



Recent Developments Concerning Professional Fees in Bankruptcy

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Professional Fee Developments in 3 Contexts:

- Dismissed Involuntary Cases (11 U.S.C. § 303(i))
- Oversecured Creditors (11 U.S.C. § 506(b))
- Post-ASARCO Professional Retention (11 U.S.C. §§ 327(a), 328(a) & 330(a)(1))

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VENABLE 2



Context #1: Dismissed Involuntary Cases

Overview of 11 U.S.C. § 303

- § 303(b) governs who may file an involuntary petition. Generally:
 - If the debtor has more than 12 creditors, then 3 or more entities holding claims which are matured, not contingent as to liability or subject to a bona fide dispute as to liability or amount, and total in the aggregate at least \$15,325 (in excess of any secured amounts)
 - If the debtor has fewer than 12 creditors, excluding employees, insiders and holders of voidable transfers, then 1 or more entities holding claims totaling at least \$15,325

VENABLE 3




Context #1: Dismissed Involuntary Cases

Overview of 11 U.S.C. § 303

- § 303(i) provides the consequences of dismissal of an involuntary petition:
 - (i) If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—
 - (1) against the petitioners and in favor of the debtor for—
 - (A) costs; or
 - (B) a reasonable attorney's fee; or
 - (2) against any petitioner that filed the petition in bad faith, for—
 - (A) any damages proximately caused by such filing; or
 - (B) punitive damages.

VENABLE 4




Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

DVI Receivables XIV, LLC v. Rosenberg (In re Rosenberg), 779 F.3d 1254 (11th Cir. 2015) cert. denied sub nom. U.S. Bank, N.A. v. Rosenberg, 136 S. Ct. 805 (2016)

- Held:
 - Under 11 U.S.C. § 303(i), if an involuntary bankruptcy is dismissed, petitioning creditors may be liable for the putative debtor's attorneys' fees incurred (1) in obtaining dismissal; (2) sustaining dismissal on appeal; (3) seeking to recover the fees in categories 1 and 2 (a.k.a. "fees on fees"); and (4) prosecuting bad-faith claims for damages under § 303(i)(2)
 - De facto petitioner (*i.e.*, servicer that filed petition) may be jointly liable with named petitioners for § 303 judgment

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI:

- Pre-petition securitization transaction beginning in November 2000
- Affiliates of debtor Rosenberg entered into equipment leases, which the debtor guaranteed
- The lessor, DVI Financial, transferred its interests in the leases and related obligations to certain pass-through entities (a.k.a. the "DVI Entities"), which issued notes secured by the leases in exchange for loans to purchase the equipment
- DVI Financial retained the servicing rights with respect to the leases

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI, continued:

- The DVI Entities transferred their rights and interests in the leases to U.S. Bank, as trustee for the noteholders
- DVI Financial ultimately filed for bankruptcy relief and Lyon Financial Services became the successor servicer for the leases
- In December 2003, Lyon (as successor servicer) sued Rosenberg and the lessees in state court

VENABLE 




Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI, continued:

- In August 2005, the parties settled the action and restructured the lease obligations
- As part of the settlement, Rosenberg provided a replacement guaranty in favor of Lyon (as successor servicer and agent of U.S. Bank) and a related confession of judgment
- The DVI Entities were not parties to the settlement. Jane Fox, Lyon's Director of Operations, signed the agreement on behalf of Lyon (as successor servicer and agent of U.S. Bank)

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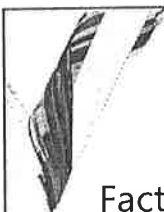


Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI, continued:

- In July 2008, Lyon, as agent for U.S. Bank, filed a confession of judgment action against Rosenberg and a judgment was entered a month later
- In November 2008, Jane Fox, on behalf of the DVI Entities, filed an involuntary petition against Rosenberg in the E.D. Pa. (later transferred to the S.D. Fla.)
- The DVI Entities asserted 6 claims totaling approximately \$5.4 million based on Rosenberg's 2005 guaranty

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI, continued:

- In August 2009, the bankruptcy court dismissed the involuntary petition, holding, among other things, that (1) the DVI Entities were not eligible creditors of Rosenberg because the 2005 guaranty ran to Lyon, not the DVI Entities; and (2) the DVI Entities were not "real parties in interest" because they were merely pass-through entities created to facilitate the securitization
- The bankruptcy court retained jurisdiction to award amounts under § 303(i)
- The petitioners unsuccessfully appealed the dismissal order

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Facts of DVI, continued:

