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The World After *Baker Botts*: Compensation for Successfully Defending Fee Applications

by

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Can counsel ever recover fees for successfully defending objections to their fee applications? Before the Supreme Court's 2015 decision in *Baker Botts L.L.P. v. ASARCO LLC*,[1] the case law was fairly well settled. Generally, courts allowed fees for defending fee applications when the professional "substantially prevailed" in the defense. However, in *Baker Botts*, a majority of the Supreme Court held that attorneys employed under § 327(a) of the Bankruptcy Code[2] are not permitted under § 330(a)[3] to recover the costs of

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[1]Baker Botts L.L.P. v. ASARCO LLC, 135 S. Ct. 2158 (2015).

[2]Section 327(a) provides as follows:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a).

[3]Section 330(a)(1) provides as follows:

> After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1101 —(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and(B) reimbursement for actual, necessary expenses.

successfully defending their fee applications. The Court relied on the American Rule, which mandates that each litigant pays its own attorneys' fees. But the Court appeared to leave the door open to a possible contract exception under § 328(a) of the Bankruptcy Code.[4]

Most courts have yet to deal with *Baker Botts*. But bankruptcy courts in Delaware have recently done so and have ruled that indemnification or compensation for the successful defense of fee applications is not a "reasonable" term of employment under § 328(a).[5] Because this has not been settled by controlling precedent in any jurisdiction, it is a live issue whether counsel may contract under § 328(a) to receive indemnification or compensation for defense costs from the bankruptcy estate.

One might ask, why is this issue important? Admittedly, the facts in *Baker Botts* were extraordinary and unlikely to be repeated any time soon.[6] Arguably, *Baker Botts* may encourage strategic objections to fee applications by parties seeking leverage in a bankruptcy case. Equally arguably, bankruptcy courts are well equipped to deal with strategic objections through the use of Federal Rule of Bankruptcy Procedure 9011, which authorizes the court to impose sanctions for bad-faith litigation conduct. Debtor's counsel in *Baker Botts* could probably offer five million reasons why this issue is important—all of them dollars.[7] This issue is important to bankruptcy professionals seeking compensation under § 330(a); to bankruptcy attorneys objecting to such compensation; to clients who have to pay it; and to creditors who

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11 U.S.C. § 330(a)(1).

[4]Section 328(a) provides as follows:

> The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. § 328(a).

[5]*In re* Boomerang Tube, 548 B.R. 69 (Bankr. D. Del. 2016).

[6]The confluence of facts in the case was extraordinary. The challenge was by the reorganized debtor, which, at the time of the challenge, was under the control of the corporate parent that had suffered a multi-billion dollar judgment in favor of the debtor. As a result of the judgment, the debtor's creditors were fully paid (plus post-petition interest and allowed attorneys' fees), leaving the reorganized debtor with a surplus, funded by its corporate parent. Ordinarily, a reorganized debtor in that position would be delighted with the work of its counsel and would not object to its fees (as evidenced by the bankruptcy court's award of a $4.1-million fee enhancement for extraordinary performance). But in this case, the underlying fight appeared to be between the reorganized debtor and its corporate parent over the surplus.

[7]This is the amount of defense costs that the Supreme Court ruled was not compensable in *Baker Botts*.

usually bear its financial burden. However, the fact that the Supreme Court believed this issue was important enough to address should be a sufficient answer to the question.

This article examines the recent evolution of the case law regarding compensation for successfully defending fee applications, focusing on the Supreme Court's decision in *Baker Botts* and the recent decision of the Delaware Bankruptcy Court in *In re Boomerang Tube*.[8] It is argued that (1) the indemnification of defense costs is a "reasonable" term and condition of employment under § 328(a); (2) a retention agreement approved under § 328(a) of the Bankruptcy Code that specifically provides for the indemnification of defense costs is a contract exception to the American Rule; and (3) such defense costs are allowable under § 330(a) because § 328 trumps the former. The countervailing policy considerations surrounding the defense-cost issue are not addressed because they found little traction in the Supreme Court. The Court has instructed that we must "follow the text [of the Bankruptcy Code] even if doing so will supposedly 'undercut a basic objective of the statute.'"[9] This article will not address the legislative history of §§ 327, 328, and 330. Although these sections have been amended several times since their introduction in the Bankruptcy Code, none of the amendments is relevant to the defense-cost issue, and the legislative history offers little insight into this subject.[10]

I. THE WORLD BEFORE *BAKER BOTTS*

The defense-cost world may be divided into two periods: before the Supreme Court's decision in *Baker Botts* and after *Baker Botts*. Before *Baker Botts*, the prevailing case law (or at least the practice) provided that fees incurred defending fee applications would be compensable when the defending party "substantially prevailed."[11] In fact, the United States Trustee

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[8]*In re* Boomerang Tube, 548 B.R. 69 (Bankr. D. Del. 2016).

[9]Baker Botts, L.L.P. v. ASARCO, LLC, 135 S. Ct. 2158, 2169 (2015).

[10]*See, e.g.*, 11 U.S.C. § 328 (1978) (subsequent amendments Pub. L. 98-353, 98 Stat. 370 (1984) and Pub. L. 109-8, 119 Stat. 194 (2005)); 11 U.S.C. § 330 (1978) (subsequent amendments Pub. L. 98-353, 98 Stat. 370 (1984); Pub. L. 99-554, 100 Stat. 3099(1986); Pub. L. 103-394, 108 Stat. 4199 (1994); Pub. L. 109-8, 119 Stat. 74 (2005)). *See also* S. REP. NO. 95-989, at 38-41 (1978); H.R. REP. NO. 95-595, at 328-330 (1977).

[11]*See, e.g.*, Smith v. Edwards & Hale, Ltd., (*In re* Smith) 317 F.3d 918, 929 (9th Cir. 2002); Hennigan Bennett & Dorman LLP v. Goldin Assocs. (*In re* Worldwide Direct Inc.), 334 B.R. 108, 111 (D. Del. 2005) ("[R]equiring counsel who has successfully defended a fee claim to bear the costs of that defense is no different than cutting counsel's rate or denying compensability on an earlier fee application."); *In re* CCT Commc'ns, No. 07-10210 (SMB), 2010 WL 3386947, at *8-9 (Bankr. S.D.N.Y. Aug. 24, 2010) (allowing attorney's fees and expenses in defending fee application where applicant "substantially prevailed, and denial of the defense costs would dilute its award").

However, some courts were reluctant to award fees for the successful defense of fee applications. *See, e.g.*, *In re* 530 West 28th Street LP, No. 08-13266 (SMB), 2009 WL 4893287, at *11 (Bankr. S.D.N.Y.

("UST") in *Baker Botts* argued in favor of providing reasonable compensation to counsel for the successful defense of their fee applications.[12]

II. ENTER *BAKER BOTTS*

After filing for Chapter 11, ASARCO, as debtor-in-possession, successfully prosecuted fraudulent-transfer claims against its corporate parent, ultimately obtaining a judgment in excess of $7 billion. As a result of this judgment, ASARCO was able to fully pay its creditors and emerged from bankruptcy under the ownership of its corporate parent.

ASARCO's bankruptcy counsel filed fee applications pursuant to § 330(a)(1). By then, ASARCO had been reorganized and was returned to the control of its corporate parent—which had suffered the multi-billion dollar judgment. ASARCO objected to the fee applications. The bankruptcy court overruled ASARCO's objections and granted the attorneys $120 million for their work in the case, plus a $4.1-million fee enhancement for exceptional performance, and over $5 million for time spent defending their fee applications. The District Court affirmed. Reversing this decision, the Fifth Circuit Court of Appeals held that the Bankruptcy Code did not authorize the recovery of attorneys' fees for defending fee applications, reasoning that "Section 330(a) does not authorize compensation for the costs counsel or professionals bear to defend their fee applications."[13]

The Supreme Court affirmed on appeal.[14] Noting that the American Rule is deeply rooted in the common law, the Court stated that it would not deviate from the rule without explicit statutory authority or contractual language. The Court determined that Congress did not intend to depart from the American Rule because neither § 327(a) nor § 330(a) of the Bankruptcy Code expressly allows compensation for fee-defense litigation, and only provides for "reasonable compensation for actual, necessary services rendered."[15] The Court noted that defending fee applications neither constituted "services" nor a benefit to the estate.[16] In the Court's view, the only benefit in

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Dec. 11, 2009) (choosing not to award fees incurred in defending fee application where the objections were made in good faith, stating that there was "no reason to deviate from the American Rule under which litigants must bear their own legal expenses").

See, generally, Timothy S. Springer, Damned If You Do, Damned If You Don't—Current Issues for Professionals Seeking Compensation in Bankruptcy Cases under 11 U.S.C. § 330, 87 AM. BANKR. L.J. 525, 536-42 (2013).

