provisions of the Bankruptcy Code relevant to the compensation of professionals are § 327, § 328, and § 330. [4] Under § 327(a) the trustee may, with the court's approval, employ various professionals to assist in carrying out the trustee's duties in a reorganization, provided that the professional holds no interest adverse to the estate and is disinterested as defined in § 101(14) of the Code. [5] Section ***488** 328(a) provides that the terms of the employment may be, on any reasonable terms and conditions, including on a retainer, hourly, or contingent fee basis. Significantly, the court is expressly granted the power to award compensation different from the terms previously approved if it finds that the original terms "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." [6]

Under § 330, subject to limitations imposed at the time of retention under § 328, the court ultimately must determine that the compensation to be awarded is "reasonable" for "actual, necessary services" rendered by the professional. Subsection (a)(3)(A) thereof provides:

In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title. [7]

***489** Subsection (a)(4)(A) provides:
Except as provided in subparagraph (B), the court shall not allow compensation for—
(i) unnecessary duplication of services; or

(ii) services that were not—
(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case. [8]

Rules 2014 and 2016 of the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules" or "Rules") [9] relate to compensation of professionals. [10] Rule 2014 provides that an application for employment must state, among other things, "specific facts showing the necessity for the employment," "the [professional] services [to be] rendered," and "any proposed arrangement for compensation." [11] The application must be accompanied by a verified statement of connections with the debtor, creditors, and parties in interest as well as their attorneys, accountants, and the office of the United States Trustee. Bankruptcy Rule 2016 requires a "detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested." [12] Local rules may impose additional requirements for fee applications by professionals. [13]

In summary, the Code and the Rules thereunder permit an investment banking firm to be retained under a contract providing for a monthly retainer and additional performance-based fees consistent with the terms of such contracts outside bankruptcy. There is no mandatory requirement that such a firm be retained on an hourly-rate ***490** basis. Under Rule 2016 there is a requirement to account for time expended, but how this is to be done is not prescribed. [14]

The crux of the interpretative process is the interplay of §§ 328(a) and 330(a). In particular, § 328(a) permits retention "on any reasonable terms and conditions," but, "notwithstanding such terms and conditions," permits the court, when subsequently reviewing an application for compensation, to award a different amount if the original terms prove to have been improvident in light of developments unforeseeable (not merely unforeseen) at the time the original terms were approved. [15]

Section 330(a)(3)(A) sets forth the five elements for a court to consider in determining "reasonable compensation," which include time spent and rates charged. [16] Furthermore, the services must be actual, necessary, and reasonably likely to benefit

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the estate. [17] If a court views § 328(a) retentions as subject to the "reasonableness" standards of § 330(a), then a court, as many have, could reject the terms of a previously approved retention agreement, ignoring the provision of § 330(a)(1) to the effect that compensation awards thereunder are subject to § 328.

III. Legislative History

The relevant provisions of the Code are not ambiguous and legislative history adds very little. A discussion in the House Report of § 330, however, provided that the section was intended to overrule *Massachusetts Mutual Life Insurance Co. v. Brock*, [18] which required fees to be determined based on notions of conservation of the estate. [19] Congressman Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, upon introducing the House Amendment to the Senate Amendment to H.R. 8200, stated:

> Section 330(a) contains the standard of compensation adopted in H.R. 8200 as passed by the house rather than the contrary standard contained in the senate amendment. Attorney's fees in bankruptcy ***491** cases can be quite large and should be closely examined by the court. However, bankruptcy legal services are entitled to command the same competency of counsel as other cases. In that light, the policy of this section is to compensate attorneys and other professionals serving in a case under title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under title 11. Contrary language in the senate report accompanying s. 2266 is rejected, and Massachusetts Mutual Life Insurance Company v. Brock, 405 F.2d 429, 432 (5th cir. 1968) is overruled.
>
> Notions of economy of the estate in fixing fees are outdated and have no place in a bankruptcy code. [20]

Evidently, Congress's objective was to compensate professionals in bankruptcy at rates comparable to what they are paid by the market and thus encourage high quality professionals to work in bankruptcy with the expectation that they will contribute to the efficiency and success of the process.

IV. Compensation and Practices in the Investment Banking Industry

It seems axiomatic that securities firms, investment bankers, and financial advisors play an indispensable role in originating and facilitating diverse transactions essential to modern day business. [21] Indeed, their role is not limited to mature capitalist economies but also extends to political systems in the developing countries. Therefore, it is not unusual for a major company in Chapter 11 to seek to retain the services of such a firm with its institutional expertise and global contacts.

A justified criticism of the Chapter 11 process is that it is too often a failure, not only in cases in which no plan of reorganization is confirmed, but also in many cases in which a plan is confirmed but the company nevertheless fails. The expensive and cumbersome process can destroy economic value. According a proper role to a skilled financial advisor should assist the debtor, the creditors, and the court in making intelligent and realistic evaluations of a debtor's ***492** economic viability and how best to maximize and preserve economic value. The investment banker can assist in testing the market for ascertaining the value of the debtor's business.

Indeed, in dealing with the privatization of Conrail, Congress acknowledged the crucial role of investment bankers and the importance of retaining highly qualified firms. The legislation authorizing a public offering for the sale of Conrail, Public Law Number 99-509 (1986), required the Secretary of Transportation, in consultation with the Secretary of the Treasury and the Chairman of the Board of Conrail, to retain investment banking firms to act as co-lead managers of the public offering and

to establish a syndicate to underwrite the public offering of Conrail common stock. Significantly, section 4011(a)(2) of the legislation states:

> In selecting the investment banking firms to serve as co-lead managers of the public offering under paragraph (1), consideration shall be given to the firm's institutional and retail distribution capabilities, financial strength, knowledge of the railroad industry, experience in large scale public offerings, research capability, and reputation. In addition, recognition shall also be given to contributions made by particular investment banking firms before the date of the enactment of this Act in demonstrating and promoting the long-term financial viability of the Corporation. [22]

When the United States made the decision to divest itself of Conrail, it retained Goldman, Sachs & Co. as its financial advisor under standard industry terms and conditions. Goldman's contract included a fixed monthly retainer and contingent fees based on a percentage of the value of a successful transaction. Goldman was not required to maintain or provide detailed time records. [23]

By contrast, in the two Hillsborough Holdings Corp. cases, [24] the bankruptcy courts denied all compensation to two prominent firms, Merrill Lynch & Co. and Bear Stearns & Co., for not providing such information. It is ironic that a bankruptcy court treated a monthly ***493** retainer with such scorn and skepticism, seeking to have the banker demonstrate benefit to the estate by each employee in part measured on an hourly compilation of work done. While the critic may say that it is easy for a court to judge the success of a banker in raising capital or concluding a successful sale of assets, it is not easy for a court to evaluate the worth of a $200,000 monthly advisory fee without detailed hourly work descriptions. Clearly, such an evaluation cannot be based entirely on faith. Unfortunately, recording time in tenths of an hour and including detailed descriptions does not really add a great deal to the knowledge of the court except to demonstrate that various persons spent time doing the various things investment bankers do and are requested to do by clients: valuation analysis, seeking sources of capital, or merger or acquisition opportunities. Suppose the court was told the banker spent 100 hours as requested by the debtor doing various economic models and forecasts with respect to future earnings under different business configurations or that a Managing Director made six telephone calls or on-site visits to company executives to discuss the financial forecasts or merger candidates. If a firm is hired on a fixed monthly retainer for having a myriad of such services available, how does a court intelligently apportion value and benefit to the debtor's estate when there is not a standard hourly rate for such services?

The practice of some bankruptcy courts in attempting to squeeze the investment banks into the lawyer/accountant mold, and their failure to understand what the banks contributed to the process has discouraged some highly qualified firms from seeking to participate in the reorganization process, which only serves as a detriment to the process. For example, in the Chapter 11 reorganization of Special Metals Corp., Merrill Lynch withdrew its application to serve as financial advisor to the debtor after the U.S. Trustee objected to the terms of its proposed engagement agreement and the court appeared unwilling to approve the terms of the agreement negotiated with the debtor. [25] The principle adverse effect is that the most experienced and highly qualified firms will forgo bankruptcy work if their compensation is uncertain, if they are required to change the culture of how they do business by requiring detailed time records, if they are being compensated on an hourly basis, and if they are forgoing standard indemnification against claims, litigation, and other costs arising from this work.

***494** This outcome seems inconsistent with legislative intent and preference in enacting § 330 of the Bankruptcy Code, [26] which authorizes compensation. H.R. Rep. 95-595, discussed above, reflects Congress's concern that professionals would have little incentive to practice in bankruptcy if they were not compensated at rates which were comparable to what they could earn outside bankruptcy. While the reorganization process can and does go forward without such “blue chip” professionals, and one cannot prove that employing their skills would have led to a better result in any particular case, it is clear that debtors and committees of creditors believe the advisor's services add value and enhance the prospects of a successful reorganization.

Bankers at all levels work prodigious hours, often including evenings and weekends as part of a typical work-week.[27] The issue is not whether they spend the time to justify the compensation. To the contrary, unlike in determining compensation for lawyers and accountants, time spent has never been an important component in how investment bankers are compensated by the marketplace. Bankers are not assigned hourly rates and are typically compensated by their employers by having an annual fixed salary with incentive bonus compensation based on an assessment of performance or results achieved. The structures of fee arrangements with clients are often quite complex and have many variables; however, under the most common arrangements, fees are based on results achieved. In an underwriting agreement, the banker is paid a percentage of the proceeds the syndicate generates from the successful sale of securities. In a successful merger or acquisition, the banker is paid a percentage of the value. For advisory services such as a valuation opinion, a banker is paid an agreed-upon fee.

Since time expended, detailed work descriptions, and hourly rates are not part of the compensation system for investment firms, there has been no economic necessity or compelling logic for creating such a data collection system and attendant procedures within these firms. Since this information bears no relation to the prevalent billing practices of the industry, to the banker the information might be interesting but mostly useless. In contrast, lawyers and accountants have sophisticated systems for recording time and work descriptions since billing on an hourly rate is the prevalent method in their professions. The courts, the U.S. Trustees, fee examiners, and creditors' committees are constantly evaluating applications from these ***495** professionals and are very experienced at doing so. In courts' efforts to grapple with assessing the banker's work, they have had the most difficulty with a monthly fixed advisory fee paid "hell or high water" unrelated to time expended or hourly rates. The courts have had less difficulty in accepting a contingent performance-based fee not calculated on time and hourly rates.

Logically, a firm that has worked successfully with the company in the past is often preferred and may well be the best choice, but issues of potential conflicts of interest may prohibit that choice.[28] In addition to the uncertainty created by courts' varying treatment of investment banker compensation, courts have limited the value of investment bankers' services by refusing to allow investment bankers familiar with the bankrupt entity from providing services during reorganization.[29] This limitation only compounds the judicial misunderstanding of investment bankers' role in reorganization, and makes it more difficult for investment bankers to make meaningful contributions to the reorganization process.

V. Survey of Case Law

The cases addressing investment banker compensation principally focus on whether the financial advisor was retained under § 328(a) or § 330(a) and the differing consequences thereof. For purposes of analysis, the standards for retention under § 328(a) and § 330(a) are described respectively as "sanctity of contract" and "reasonableness."[30]

The predominant approach taken by bankruptcy courts is to use the so-called lodestar approach—reasonable hours expended multiplied by reasonable hourly rates—as described in *In re Drexel Burnham* ***496** *Lambert Group, Inc*.[31] This approach is sometimes augmented by the consideration of additional factors such as the twelve enumerated in *Johnson v. Georgia Highway Express, Inc*.,[32] a non-bankruptcy case, in determining the "reasonableness" of compensation under § 330.[33] Even though investment bankers bill on an entirely different basis, the courts have artificially attempted to convert monthly retainers into fees based on hourly rates and time expended, for which recording mechanisms were mostly non-existent.