- The bankruptcy court held a bench trial as to attorneys' fees under § 303(i)(1) and concluded that the debtor was entitled to attorneys' fees incurred (1) in obtaining dismissal; (2) sustaining dismissal on appeal; (3) seeking to recover the fees in categories 1 and 2 (a.k.a. "fees on fees"); and (4) prosecuting bad-faith claims for damages under § 303(i)(2)
- In total, the bankruptcy court awarded more than \$1 million in fees/costs
- Reference was withdrawn as to the debtor's bad-faith claims for damages under § 303(i)(2)
- The district court held a jury trial, which resulted in a bad-faith judgment against the petitioners and a damages award of \$360,000 (reduced from the jury's award of \$6.12 million in compensatory and punitive damages)

VENABLE 11




Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Analysis of DVI:

- The Eleventh Circuit generally affirmed the bankruptcy court but remanded to determine the amount of reasonable attorneys' fees awardable in connection with the bad-faith litigation, which continued for 2 years after the bankruptcy court's original judgment
- The issue of attorneys' fees for obtaining dismissal (Category 1) was not appealed

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Analysis of DVI, continued:

- Looking to the text of § 303(i)(1), the Court found that there are only 2 preconditions to an award of fees: (1) if the petition is dismissed other than by consent; and (2) the debtor does not waive the right to judgment
- The Court concluded that there is no limitation precluding recovery of appellate fees (Category 2) or fees incurred after the date of dismissal (Categories 3 and 4)
- In so holding, the Court rejected the reasoning of Higgins v. Vortex Fishing Sys., Inc., 379 F.3d 701 (9th Cir. 2004) (holding that bankruptcy court abused its discretion in awarding putative debtor's previously incurred appellate fees under § 303(i)(1)); see also Adell v. John Richards Homes Bldg. Co. L.L.C. (In re John Richards Homes Bldg. Co. L.L.C.), 552 F. App'x 401 (6th Cir. 2013) (rejecting Higgins as unsupported by language of § 303(i) and contrary to legislative intent)

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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Analysis of DVI, continued:

- The Court next addressed the issue of whether a putative debtor may recover "fees on fees" or attorneys' fees and costs under § 303(i)(1) for prosecuting bad-faith damages under § 303(i)(2) (Category 3)
- According to the Court, "[t]he issue is whether these two subsections are exclusive of each other or whether they can and should be read together and harmonized"
- The Court looked to cases from other jurisdictions for guidance and concluded that the subsections should be read together, reasoning that § 303(i)(1) applies to all phases of § 303 proceedings and § 303(i)(2) applies only to the additional, bad-faith litigation phase


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Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Analysis of DVI, continued:


- Finally, the Court concluded that although Lyon was not expressly listed as a petitioner, the evidence showed that Lyon was sufficiently intertwined with the DIV Entities so as to be held jointly liable for fees and costs under § 303(i) as a de facto petitioner



Context #1: Dismissed Involuntary Cases Application of 11 U.S.C. § 303

Significance of DVI:

- Consequences of dismissal can be severe
 - Attorneys' fees under § 303(i)(1) are often seen as presumptively due
- Make sure the petitioners comply with § 303(b)
 - Failure to do so may result in dismissal (and attorneys' fees)
 - Failure to comply may result in a bad-faith finding



Context #1: Dismissed Involuntary Cases

Application of 11 U.S.C. § 303

Fourth Circuit / Maryland Guidance:

- Limited case law; precise issues in DVI have not been addressed
- Notable Decisions:
 - Atlas Mach. & Iron Works, Inc. v. Bethlehem Steel Corp., 986 F.2d 709 (4th Cir. 1993) (holding that “[t]o determine bad faith, a court examines whether a reasonable person would have filed the petition (objective test) as well as the motivations of the petitioner (subjective test)” and concluding that objective bad faith was met where petitioning creditor’s interpretation of the involuntary filing requirements was unreasonable and subjective test was met where purpose of filing was to collect a debt)
 - Koffman v. Osteoimplant Tech., Inc., 182 B.R. 115 (D. Md. 1995) (Smalkin, J.) (holding that “[a]fter the bankruptcy court abstains from jurisdiction over an involuntary petition pursuant to section 305(a)(1), the court may not then award damages or impose sanctions for the filing of that petition under section 303(i).”)
 - In re Lai Di Zhu, No. 10-19901PM, 2010 WL 4259553 (Bankr. D. Md. Oct. 21, 2010) (Mannes, J.) (dismissing involuntary petition after petitioner failed to post a bond, imposing attorneys’ fees, and imposing punitive damages for bad-faith filing, relying on Atlas and finding “[t]he Bankruptcy Court is not a vehicle for the collection of accounts receivable”)