[12]135 S. Ct. at 2168. The Supreme Court pointed out that the "United States took the opposite view below, asserting that 'requiring a professional to bear the normal litigation costs of litigating a contested request for payment. . .dilutes a bankruptcy fee award no more than any litigation over professional fees.'"

[13]In re ASARCO, LLC, 751 F.3d 291, 299 (2014).

[14]135 S. Ct. 2158. Thomas, J., delivered the opinion of the Court, joined by Roberts, C.J., and Scalia, Kennedy, and Alito, JJ., and by Sotomayor, J., in part.

[15]§ 330(a)(1)(A).

[16]*Baker Botts*, 135 S. Ct. at 2165-2167.

fee-defense litigation was to the attorneys; defending their fee applications provided no additional benefit to the estate.[17] The Court concluded that "Congress has not granted us roving authority to allow counsel fees whenever we might deem them warranted" and that the Court's "job is to follow the text even if doing so will supposedly 'undercut a basic objective of the statute.'"[18] In sum, it held that fees or expenses incurred by counsel in defending their fee applications are not compensable under § 330(a)(1) because § 330 does not provide an exception to the American Rule.

Did the Supreme Court rule that defense costs in bankruptcy cases are always prohibited? The Court posed this question at the outset: "The question before us is whether § 330(a)(1) permits a bankruptcy court to award attorneys' fees for work performed in defending a fee application in court."[19] The Court then answered it: "We hold that it does not."[20] Is that the end of the matter? If § 330(a)(1) does not allow defense costs, there is no contract exception because compensation can only be awarded under § 330(a)(1). So why did the Supreme Court so clearly articulate the existence of the contract exception: The American Rule applies "unless a statute *or contract* provides otherwise."[21] It is submitted that the Court was not issuing a fiat against defense costs, but rather limiting its ruling to the prohibition of defense costs, *unless a contract provides otherwise.*[22] The Court appeared to deliberately leave the door open to the contract exception: "[T]he Supreme Court did not hold that section 330 prohibits the allowance of defense fees and merely held that it did not expressly authorize them. . . Therefore, the contract exception to the American Rule is not precluded by the ruling in [*Baker Botts*]."[23]

In contrast to the majority, the dissent by Justice Breyer focused on § 330(a)(3), finding that bankruptcy courts have wide discretion to establish "reasonable compensation" under § 330(a)(3).[24] Justice Breyer noted that

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[17]*Id.*

[18]*Id.* at 2169.

[19]*Id.* at 2162.

[20]*Id.*

[21]*Id.* at 2164 (emphasis added).

[22]It might be argued that the Supreme Court missed the bankruptcy forest for the trees. In focusing on whether §§ 327 and 330 explicitly provided a statutory exception to the American Rule, the Court may have overlooked that fee-shifting is inherent in the Bankruptcy Code. The Code provides that certain litigation costs must be paid by the bankruptcy estate, regardless of whether the services were rendered to the estate or were adverse to the estate, or resulted in the party substantially prevailing. For example, attorneys' fees incurred by an official committee in litigating against the debtor are generally payable by the debtor, regardless of whether the committee substantially prevailed. This argument appears to have been made to, and rejected by, the Fifth Circuit. *In re* ASARCO LLC, 751 F.3d 291, 301-302 (2014)("Baker Botts asserts that the American Rule is inapplicable in bankruptcy, because the statutory provision for professional compensation overrides the American Rule."). But the argument was abandoned before the Supreme Court. In view of the Supreme Court's decision, this ship has probably sailed.

[23]*In re* Boomerang Tube, Inc., 548 B.R. 69, 73 (Bankr. D. Del. 2016).

[24]*Baker Botts*, 135 S. Ct. at 2169. Dissent by Breyer, J., and joined by Ginsburg and Kagan, JJ.

§ 330(a)(3) specifies that a court shall "consider the nature, the extent, and the value of. . .services, taking into account *all relevant factors*."[25] For the dissent, all relevant factors may include the time, effort, and expense to recover professional fees.[26] In addition, he pointed out the majority's interpretation "undercuts a basic objective of the statute" to establish compensation customarily charged by "comparably skilled practitioners in cases other than" bankruptcy cases.[27] According to the dissent, "the extensive process through which a bankruptcy professional defends his or her fees may be so burdensome that additional fees are necessary in order to maintain comparability of compensation."[28] Thus, "to maintain comparable compensation, a court may find it necessary to account for the relatively burdensome fee-defense process required by the Bankruptcy Code. Accounting for this process ensures that a professional is paid 'reasonable compensation.'"[29]

The dissent's main argument is best summarized by its dilution example, that the uncompensated cost of defending a fee application would dilute the compensation ultimately awarded.

> Consider a bankruptcy attorney who earns $50,000—a fee that reflects her hours, rates, and expertise—but is forced to spend $20,000 defending her fee application against meritless objections. It is within a bankruptcy court's discretion to decide that, taking into account the extensive fee litigation, $50,000 is an insufficient award. The attorney has effectively been paid $30,000, and the bankruptcy court might understandably conclude that such a fee is not "reasonable."[30]

The dissent concluded that courts must have the discretion to award fees for the successful defense of fee applications.

It is important to understand what *Baker Botts* decided. It affirmed that the American Rule is alive and well, and it ruled that (1) deviation from the American Rule requires explicit statutory authority or a contract exception, and §§ 327 and 330 and did not contain the requisite statutory authority; and (2) defending a fee application is not a "service" under § 330. It is equally important to understand what *Baker Botts* did not decide. *Baker Botts* did not rule that § 330 prohibits defense costs, and, therefore, it does

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[25]*Id.*

[26]*Id.* at 2170.

[27]*Id.* (quoting § 330(a)(3)(F)).

[28]*Id.* at 2170-71.

[29]*Id.* at 2171.

[30]*Id.* at 2170. *See also* Smith v. Edwards & Hale Ltd. (In re Smith), 317 F.3d 918, 928 (9th Cir. 2002); and *In re* Huepenbecker, Case No. DK 12-02269, 2015 Bankr. Lexis 2352 (Bankr. W.D. Mich. July 13, 2015).

not prevent a contract exception to the American Rule.[31]

Consequently, the application of *Baker Botts* is limited in two ways: (1) to cases in which the debtor (*i.e.*, not a party in interest) challenges the defense costs; and (2) to cases in which counsel's retention agreement does not specifically provide for indemnification or compensation for defense costs.

In *Baker Botts*, it was the debtor who challenged the defense costs. According to the Supreme Court, the American Rule mandates that "[e]ach litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise."[32] Therefore, the American Rule is not implicated unless the defense costs are shifted to the losing litigant. What if the challenge is not by the debtor or the bankruptcy estate, but by a party in interest, *e.g.*, the UST? Would the American Rule prohibit defense costs, since no attempt is made to recover such costs from the losing litigant? If someone other than the debtor or the estate representative objects to the fees, the American Rule may not be applicable. If the challenge is by an official committee or by an individual creditor, they have a pecuniary interest in the outcome because it may affect the distribution to the committee's constituents or to the objecting creditor. Therefore, it could be argued that the defense costs will be shifted, albeit indirectly, to the objecting litigant. However, if the challenge is made by the UST, which has no pecuniary interest in the outcome, this argument cannot be sustained.[33]

Second, in *Baker Botts*, the retention agreement did not provide for the indemnification or compensation for defense costs. The Supreme Court acknowledged that a contract could render the American Rule inapplicable: the American Rule applies "unless a statute *or contract* provides otherwise."[34] Therefore, *Baker Botts* may not apply if there is a contract exception. An example of this exception could be a retention agreement approved under § 328(a) of the Bankruptcy Code that specifically provides for the indemnification of defense costs. Thus, a post-*Baker Botts* court may use the contract exception to avoid the mandate of the American Rule.

III. THE UNITED STATES TRUSTEE SPEAKS

After *Baker Botts*, the Executive Office for United States Trustees issued

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[31] *See In re* Boomerang Tube, 548 B.R. 69, 73 (Bankr. D. Del. 2016) ("[T]he Supreme Court did not hold that section 330 prohibits the allowance of defense fees and merely held that it did not expressly authorize them. . .Therefore, the contract exception to the American Rule is not precluded by the ruling in [*Baker Botts*].").

[32] *Baker Botts*, 135 S. Ct.at 2164 (quoting Hardt v. Reliance Standard Life Ins. Co., 560 U.S. 242, 252-253 (2010)).

[33] This is not to suggest the UST does not have standing to object, only that its lack of a pecuniary interest may render the American Rule inapplicable.