In recent major cases, financial advisors have been retained pursuant to § 328(a) and have been awarded compensation for the most part consistent with the terms of the original retention orders while the court has expressly reserved its right to review the applications under § 330(a).[34] While it is by no means settled law or the practice in all jurisdictions, precedent has emerged

in several circuits that financial advisor retention may be on a monthly fixed retainer without submission of the kind of detail required by the lodestar approach. [35]

A survey of some of the leading cases demonstrates the difficulty courts have had in dealing with appropriate compensation for investment bankers.

A. "Sanctity of Contract" Under § 328(a)

Certain courts have held that once a retention agreement is, after a hearing, unambiguously approved under § 328(a), the terms and conditions of such contract are binding and not subject to modification except under the "improvident and unforeseeable developments" standard. [36] Cases decided under § 328(a) demonstrate that several circuit courts recognize that retention of a financial advisor under the express provisions of § 328(a), with the details of the compensation arrangements spelled out, will be binding on all the parties and the ***497** court. [37] The only criterion for modification of the contract is the "improvident" standard set forth in § 328(a). [38]

In *In re Airspect Air, Inc.*, [39] the bankruptcy court was criticized by the bankruptcy appellate panel for subjecting the financial advisor's application for compensation to the standards of § 330. [40] The appellate panel stated that "[t]he widely accepted general rule is that bankruptcy courts, once having approved employment under § 328, may not later switch to § 330 to award fees." [41] Moreover, the panel commented that, "[u]nder § 328, an intervening circumstance, in order to render improvident a court's decision to grant a fee application, must be one that would have affected the court's decision in the first place." [42]

Under § 328(a), a court's inquiry into reasonableness should be conducted at the time the application is presented. [43] The financial advisor then has every right to rely upon the terms approved with assurance that if it performs its part of the contract, it will be compensated as agreed. Its performance will only be subjected to an after-the-fact evaluation for "reasonableness" under § 330 when there is proof of improvidence as a result of developments that were unforeseeable at the time of original retention. [44] In *Airspect Air*, there were no such unforeseeable developments [45] and indeed there does not appear to be any reported case indicating what kind of developments might be considered "unforeseeable." The test is whether the court could have reasonably foreseen the development. [46]

In *In re National Gypsum Co.*, [47] the Fifth Circuit reversed the lower court's reduction of fees awarded to Donaldson Lufkin & Jenrette Securities Corp. and held that terms of retention approved under § 328(a) could not be summarily changed. [48] Although the retention order made no reference to § 328(a), the circuit court treated express ***498** approval of the terms and conditions of a proposed engagement agreement as retention under § 328(a), with the explicit rationale that the failure to honor these agreements is inconsistent with the intent of Congress in passing the Bankruptcy Code of 1978 ("1978 Code"). [49] The court held that § 328(a) eliminated the uncertainty inherent in a subsequent review for "reasonableness" under § 330. [50] Compensation could only be changed if the original terms and conditions proved improvident in light of conditions that could not have been anticipated when the agreement was negotiated and approved. [51] Courts have a duty to protect those agreements and expectations. [52]

Donaldson Lufkin & Jenrette was retained at a flat fee of $125,000 per month subject to the court's right to consider the reasonableness of the compensation for both interim and final applications. [53] The district court concluded that § 328(a) was not applicable given the reservation of the right to review the compensation. [54] The circuit court disagreed, citing the legislative

history of the 1978 Code and stating, "most ... able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done." [55] The court cited with approval *Pitrat v. Reimers (In re Reimers)*, [56] and *In re Dividend Development Corp.*, [57] wherein the court stated that a determination as to reasonableness is made at the time of retention under § 328. [58]

In *In re Circle K Corp.*, [59] the Ninth Circuit stated, "[o]f course a bankruptcy court is not compelled to accept a professional's employment under § 328 merely because the application cites the statutory provision." [60] The court, differing with the implicit approach ***499** of the Fifth Circuit, held that a § 328(a) retention must be unambiguous and express. [61] Merrill Lynch requested employment under § 328(a) and the bankruptcy court approved the proposed retention agreement in an order stating that Merrill was to be paid "without further court order." [62] Of course, any such payments were made subject to the "improvident unforeseeable development" standard incorporated in § 328(a). [63] Merrill Lynch was awarded the fees contemplated by its original retention agreement, including a monthly fixed fee. [64]

Decisions by the bankruptcy court in *In re Circle K Corp.* [65] are also instructive about how a court asserts its right to modify § 328(a) retentions. Salomon Brothers, Inc. was retained by the Official Unsecured Creditors' Committee under an agreement providing for a fixed monthly fee, subject to the court's review of a final fee application. [66] Salomon submitted a final fee application for $3,228,973, stating that it had expended 500 hours on the engagement with only a brief description of the categories of services provided. [67] The court held that, notwithstanding approval of an agreement under § 328, it had the authority to approve final fees different from the original agreement if the original terms proved improvident in light of developments not capable of being anticipated originally. [68] Furthermore, the original agreement did not mandate detailed time-keeping. [69] The court held that while the original order met the "bare" requirements of § 328, the court retained the power to determine whether ***500** Salomon actually did the work. [70] The engagement agreement provided that if the monthly work were insubstantial, the monthly fee would be reduced. [71] Since Salomon voluntarily reduced its fees for certain months, it should explain the criteria for these reductions to permit the debtor and the court to determine if similar reductions to the flat fees for other periods were appropriate. [72] This case is interesting in that the court viewed its modifications as consistent with § 328(a) since the original retention could be interpreted as a fixed fee subject to adjustment for reduced work. [73] Thus it was implicit that the court could make an inquiry as to the amount of work done during a particular period and the appropriateness of further reductions. [74]

In *In re Circle K Corp.*, [75] on remand from the Ninth Circuit, the bankruptcy court analyzed requests by Houlihan, Lokey, Howard & Zokin Inc. ("Houlihan, Lokey") for compensation for two distinct periods of the reorganization. [76] As to the first period which was deemed to be under § 330, the court found that the firm had not maintained time records nor provided sufficient documentation of services, even though Houlihan, Lokey agreed at the outset to maintain such records. [77] The court found that Houlihan, Lokey's records for the first retention period lacked adequate detail to allow the court to evaluate what work was performed and whether the work was necessary for the reorganization. [78] For the second period, judged under § 328(a), the court held that the firm could recover its fees for work performed as an advisor to the Bondholders' Committee, as its services appeared reasonably likely to benefit the Bondholders' Committee, even though the plan of reorganization proposed by the Committee was not adopted. [79] Houlihan, Lokey's sixty-eight page billing ***501** statement for the second period was sufficient to meet the Code's requirements. [80] The result was correct. A § 328(a) retention should not be subject to § 330(a) criteria which the court applied.

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In *In re Farmland Industries, Inc.*,[81] the bankruptcy court approved the retention of Houlihan, Lokey as financial advisor to the Unsecured Creditors' Committee with a $150,000 monthly retainer and a transaction fee of one percent of certain proceeds to be paid to unsecured creditors.[82] Upon reviewing Houlihan, Lokey's application for compensation the bankruptcy court approved the monthly fees under § 328(a) and approved the transaction fee under § 330(a).[83] The logic of the bankruptcy court's dissecting the original retention agreement in this manner is unclear.[84] If the retention agreement provides that an advisor is to be paid a one percent transaction fee, subject to the transaction's being successfully completed, why is it necessary to measure this by the "reasonableness" standards of § 330? Under § 328(a), if the transaction is successful, the one percent fee would be payable under the terms of the contract. Under § 330(a), the court could have reduced the percentage or allowed no compensation.

In *In re Federal Mogul-Global, Inc.*,[85] the Third Circuit considered the appeal by the Equity Committee of the decision by the bankruptcy court to modify the proposed terms of the Committee's application to retain Deloitte & Touche LLP as financial advisor under § 328(a).[86] Over objections from the Unsecured Creditors' Committee and the Asbestos Personal Injury Claimants, the court approved the application under § 328(a) with a cap on monthly fees of $30,000, as opposed to $200,000 per month for the first five months and $125,000 per month thereafter as set forth in the application.[87] The Equity ***502** Committee's argument that a court was compelled to approve an application utilizing employment on an hourly basis as inherently reasonable under § 328(a) was specious.[88] Section 328(a) clearly authorizes retention on an hourly basis but that does not mean that a court must accept any particular hourly rates proposed by an applicant.[89] The court has the duty to make a determination as to the reasonableness of the proposed terms at the time of retention.[90] The court in dicta appeared to imply that, after approving a § 328(a) application without a cap, a court could subsequently impose one.[91]

The Committee, making an alternative argument that was wholly contradictory to its primary position, stated that the amount of monthly compensation was not a term of employment that could be approved under § 328(a) but only § 330(a)(1) after the services were rendered. The court rejected the Committee's position, noting that terms and conditions were inclusive terms.[92]

The Committee also asserted that the "reasonableness" standards of § 330(a)(1) could not be applied by a court in ruling on applications for initial retention under § 328(a). The court held that a court could consider such factors without commenting on whether such factors were exclusive.[93]

While § 328 was purportedly intended to impose "limitations" on compensation at the time of retention, by its terms it is an open-ended authorization to permit "any reasonable terms and conditions" that a court may approve. The terms and conditions can vary from a fixed monthly retainer (with or without the requirement of maintaining detailed time records and descriptions of services rendered), to an hourly rate, contingent fees, or indeed any arrangement and terms the court finds "reasonable." The analytical inquiry under § 328 is often what the order approving retention provides. Unless the order expressly incorporates and approves the proposed retention agreement verbatim, it is the order which governs. If a retention order includes ***503** a reservation of the right to review, while stating it is a § 328(a) retention, it may be viewed as intellectually muddled or inconsistent, but in practice it may be treated as a § 330(a) retention.[94]

B. "Reasonableness" Under § 330

Subject to the provisions of § 328, § 330 is applicable in determining the appropriateness of requests for compensation after the services have been rendered. This section considers whether § 330 should be universally applied to all applications for compensation. In *Zolfo, Cooper & Co. v. Sunbeam-Oster Co.*,[95] the Third Circuit stated unequivocally that fees are governed by

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§ 330.[96] Rule 2016 requires, unless the court provides otherwise, a detailed statement of time expended and services rendered. Furthermore, industry practices do not necessarily equate with "reasonableness."[97] Thus, many courts have felt compelled to demand detailed time records and descriptions from a financial advisor.[98]

1. Lodestar Approach

In applying § 330, many courts have adopted the position that the lodestar approach is the appropriate way to determine a financial advisor's compensation and, indeed, this approach predominates under cases construing § 330.[99]

***504** In *Drexel*,[100] one of the more thoughtful cases on this subject, the court made a conscientious effort to understand the role of all the professionals and to work out a fair modus operandi for compensation. The *Drexel* court unequivocally stated that the intent of Congress in adopting the Bankruptcy Code was that the market and not the courts must set the rates for professionals in bankruptcy.[101] If an hourly rate of $500 for a senior attorney is standard in a particular jurisdiction, it is not the function of the judge to reduce it based on his or her parochial notions of fairness or appropriateness. However, the court retains the authority under § 330 to review *all* requests for compensation to determine if the services were necessary and beneficial to the estate.[102] Furthermore, the court stated that there was a "strong presumption that the lodestar product is reasonable under § 330."[103]

The *Drexel* court noted that its role, as distinguished from that of the debtor, the committees, and professionals, was changed by the adoption of the Bankruptcy Code in 1978, with most responsibility for negotiating a consensual plan of reorganization being transferred to the various parties in interest and the professionals selected by them.[104] Accordingly, since the consumers of the services choose professionals after a highly selective process and negotiating terms of employment, the degree to which a court should second-guess such arrangements is limited to a determination as to reasonableness.