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Context #2: Oversecured Creditors

Overview of 11 U.S.C. § 506(b)

- § 506(b) provides that oversecured creditors may recover post-petition interest and reasonable fees, costs, and charges provided for under the relevant agreements:
 - (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

In re 804 Congress, L.L.C., 756 F.3d 368 (5th Cir. 2014)

- Held:
 - An oversecured lender's recovery of legal fees from the proceeds of its collateral, which was sold at a court-ordered non-judicial foreclosure after the automatic stay had been lifted, was subject to the reasonableness standard of § 506(b)
 - Because the lender did not substantiate its legal fees, the Court found them to be unreasonable and therefore not allowable as a secured claim, but remanded the case to the bankruptcy court to determine whether they could be treated as an unsecured claim under § 502

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

Facts of 804 Congress:

- Wells Fargo was the first-priority secured lender of the debtor, which owned a Texas office building
- The bankruptcy court lifted the stay to allow Wells Fargo to foreclose "in accordance with applicable state laws"
- The trustee under the DOT conducted a foreclosure sale, and the property was sold for \$4.355 million—enough to pay the trustee's 5% commission under the DOT, all of Wells Fargo's secured claim, including attorneys' fees, all of the second-lien holder, and \$222k to the debtor

VENABLE 20



Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

Facts of 804 Congress, continued:

- The bankruptcy court exercised jurisdiction over the sale proceeds
- The court disallowed most of the trustee's commission as unreasonable—allowing only an amount equal to the trustee's hourly rate multiplied by the hours spent in connection with the sale
- The court disallowed all of Wells Fargo's \$88k in attorneys' fees because it had not filed a proper fee application or provided documentation or testimony demonstrating reasonableness
- On appeal, the district court reversed, holding that the bankruptcy court ceased to have jurisdiction over the property and sale proceeds when it granted relief from the stay

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

Holding of 804 Congress:

- The Fifth Circuit disagreed with the district court, and held that the bankruptcy court did not give up jurisdiction over the property (and the proceeds thereof) when it lifted the stay, noting that "[l]ifting the automatic stay to allow Wells Fargo to foreclose was not tantamount to an abandonment of the property"
- The Circuit Court held that the § 506(b) reasonableness standard applied to Wells Fargo's post-petition legal fees (and the trustee's commission) and affirmed the bankruptcy court's disallowance under an abuse of discretion review
- The Court remanded the question of whether Wells Fargo and the DOT Trustee could recover the disallowed amounts as unsecured claims under § 502

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

- On remand, in In re 804 Congress, L.L.C., 529 B.R. 213, 222 (Bankr. W.D. Tex. 2015), the bankruptcy court held that fees and costs disallowed as secured claims under § 506(b) may be allowed as unsecured claims if allowable under state law
- The court reasoned that § 502 governs allowance of all claims and § 506 governs the more narrow question of allowance of claims as secured, meaning that disallowance under § 506(b) was not determinative of allowance under § 502 (consistent with First, Ninth and Eleventh Circuits)
- Ultimately, the court (1) disallowed Wells Fargo's attorneys' fees claim as unreasonable under § 502 and state law for the same reason as under § 506(b)—lack of evidence of reasonableness; and (2) allowed the balance of the trustee's fee as an unsecured claim

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

Fourth Circuit / Maryland Guidance:

- Analogous Maryland precedent: In re Korangy, 106 B.R. 82 (Bankr. D. Md. 1989) (Mannes, C.J.)
- Oversecured lender; state-law judicial foreclosure after stay was lifted
- However, unlike 804 Congress there were two final, unappealed state court orders allowing the secured lender's attorneys' fees
- Chief Judge Mannes held that § 506(b) preempted state law on the issue of an oversecured lender's entitlement to post-petition attorneys' fees and thus the state court orders were not entitled to preclusive effect
- No Fourth Circuit / Maryland precedent on whether attorneys' fees disallowed as secured claims under § 506(b) may be recovered as unsecured claims under § 502

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Context #2: Oversecured Creditors

Application of 11 U.S.C. § 506(b)

Significance of 804 Congress and Korangy:

- Because § 506(b) reasonableness applies, attorneys representing secured creditors in bankruptcy cases should track time as if representing a bankruptcy debtor—the burden will be on the creditor to prove reasonableness
- Notable Fourth Circuit / Maryland Decisions:
 - In re Ward, 190 B.R. 242 (Bankr. D. Md. 1995) (Mannes, C.J.) (holding that oversecured creditor's claim for attorneys' fees under § 506(b) was subject to Johnson factor/Iodestar review)
 - In re Consol. Properties Ltd. P'ship, 152 B.R. 452 (Bankr. D. Md. 1993) (Derby, J.) (same)