[34] *Baker Botts*, 135 S. Ct. at 2164 (emphasis added).

questions and answers regarding its policy in response to *Baker Botts*. It would object to any retention application that required the bankruptcy estate to compensate or indemnify a bankruptcy professional for defense costs.[35] It relied on three grounds to support this position: (1) § 328 does not contain explicit statutory authority to deviate from the American Rule against fee-shifting; (2) paying for defense cost is neither a term of employment nor reasonable because it is not a "service" to the client; and (3) § 330(a)(1) governs the award of compensation, and *Baker Botts* precludes defense costs under § 330(a)(1).[36]

Given the Supreme Court's instruction in *Baker Botts*, it is difficult to argue with the UST's first ground that § 328 does not contain explicit statutory authority to deviate from the American Rule against fee-shifting: "We have recognized departures from the American Rule only in 'specific and explicit provisions for the allowance of attorneys' fees under selected statutes'."[37] *Baker Botts* has settled this issue with respect to § 327, and, at least on this issue, there does not appear to be any meaningful distinction between § 327 and § 328.[38] But the fact that § 328 does not contain explicit statutory authority to deviate from the American Rule does not end the analysis of whether defense costs are permitted in § 328 engagements. It begins the analysis. Despite the lack of explicit statutory authority, defense costs should be permitted under the contract exception recognized by *Baker Botts*.

There is ample room for disagreement on the UST's second and third grounds. First, the Third Circuit in *In re United Artists Theatre Co.* has rebutted the UST's argument that defense costs is neither a term of employment nor reasonable because it is not a "service" to the client.[39] In *United Artists*, the Third Circuit rejected the UST's objection that indemnification was unreasonable under both §§ 327(a) and 328(a). The court held that it

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[35]"[T]he USTP will generally object to efforts to pay fees-on-fees in circumvention of ASARCO [*Baker Botts*]." Frequently Asked Questions—Professional Compensation https://www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp., Q&A #4. *See also* Clifford J. White III, *Professional Fees, Corporate Governance, Predictability and Transparency in Chapter 11*, 35 AM. BANKR. INST. J. 12, 67 (2016) ("the USTP will be alert and will object to any further attempts to eviscerate the Supreme Court's decision").

[36]Frequently Asked Questions—Professional Compensation https://www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp., Q&A #4.

[37]*Baker Botts*, 135 S. Ct. at 2164.

[38]It might be possible to advance at least two arguments. First, express authorization is not necessarily required for every term of employment. Section 328(a) refers to "any reasonable terms and conditions." Many terms and conditions rise in a retention agreement that are not expressly mentioned in § 328(a), but are permissible. *See, e.g.*, *In re* United Artists, 315 F.3d 217 (3d Cir. 2003) (permitting debtor's indemnification of its financial advisor for the advisor's own negligence). *See also* Robert J. Keach & Brady C. Williamson, *The Boomerang Effect: Is There a Contract Exception to ASARCO (and If Not, What Then)?*, 35 AM. BANKR. INST. J. 14, 96 (2016)("reasonableness cannot be limited to terms that literally benefit the estate"). Second, although not recognized by the Supreme Court in *Baker Botts*, fee shifting is inherent in the Bankruptcy Code. *See supra* note 22.

[39]*United Artists*, 315 F.3d 217.

was "reasonable" under § 328 for a debtor to indemnify its financial advisor for its negligence.[40] If the indemnification of negligence is "reasonable" under § 328(a), an indemnification of defense costs should be no less "reasonable" because an indemnity for negligence is no more a "service" to the client than an indemnity for defense costs. The Third Circuit's holding is illustrative of the fact that § 327(a) and § 328(a) each presents a different standard for "reasonableness." What may not be "reasonable" in a retention under § 327(a), might be "reasonable" in a retention under § 328(a).

Second, while it is not disputed that § 330(a) governs the awarding of compensation, § 330 is, by its own terms, subject to § 328. In other words, § 328 trumps § 330(a). To subject engagements approved under § 328(a) to the same standard as engagements approved under § 327(a) would unnecessarily restrict § 328(a), and, contrary to the plain language of § 330(a), would make § 330(a) trump § 328(a), not *vice versa.* If a debtor's indemnification of a financial advisor's own negligence constitutes "reasonable terms and conditions of employment" under § 328(a)—as the Third Circuit held in *United Artists*—it must be compensable under § 330(a), and, contrary to the UST's position, there is nothing in *Baker Botts* to preclude this.[41] The fact that both § 328(a) and § 330(a) use the word "reasonable" does not mean § 330(a) can be used to deny fees or compensation previously approved under § 328(a).[42] The scope of what is "reasonable" under § 328 is broader than what may be "reasonable" under § 330(a).

Admittedly, *United Artist* is pre-*Baker Botts*, but that should be irrelevant because *Baker Botts* did not deal with the § 328(a)-contract exception to the American Rule.[43] Moreover, unless and until reversed, *United Artists* remains of precedential value and binding in the Third Circuit.

IV. IN RE BOOMERANG TUBE

One of the first reported decisions on defense costs in the post-*Baker Botts* world was from the Delaware bankruptcy court. In *Boomerang*,[44] coun-

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[40]*Id.* at 222. The indemnification covered liability and attorneys' fees and expenses arising from the financial advisor's negligence in the rendition of its services but did not apply to liability resulting from gross negligence, bad faith, willful misfeasance, or reckless disregard of its obligations or duties. *Id.* at 222, n. 4.

[41]*See supra* note 31.

[42]The *dicta* in *In re Federal Mogul-Global Inc.* (a court may consider the § 330(a) factors when evaluating the reasonableness of a requested fee structure under 328(a)) does not direct a different result because (1) it is explicitly stated to be *dicta*; (2) § 328 explicitly trumps § 330(a); and (3) the Third Circuit, just nine months earlier in *United Artists*, ruled that an indemnity for negligence was a reasonable term and condition of employment under § 328(a). *In re* Federal Mogul-Global Inc., 348 F.3d 390, 408 (3d Cir. 2003).

[43]*See supra* note 31.

[44]*In re* Boomerang Tube, 548 B.R. 69 (Bankr. D. Del. 2016).

sel to the official committee of unsecured creditors sought approval under § 328(a) of its retention application, which included a provision entitling counsel to indemnification from the bankruptcy estate for fees incurred in the successful defense of its fee applications.[45] It is likely that counsel structured its claim to defense costs as an indemnity to take advantage of the history of bankruptcy courts' approving the indemnification of financial advisors under § 328(a).[46] The UST objected to this provision as both precluded by *Baker Botts* and unreasonable. Siding with the UST, Judge Mary Walrath rejected the indemnification provision and ruled that it was not permissible under the Bankruptcy Code.

Judge Walrath concluded that § 328(a) does not explicitly allow defense costs to the successful party in litigation. In other words, § 328(a) does not provide a statutory exception to the American Rule, the rule applied, and each party must pay its own defense costs.[47]

Significantly, Judge Walrath acknowledged that *Baker Botts* did not hold that § 330 precludes compensation for defense costs, and therefore it did not prevent a contract exception to the American Rule.[48] Nonetheless, she concluded the retention agreement was not a contract exception to the American Rule. Judge Walrath reasoned that, because the agreement was between the creditors' committee and its counsel, if counsel succeeded in its fee defense, a third party (*i.e.*, the bankruptcy estate) would be bound by the contract and saddled with the costs. This type of contract (*i.e.*, a contract to

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[45]548 B.R. 69 (Bankr. D. Del. 2016):

> As part of the compensation payable to Brown Rudnick, the Committee agrees that Brown Rudnick shall be indemnified and be entitled to payment from the Debtors' estates, subject to approval by the Court pursuant to 11 U.S.C. §§ 330 and 331, for any fees, costs or expenses, arising out of the successful defense of any fee application by Brown Rudnick in these bankruptcy cases in response to any objection to its fees or expenses in these Chapter 11 cases.

Application for Order Authorizing the Retention of Brown Rudnick LLP as Co-Counsel for the Official Committee of Unsecured Creditors, Boomerang Tube, LLC, Case No. 15-11247 (Bankr. D. Del., July 20, 2015), ECF No. 271, at ¶16.

[46]*See, e.g.*, Diana G. Adams & Roberta A. DeAngelis, *Does 'Improvident' Mean 'Immutable'?* AM. BANKR. INST. J. 18, 18 (2009)("In the not-too-distant past, the retention applications of investment bankers and financial advisors not only sought section 328 approval but also included indemnification agreements. The U.S. Trustees filed objections to these agreements. . . . Over time, the terms of indemnification acceptable to the U.S. Trustees were worked out."). *See also United Artists*, 315 F.3d 217 (3d Cir. 2003) (approving debtor's indemnification of financial advisor for the advisor's own negligence).

[47]To further validate her conclusion, Judge Walrath referred to several other Code provisions that contain explicit exceptions to the American Rule, noting that §§ 110(i)(1)(C), 303(i)(1)(B), 362(k)(1), 526(c)(2), 707(b)(4)(A), and 707(b)(5)(A) all allow for an award of fees to the prevailing party. *Boomerang Tube*, 548 B.R. at 72-73. Interestingly, all the fee-shifting provisions cited shift to third parties the obligation to pay the debtor's attorneys' fees, not *vice versa*.