After a careful process and studying proprietary data under seal from law firms and accountants, the *Drexel* court came to the conclusion that their fee structures were by-and-large appropriate and awarded them most of the compensation requested during the course of the case.[105] However, with the candid admission that it did not well understand the economics, cost structure, or services of the investment ***505** banking profession, the court was not as generous in its assessment of such firms.[106]

The court recognized that bankers do not easily maintain time records or bill on an hourly basis.[107] It noted that the role of bankers in Chapter 11 cases is growing as a result of the increasing number of major corporations utilizing the reorganization process.[108] The court reviewed a variety of retention arrangements from most of the major Chapter 11 cases and concluded that the regular practice is to allow the banker a monthly retainer at the outset of the engagement.[109] The *Drexel* court, however, commented that the retainer arrangements may be "oligopolistic" behavior by the investment banking firms.[110] The court was critical of the bankers for wanting to assure their compensation is paid notwithstanding the financial status of the debtor. To the court, this amounted to wanting to "sip the cream and leave the skimmed milk to others."[111] The court concluded that investment bankers may be retained pursuant to § 328(a) on a monthly retainer, contingent fee, or hourly basis, but, in any case, § 330(a) governs.[112] The court resolved the potential conflict between the bankers' practices and the Code by promulgating detailed requirements for fee applications and held that the Guidelines for Bankruptcy Fee Applications promulgated by the Southern District of New York applied to *all* professionals.[113]

The *Drexel* court found the world of lawyers and accountants quite competitive and did not have much difficulty in evaluating the services of such professionals. The fees awarded the major law firms and accounting firms were substantial, in the millions

of dollars, and in ***506** most cases the hourly rates of the various professionals were very similar. [114] By contrast, the court required the financial advisors, Rothschild, Inc. and Goldin Associates, L.P., to resubmit applications containing the detailed information required of lawyers and accountants. [115] While a thoughtful opinion, *Drexel* failed to follow the implications of its recognition that the market and industry standards should be the guidelines for reasonable compensation, that fixed-fee monthly retainers are the norm, and that well-established billing practices for this industry are not based on a lodestar method. In the end, once it determined § 330 applied, it concluded that the lodestar approach was necessary. [116]

While § 330(a) does include time expended and customary rates charged as relevant factors, the statute does not compel the adoption of the lodestar approach or prescribe how an applicant might provide sufficient information on time expended and on customary billing practices. [117]

In *In re EWI, Inc.*, [118] the Bankruptcy Court for the Northern District of Ohio held that § 330 governs, notwithstanding prior approval of a retention agreement providing for fixed fees for the sale of certain of a debtor's assets. [119] The assets were successfully sold by Schroder Wertheim & Co., which sought the specified fees and reimbursement of legal costs incurred by its counsel, Fulbright & Jaworski. [120] The court held that the burden was on the applicant "to establish the entitlement to and reasonableness of a fee." [121] Although the court stated that the lodestar method was the standard in the Sixth Circuit, [122] the court held that it was inapplicable in this case since the engagement letter provided for a fixed fee and the "financial advisors, in general, do not keep itemized time records of the services they perform." [123] ***507** The court held that it had the right to adjust any fee award based upon work quality and results achieved combining the standards of §§ 328 and 330. [124] The court found that Schroder did find a stalking horse bidder but did little else thereafter to assist in finding the ultimate successful bidder and reduced Schroder's fees by twenty-five percent of the amount requested. [125] The court correctly observed that the lodestar approach was, in this case, neither sensible nor mandatory. [126] Again, as in *Drexel*, it legislatively merged §§ 328 and 330 and rewrote the terms of the original contract.

In *In re Apex Oil Co.*, [127] the Eighth Circuit, in considering compensation for an examiner appointed by the court, held that the lodestar method is an "appropriate method" for calculating compensation under § 330. [128] After making this lodestar calculation, it continued, stating that a court should judge the reasonableness of that figure under the standards of § 330 and Rule 2016. [129] The court noted that the lodestar amount presumably incorporates "(1) the novelty and complexity of the issues, (2) the special skill and experience of counsel, (3) the quality of representation, and (4) the results obtained," but that "these factors normally cannot serve as independent bases for increasing the fee awards above the lodestar amount." [130] However, an increase in the lodestar amount is permissible "in certain 'rare' and 'exceptional' cases, supported by 'specific evidence' on the record and detailed findings by the lower courts." [131]

In *Kula v. Chamberlain* (*In re Kula*), [132] the court held that a lodestar calculation, while preferred, is not mandatory, but that "bankruptcy courts must *either* make an express lodestar calculation *or* make a finding that the lodestar is inappropriate under the circumstances." [133]

The elements that the court discussed as part of the lodestar are characteristically the elements that most legal professional codes include as appropriate considerations in billing by attorneys. The ***508** lodestar approach is perfectly consistent with the usual and customary practices of the legal professional. It is not necessarily consistent with the practices of other professions. Confronted with alternative methods of billing, the courts have understandably but unnecessarily attempted to apply the lodestar approach to financial advisors. [134]

2. Variant Approaches

a. Criteria for Allowance

Notwithstanding certain deficiencies in the financial advisor's compliance with the retention or fee application requirements of the court, in each of the following cases the courts reviewed contribution to the success of the reorganization and awarded compensation deemed "reasonable." These cases represent a flexible approach and a conscientious effort to balance various factors to reach an equitable result.

In *In re Chicago, Milwaukee, St. Paul and Pacific Railroad Co*., [135] the circuit court held that the contract between the Trustee and Shearson Lehman Brothers, Inc. ("Shearson") approved by the district court governed the compensation to be received by Shearson, notwithstanding a subsequent informal agreement between the parties to modify the terms. [136] The court also reversed the district court's denial of compensation based on a finding of misconduct by Shearson in concealing certain documents from the lower court in connection with its fee application. [137] The net effect was that Shearson was awarded a fee of $1 million in addition to its fixed retainer payments of $100,000 each quarter, not the $5 to $6 million in additional compensation sought by Shearson and supported in part by the Trustee. [138]

Shearson was initially retained in 1979 to provide various advisory services to the Trustee with billing on an hourly basis. [139] Shearson was separately compensated for a sale of the railroad's timberlands. [140] A special master determined that about one-third of the railroad's ***509** business could be reorganized but that the other segments of the railroad should be sold. [141] In 1982, an offer for purchase of the core assets was made. [142] Shearson renegotiated the terms of its agreement with the Trustee. [143] Shearson argued that the nature of the services involved in assisting in the sale of the core assets was "a transaction separate from the regular advisory [activities] envisioned by Shearson when it was first retained." [144] It also noted that: "(1) its regular practice was to receive a flat retainer or percentage transaction fee rather than hourly rate compensation; [and] (2) the average hourly rate it received ($133) was significantly lower that its normal fees for services ...." [145] Under the revised agreement approved by the court (the "1982 Agreement"), Shearson had a major role in developing a plan of reorganization and negotiating a sale of the core assets. [146] The revised terms followed the industry norms of a fixed retainer and a contingent amount, in this case up to an additional $1 million for services beneficial to the estate not fairly compensated by the retainer. [147] The district court found the terms "fair and reasonable and ... in accordance with the normal practice of the investment banking industry." [148]

A bidding contest for the core assets resulted in substantially improved offers during the period from 1982 through 1985. [149] Shearson again sought to modify its compensation arrangements to provide that it be paid a percentage of any successful sale. [150] No revised contract was presented to the district court; however, the Trustee indicated his willingness to reconsider and ultimately supported Shearson's fee application to the court for a fee of $5 to $6 million plus an unremunerated success fee. [151] The ultimate sale, for which Shearson was given much credit, produced substantial benefits ***510** to creditors and shareholders. [152] The fee application was referred to a special master who concluded that Shearson should not be limited to the compensation provided by the 1982 Agreement which was based on the 1982 offer but should be awarded $2,047,500 in additional compensation. [153] The special master also concluded that the record did not support a finding of intentional misconduct by Shearson in the fee process. [154] The district court ruled that Shearson was bound by the 1982 Agreement, that

Shearson had not met the evidentiary burden of justifying any additional compensation thereunder, and that Shearson had engaged in misconduct by concealing documents which justified the dismissal of its application. [155]

The circuit court held that the special master's findings of fact would stand unless clearly erroneous and thus, the district court's finding of intentional concealment of information was not an intentional breach of a duty of disclosure. [156] Interestingly, Shearson asserted that the 1982 Agreement was not the final word on its entitlement to compensation and that the court should make a judgment based on the services rendered and contribution to the reorganization process. [157] The circuit court, however, held that the 1982 Agreement would be honored, noting that the 1982 Agreement addressed the issue of additional compensation. [158] Furthermore, the district court, as a court of equity with broad discretion over fees, had made the determination that Shearson should be bound by the 1982 Agreement since it "offered utterly no reason why it should not be bound by the [1982] agreement." [159] The implication is that a court applying equitable principles could have ignored the strictures of the 1982 Agreement. [160]

The court noted with approval the district court's finding that the agreement was the product of negotiations between legally sophisticated parties and by its terms was intended comprehensively to describe the services to be rendered. [161] The circuit court also noted ***511** its reluctance to encourage parties to seek repeated increases in compensation "whenever they glimpse a bigger pot of gold at the end of the rainbow ...." [162]

In considering whether the record justified additional compensation under the 1982 Agreement, the court held that the "technical" requirements of the 1982 Agreement may not have been satisfied but that the additional $1 million fee was justified. [163] The two technical requirements were: (i) the Trustee and Shearson must negotiate the amount of any additional fee and (ii) the court must determine that Shearson was not adequately compensated by the retainer payments. [164] On the first point, the record unequivocally made clear that the Trustee and Shearson did negotiate about additional compensation, not strictly confined to the $1 million limitation in the 1982 Agreement, and that the Trustee would support an additional fee of at least $1 million. [165] On the second requirement, the circuit court rejected the district court's parsimonious approach of interpreting the special master's recommendation that Shearson be awarded $2,847,500 as not encompassing a finding that Shearson had not been adequately compensated by the retainer payments. [166] Under his findings of fact, the special master did not view the $1 million limitation of the 1982 Agreement as binding. [167] The court noted that the role of the financial advisor contributed substantially to an "immensely successful" reorganization. [168]

While this case was under the predecessor statute, it continues to be useful in analyzing similar issues under the Code as the courts struggle with determining standards of "reasonableness" for financial advisors' compensation under § 330. The case indicated that as circumstances changed, the advisor and the Trustee agreed that a standard industry retention agreement, not on an hourly basis, but a fixed retainer and a success fee would be fair and presumably produce better results for the creditors, shareholders, and the public. [169] Indeed, ***512** at the end of the bidding the best offer was improved by $187 million. [170]

The terms of the 1982 Agreement as approved by the district court governed with the caveat that the application of equitable principles could justify awarding higher fees. [171] This concept also supports decreasing fees, but such a decrease ought to require compelling evidence that the financial advisor failed to perform the services specified in a competent and diligent manner, *not* the application of irrelevant criteria absent from the contract such as hours expended, assumed hourly rates, or failure to make some extraordinary contribution to the reorganization.