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Context #3: Post-ASARCO Retention of Professionals

Overview of ASARCO

- Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158, 192 L. Ed. 2d 208 (2015)
 - Decided in June 2015
 - Supreme Court held that professionals retained under § 327(a) may not receive compensation for fees incurred defending fee applications because such fees are not fees for “actual, necessary services rendered” on behalf of the estate as required under § 330(a)(1)

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- In re Boomerang Tube, Inc., Case No. 15-11247 (Bankr. D. Del.) (Walrath, J.)
 - In July 2015 (about a month after ASARCO was decided), the Creditors' Committee sought to retain 2 firms as counsel
 - The Committee sought approval of compensation provisions providing that the bankruptcy estates would indemnify the firms for any fees, costs or expenses arising out of the successful defense of their fee applications
 - The Committee sought approval of the indemnification provisions pursuant to § 328(a), which provides that, subject to court approval, estate representatives "may employ ... a professional person ... on any reasonable terms of employment"
 - The United States Trustee objected, arguing that the provisions violated ASARCO

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- In re Samson Res. Corp., Case No. 15-11934 (Bankr. D. Del.) (Sontchi, J.)
 - Similar to Boomerang
 - In September 2015 (about 3 months after ASARCO was decided), the debtors sought to retain chapter 11 counsel
 - The debtors sought approval under § 328(a) of provisions providing that the bankruptcy estates would indemnify the firms for any fees, costs or expenses arising out of objections of third parties to their fee applications
 - The United States Trustee objected, arguing that the provisions violated ASARCO

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- In re New Gulf Res., LLC, Case No. 15-12566 (Bankr. D. Del.) (Shannon, C.J.)
 - In December 2015 (about 6 months after ASARCO was decided), the debtors sought to retain Baker Botts (debtor's counsel in ASARCO) as chapter 11 counsel
 - The debtors sought approval of a "Fee Premium" whereby BB's aggregate fees would be increased by 10%
 - The Fee Premium would be (1) earned at the time of services, but only payable upon final approval of BB's fees; and (2) waived by BB if it did "not incur material fees and expenses defending against any objection" to BB's fee applications (waiver would not be impacted by the outcome of any such objection)
 - The United States Trustee objected, arguing that the Fee Premium violated ASARCO

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- In re Boomerang Tube, Inc., No. 15-11247, 2016 WL 385933 (Bankr. D. Del. Jan. 29, 2016):
 - After substantial briefing by all parties, at the end of January 2016, Judge Walrath denied approval of the indemnification provisions, holding:
 - (1) "[A]lthough section 328 is an exception to section 330, it, like section 330, is not a 'specific and explicit' statute which 'authorize[s] the award of a reasonable attorney's fee, fees, or litigation costs,' that 'refer[s] to a prevailing party in the context of an adversarial action.'" (quoting ASARCO)
 - (2) The engagement letters did not qualify as contractual exceptions to the American Rule because:
 - (a) The contracts were agreements between two parties (the Committee and the firms) but sought to obligate a third party (the estate) to pay defense costs
 - (b) The contracts were not bi-lateral agreements, as they were subject to approval and modification by the bankruptcy court

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- In re Boomerang Tube, Inc., No. 15-11247, 2016 WL 385933, continued:
 - (3) The indemnification provisions failed to satisfy the reasonableness requirement of § 328(a) because fees incurred defending fee applications are not for services provided to the Committee and cannot be reasonable
 - (4) Market factors (i.e., whether indemnification provisions are commonplace) are no longer relevant to the reasonableness of fees for defense of fee applications after ASARCO
 - (5) The court rejected the Committee's arguments that
 - (a) ASARCO was distinguishable because there was no agreement in advance under § 328(a) to pay defense fees
 - (b) There is a distinction between approval of fees under § 328(a)(1)(A) and expenses under § 328(a)(1)(B)

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- Applying Boomerang:
 - In New Gulf, on February 1, 2016, Chief Judge Shannon issued a letter ruling adopting the reasoning of Boomerang and denying the requested Fee Premium
 - In Samson, on February 8, 2016, Judge Sontchi issued a letter ruling adopting the reasoning of Boomerang and denying the fee-defense provisions

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Context #3: Post-ASARCO Retention of Professionals 3 Delaware Cases

- Significance of Boomerang (and New Gulf and Samson)
 - ASARCO (at least in Delaware) means no fees for defense of fee applications until the Bankruptcy Code is changed