[48]*See supra* note 31.

which the debtor is not a party), she reasoned, cannot bind the bankruptcy estate.

However, Judge Walrath later undercut this rationale by stating that she would have arrived at the same conclusion even if the debtor were a party to the retention agreement.[49] This may have been in recognition of the fact that a contract between the committee and its counsel would, in fact, bind the bankruptcy estate, once approved by the court.

But whether the contract would bind the estate may be a different question from whether it would qualify for the contract exception to the American Rule. The contract exception requires a contract between the professional and the party to whom the fees are to be shifted. Arguably, a contract between the creditors' committee and its counsel may not satisfy this requirement despite the fact that the contract may be binding on the estate. As a consequence, counsel may not be entitled to defense costs because it would be inconsistent with § 330 and may not satisfy the requirements of the § 328(a)-contract exception to the American Rule. Therefore, it is at least possible that the failure to contract with the estate may deprive the committee professional of the contract exception. This would seem avoidable if the debtor acknowledges its agreement to the defense-cost provision. Nonetheless, Judge Walrath was right; there is little substantive difference whether the defense-cost agreement is between the debtor and its counsel or between the creditors' committee and its counsel. While, in the former, the defense costs are shifted directly to the client (*i.e.*, the debtor), in the latter, the costs are almost always shifted to the committee's constituents (*i.e.*, the unsecured creditors), who bear the administrative costs of the bankruptcy case.

Finally, Judge Walrath determined that the retention agreement was a contract subject to approval and modification by the court under § 328(a). However, after considering whether the defense-cost provision fell within the scope of "reasonable terms and conditions of employment" under § 328(a), she held that the provision was not "reasonable" because it did "not involve any services for the Committee."[50] Applying the rationale in *Baker Botts*—and subjecting § 328(a) to the same standard as § 330(a)—Judge Walrath

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[49]*Boomerang Tube*, 548 B.R. at 79, n. 6 ("The Court would reach the same conclusion if the fee defense provisions were in a retention agreement filed by any professional under section 328(a) — including one retained by the debtor. Such provisions are not statutory or contractual exceptions to the American Rule and are not reasonable terms of employment of professionals."). Delaware Bankruptcy Judges Brendan Shannon and Christopher Sontchi later formally extended *Boomerang*'s reasoning to debtor's counsel. *See* Letter from Hon. Brendan Linehan Shannon to Counsel, *In re* New Gulf Resources LLC, No. 15-12566 (Bankr. D. Del. Feb. 1, 2016), ECF No. 228; and Letter from Hon. Christopher S. Sontchi to Counsel, *In re* Samson Resources Corp., No. 15-11934 (Bankr. D. Del. Feb. 8, 2016), ECF No. 641.

[50]*Boomerang Tube*, 548 B.R. at 75.

concluded that the defense-cost provision benefited only counsel, rather than the committee or the bankruptcy estate.

Judge Walrath recognized that some "courts generally hold that exculpation and indemnification clauses are permissible in retention agreements if the clauses are reasonable in accordance with 11 U.S.C. § 328(a)."[51] She noted that the Third Circuit has held that indemnification provisions, even for negligence, may be approved as "reasonable" under § 328(a). Yet, she dismissed this and other lower court holdings as unpersuasive "because they all predate [*Baker Botts*] and most involve cases granting fees in bankruptcy cases for defending fee applications with little analysis of why such services benefitted the estate or counsel's client."[52]

The crux of *Boomerang* is its "reasonableness" analysis under § 328(a), and its determination that defense costs are not "reasonable" under § 328(a). Does *Baker Botts* necessarily lead to *Boomerang's* conclusion? It is submitted that the Supreme Court believed it "reasonable" for parties to agree to compensate counsel for defense costs. After all, the Supreme Court stated that, under the American Rule, each litigant pays its own fees "unless a statute or *contract* provides otherwise."[53] Because it was not in issue, the Supreme Court did not address whether an agreement to pay defense costs would constitute "reasonable" terms and conditions of employment under § 328(a).

Section 328(a) permits employment "on any reasonable terms and conditions." *Baker Botts* recognized that parties can agree to shift defense costs, and *United Artists* and other courts have held indemnification provisions to be "reasonable" under § 328(a), even if they benefit the professional and not the debtor.[54] Is an indemnification of defense costs any different from an indemnification of other liability? An indemnity for negligence is no more a "service" or a benefit to the client than an indemnity for defense costs. The Third Circuit approved the former under § 328(a) but Judge Walrath rejected the latter. However, there does not appear to be any meaningful distinction between the two.

Boomerang's conclusion—that defense-cost provisions can never constitute "reasonable" terms of employment under § 328(a)—was not mandated by *Baker Botts* because the Supreme Court did not have the opportunity to

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[51]548 B.R. at 75-76, referring to cases cited by Committee counsel in support of its position: *In re Firstline Corp.*, No. 06-70145, 2007 WL 269086, at *2 (Bankr. M.D. Ga. Jan. 25, 2007) (citing *United Artists Theatre Co.*, 315 F.3d 217, 230 (3d Cir. 2003) (approving broad exculpation provision for debtor, trustee, and the committee, and their advisors, attorneys, consultants or professionals, with exception for gross negligence, willful misconduct, and breach of fiduciary duty).

[52]*Boomerang Tube*, 548 B.R. at 77.

[53]*Baker Botts*, 135 S. Ct. at 2164 (emphasis added).

[54]*See, e.g.*, *United Artists*, 315 F.3d 217; *In re* DEC Int'l, Inc., 282 B.R. 423, 424 (W.D. Wis. 2002); *In re* Joan & David Halpern, Inc., 248 B.R. 43, 47 (Bankr. S.D.N.Y. 2000); *In re Firstline Corp.*, 2007 WL 269086, at *2 (citing *United Artists*); and *In re* Potter, 377 B.R. 305, 306-308 (Bankr. D. N.M. 2007).

address whether a defense-cost provision (or an agreement to indemnify counsel for defense costs, as presented in *Boomerang*) would constitute "reasonable" terms of employment under § 328(a).

The *Boomerang* court, after conceding that § 328 is an exception to § 330(a),[55] failed to articulate persuasively why an agreement to indemnify counsel for defense costs proposed under § 328—an exception to § 330(a)—should be subject to the § 330(a) standard that the "services" be rendered to the committee or the estate. To the extent Judge Walrath relied on *Federal Mogul* to consider the § 330(a) factors in determining the "reasonableness" of the defense-cost indemnity under § 328, it was appropriate. But the analysis should not end there. Since § 328 trumps § 330(a), the scope of what is "reasonable" under § 328 is broader than what may be "reasonable" under § 330(a).[56] To restrict § 328 to the § 330(a) standard disregards the Code's instruction that § 328 trumps § 330(a), not *vice versa*.

The UST, citing the examples in § 328(a), argued in *Boomerang* that § 328 is limited to *how* the professional is to be paid, and does not apply to the *type of services* for which the professional may be paid.[57] But this argument is undercut by the following: (1) the words of the statute clearly state that the examples are inclusive, not exhaustive;[58] (2) contrary to the UST's position, the Third Circuit in *United Artists* applied § 328(a) to a type of

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[55]*Boomerang Tube*, 548 B.R. at 72 ("The Court concludes that. . . section 328 is an exception to section 330".).

[56]*See, e.g.*, *United Artists*, 315 F.3d 217 (debtor's indemnification of its financial advisor for the advisor's own negligence was "reasonable" in a retention under § 328 even though it may not have been "reasonable" in a retention under § 327).

[57]Objection of the United States Trustee to Order Authorizing Retention of Brown Rudnick LLP, ¶¶ 17-18, *In re* Boomerang Tube, LLC, Case No. 15-11247 (Aug. 3, 2015), ECF No. 314:

> [S]ection 328 addresses the question of *how* the professional is to be paid, but not the type of services *for which* the professional may be paid. Section 328(a)'s examples all involve forms of payment, and a term authorizing fees for fee defense is not a form of payment. . . It follows that the 'terms and conditions' that can be approved under section 328(a) should be limited to those addressing the forms of compensation and similar matters, like hourly vs. contingent fees, not the scope of substantive work for which the professional may be compensated, like fee defense litigation. As a result, section 328(a) does not authorize the Court to approve the Fee Defense Provisions.