In *In re Saybrook Manufacturing Co*.,[172] the court was faced with the application of a financial advisor, unfamiliar with the requirements of the Code, which rendered services without authorization by the court and sought a fee under a pre-petition contract with the debtor.[173] Although it was instrumental in finding a purchaser for the debtors' assets, the advisor's application was opposed by the debtors and certain secured bank creditors.[174] The pre-petition contract provided for a fee of eight percent of any equity investment in the debtors procured by the advisor.[175] The advisor, Fulcrum International Ltd. ("Fulcrum"), stated in its application that it spent 162 hours on the engagement and was entitled to a fee of $302,000 as eight percent of the sale price of $3,775,000.[176] The objectants noted that of the 162 hours, 51.3 hours were pre-petition, 45 hours were a bulk estimate with no supporting data and 51 hours were spent preparing its fee application.[177] Thus, only about sixty hours were spent on post-petition advisory services which would imply an hourly rate of approximately $5,000.[178] The court, on very solid grounds, could have denied Fulcrum any compensation for failure to be properly retained under § 328, failure to provide adequate data on services rendered under ***513** § 330, and failure to find an equity investor.[179] An equity investment presumably would have led to the reorganization of the debtors as an on-going business. Instead, Fulcrum found a purchaser for the debtor's assets.[180] Nevertheless, over the objections of the debtors and the bank lenders, the court awarded Fulcrum $75,000, focusing on its substantial contribution to the process.[181] Significantly, the purchaser and the other parties conceded that Fulcrum was essential in finding the purchaser and that they were aware that Fulcrum was providing such services during the pendency of the case.[182] The court, in the exercise of its equitable powers, approved Fulcrum's application for retention *nunc pro tunc* because of Fulcrum's reliance on the debtors to handle "technical matters" with the bankruptcy court.[183]

In applying the § 330 standards, the court stated that it was persuaded that investment bankers customarily do not charge on an hourly basis and accordingly do not maintain contemporaneous time records.[184] The court stated: "[w]hen documentation is inadequate, the court is not relieved of its obligation to award a reasonable fee, but has the power to make such an award without the need of further evidentiary hearings."[185] The court awarded Fulcrum a fee equal to about two percent of the sale price.[186] The court determined a "reasonable" fee by focusing on the demonstrable and quantifiable benefit to the estate by the financial advisor.[187] If the benefit had been less clear, it is assumed that the deficiencies here might well have resulted in denial of any compensation.

In re Public Service Co. of New Hampshire[188] is an extraordinary case for the detail with which the court examined the roles of two financial advisors: First Boston Corporation ("First Boston"), as advisor to the debtor; and Rothschild, Inc. ("Rothschild"), as advisor ***514** to the Equity Committee.[189] Both firms sought an "enhancement" fee for services rendered over and above the financial advisory services covered by fixed monthly retainers.[190]

Although there were objections to the monthly retainers, the court, on the basis of the extensive evidentiary record, had little difficulty in approving such payments.[191] The court described the services as:

> [A]nalyzing the company's financial condition; preparing financial forecasts; assisting valuation analysis and scenarios covering various options for internal reorganization and/or sale or liquidation alternatives; assisting in the development of a business plan ..., mergers, joint ventures or other sale or disposition of assets; analyzing and recommending an appropriate capital structure for the reorganized company ...; assisting in the negotiation and development of an internal reorganization plan; and generally organizing the data ... requested not only by management ... but also by other parties-in-interest.[192]

First Boston stated that it expended 18,070 hours from 1988 through 1990 at an implied rate of $197.58 per hour for the fee requested. [193] In response to objections, the court noted the quality and extent of the services rendered and the expertise of the First Boston professionals in utility transactions, ruling that fees requested for the financial advisory services were reasonable under § 330. [194] Although it expressed some reservation about fixed monthly retainers based on its frustration with First Boston's performance toward the end of the case, the court stated, "it was a common practice in major Chapter 11 cases" in 1989 when the case began but that "the recent trend had been to the contrary." [195] The court did not follow the "trend." Rather, it recognized that desirability of having an advisor on call and the logic of having some fixed compensation for acceptance of such an assignment. [196] Furthermore, it refused to engage in "nit-picking their ***515** services hour-by-hour as though they had been retained on an hourly basis." [197]

The analysis of why the court awarded a "success" fee to Rothschild but denied one to First Boston provides instructive insight into the complex roles financial advisors may play in the reorganization process. The prosaic factors of time expended, detailed time records, and descriptions had little relationship to determining the value of the services. [198] In short, it had more to do with skill, diligence, and, to a large degree, luck and the achievement of quantifiable benefits for the estate.

First Boston requested a "transaction fee" of $4.5 million for merger and acquisition services. [199] The debtor, after a competitive bidding process, was eventually acquired by Northeast Utilities in a transaction valued at $2.3 billion. [200] The court found that First Boston contributed little to the sale and plan process and had failed to follow the suggestions of the court that it devise an orderly process and ground rules for competitive bidding. [201] Unfortunately for First Boston, the debtor lost control of the reorganization process when "exclusivity" was terminated and competing plans for reorganization were introduced by other parties. [202] As the court stated, "no one ended up wanting to deal with the debtor with regard to the debtor's own plan." [203]

First Boston argued that the debtor's stand-alone plan served as a "stalking horse" that inspired the higher and better bids. [204] One of the key elements in determining the viability and value of any plan was the resolution of the issue of rates that could be charged consumers by this regulated utility. The resolution of this issue required negotiations with the State of New Hampshire and action by its legislature. [205] The lower the rates negotiated with the State, the lower the value of ***516** the enterprise and the return to creditors and shareholders. The Debtor's Plan was viewed as a "straw stalking horse" since no one took it seriously. [206] No agreement on rates had been reached with the State nor was there any source of funding for a substantial cash component of the plan. [207] Later, First Boston gave the debtor a proposal to fund the cash component by proposing to act as the underwriter for $1.5 billion in first mortgage bonds of Public Service. [208] The court, however, found that its offer was not a firm commitment but subject to a number of conditions such as approval by the Legislature of seven annual rate-increases of 5.5%. [209] The court found that First Boston played a passive, absent, and ineffective role in terms of the process that resulted in the final sale of the company and the adoption of a plan of reorganization. [210]

In conclusion, the court stated that the criterion for earning a transaction fee is a demonstration of value in addition to that created by the circumstance of multiple bids and plans. [211] The court was critical of First Boston's failure to exercise leadership over the plan process and negotiate with other interested parties toward a consensual plan. The court also expressed its frustration that the "consummate professionals at First Boston" could not structure the bidding process in an imaginative way to deal with the complexities of this case, stating:

> If they can't work around problems like that, I don't understand what they are doing. If that's true, I shouldn't have been paying them flat fees for the last year and a half, I should have waited until we had a rate argument and then bring these professionals in to create a bidding process. [212]

Part of the problem for First Boston was that its client, the debtor's management, was attempting to reorganize on a stand-alone basis, and until it was inevitable, the debtor was not interested in being acquired by another utility. Even if First Boston's "passive" role might have ***517** been appropriate or intelligent strategy in carrying out its client's directives, the failure of such strategy justified the conclusion that these efforts produced little added value to the estate. Thus, no "enhancement fee" was earned.

In contrast, the court awarded Rothschild the $1 million "enhancement" fee it sought for its role in the adoption of the final plan and acquisition of the debtor by Northeast Utilities. [213] Rothschild was advisor to the Equity Committee, [214] the constituency below creditors that often receives nothing in an insolvency context and has correspondingly little leverage. The U.S. Trustee objected to the fee on the ground that the work done was inherent in the normal services rendered by a financial advisor to an equity committee and presumably was fairly compensated for by the monthly retainer. [215] The court noted that the result achieved for the common and preferred shareholders was excellent, from the possibility of nothing in 1989 to $500 million for this group at the end. [216] The court praised Wilbur Ross of Rothschild as "a sharp bargainer and strategist who would and did keep his constituency 'in the action' until the end." [217] However, that alone did not justify an enhancement fee.

The $1 million fee was justified because Rothschild exercised "considerable dexterity in devising strategies to confront what was not only an unprecedented case but an unprecedented absence of direction and control by the debtor in reorganization at the crucial times when its fate was being decided." [218] Further, Rothschild devised novel securities that added $55 million in value to its constituency without cost to creditors. [219] Thus, although expressly retained for merger and acquisition services, First Boston's failure to contribute materially to the successful acquisition justified its denial of a fee while Rothschild's ingenuity and proactive role justified its additional fee. [220] In summary, these three cases support fixed monthly fees, bonuses, or contingent compensation on a showing of benefit to the debtor's estate.

518** ***b. Criteria for Disallowance

In the *Hillsborough Holdings* [221] proceedings, the debtor, the Unsecured Creditors Committee, and the Official Committee of Bondholders ("Bondholders Committee"), with the court's permission retained counsel, major accounting firms and financial advisors. The debtor retained Merrill Lynch & Co., Inc. ("Merrill Lynch") and the Bondholders Committee retained Bear Stearns & Co., Inc. ("Bear Stearns") as financial advisors, both under retention agreements providing for fixed monthly fees and additional compensation for the completion of certain other transactions. [222] Both firms submitted applications for interim compensation, which were denied in total by the court on the grounds that each failed to comply with the requirements of Rule 2016(a) to provide detailed time records describing its services, and failed to comply with the requirements of § 330 in demonstrating any tangible benefit to the reorganization process. [223]

The court stated that it found no authority to exempt financial advisors from the strictures of Rule 2016(a) but only authority to the contrary. [224] The court distinguished *Saybrook*, [225] noting that Fulcrum at least set forth the total hours spent (without detail) and demonstrated some benefit to the estate in terms of its role in the sale of assets. [226] In the court's view the absence of detailed time records made it "impossible to determine the reasonable value of the services rendered." [227]

***519** The court ignored the precedent that retentions expressly under § 328 may modify or avoid the requirements of Rule 2016(a) or that retentions governed by § 330, in recognition of the practices of the industry, need not, for example, provide

time records for each professional in tenths of an hour along with detailed descriptions of the services rendered, as might be appropriate for lawyers. While a court has the authority to impose requirements it deems appropriate, the issue is one of the fairness or usefulness of such requirements. The court stated that, "[w]hile this Rule may not please the community of investment advisors, this Court is constrained to conclude that the Bankruptcy Rules are controlling, not the general policy or custom of investment advisors which prevails in the operation of the business of investment bankers or advisors." [228]

In the first case concerning Bear Stearns' application, Bankruptcy Judge Paskay expressed a generally skeptical view of the work and billing practices of investment bankers in the bankruptcy context. [229] He echoed the view that theirs is "a strange, but wonderful place where a large amount of money is spent, generally at the expense of debtors in Chapter 11." [230] He cited *Saybrook* with approval to the effect that the estate is not "a cash cow to be milked to death by professionals seeking compensation for services rendered which have not produced a benefit commensurate with the fees sought." [231]

The services Bear Stearns describes in its application, studying and assessing the value and viability of the debtor's business, including conferring with its client and other professionals in the case, appear to be appropriate and useful activities. [232] The judge criticized the firm for reviewing a motion by the debtor to extend its exclusive right to propose a plan of reorganization. [233] Nothing is more fundamental than the matter of which party controls the plan process, yet the input from a financial advisor, not on legal issues but rather from an economic perspective, could be very important. The court stated that it did not understand the "due diligence" process that is the framework of various services described by Bear Stearns in its application. [234] It also ***520** criticized Bear Stearns for reviewing management's business plan, noting that it was unaware there was such a plan, and in response to a statement that Bear Stearns's restructuring professionals met with other Committee professionals to prepare an objection to the motion to extend exclusivity, said: "This Court is utterly at a loss to understand how Bear Stearns restructured professionals and who were the professionals who were restructured." [235] The court assumed that these services were unnecessary, often duplicative of the work of lawyers and accountants, and of no demonstrable benefit to the estate. [236] The opinion reflects a lack of understanding or appreciation of the nature of the work of investment bankers and stands in sharp contrast to the view of the court expressed in *Public Service*.

It is important to note that the Bondholders Committee and the debtor each made the judgment that these services were essential to produce a viable plan of reorganization. [237] The court also seemed to say that any investment banker's regular advisory work is to be judged by its demonstrable benefit to the estate, and thus it imposed a standard that might be more appropriate if a transaction fee or enhancement fee for hitting a "home run" were sought. [238] Under this rationale, an advisor could perform its advisory services in an excellent manner but still be penalized for not doing something extraordinary. This, of course, is not how "reasonableness" under § 330 has been applied to lawyers and accountants.