The UST has also argued that, since § 330(a) and § 328(a) both use the word "reasonable," any term that would not be permitted by § 330(a) is also not permitted by § 328(a). Acting United States Trustee Objection to the Application of Kirkland & Ellis LLP, In re Samson Resources Corp., Case No. 15-11934 (Bankr. D. Del., Nov. 23, 2015), ECF No. 389, ¶¶ 27-29 (citing *In re Federal Mogul-Global, Inc.*, 348 F.3d 390, 407-08 (3d Cir. 2003)). This argument appears to have gained traction with the *Boomerang* court. *Boomerang Tube*, 548 B.R. at 77-78. But it was rejected earlier by the Third Circuit. In *United Artists*, the Third Circuit rejected the UST's contention that a debtor's indemnification of a financial advisor for its own negligence — which would not have been permitted under § 327(a)—was similarly not permitted under § 328(a). The Third Circuit ruled that such indemnification was permissible under § 328(a).

[58]*See also* 11 U.S.C. § 102(3) ("'includes' and 'including' are not limiting").

"service" (*i.e.*, the indemnification of a financial advisor);[59] and (3) Judge Walrath's opinion, which thoughtfully considered counsel's arguments, is conspicuously silent on this specific argument.

Admittedly, *Baker Botts* made much of the fact that fee-defense services are not "services" to the bankruptcy estate. But that was in the context of § 330(a), not § 328(a). While it can be argued that § 328 may be read in the same light that the Supreme Court read § 330, this is neither mandated by *Baker Botts* nor consistent with the Code's plain language.

Boomerang failed to accord *United Artists*[60] its due precedential weight. In *United Artists*, the debtor's financial advisor sought retention on terms that required the debtor to indemnify the advisor for the advisor's own negligence. The UST objected to indemnification on the basis that it was not "reasonable" under either § 327(a) or § 328(a). Overruling this objection, the Third Circuit held that it was "reasonable" under § 328(a) to indemnify the financial advisor for its own negligence. The *Boomerang* court dismissed *United Artists* on four grounds: (1) it predated *Baker Botts*; (2) it did not address whether § 328(a) is a statutory exception to the American Rule; (3) it did not address whether a retention agreement approved under § 328(a) is a contract exception to the American Rule; and (4) it dealt with indemnification of financial advisors, who are typically provided similar protections outside bankruptcy. None of these grounds compels the *Boomerang* result.

First, *Baker Botts* neither overruled *United Artists* nor is it controlling in this situation. Unlike *Boomerang*, *Baker Botts* did not address the contract exception to the American Rule under § 328(a).[61] Therefore, it is not significant that *United Artists* predated *Baker Botts*. Judge Walrath reasoned that *Baker Botts* prevented her "from concluding that section 328 permits defense fees even if they were routinely allowed by the market in bankruptcy or non-bankruptcy contexts prior to that ruling."[62] She adopted the UST's argument that *Baker Botts* "expressly rejected the consideration of such [market] factors" in determining the reasonableness of the indemnification agreement.[63] But *Baker Botts* did not reject (much less expressly) the consideration of market factors. In *Baker Botts*, what the Supreme Court rejected was the UST's policy argument that "awarding fees for fee-defense litigation is a 'judicial exception' necessary to the proper functioning of the Bankruptcy Code."[64]

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[59]*United Artists*, 315 F.3d 217. *See also In re* Potter, *supra* note 54 (approval of indemnification of attorney under § 328).

[60]*Id.*

[61]*Boomerang Tube*, 548 B.R. at 73 ("the contract exception to the American Rule is not precluded by the ruling in [*Baker Botts*]").

[62]*Boomerang Tube*, 548 B.R. at 78.

[63]*Id.*

[64]Baker Botts, L.L.P. v. ASARCO, LLC, 135 S. Ct. 2155, 2168 (2015).

But the Supreme Court did not mandate a *per se* rejection of market factors. Market factors are not dispositive, as the Third Circuit recognized in *United Artists*: "[T]hat indemnification provisions . . . are now common in the marketplace does not automatically make them 'reasonable' under § 328. Our approach is 'market driven,' not 'market determined'."[65] The fact that *United Artists* predated *Baker Botts* does not lessen its precedential value.

Second, it is beside the point that § 328(a) is not a statutory exception to the American Rule because that was not in issue in *United Artists* and was not relevant to its holding. It may be argued, for example, that the American Rule was not even implicated in *United Artists* because the challenge to indemnification was made by the UST, not by the party to whom the costs were proposed to be shifted.[66]

Third, the fact that the *United Artists* court did not characterize the indemnification provision as a "contractual exception to the American Rule" does nothing to alter the Third Circuit's unanimous ruling[67] that indemnification of a financial advisor's negligence was "reasonable" under § 328(a).[68]

Finally, there is no principled basis for permitting indemnification of financial advisors for their own negligence, but prohibiting indemnification of counsel for defense costs. An indemnity for negligence is no more a "service" or a benefit to the client than an indemnity for defense costs. Even the UST has recognized there is no basis for differentiating between financial advisors and counsel.[69] For these reasons, it can at least be argued that Third Circuit precedent in *United Artists* required a different result than reached in *Boomerang*.

Judge Walrath seemed challenged by the fact that defending fee applications is not a "service" that benefits the client. This apparent imbalance of benefits was accentuated by her focus on a single provision in the retention agreement, to the exclusion of all the other provisions. The fact that the defense-cost provision does not benefit the client should not render it impermissible under § 328(a), if it is customary and otherwise reasonable, and if the retention agreement, when considered in its entirety, benefits the client. Not every provision in a retention agreement will benefit the client. Reten-

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[65]*In re* United Artists, 315 F.3d 217, 230 (3d Cir. 2003).

[66]*See, e.g.*, *In re* Macco Properties, Inc., 540 B.R. 793 (Bankr. W.D. Okla. 2015) (stating that American Rule precludes fee shifting between adversaries but does not apply to preclude estate professionals from being compensated by the estate for defending their fees against challenges by others.).

[67]Ambro, Alito, and Rendell, JJ., each issued separate opinions, but all concurred in this holding.

[68]Again, the American Rule may not even have been implicated in *United Artists*. *Supra* note 66.

[69]"Non-lawyer professionals, such as financial advisors, are entitled to no better and no worse treatment with respect to legal fees for defending objections to fee applications in a bankruptcy case." Frequently Asked Questions—Professional Compensation https://www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp., Q&A #9. *See also In re* Potter, *supra* note 54 (approval of indemnification of attorney under § 328).

tion agreements include many provisions, not all of which necessarily serve the client's interests. Some provisions, like indemnities and defense costs, are for the benefit of the professional. This is true of every retention agreement, both inside and outside bankruptcy. A retention agreement represents a bundle of rights and benefits, and should be analyzed in its entirety to determine if "services" are provided to and benefit the client. Under § 328(a), the bankruptcy court must determine if the terms and conditions of employment are "reasonable." This requires the court to examine the bundle of rights and benefits exchanged between the parties. This cannot be determined on a provision-by-provision basis. It would be inappropriate, for example, to look at the defense-cost provision in isolation. If, to be approved under § 328(a), every term in a retention agreement had to satisfy the "service" or benefit-to-the-client criterion of § 330(a), many terms that are now customary and have long been approved by bankruptcy courts (and even by the UST) could no longer stand and could not now be approved under § 328(a).[70]

Perhaps Judge Walrath was concerned that approving a defense-cost provision under § 328(a) might create a too-easily available exception to *Baker Botts* that would swallow the rule. But it was the Supreme Court which identified the contract exception, and left the door open. It was unlikely inadvertent. And even if so, it is for the Supreme Court to fix.

After *Boomerang*, two additional Delaware Bankruptcy Judges rejected attempts by attorneys to be compensated for their defense fees. In letters to counsel, Chief Judge Brendan Shannon in *In re New Gulf Resources LLC*,[71] and Judge Christopher Sontchi in *In re Samson Resources Corp.*,[72] announced that they would follow Judge Walrath's decision in *Boomerang*. Notably, both cases involved the debtor and its counsel, thus providing the formal adoption of *Boomerang's* footnote 6.[73] Although *Samson Resources* mirrored the facts of *Boomerang*, in *New Gulf Resources* the debtor's counsel sought bankruptcy court approval of a 10-percent premium in its fees, payable only in the event counsel incurred material fees and expenses defending its fee applications.[74] Counsel contended that the premium compensated for the

[70]*See, e.g.*, Adams & DeAngelis, *supra* note 46, at 18 ("Over time, the terms of indemnification acceptable to the U.S. Trustees were worked out."). *See also United Artists*, 315 F.3d 217 (approving debtor's indemnification of financial advisor for its own negligence), and *In re* Potter, *supra* note 54 (approval of indemnification of attorney under § 328).

[71]Letter from Hon. Brendan Linehan Shannon to Counsel, *In re* New Gulf Resources LLC, No. 15-12566 (Bankr. D. Del. Feb. 1, 2016), ECF No. 228.

[72]*See* Letter from Hon. Christopher S. Sontchi to Counsel, *In re* Samson Resources Corp., No. 15-11934 (Bankr. D. Del. Feb. 8, 2016), ECF No. 641.

[73]"The Court would reach the same conclusion if the fee defense provisions were in a retention agreement filed by any professional under section 328(a)—including one retained by the debtor." *Boomerang Tube*, 548 B.R. at 79, n.6.

[74]Debtors' Application for Entry of an Order Authorizing the Retention and Employment of Baker Botts L.L.P. as Counsel for the Debtors and Debtors in Possession, *New Gulf Resources*, No. 15-12566

risk of defending its fees without compensation for the actual cost of defense.[75] Judge Shannon rejected this risk premium, finding that the proposed structure ran afoul of the holdings in *Baker Botts* and *Boomerang*.[76]

Judge Shannon reached the correct conclusion—although one might disagree with his reasoning. Applying a risk premium in bankruptcy cases to compensate for defense costs seems wrong because it would create a different standard of compensation from non-bankruptcy cases.[77] Professionals in bankruptcy cases are required to charge comparable rates to those offered to non-bankruptcy clients.[78] A risk premium in bankruptcy cases runs counter to this requirement, not to *Baker Botts*. The parties to a retention agreement approved under § 328(a) cannot simply agree to whatever terms they like. Unlike typical bilateral contracts in the non-bankruptcy context, retention agreements are subject to the objection of creditors, the UST, and other parties in interest, and must be approved by the bankruptcy court. The terms and conditions of retention must be "reasonable" under § 328(a). A bankruptcy court reviewing a retention agreement under § 328(a) may find, after considering the entire agreement, that a risk premium is not "reasonable" and, therefore, should not be approved under § 328(a).

Despite the rejection by some Delaware bankruptcy judges of defense-cost provisions, it remains a live issue in jurisdictions outside Delaware, and even in Delaware if the parties intend to seek appellate review.[79]

V. OTHER JURISDICTIONS CONSIDERING *BAKER BOTTS*

Only a few other courts have addressed defense-cost issues after *Baker*

(Bankr. D. Del. Dec. 19, 2015), ECF No. 54 at ¶¶ 13-15. Prior to bankruptcy, counsel charged the debtors a preferred rate, which incorporated a discount of 10-15% off counsel's standard billing rates. The debtors retained the right to object to counsel's fee applications, but, the risk premium, once triggered, was payable regardless of the outcome of the objection. *Id.* at ¶ 13.

[75]Id. at ¶¶ 14-15.

[76]Letters from Hon. Brendan Linehan Shannon to Counsel, *New Gulf Resources*, No. 15-12566 (Bankr. D. Del.), ECF Nos. 228 (Feb. 1, 2016) and 395 (Mar. 17, 2016).

[77]The Fifth Circuit seemed to have invited this risk premium. "When firms become aware that they may not be reimbursed for defending core fee applications, they can anticipate this possibility in their hourly rates and by thoroughly documenting fee applications." *In re* ASARCO, LLC, 751 F.3d 291, 301, n.7 (5th Cir. 2014).

[78]Fee Application Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses filed under 11 U.S.C. § 330 by Attorney's in Larger Chapter 11 Cases, 28 C.F.R. Part 58, Appendix B, Part B.1 ("United States Trustee seeks. . .[t]o ensure adherence to the requirements of section 330 of the Code so that all professional compensation is reasonable and necessary, particularly as compared to the market measured both by the applicant's own billing practices for bankruptcy and non-bankruptcy engagements and by those of other comparable professionals").

[79]Delaware Bankruptcy Judges Carey, Gross, and Silverstein do not appear to have yet addressed the issue, but, in view of the precedents already set by Judges Walrath, Shannon, and Sontchi, it seems unlikely that these judges would take a different path.

Botts. The Michigan bankruptcy court in *Huepenbecker*[80] held that *Baker Botts* precluded it from awarding defense costs. Sympathetic to the plight of counsel, the court noted:

> [It] cannot turn a blind eye to the impact that *Baker Botts* will have on the members of the bar whose livelihood depends on approval of fees under § 330. Today's decision, and Mr. Davidoff's unhappy experience with Mr. Budzynski, presents a telling example of the hardship to estate professionals (and debtors' counsel in chapter 12 and 13 cases) whose fee petitions draw objection. Mr. Davidoff has spent at least $1,925.00 of his own (non-compensable) time seeking $6,625.00 in fees for [re]presenting his client. Constrained by *Baker Botts*, the court will approve fees in a reduced amount, totaling only $4,700.00 for the first and second applications. This means that Mr. Davidoff will net only $2,781.00, resulting in an effective rate of approximately $146.00 per hour. The result, though dictated by recent precedent, undermines important policies affecting administration of estates.[81]

Notably, *Huepenbecker* did not consider the contract exception. Therefore, the issue appears to remain unaddressed in that district.

In re River Road Hotel Partners, LLC[82] extended *Baker Botts* to financial advisors.[83] This is not surprising because there is nothing in *Baker Botts* to suggest that the Supreme Court was singling out lawyers. In *River Road Hotel*, an Illinois bankruptcy court applying *Baker Botts* held that the debtors' financial advisor was not entitled to attorneys' fees incurred in its fee defense. The financial advisor's retention had been approved under § 328(a), and its engagement letter explicitly provided that the advisor would be indemnified for "all 'reasonable' expenses (including reasonable counsel fees and expenses)."[84] Although the court rejected the advisor's contract exception to the American Rule, this was because the retention order expressly provided that reimbursement of attorneys' fees was subject to review and approval

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[80] *In re* Huepenbecker, Case No. DK 12-02269, 2015 Bankr. Lexis 2352 (Bankr. W.D. Mich. 2015).

[81] *Id.* at *9.

[82] *In re* River Road Hotel Partners, LLC, 536 B.R. 228 (Bankr. N.D. Ill. 2015), *aff'd sub nom.* Bletchley Hotel At O'Hare Field LLC v. River Rd. Hotel Partners LLC, Case No. 15-C-8063 (N.D. Ill. Aug. 4, 2016), *appeal filed*, Case No. 16-3432 (7th Cir., Sept. 14, 2016).

[83] Affirmed on appeal, the district court rejected the financial advisor's attempt to restrict *Baker Botts* to lawyers, finding it was an "irrelevant distinction." *See* Case No. 15-C-8063 (N.D. Ill. August 4, 2016), n.61. This is also the position of the UST.

[84] *River Road Hotel*, 536 B.R. at 232.

under § 330.[85] The result might have been different if the retention order had not specifically required the § 330 standard for approval. The effect was to eliminate the protection offered by § 328(a) and to thrust the fee-defense claim directly into the teeth of *Baker Botts*.

At least one court has distinguished *Baker Botts*. In *In re Macco Properties, Inc.*, an Oklahoma bankruptcy court considered objections by former equity owners of the debtor to the defense cost of the bankruptcy trustee's professionals.[86] The bankruptcy trustee supported compensating the professionals for their successful fee defense. Distinguishing *Baker Botts*, the *Macco* court allowed defense costs on the basis that the fee objection was made by a third party, not by the bankruptcy estate.

> [U]nlike ASARCO, the *estate* does not oppose compensating the Estate Professionals. Trustee, as sole representative of the estate, fully supports payment, and is advocating in favor of granting the Estate Professionals' applications in order to complete the administration of both the Chapter 11 estate and the Chapter 7 estate.[87]

The *Macco* court distinguished between a bankruptcy estate paying for expenses incurred by counsel defending themselves against third parties and counsel defending themselves against the estate itself, and, on that basis, found *Baker Botts* not applicable.

> Because ASARCO itself, the proposed payor of the fees, objected to Baker Botts' compensation application, comments concerning objections by other parties in interest are pure dicta, and the Court declines to draw any inference that the American Rule (precluding fee shifting between the litigating parties) precludes professionals from being paid *from the estate* for defending against claims and objections asserted by a party *other than* a duly appointed representative of the estate.[88]

Although the *Macco* court correctly concluded that the American Rule was not implicated, it failed to persuasively articulate the basis for allowing defense costs. The professionals in *Macco* were not engaged under § 328(a) pursuant to retention agreements that included defense-cost indemnification.

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[85]The retention order provided that the reimbursement of "out-of-pocket expenses shall be subject to further review and approval by the Court *pursuant to section 330* of the Bankruptcy Code." *River Road Hotel*, 536 B.R. at 232-33 (emphasis added).

[86]540 B.R. 793 (Bankr. W.D. Okla. 2015).

[87]*Id.* at 877.

[88]*Id.* at 878, n.439.