In the *Gillett Holdings* proceedings, [239] the court analyzed two interim applications for compensation by Smith Barney, Harris Upham & Co., Inc. ("Smith Barney") in excruciating detail and found them substantially deficient, although Smith Barney made a good faith attempt to meet the requirements imposed by the court. [240] Smith Barney provided a breakdown of time expended in tenths of an hour with descriptions of services rendered by each professional. [241] The court initially rejected the terms proposed by the debtor to retain Smith Barney for a $150,000 per month retainer and a potential success fee ***521** of $3 million, without the need to maintain detailed time records. [242] The court expressly rejected the argument that industry norms should apply in bankruptcy. [243] The court order authorizing Smith Barney's retention was conditioned on being held to "the same basic practices and standards of other professionals." [244] In the court's view, this meant that Smith Barney would be subject to a lodestar test of reasonable hours multiplied by a reasonable hourly rate and compliance with the fee application

detail required of lawyers and accountants. [245] The court was also influenced by the fact that the debtor had paid Smith Barney substantial fees for prepetition "workout" services. [246]

Smith Barney and the court subsequently disagreed about the intent of the retention order. [247] Smith Barney interpreted it to mean that it could receive fixed monthly fees subject to time recording and subsequent review for "reasonableness" under § 330. [248] The court stated that in this case a fixed monthly fee had not been justified. [249] Smith Barney argued that a fixed monthly fee, the industry norm, was sanctioned by § 328(a) and approved by the court and that it was "an ex post facto revision" to deny the monthly retainer. [250] The court, in connection with the second Smith Barney application, stated that it is not a § 328(a) application unless the order "expressly and unambiguously states specific terms and conditions (e.g., specific ***522** hourly rates or contingency fee arrangements) that are being approved pursuant to the first sentence of § 328(a)." [251] Otherwise stated, the application was a retention under § 327 with compensation to be determined after performance under § 330. [252] Although the court cleared up the ambiguity by its subsequent opinion, the analysis is questionable, treating an explicit $150,000 per month retainer as insufficient to fall within the ambit of a "retainer" as mentioned in § 328(a). The decision does serve as a warning to make retention under § 328(a) not just implicit, but unambiguous.

Having concluded that § 330 and Rule 2016(a) applied, the court (citing cases wherein the professionals typically billed on an hourly basis) held that the framework for determining bankruptcy fees in the Tenth Circuit was the lodestar method with the twelve factors of *Johnson v. Georgia Highway Express, Inc*. [253] The court further indicated that this principle was affirmed by the U.S. Supreme Court in *Blanchard v. Bergeron*. [254] The court noted that the lodestar method is the beginning, not the end of the analysis. [255] Billable hours are not necessarily compensable hours and an assessment of "reasonableness" must include the matter of benefit to the estate. [256]

Under the foregoing criteria, the court reviewed Smith Barney's submissions and found much fault: [257] there were no hourly rates of each professional; there was little useful information about experience or professional qualifications; the implied average hourly rate of $562 was "ridiculous" in comparison to a rate of $250 for counsel; time entries were cryptic, inadequate or incomplete; data on the twelve *Johnson* factors were missing; and there was apparent duplication of effort, little justification for inter-office conferences, multiple personnel attending meetings or reviewing the same documents, and the performance of ministerial tasks or tasks outside the scope of employment. [258] Some eighteen percent of the time was spent in travel and ***523** some forty-three percent was not spent on producing written analyses, but in conference calls and meetings. [259] The burden is on the applicant to prove the value of its services, and the fee application should demonstrate that the services rendered were reasonable. [260]

The court asked how the monthly retainer fit in with the potential success fee of $3 million and presumed correctly that the retainer fee was intended to cover customary and routine financial advisory services even if there were no successful reorganization. [261] The implication is that the value of the "routine" services must stand on its own and not be viewed as justified by the ultimate success of the reorganization for which an additional $3 million might be paid. [262] This rationale subjects the monthly retainer to a difficult standard to meet in terms of concrete benefit.

In a case in which the banker made a conscientious attempt to establish record-keeping practices, the court found them deficient, except that it permitted the court to imply an average hourly rate. [263] The court, ignoring legislative history, assumed that a fair rate for counsel is appropriate for all professionals. On the basis of its factual findings and view of the law, the court drastically reduced the amount of compensation awarded to Smith Barney to $298,343.75 [264] against a request of $800,000. [265] The case

illustrates the perils to any investment banker of having to justify the compensation that would be earned under a fixed retainer under the lodestar method. Nothing is certain and the banker is forced to attempt to adapt his industry practices to those of the legal profession.

In *In re Burlington Motors Holdings, Inc*.,[266] the district court vacated the decision of the bankruptcy court on the fee application of Chanin and Company ("Chanin"), financial advisor to the Unsecured Creditors' Committee.[267] The court held that § 330(a) contemplates a right to a hearing by a fee applicant and that under the ***524** procedure followed by the bankruptcy judge, Chanin was not given an opportunity to defend its fee request.[268] Bankruptcy Judge Bailick, on her own motion and after reviewing the report of the fee auditor recommending approval of the amount requested, reduced the amount substantially.[269] Although the bankruptcy court held a hearing on the fee application and asked certain questions which Chanin answered, the district court held that the lower court's failure to alert Chanin that it might reduce its fees was conceivably a violation of "due process" and Chanin should have been given the opportunity to respond to the concerns voiced by the court in its opinion.[270] While it is undisputed that a court may on its own motion review and reduce fees,[271] the Third Circuit requires that there be a real opportunity for the applicant to respond to the objections that might lead to a reduction in fees.[272]

In re Busy Beaver Building Centers[273] suggests that an applicant whose fees are reduced may have the right to a further hearing if it demonstrates it lacked the opportunity to respond to issues or objections not raised at an initial hearing.[274] This practice may be appropriate in the context of a sua sponte action by the court[275] as to which there was no foundation at the original hearing, but if applied broadly, would require courts to alert applicants to possible deficiencies and other material concerns that could result in fee reductions. An alternative view is that the applicant has the burden of persuading the court as to the merits of its fee application, responding to objections from other parties, if any, and that the applicant is entitled to reconsideration only in unusual circumstances amounting nearly to a lack of due process.

The bankruptcy court in *In re Burlington Motor Holdings, Inc*.,[276] had set forth several factors justifying its decision to reduce Chanin's fees from the requested amount of $630,000 to $515,000.[277] Chanin ***525** was engaged at a rate of $60,000 a month and it sought $630,000.[278] Alex Brown & Sons, Inc. ("Alex Brown"), as advisor to the debtor, billed at a rate of $75,000 per month but voluntarily reduced its fee to $50,000 for months when activity was slow.[279] A fee auditor reviewed all applications, requesting supplemental information in certain cases, and issued a report essentially recommending approval of the applications as filed or with insignificant reductions.[280] The court reduced Alex Brown's and Chanin's fees—Alex Brown from $838,709 to $800,000 and Chanin's from $630,000 to $515,000.[281] The court did not feel bound by the fixed monthly retainers. If Chanin had reduced its fees during the same period as did Alex Brown, a period when it appeared that a purchase of the debtor's assets and confirmation of a plan was likely, Chanin's fees would have been $570,000.[282] The court stated that it is not sufficient for Chanin to state that a $60,000 monthly fee is the rate it has charged other clients for the services rendered in this case but that it must demonstrate that the work done in this case merits $60,000 a month.[283]

The fee auditor's lodestar analysis indicated Chanin's implied hourly rates for various personnel would have produced an aggregate of $76,000 less than the fixed monthly retainer or $554,000.[284] The court held that this was an appropriate adjustment to a monthly retainer.[285] Furthermore, the court stated that though both Alex Brown and Chanin claimed credit for the successful reorganization, and though there was no "corroboration from a disinterested third party," this dispute supported some reduction in each firm's fees.[286] The court also noted that there were "persuasive problems" with both Chanin's and Alex Brown's application in terms of compliance with the Local Rules of the Delaware Bankruptcy Court.[287]

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The bankruptcy court seems well within its prerogatives to have reduced the fees as it did, once it determined that these fixed monthly ***526** retainers were subject to a lodestar analysis under § 330. The fact that the reductions were not very onerous suggests a flexibility on the part of the court arising from its understanding of the role of these advisors in the successful reorganization of the debtor.

For the most part it appears that courts have not rewritten the provisions of retainer agreements providing for contingent or success fees, though theoretically they could do so under § 330 standards and subject the fees to a lodestar analysis.[288] Compensation could be denied for failure to document time expended or because the amount sought was disproportionate to the lodestar amount.[289] Instinctively and correctly, the courts probably judged that being paid a percentage for arranging a successful transaction was fair, reasonable, consistent with the industry norms, and most importantly, produced a demonstrable benefit to the estate.

A court may be on solid ground in holding § 330 applicable when the § 328(a) retention was made conditional; however, applying such tests always involves an awkward, possibly unjust or illogical standard. The work of a financial advisor ebbs and flows as required by the dictates of the client and the reorganization process. Furthermore, the use of hourly rates and billings on the basis of time expended, in this context, does not necessarily demonstrate much about the value of an advisor's contribution to the reorganization process.

Many courts felt that they could only do their job of reviewing and determining the "reasonable" value of services by looking at hours expended against an hourly rate and further making some subjective judgment of "benefit to the estate." If five members of a firm worked a total of 100 hours during a month and were paid $250,000, a court may be "shocked" that the firm was being paid $2,500 an hour, rates drastically greater than the highest fees for partners in major law firms. ***527** Equally, a court or U.S. trustee or fee auditor, with no real experience or understanding of the value of services, might conclude that their advice and studies produced little benefit or duplicated services that could be performed by a debtor's management, accountants or bankruptcy lawyers. Hostility and skepticism were manifest in opinions making pejorative comments about greed and excessive, unjustified compensation. Nevertheless, the parties in interest have persisted in their desire to have financial advisors participate.

C. Current Developments

Though somewhat grudgingly, the reorganization process has moved toward accommodation.[290] In the best tradition of the U.S. judicial system, through experience and trial and error, the standards for evaluating compensation for bankers in an increasing number of jurisdictions, such as the Southern District of New York, have evolved into a process that appears to be fairer to the bankers while also meeting the concerns of the court in fulfillment of its statutory duty to monitor compensation. In *Enron*, The Blackstone Group ("Blackstone") was retained under an agreement which lists thirteen categories of financial advisory services for which it was to be paid a fixed monthly fee and certain contingent transaction fees.[291] The monthly retainer was subject to a downward adjustment for reduced activity, not based upon individual hours but upon an aggregate of hours worked by all professionals over a two-month period.[292] Blackstone agreed to provide monthly statements to the court with a summary of hours worked.[293] Although Blackstone sought approval for its financial advisory services under § 328, the court's order stated that all fees were subject to review under § 330 but that certain transaction fees could only be challenged under § 328 standards.[294] ***528** The order also allowed the U.S. Trustee, the debtors, and the Unsecured Creditors' Committee to object to *all* fees on any ground, including the reasonableness standard of § 330.[295] After extensive negotiations among the parties, the court crafted orders establishing procedures for compensation for all professionals. The reporting requirements for Blackstone were not equivalent to those for attorneys and accountants and did not appear to have been onerous for Blackstone

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to meet. Blackstone stated that it did not maintain detailed time records or have hourly rates for its professionals and, pursuant to the retention order, it was not required to do so since it was being retained on a fixed monthly basis.[296] Blackstone did maintain a summary of aggregate hours.[297] Its monthly statements filed with the court simply included a single sentence to the effect that it had expended a certain number of hours.[298] Blackstone described in general terms the categories of services rendered.[299] The court clearly has relaxed the reporting requirements and not based compensation on an hourly basis.