Therefore, according to *Baker Botts*, § 330(a) allows compensation only for services rendered to the debtor or the estate. The *Macco* court found that defending fee applications from third-party objections constituted "'actual, necessary services rendered' to assist the Trustee in completing the administration of the estate" because the "Trustee cannot complete the administration of the estate until all administrative expense claims are liquidated."[89] However, this reasoning is not compelling. First, if correct, it should not matter whether the objections are made by a third party or by the debtor or the trustee-in-bankruptcy, because, in any case, the fee defense will assist the administration of the estate by liquidating administrative claims. Yet, it is clear from the *Macco* opinion that the fact the objectors were third parties, not the bankruptcy trustee, was pivotal to the decision.[90] Second, if correct, it should not matter whether the fee defense was successful or unsuccessful. The Supreme Court rejected this argument in *Baker Botts* and identified its flaw: "the proposed provision of a 'service' exists whether or not a § 327(a) professional prevails in his fee dispute."[91] It would seem untenable that any court, either before or after *Baker Botts*, would allow indemnification or compensation for *unsuccessful* fee defense.[92]

VI. WHERE DO WE GO FROM HERE?

This much is clear: *Baker Botts* is the law of the land. Bankruptcy professionals would be well advised to accept the decision and not spend time devising ways to get around it. But we should understand what *Baker Botts* decided, and what it did not decide.

This is where we are. If the professional's retention is approved pursuant to § 327(a) and not § 328(a), the professional will not be entitled to defense costs because compensation is awarded under § 330(a), and § 330(a) only allows compensation for services rendered to the debtor or the estate. *Baker Botts* has instructed that defending fee applications is not such a service. This is so regardless of whether the terms of the professional's retention included defense costs because § 330(a) only allows compensation for services to the client, and fee defense is not a service to the client. But, as *Boomerang* acknowledged, *Baker Botts* did not hold that § 330 precludes compensation for defense costs, and, therefore, *Baker Botts* does not prevent a contract ex-

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[89] *Id.* at 878.

[90] To avoid any doubt, the *Macco* court emphasized: "Let it be said again: Trustee has no objection to compensating Counsel in the full amount billed by Counsel, and Counsel is not litigating against the estate." *Id.*

[91] Baker Botts, L.L.P. v. ASARCO, LLC, 135 S. Ct. 2158, 2166 (2015).

[92] *See, e.g.*, *Baker Botts*, 135 S. Ct. at 2166 ("We decline to adopt a reading of § 330(a)(1) that would allow courts to pay professionals for arguing for fees they were found never to have been entitled to in the first place.").

ception to the American Rule.[93]

If the terms of the professional's retention include an indemnification for defense costs that was approved under § 328(a), defense costs should be allowable under § 330(a), because § 330(a) is subject to § 328.[94] This means if the defense-cost indemnity is a "reasonable" term and condition of employment under § 328(a), defense costs are allowable under § 330(a), even though the service may be for the benefit of the professional, and not the client.

Therefore, the critical threshold question is whether defense-cost indemnity is a "reasonable" term or condition of employment under § 328. This is not a novel question. It has been previously presented to courts, and the answer has usually been yes. Of course, that history was before *Baker Botts* and usually in the context of financial advisors. Does that make a difference? *Boomerang* answered yes. But the fact this history predated *Baker Botts* should be irrelevant. First, defense-cost indemnification approved pursuant to § 328(a) qualifies for the contract exception explicitly recognized by *Baker Botts*. Second, any indemnity approved under § 328(a) should be allowable under § 330(a) because § 328 trumps § 330(a). Finally, there is no principled basis to treat financial advisors differently from attorneys (unless required by the applicable rules of professional conduct).[95] The defense-cost indemnity must be limited to the successful defense of the professional's fee applications.[96] It may be wise to also limit it to challenges by persons other than the client (*i.e.*, other than the debtor or the committee, as the case may be). While not strictly required, this may enhance the "reasonableness" of the indemnity.[97]

In *Boomerang*, Judge Walrath seemed challenged by the fact that defending fee applications is not a "service" to the client. Indeed, the Supreme Court made much of this in *Baker Botts*. The fact that fee defense does not necessarily benefit the bankruptcy estate should not render it impermissible under § 328(a), if it is customary and otherwise reasonable. A retention agreement must be reviewed in its entirety to determine if "services" are provided to and benefit the client. Not all provisions in a retention agreement benefit the client. Some provisions, like indemnities and defense costs, benefit the professional. Every provision is not required to satisfy the "ser-

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[93]*See supra* note 61.

[94]In the case of committee professionals, to strictly comply with the contract exception, it would be prudent to obtain the debtor's agreement to any defense-cost provision. This can be accomplished by having the debtor sign a line on the professional's engagement letter confirming its agreement to the provision.

[95]*See supra* note 69.

[96]*See supra* note 92. The maxim "less is more" is often applicable to indemnifications that require court approval: the more limited the indemnification, the greater the prospects for court approval.

[97]Of course, in the event the extraordinary facts of *Baker Botts* strike again, the indemnity, by its own terms, would not be applicable; leading to the same result.

vice" or benefit-to-the-client criterion of § 330(a). Otherwise, some provisions that courts have approved in the past could no longer be approved under § 328(a).[98] This would result in § 330(a) overriding § 328, which would be contrary to the plain language of the statute.

Can the parties to a retention agreement proposed under § 328(a) agree to whatever terms they like? Of course not. Section 328(a) is not a license to run roughshod over the Bankruptcy Code. Unlike typical bilateral contracts, retention agreements are subject to the objection of creditors, the UST, and other parties in interest, and must be approved by the bankruptcy court. The terms and conditions of retention must be "reasonable" under § 328(a). Any provision that violates the Bankruptcy Code or public policy would not be "reasonable" and should not be approved.[99] A bankruptcy court should not be required to approve a component of the retention agreement solely because the other provisions in the agreement are reasonable. For example, a provision that proposed to compensate a professional for its unsuccessful defense of fee applications, or that proposed to indemnify the professional for its own willful misconduct, should be considered in the context of the entire retention agreement, and likely rejected on its merits; not rejected simply because the specific provision did not constitute a "service" to the client.

The UST will object to retention applications that include defense costs,[100] and some courts are applying *Baker Botts* to prohibit compensation for such costs.[101] For example, Delaware bankruptcy courts have made it clear that retention applications purporting to allow indemnification or compensation for defense costs are not "reasonable" and therefore not permissible under § 328(a).[102] Still, it is a live issue in jurisdictions that have not considered post-*Baker Botts* fee-defense compensation. And, as noted, it remains a live issue even in Delaware.

Because the vast majority of jurisdictions have yet to consider the issue, these jurisdictions are unencumbered by cases like *Boomerang*. There, bank-

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[98]*See, e.g.*, Adams & DeAngelis, *supra note* 46 at 18 ("Over time, the terms of indemnification acceptable to the U.S. Trustees were worked out."). *See also* United Artists Theatre Co. v. Walton, 315 F.3d 217 (3d Cir. 2003) (approving debtor's indemnification of financial advisor for its own negligence).

[99]It may be incumbent on the professional seeking approval of its retention agreement under § 328(a) to flag for the bankruptcy court and all parties in interest any proposed terms or conditions of employment that might be problematic.

[100]See supra note 35.

[101]*See, e.g.*, *In re* Boomerang Tube, 548 B.R. 69 (Bankr. D. Del. 2016); *In re* River Road Hotel Partners, 536 B.R. 228, 239-41, *aff'd sub nom.* Bletchley Hotel at O'Hare Field v. River Road Hotel Partners, Case No. 15-C-8063, 2016 WL 4146480 (N.D. Ill. Aug. 4, 2016); and *In re* Huepenbecker, Case No. DK-12-02269, 2015 Bankr. LEXIS 2352, at *5 (Bankr. W.D. Mich. 2015).

[102]*Boomerang Tube*, 548 B.R. at 70; *In re* Samson Resources Corp., No. 15-11934 (CSS), (Bankr. D. Del. Feb. 8, 2016), ECF No. 641; *In re* New Gulf Resources LLC, No. 15-12566 (BLS) (Bankr D. Del. 2016), ECF Nos. 228 and 395.

ruptcy professionals are free to seek approval under § 328(a) of indemnification or compensation for defense costs in their retention applications. However, these professionals may have to demonstrate that a benefit, which seemingly accrues only to the bankruptcy professionals, and not the client, is a "reasonable" term and condition of employment under § 328(a). In the event (albeit unlikely) the professional is unwilling to render services without such indemnification or compensation, approving such a provision may provide the needed benefit to the client because, without it, the client may be deprived of the professional of its choosing. In any event, it may be argued that indemnification under § 328(a) has long been considered a "reasonable" term and condition, and that *Baker Botts* does not alter that fact.[103]

It also may be argued that *Boomerang*'s apparent conflation of § 330(a) and § 328(a)—by requiring fee-defense to constitute "service" to the client in accordance with § 330(a)—is neither mandated by *Baker Botts* (which did not deal with this issue) nor consistent with the fact that § 328 is an exception to § 330(a). To subject § 328 to the same standard as § 330(a) unnecessarily limits § 328's exception from § 330(a).[104] The effect is to make § 330(a) trump § 328, not *vice versa* as the statute commands.