This amalgam of § 328(a) with § 330 is interesting as a compromise imposed by the court, and it appears to meet some of the problems noted in earlier cases. Yet, virtually all of the court's requirements, except for the limited right of review under § 330, could have been incorporated in a § 328(a) retention order. In a situation in which the advisor is paid substantially the amount that a fixed monthly fee would produce, there may not be much controversy in such hybrid arrangements. However, not all firms will be willing to accept such engagements and the uncertainties involved. Eventually the market accommodates such risks by increasing prices and an unintended result may be that the advisor's services under § 330 will be more costly than a retention under § 328.

The reluctance to permit a monthly fixed fee to be final and not subject to further review may, in part, result from the bias expressed ***529** by certain courts that financial advisors are unjustly enriched at the expense of the debtor and are overcompensated.[300] It is therefore instructive to consider the economics and profitability of an investment banking firm. In 2002 Merrill Lynch had approximately 51,000 employees, revenues of approximately $28.2 billion and net earnings of approximately $2.5 billion or a return on equity of approximately 11.7%.[301] In 2002 Goldman Sachs had net revenues of approximately $14 billion and net earnings of approximately $2.1 billion or an 11.3% return on equity.[302] Both firms were no more profitable than many other businesses. Compensation for Merrill's 51,000 employees was approximately $9.4 billion.[303] While averages can be misleading and there are instances, as in other businesses, of certain senior personnel being highly compensated, it is erroneous to extrapolate that a basic monthly retainer produces extraordinary or unreasonable compensation to an investment banking firm.

V. Conclusions

While it is understandable that bankruptcy courts and U.S. Trustees would gravitate towards evaluating applications for compensation by investment banking firms under standards prevailing for lawyers and accountants, this approach is both unfair and unnecessary. It is fundamentally consistent with the intent of the Bankruptcy Code that professionals be compensated for bankruptcy work at an equivalent level to what they are paid for such work by the market. Having been retained under an engagement agreement approved by the bankruptcy court as reasonable, the financial advisor should have assurance that the terms of the contract will be honored by the court and not substantially vitiated in the context of a subsequent review by a court under artificial and often irrelevant standards.

A salient point missed by many courts is that a great deal of the work of an investment banking firm in a reorganization is done on ***530** a contingent basis. The “home run” compensation is the percentage fee earned, for example, for a successful public offering or a merger or acquisition, not the standard monthly advisory fees. Courts need not fall into the “frolic and detour” of trying to assess, after the fact, the value of the services rendered for a monthly advisory fee. Once a court, after an evidentiary hearing, determines that the financial advisor has the requisite experience and qualifications needed to render the services proposed in a particular case and that, for example, a monthly fee for a Merrill Lynch or Goldman Sachs of $200,000 is reasonable and consistent with industry standards for such services, and that this determination is consistent with the Bankruptcy Code, it should then be final. The profitability of an investment banking firm is highly dependent upon a successful deal flow. The firm retained in bankruptcy may expend enormous resources, do an excellent job, and yet never earn the potentially multi-

million dollar transaction fee. Thus, it seems reasonable for a court to provide some assurance of compensation in terms of a fixed monthly fee.

Section 328, as many courts now acknowledge, permits a monthly retainer that is not based on hourly rates and not subject to revision or nullification unless the agreement was improvident for circumstances unforeseeable at the time it was approved. This test gives the banker substantial assurance that the monthly fee will be paid since the exception requires some extraordinarily unpredictable occurrence.

Even if § 330 standards are to be imposed, creative judges can impose reasonable reporting requirements that are not onerous and give the court adequate information with which to determine that the advisory services bargained for are being performed. It is also possible for the courts to interpret the "reasonableness" standard in a fashion more consistent with an understanding of how the investment banking firm operates and the value it contributes. Section 328(a) retention agreements may also contain various agreed mechanisms for the reduction of the monthly fee. While a court may make every retention subject to the "reasonableness" standards of § 330 and utilize the lodestar approach, this practice ultimately may be counter-productive by causing qualified professionals to leave the field.

There is a natural reluctance by courts and other parties in interest to limit their ability to review and object to a professional's compensation in bankruptcy. Unfortunately, the professional most often vulnerable to such objections appears to be the investment banker and, in particular, its monthly advisory fee. The "plain meaning" of § 328(a) is that a banker may be employed on a fixed monthly retainer. The ***531** legislative intent is equally unambiguous that the compensation provisions of the 1978 Code were intended to be a radical departure from the Bankruptcy Act in mandating that professionals be compensated, not at discounted, but at market rates. Logically implicit in this concept is that terms of employment be consistent with industry norms. Where plain language and policy converge, the courts should acknowledge the appropriateness of industry norms. [304] The resistance of some courts to this concept stems from the age-old conflict between a court's view of its legitimate role and discretion in interpreting and reconciling statutes and appropriate deference to legislative authority. Concerns of fairness and due process dictate that bankers should be judged by industry standards.

The best judge of efficacy of the banker's performance on a monthly advisory basis is the client, be it a debtor or a committee. If the debtor or a committee judges the commitment to have an advisory firm's resources at its disposal not to be worth the cost, the client always has the right to terminate the engagement subject to the terms of the agreement just as in the non-bankruptcy context and presumably has every incentive and, indeed, the fiduciary duty to do so. The court and other parties in interest have an interest in fees being paid to an investment banker, but once the banker is retained, absent truly extraordinary circumstances, the contract approved by the court should be honored if the banker fulfills its own obligations under it. The notion that creditors, the debtor or the court are free to modify the contract, absent compelling reasons, is not only unjust but adversely affects the reorganization process in general. The Code recognizes that not all professionals must be compensated as if they were part of an immutable, platonic class of "professionals" but, in fact, permits distinctions to be made consistent with commercial reality.

The Code and its legislative history authoritatively establish that financial advisors should be paid according to those compensation arrangements prevalent within the industry and that manifestly includes fee arrangements not based on time expended and hourly rates. In complex, large-scale bankruptcies, the expertise of financial advisors is often crucial to a successful reorganization. Therefore, adhering to a fair system fully consistent with the Code is vital to ensuring that the most competent financial advisors have reasonable incentives to be involved with corporate reorganizations. Courts should cease trying to fit the proverbial "square peg" into a round hole and focus on the banker's contribution toward a successful reorganization.

Footnotes

a1 Partner and Chairman of the Corporate Reorganization Group, Hughes Hubbard & Reed LLP, New York, New York. Yale Law School, LL.B. The author currently serves as Trustee for the liquidations of A.R. Baron & Co., Inc., and New Times Securities, Inc., under the Securities Investor Protection Act of 1970.
The author expresses his appreciation to Peter Moyers, an associate with Hughes Hubbard & Reed LLP, New York, New York, for his assistance in the research for this article.

1 *See, e.g.*, Application of the Debtors Pursuant to Sections 327(a) and 328(a) of the Bankruptcy Code for Authorization to Employ the Blackstone Group, L.P. as Financial Advisors at 9, *In re* Enron Corp., 302 B.R. 455 (Bankr. S.D.N.Y. 2003) (No. 01-16034) (on file with author); Final Order Pursuant to 11 U.S.C. §§ 327(a) and 328(a) Authorizing the Employment and Retention of the Blackstone Group L.P. as Financial Advisor for the Debtors and Debtors-in-Possession at 2-3, *In re Enron* (No. 01-16034) (on file with author); Fourth Interim Application of the Blackstone Group L.P. as Financial Advisor to Enron Corp. and Its Affiliates for an Allowance of Interim Compensation for Services Rendered and Reimbursement of All Actual and Necessary Out-of-Pocket Expenses Incurred in Rendering Such Services for the Period January 1, 2003, Through April 30, 2003, at 7-10, *In re Enron* (No. 01-16034) (on file with author).

2 For example, if the banker arranged a successful merger or public offering of securities, it was paid an agreed-upon fee that bore no relation to hourly rates for time expended; if hired for financial advisory services, it was paid a fixed fee or a monthly retainer.

3 Final Order Pursuant to 11 U.S.C. §§ 327(a) and 328(a) Authorizing the Employment and Retention of the Blackstone Group L.P. as Financial Advisor for the Debtors and Debtors-in-Possession at 2-3, *In re Enron* (No. 01-16034) (on file with author).

4 11 U.S.C. §§ 327, 328, 330 (2000). Section 331 permits the allowance of interim compensation to professionals during the pendency of a case. An official committee appointed by the court under § 1102 may under § 1103 employ professionals subject to the provisions of § 328(a).

5 *Id.* § 101(14). Section 101(14) provides that
"disinterested person" means person that—
(A) is not a creditor, an equity security holder, or an insider;
(B) is not and was not an investment banker for any outstanding security of the debtor;
(C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or any attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;
(D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and
(E) 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 an investment banker specified in subparagraph (B) or (C) of this paragraph for any other reason[.]

6 11 U.S.C. § 328(a).

7 *Id.* § 330(a)(3)(A). The Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994), amended § 330(a) to enumerate certain specific factors to be considered among all relevant factors. *See In re* Intelogic Trace, Inc., 188 B.R. 557, 560 (Bankr. W.D. Tex. 1995).

8 *Id.* § 330(a)(4)(A).

9 FED. R. BANKR. P. 2014, 2016 (2002).

10 Rule 1001 provides that the "[Bankruptcy Rules] shall be construed to secure the just, speedy and inexpensive determination of every case and proceeding." FED. R. BANKR. P. 1001.

11 FED. R. BANKR. P. 2016.

12 An Advisory Committee Note to the 1991 amendment of subdivision (a) of Rule 2016 providing for submission of a copy of an application to the U.S. Trustee states that the subsection was amended to permit the U.S. Trustee to monitor applications under § 330. FED. R. BANKR. P. 2016 Advisory Committee Note (1991). Does this imply that the U.S. Trustee should have no such role for § 328(a) applications after the retention is approved?

13 Such rules are subject to judicial review and may be rejected. *See In re* Kindhart, 160 F.3d 1176, 1179 (7th Cir. 1998).

14 FED. R. BANKR. P. 2016.

15 11 U.S.C. § 328(a) (2000).

16 *Id*. § 330(a)(3)(A).

17 *See id*. § 330(a)(1), (a)(4)(A).

18 405 F.2d 429 (5th Cir. 1968).

19 *See id*. at 432.

20 H.R. REP. NO. 95-595, at 329-30 (1977).

21 ROBERT G. ECCLES & DWIGHT B. CRANE, DOING DEALS: INVESTMENT BANKS AT WORK 35-47 (Harvard Univ. Press 1988) (discussing investment banks' crucial role in connecting issuers, broadly defined, with investors); *see also* SAMUEL L. HAYES III & PHILIP M. HUBBARD, INVESTMENT BANKING: A TALE OF THREE CITIES (Harvard Business School Press 1990) (tracing the historical roots of investment banking in the U.S., Japan, and the UK to modern day prominence in the financial world).

22 Omnibus Budget Reconciliation Act of 1986 § 4011, Pub. L. No. 99-509, 100 Stat. 1874 (1986).

23 The author represented Goldman Sachs & Co. as financial advisor to the United States and subsequently the Underwriting Syndicate in the Conrail public offering in 1987.

24 *In re* Hillsborough Holdings Corp., 125 B.R. 837 (Bankr. M.D. Fla. 1991) [hereinafter *Hillsborough I]; In re* Hillsborough Holdings Corp., 142 B.R. 1006 (Bankr. M.D. Fla. 1992) [hereinafter *Hillsborough II*].

25 *In re* Special Metals Corp., No. 02-10335, slip op. (Bankr. E.D. Ky. Mar. 27, 2002), *available at* http://www.kyeb.uscourts.gov/opin/howopin/specialmetals02-10335execcon.opi.htm; *Special Metals Gets New Advisor*, METALS WEEK, July 15, 2002, *available at* 2002 WL 13601897.

26 11 U.S.C. § 330 (2000).

27 ECCLES & CRANE, *supra* note 21, at 40.

28 The financial advisor cannot hold or represent an interest adverse to the debtor and must be "disinterested" within the meaning of § 101(14) of the Bankruptcy Code, modified by § 1107(b). 11 U.S.C. §§ 101(14), 1107(b). Previously acting as an underwriter of securities would be disqualifying.

29 *See In re* AroChem Corp., 176 F.3d 610, 629 (2d Cir. 1999); *In re* Interwest Bus. Equip., Inc., 23 F.3d 311, 318 (10th Cir. 1994); United States Tr. v. Price Waterhouse, 19 F.3d 138, 141-42 (3d Cir. 1994); *In re* CF Holding Corp., 164 B.R. 799, 804-07 (Bankr. D. Conn. 1994).

30 *See In re* Drexel Burnham Lambert Group, Inc., 133 B.R. 13, 26, 32 (Bankr. S.D.N.Y. 1991). The former underscores the significance of the agreed-upon terms between the estate and hired professionals; the latter highlights the court's capacity to ensure that the fees paid to professionals are a reasonable reflection of the work done for the estate.

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31 133 B.R. 13, 22 (Bankr. S.D.N.Y. 1991).

32 488 F.2d 714 (5th Cir. 1974).

33 *Id*. at 716-19.

34 *E.g*., Final Order Pursuant to 11 U.S.C. §§ 327(a) and 328(a) Authorizing the Employment and Retention of the Blackstone Group L.P. as Financial Advisor for the Debtors and Debtors-in-Possession at 2-3, *In re* Enron, 302 B.R. 455 (Bankr. S.D.N.Y. 2003) (No. 01-16034) (on file with author).

35 *See In re* Circle K Corp., 279 F.3d 669, 674 (9th Cir. 2001), *cert. denied*, 536 U.S. 959 (2002); *In re* Barron, 225 F.3d 583 (5th Cir. 2000); *In re* Nat'l Gypsum Co., 123 F.3d 861, 862-63 (5th Cir. 1997).

36 *In re Circle K Corp*., 279 F.3d at 674; *In re Barron*, 225 F.3d at 586.

37 *See In re Barron*, 225 F.3d at 586.

38 *See id*.

39 288 B.R. 464 (B.A.P. 6th Cir. 2003).

40 *Id*. at 470.

41 *Id*.

42 *Id*. at 471.

43 *See id*. at 470.

44 *Id*. at 471.

45 *Id*.

46 *See id*.

47 123 F.3d 861 (5th Cir. 1997).

48 *Id*. at 862.

49 *Id*.

50 *Id*.

51 *Id*.

52 *Id*. at 863.

53 *Id*. at 862.

54 *Id*.

55 *Id*. at 862.

56 972 F.2d 1127, 1129 (9th Cir. 1992).

57 145 B.R. 651 (Bankr. C.D. Cal. 1992).

58 *In re Nat'l Gypsum Co*., 123 F.3d at 863 n.2.

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59 279 F.3d 669 (9th Cir. 2001).

60 *Id*. at 671 n.2. In *In re B.U.M. International, Inc*., 229 F.3d 824 (9th Cir. 2000), Friedman Enterprises was retained as an advisor to the debtor at a monthly fee of $7,500 and certain contingent fees. *Id*. at 825. A subsequent objection from the Official Creditors' Committee and the U.S. Trustee resulted in the retention order being modified, although the court thought it was unnecessary, to provide that any employment would be subject to further review as reasonable and beneficial to the estate, and subject to disgorgement if not. *Id*. at 826. The court ultimately approved the monthly fee portion of the application but denied the contingent fees. *Id*. at 827. On appeal, the district court affirmed the bankruptcy court. *Id*. On further appeal, the circuit court held that there can be no after-the-event inquiry into the compensation arrangements if the firm had been retained under § 328 but that the reservation language here gave the bankruptcy court the right to conduct a § 330 "reasonableness" review. *Id*. at 829-30.

61 *In re Circle K Corp*., 279 F.3d at 671, 673-74.

62 *Id*. at 673.

63 *See id*. at 671.

64 *See id*. at 673.

65 165 B.R. 653 (Bankr. D. Ariz. 1994).

66 *Id*. at 655.

67 *Id*.

68 *Id*. at 656 (citing Pitrat v. Reimers (*In re* Reimers), 972 F.2d 1127, 1128-29 (9th Cir. 1992)).

69 *Id*. at 656.

70 *Id*. at 656-57.

71 *Id*. at 657. Salomon was also retained under a separate agreement to do certain divestiture work for a monthly fee to be supported by time records submitted to the U.S. Trustee. *Id*. at 655. The court held that because detailed time records were required and not provided, the application had to be supplemented. *Id*.

72 *Id*. at 657.

73 *Id*. at 656.

74 *See id*. at 656-57.

75 191 B.R. 426 (Bankr. D. Ariz. 1996).

76 *Id*. at 429.

77 *Id*. at 433; *see also In re* ACT Mfg., Inc., 281 B.R. 468, 473 n.5 (Bankr. D. Mass. 2002) (suggesting that it is appropriate to relax strict time-reporting requirements for financial advisors since this is not a standard industry practice).

78 *In re Circle K Corp*., 191 B.R. at 428.

79 *In re* Circle K Corp., 294 B.R. 111, 125-26 (Bankr. D. Ariz. 2003).

80 *Id*. at 120-23.

81 296 B.R. 188 (B.A.P. 8th Cir. 2003).

82 *Id*. at 190.

83 *Id*. at 192-93. The issue on appeal was the appropriateness of allowing the one percent transaction fee to be paid directly from the proceeds of the recoveries obtained by the creditors' committee, as opposed to the debtor's general estate, and the court held that such an arrangement was acceptable if there were an agreement to this effect. *Id*. at 190.

84 *Id*. at 193.

85 348 F.3d 390 (3d Cir. 2003).

86 *Id*. at 393.

87 *Id*. at 398. Interestingly, the financial advisor was to be paid on an hourly basis subject to the monthly cap. *Id*. at 399. The court relied on *Zolfo, Cooper & Co. v. Sunbeam-Oster Co*., 50 F.3d 253, 261 (3d Cir. 1995), for the proposition that a court is not compelled either to approve or reject an application for retention on the terms proposed but is free to modify such terms. *In re Fed. Mogul-Global, Inc*., 348 F.3d at 398. The applicant, of course, can accept or reject any such modifications.

88 *In re Fed. Mogul-Global, Inc*., 348 F.3d at 399.

89 *See id*.

90 *Id*. at 403.

91 *Id*. at 400-03.

92 *Id*. at 407.

93 *Id*.

94 *Id*.

95 50 F.3d 253, 263 n.10 (3d Cir. 1995).

96 *Id*. at 257.

97 In *In re Commercial Financial Services, Inc*., 298 B.R. 733 (B.A.P. 10th Cir. 2003), the Tenth Circuit Bankruptcy Appellate Panel upheld the bankruptcy court's order awarding Houlihan, Lokey $904,000 in compensation of the $1,920,967 sought. The court held that the fact that a monthly retainer is prevalent in the marketplace, while relevant, does not dictate how a court determines reasonableness under § 330. *Id*. at 750. “[A] typical method of compensation in any given market does not make the amount sought [necessarily] reasonable.” *Id.; see also In re* Thermadyne Holdings Corp., 283 B.R. 749, 757 (B.A.P. 8th Cir. 2002).

98 *See In re* Saybrook Mfg. Co., 108 B.R. 366, 371 (Bankr. M.D. Ga. 1989); *Hillsborough I, supra* note 24, at 840 (“[I]n the absence of a time record, it is almost impossible to determine the reasonable value of the services rendered.”); *In re* ACT Mfg. Inc., 281 B.R. 468, 483 (Bankr. D. Mass. 2002) (“Professionals who lump time together or have woefully inadequate descriptions, such as ‘research,’ ‘work on motion,’ ... do so at their peril.”).

99 “Lodestar” is the amount calculated by multiplying the number of hours reasonably expended by a reasonable hourly rate. In *In re UDC Homes*, 203 B.R. 218 (Bankr. D. Del. 1996), Houlihan, Lokey was retained as financial advisor to the Preferred Stockholders for $75,000 per month. *Id*. at 220. The court analyzed the services performed, and applied an hourly rate analysis based on information supplied by Houlihan, Lokey, who conceded that it sometimes billed on an hourly basis. *Id*. at 224. The rate would have been as much a $3,300 per hour during one month when activity was minimal. *Id*. at 223. The fee auditor and the court found the application deficient in terms of comparative data for similar charges outside bankruptcy. Houlihan, Lokey's fees were reduced from $332,499 to $230,000, illustrating the effect of the lodestar calculation on “fixed” retainers. *Id*. at 223.

100 *In re* Drexel Burnham Lambert Group, Inc., 133 B.R. 13 (Bankr. S.D.N.Y. 1991).

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101 *Id*. at 15-19.

102 *Id*. at 23.

103 *Id*. at 22 (citation omitted).

104 *Id*. at 15-16.

105 *See generally id*.

106 *Id*. at 34.

107 *Id*.

108 *Id*.

109 *Id*. at 38. Since most of the cases cited did not generate litigation over these arrangements, it is assumed that compensation consistent with the retention orders was approved by the respective bankruptcy courts.

110 *Id*. at 26.

111 *Id*. at 27. After a distinguished career, Judge Francis G. Conrad retired from the bench and subsequently joined PricewaterhouseCoopers LLP as a financial director. He is currently a principal with Business Strategy Advisors.

112 *Id*. at 24.

113 28 C.F.R. pt. 58 App. A. at 26 n.11 (2002). The Guidelines require maintaining detailed time records contemporaneously in tenths of an hour and apply to applications for compensation under §§ 327, 328, 330, and 331, unless the court's retention order provides otherwise. The Guidelines do permit an applicant to offer an explanation of why certain provisions should not be applicable. *See generally id*. pt. 58 App. A.

114 *In re* Drexel Burnham Lambert Group, Inc., 133 B.R. 13 (Bankr. S.D.N.Y. 1991).

115 *Id*. at 29.

116 *Id*.

117 Unlike a financial advisor who is retained on a fixed monthly retainer, attorneys are retained under § 328(a) but typically under terms based predominantly on hourly rates and requiring the submission of fee applications to be judged under § 330(a).

118 208 B.R. 885 (Bankr. N.D. Ohio 1997).

119 *Id*.

120 *Id*. at 888.

121 *Id*. at 891 (quoting *In re* Mansfield Tire & Rubber Co., 65 B.R. 446, 455 (Bankr. N.D. Ohio 1986)).

122 *Id*. (citing *In re* Brody, 950 F.2d 334 (6th Cir. 1991)).

123 *Id*.

124 *Id*. at 892.

125 *Id*. at 891-92.

126 *Id*. at 891.

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127 960 F.2d 728 (8th Cir. 1992).

128 *Id*. at 732.

129 *Id*. at 732-33.

130 *Id*. at 731-32.

131 *Id*. at 732 (citation omitted).

132 213 B.R. 729 (B.A.P. 8th Cir. 1997).

133 *Id*. at 736.

134 *See In re* Busy Beaver Bldg. Ctrs., 19 F.3d 833 (3d Cir. 1994) (recognizing that while lawyers are paid on an hourly basis, other professionals are not); *In re Apex Oil*, 960 F.2d at 730 (same).

135 841 F.2d 789 (7th Cir. 1988).

136 *Id*. at 795.

137 *Id*. at 798-99.

138 *Id*. at 799.

139 *Id*. at 791.

140 *Id*.

141 *Id*. at 791 n.1.

142 *Id*. at 791.

143 *Id*.

144 *Id*. at 792 n.2.

145 *Id*.

146 *Id*. at 792.

147 *Id*.

148 *Id*. (quoting *In re* Chi., Milwaukee, St. Paul and Pac. R.R. Co., No. 77 B 8999, slip op. (N.D. Ill. Jan. 10, 1983)).

149 *Id*.

150 *Id*.

151 *Id*. at 793.

152 *Id*. at 793 n.5.

153 *Id*. at 794.

154 *Id*.

155 *Id*.

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156 *Id.*

157 *Id.* at 794-95.

158 *Id.*

159 *Id.* at 795 (quoting *In re* Chi., Milwaukee, St. Paul and Pac. R.R. Co., No. 77 B 8999, slip op. at 20 (N.D. Ill. Jan. 10, 1983)).

160 *Id.*

161 *Id.*

162 *Id.*

163 *Id.* at 796.

164 *Id.*

165 *Id.* at 796 n.7.

166 *Id.* at 797 n.8.

167 *Id.*

168 *Id.*

169 *See generally id.*

170 The first offer was no cash and the assumption of $400 million in liabilities. *Id.* at 791. The final offer was $192 million in cash and the assumption of $395 million in liabilities. *Id.* at 793.

171 *Id.* at 797-98.

172 108 B.R. 366 (Bankr. M.D. Ga. 1989).

173 *Id.* at 367.

174 *Id.* at 367-68.

175 *Id.* at 367.

176 *Id.* at 370-71.

177 *Id.* at 368.

178 *Id.*

179 *Id.* at 370 nn.5-6.

180 *Id.* at 367.

181 *Id.* at 371.

182 *Id.* at 367.

183 *Id.* at 369.

184 *Id.* at 370.

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185 *Id*. at 371 (quoting Norman v. Hous. Auth. of Montgomery, 836 F.2d 1292, 1303 (11th Cir. 1988)).

186 *Id*. at 371.

187 *Id*.

188 160 B.R. 404 (Bankr. D.N.H. 1993).

189 *See generally id*. Salomon Brothers served as advisor to the Unsecured Creditors Committee and was paid fees comparable to the fees paid First Boston and Rothschild, but did not seek a "success" fee as did First Boston and Rothschild. *Id*.

190 *Id*. at 407-08.

191 *Id*. at 428-29.

192 *Id*. at 429.

193 *Id*. at 428.

194 *Id*. at 429.

195 *Id*.

196 *Id*.

197 *Id*.

198 *See generally id*.

199 *Id*. at 430.

200 *Id*. at 433.

201 *Id*. at 430-34.

202 *Id*. at 430; *see* 11 U.S.C. § 1121 (2000) (providing that the debtor has an exclusive right to propose a plan of reorganization for 120 days, unless extended by the court).

203 *In re Pub. Serv. Co. of N.H.*, 160 B.R. at 430.

204 *Id*. at 433.

205 *Id*. at 430.

206 *Id*. at 433.

207 *Id*. at 433-35.

208 *Id*. at 436.

209 *Id*. In contrast, Morgan Stanley & Co., Inc., the investment banker for the successful acquirer, Northeast Utilities, gave its client a firm commitment on financing on what is termed in the industry as "a highly confident" basis. *Id*. at 436 n.46.

210 *Id*. at 436.

211 *Id*. at 431.

212 *Id*. at 432.

213 *Id*. at 438.

214 *Id*.

215 *Id*.

216 *Id*. at 444-45.

217 *Id*. at 439.

218 *Id*. at 444-45.

219 *Id*. at 445.

220 *Id*. at 437, 445.

221 *Hillsborough I, supra* note 24, at 837; *Hillsborough II, supra* note 24, at 1006.

222 *Hillsborough I, supra* note 24, at 838; *Hillsborough II, supra* note 24, at 1006.

223 *Hillsborough I, supra* note 24, at 840; *Hillsborough II, supra* note 24, at 1006.

224 *Hillsborough I, supra* note 24, at 840-41. The court cited *In re Gillett Holdings, Inc*., 137 B.R. 475 (Bankr. D. Colo. 1992) [hereinafter *Gillett I*], *In re Mortgage & Realty Trust*, 123 B.R. 626 (Bankr. C.D. Cal. 1991), and *In re Baldwin Ltd*., 79 B.R. 321 (Bankr. S.D. Ohio 1987). In *Mortgage & Realty Trust*, the court stated that the banker can always decide it does not want to do bankruptcy work, but if it does, it must comply with the court's view of the legal requirements. *In re Mortgage & Realty Trust*, 123 B.R. at 631. The court added the further admonition that a banker could not withdraw from the engagement without the court's permission, which was unlikely to be given. *Id*. The court refused to approve a monthly retainer payment to Dean Witter Reynolds, Inc., advisor to the debtor, acknowledging that such a retainer may be permissible under § 328, but it would nevertheless still be subject to evidentiary justification before and after the services were rendered. *Id*. at 630.

225 *In re* Saybrook Mfg. Co., 108 B.R. 366 (Bankr. M.D. Ga. 1989).

226 *Hillsborough I, supra* note 24, at 838.

227 *Id*. at 840.

228 *Id*.

229 *Id*.

230 *Id*.

231 *Id*. (citing *In re* Chas. A. Stevens & Co., 105 B.R. 866, 872 (Bankr. N.D. Ill. 1989)).

232 *Hillsborough I, supra* note 24, at 838-39.

233 *See id*.

234 *Id*.

235 *Id*. at 839.

236 *Id*.

237 *Id*.

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238 *See id*.

239 *Gillett I, supra* note 224; *In re* Gillett Holdings, Inc., 143 B.R. 256 (Bankr. D. Colo. 1992) [hereinafter *Gillett II*].

240 *Gillett I, supra* note 224, at 477; *Gillett II*, *supra* note 239, at 257.

241 *Gillett I, supra* note 224, at 483.

242 *Id*. at 478.

243 *Id*.

244 *Id*.

245 *Id*. at 481; *see also In re* Geneva Steel Co., 258 B.R. 799 (Bankr. D. Utah 2001). The Blackstone Group was retained as financial advisor to the debtor at a monthly fee of $150,000, subject to the "reasonableness" standards of § 330. *In re Geneva Steel Co*., 258 B.R. at 801. The court stated: "Although Blackstone's appointment provides for a fixed fee of $150,000 per month plus expense, such an appointment is by no means a guarantee that fees will be awarded in that fashion. The trial court may reject a fee contract in favor of the 'lodestar' approach." *Id*. (citing Beck v. N. Natural Gas Co., 170 F.3d 1018 (10th Cir. 1999)). In response to objections by the U.S. Trustee and others, the court reduced Blackstone's fees principally as a result of diminished hours spent during the application period. *In re Geneva Steel Co*., 258 B.R. at 802. Blackstone noted that its work "ebbs and flows" with the need of the debtor. *Id*.

246 *Gillett I, supra* note 224, at 479.

247 *Id*. at 478.

248 *Id*.

249 *Id*.

250 *Id*.

251 *Gillett II, supra* note 239, at 259 (quoting *In re* C&P Auto Transport, Inc., 94 B.R. 682, 685 n.4 (Bankr. E.D. Cal. 1988)).

252 *Id*.

253 *Gillett I, supra* note 224, at 481 (citing Johnson v. Ga. Highway Express, Inc., 488 F.2d 714, 717-19 (5th Cir. 1974)).

254 489 U.S. 87, 88 (1989).

255 *Id*.

256 *Id*.

257 *Id*. at 488-89.

258 *Id*. at 483-89.

259 *Id*. at 489.

260 *Id*. at 480.

261 *Id*. at 488.

262 *Id*.

263 *Id*. at 489.

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264 *Id*. at 495.

265 *Id*.

266 Chanin & Co. v. Burlington Motor Carriers Inc. (*In re* Burlington Motor Holdings Inc.), No. 98-77, 1998 U.S. Dist. LEXIS 19102 (D. Del. Nov. 24, 1998).

267 *Id*. at *8.

268 *Id*. at *7.

269 *In re* Burlington Motor Holdings, Inc., 217 B.R. 711, 717 (Bankr. D. Del. 1997).

270 *Chanin & Co*., 1998 U.S. Dist. LEXIS 19102, at *7.

271 19 F.3d 833 (3d Cir. 1994).

272 *Id*. at 847.

273 19 F.3d 833 (3d Cir. 1994).

274 *Id*. at 848.

275 *Id*. at 846.

276 217 B.R. 711 (Bankr. D. Del. 1997).

277 *Id*. at 717.

278 *Id*. at 714.

279 *Id*.

280 *Id*.

281 *Id*.

282 *Id*. at 715.

283 *Id*. at 714.

284 *Id*. at 715.

285 *Id*. (citing *In re* UDC Homes, Inc., 203 B.R. 218 (Bankr. D. Del. 1996)).

286 *Id*. at 716.

287 *Id*. at 715.

288 *See, e.g., In re* Schepps Food Stores, Inc., 91-49816-H4-11, 1994 Bankr. LEXIS 1369 (Bankr. S.D. Tex. July 7, 1994). In *In re Schepps Food Stores, Inc*., the investment banking boutique of Peter J. Solomon sought compensation of $500,000 to cover a fixed monthly retainer and was awarded $384,000. *Id*. at *18. The court noted that, in *In re R.H. Macy*, the firm had been made aware of the requirement of maintaining detailed time records and had agreed to hourly rates between $150 to $400. *Id*. at **10-12 (citing *In re* R.H. Macy, 173 B.R. 470 (Bankr. S.D.N.Y. 1994)). The court devised its own calculation of the hourly rates for Solomon professionals, using $400 an hour as the maximum permitted in *In re R.H. Macy*. *Id*. at *18. Using the lodestar approach, the court determined that a fee of $384,000 was appropriate and ignored the fixed monthly rate that would have yielded a fee of $500,000. *Id*.

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289 *See id*. at *12.

290 *See In re* Interco, Inc., 91-40442-172, 1991 Bankr. LEXIS 439, at **4-6 (Bankr. D. Mo. 1991) (holding that the financial advisors could be retained on a monthly flat-fee basis, but that they were required to maintain time records for each individual on at least an hourly basis; also noting that the time expended was only one factor considered in determining reasonable compensation, and recognizing that the number of hours may not truly reflect the value of the services rendered).

291 Letter from Stephen Zelin, Senior Managing Director, The Blackstone Group L.P., to Stephen Cooper, Interim CEO, Enron Corp. (May 9, 2002) (on file with author).

292 *Id*.

293 *Id*.

294 Final Order Pursuant to 11 U.S.C. §§ 327(a) and 328(a) Authorizing the Employment and Retention of the Blackstone Group L.P. as Financial Advisor for the Debtors and Debtors-in-Possession at 2-3, *In re* Enron Corp., 302 B.R. 455 (Bankr. S.D.N.Y. 2003) (No. 01-16034) (on file with author).

295 *Id*.

296 Fourth Interim Application of the Blackstone Group L.P. as Financial Advisor to Enron Corp. and Its Affiliates for an Allowance of Interim Compensation for Services Rendered and Reimbursement of All Actual and Necessary Out-of-Pocket Expenses Incurred in Rendering Such Services for the Period January 1, 2003, Through April 30, 2003 at 12, *In re Enron* (No. 01-16034) (on file with author).

297 *Id*. at 13.

298 *Id*.

299 *Id*. at 6-7.

300 *See* Cynthia A. Baker, *Other People's Money: The Problem of Professional Fees in Bankruptcy*, 38 ARIZ. L. REV. 35 (1996).

301 MERRILL LYNCH & CO., INC., 2002 ANNUAL REPORT (2003), *available at* http://www.sec.gov/Archives/edgar/data/65100/000095012303002845/0000950123-03-002845-index.htm.

302 GOLDMAN SACHS, INC., 2002 ANNUAL REPORT (2003), *available at* http://www.sec.gov/Archives/edgar/data/886982/000095012303002099/0000950123-03-002099-index.htm.

303 MERRILL LYNCH & CO., INC., 2002 ANNUAL REPORT (2003), *available at* http://www.sec.gov/Archives/edgar/data/65100/000095012303002845/0000950123-03-002845-index.htm.

304 *See In re* Adler, Coleman Clearing Corp., 263 B.R. 406 (S.D.N.Y. 2001).

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