Finally, if the challenge to defense costs is made by the UST (or someone without a pecuniary interest in the outcome), *Baker Botts* may be distinguished on the basis that the American Rule is not applicable, unless the challenge is by the party to whom the costs are proposed to be shifted.[105]

The use of the so-called Blackstone Protocol may add grist to the defense-cost mill. The Blackstone Protocol (so named apparently because it first appeared in the retention order for The Blackstone Group) expressly reserves to the UST the right to object to fee applications using § 330(a)'s reasonableness standard, despite the professional's retention under § 328(a).[106] The

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[103]*See, e.g., In re* United Artists Theatre Co. v. Walton, 315 F.3d 217 (3d Cir. 2003). *See also In re* Potter, *supra* note 54 (approval of indemnification of attorney under § 328), and Keach & Williamson, *supra* note 38 at 96, ("reasonableness cannot be limited to terms that literally benefit the estate").

[104]Keach & Williamson, *supra* note 38, at 96 ("holding that such [fee-defense] provisions are not reasonable— collapses the two exceptions to the American Rule into one").

[105]*See, e.g., In re* Macco Properties, Inc., 540 B.R. 793, 877 (Bankr. W.D. Okla. 2015)(American Rule precludes fee shifting between adversaries, but does not apply to preclude estate professionals from being compensated by the estate for defending their fees against challenges by others.). However, the professional may still be at risk, if its retention agreement did not include defense costs approved under § 328(a), because it may be argued that the professional's compensation can only be allowed under § 330(a), which, according to *Baker Botts*, is limited to "services" rendered to the client, and fee defense is not such a "service."

[106]The Blackstone retention order provided that "the United States Trustee retains all rights to object to Blackstone's interim and final fee applications (including expense reimbursement) on all grounds including but not limited to the reasonableness standard provided for in Section 330 of the Bankruptcy Code." Order Authorizing the Retention of The Blackstone Group, *In re* Global Crossing Ltd., Case No. 02-40187 through 02-40241 (Bankr. S.D.N.Y. Apr. 16, 2002), ECF No. 831. *See also* Adams & DeAngelis, *supra* note 46 at 18.

Blackstone Protocol has been limited by the UST to financial advisors retained under § 328(a). Since it predates *Baker Botts* by well over a decade, it surely was not contemplated that it would be used to prohibit defense costs. It is not clear whether an *ex post facto* § 330(a) review under the Blackstone Protocol would trump a defense-cost indemnity previously approved in a § 328(a) retention. Unless the retention order specifically provided that the § 330(a) standard applied notwithstanding any approval under § 328(a), there would seem to be a good argument that any § 328(a)-approved, defense-cost provision should be compensable under § 330(a) because § 330(a) is subject to § 328. But, in the post-*Baker Botts* world, the Blackstone Protocol may prove a means to challenge defense-cost provisions.[107] Although currently limited by the UST to financial advisors approved under § 328(a), if the Blackstone Protocol were to become commonly used in retention orders,[108] it could effectively eliminate the contract-exception argument (which relies upon the application of the § 328(a) standard), and, arguably, would thrust the defense-cost claim directly into the teeth of *Baker Botts*.[109] If so, the result will follow the story of *River Road Hotel*, where the court rejected the contract exception to the American Rule because the retention order expressly provided that reimbursement of attorneys' fees was subject to review and approval under § 330.[110]

One cannot help wondering if the Supreme Court's decision in *Baker Botts* was influenced by a perception that ASARCO's counsel had already been handsomely compensated by the award of $124 million in fees (including the bonus), and whether counsel's attempt to recover an additional $5 million in defense costs was the straw that broke the camel's back.[111] To those who

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[107]*See, e.g.*, Adams & DeAngelis, *supra* note 46 at 18 ("the U.S. Trustee and the court are permitted to review the compensation at the end of the case under the standards set forth in section 330").

[108]*See, e.g.*, Order Authorizing and Approving the Employment and Retention of Guggenheim Securities LLC as Investment Banker to the Official Committee of Unsecured Creditors, *In re* Exide Technologies, Case No. 13-11482 (Bankr. D. Del. Aug. 8, 2013), ECF No. 487; and Order Authorizing and Approving Amendment to the Retention and Employment of Rothschild Inc. as Financial Advisor and Investment Banker to the Debtors, *In re* AMR Corp., Case No. 11-15463 (Bankr. D. Del. May 24, 2013), ECF No. 8290.

[109]The Blackstone Protocol is not an exception permitting or prohibiting defense fees. Instead, it permits a full § 330(a) review despite retention under § 328. The effect of this may be to enable a bankruptcy court, at the behest of the UST, to subject previously court-approved retention agreements to the § 330(a) standard of "service" and benefit to the client, regardless of the terms of the retention. *Cf. In re* River Road Hotel Partners, 536 B.R. 228 (Bankr. N.D. Ill. 2015), *aff'd*, Bletchley Hotel At O'Hare Field LLC v. River Road Hotel Partners LLC, 2016 WL 4146480 (N.D. Ill. Aug. 4, 2016), *appeal filed*, Case No. 16-3432 (7th Cir. Sept. 14, 2016).

[110]*Supra* note 85.

[111]The enormity of the fees reminds the author of what a wise bankruptcy judge described as the first rule of bankruptcy: "Pigs get fat, and hogs get slaughtered." The Fifth Circuit's opinion is more transparent than the Supreme Court's. In denying defense costs, the Fifth Circuit observed: "the huge cost of defending Baker Botts's core fees seems a drastic reduction in absolute terms, but it amounts to only about

labor in the vineyard of large chapter 11 cases (like some lawyers and some bankruptcy judges), the allowance of $120 million in fees, a bonus of $4.1 million, and defense costs of $5 million may seem both reasonable and appropriate; after all, it was undisputed that the ASARCO bankruptcy case was long, complex, and intensely litigated, and, through the efforts of its professionals, yielded an extraordinary result for creditors.[112] Yet to many who do not labor in that vineyard (like appellate judges), the size of the professional fees is breathtaking and may seem outside the realm of reasonableness.[113] One cannot help but wonder if the Supreme Court's decision was an attempt to rein in professional fees[114] and to restrict the ability of bankruptcy judges to construe the Bankruptcy Code too broadly.[115] The Fifth Circuit's opinion (more so than the Supreme Court's) reflects an undercurrent of skepticism of bankruptcy professionals. In response to the argument that denying defense costs would invite fee objections, the Fifth Circuit stated: "This court . . . observed years ago that, '[t]oo frequently, court-appointed counsel for debtor[s] and the official creditor committees' interests in a case, sharing the mutual goal of securing approval for their fees, enter into a conspiracy of silence with regard to contesting each other's fee applications.'"[116] You reap what you sow: perhaps *Baker Botts* represents the harvest of the crops sown by bankruptcy professionals.

In sum, since *Baker Botts* is Supreme Court precedent, it is difficult to overlook the Court's fee-shifting rationale and skepticism about the benefit of fee-defense compensation. Still, there are opportunities for lower courts to distinguish *Baker Botts* or to limit it to what it actually decided. We should not expect either the Supreme Court or Congress to lead us out of this situation. The Court is unlikely to take up another bankruptcy fee case for some time, and the prospect of a legislative solution (which seems to be the only

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4.4% of the core fee. Whether a deduction of this percentage renders the core fee non-comparable to charges by equally skilled practitioners in other types of legal practice is in the eye of the beholder." *In re* ASARCO LLC, 751 F.3d 291, 301 (5th Cir. 2014).

[112]The Bankruptcy Judge described the services provided by counsel as "extraordinary" and "instrumental in producing the exceptional results that were unanticipated at case commencement." *In re* ASARCO LLC, 2011 WL 2974957 (Bankr. S.D. Tex. July 20, 2011) at *3-4.

[113]Note the Fifth Circuit's comment, only two sentences into its opinion, regarding the allowed fees of ASARCO's counsel: "The firms were *well compensated*. . . for their fees and expenses for representing ASARCO." *ASARCO, LLC*, 751 F.3d at 293 (emphasis added).

[114]The Fifth Circuit warned that "[l]itigation of professionals' fee applications may become substantial, costly and time-consuming if counsel can be compensated for their self-interested efforts." *ASARCO LLC*, 751 F.3d at 300 (5th Cir. 2014). "The perverse incentives that could arise from paying the bankruptcy professionals to engage in satellite fee litigation are easy to conceive." *Id.* at 301.

[115]"Congress has not granted us 'roving authority . . . to allow counsel fees . . . whenever [we] might deem them warranted." Baker Botts, L.L.P. v. ASARCO, LLC, 135 S.Ct. 2158, 2169 (2015).

[116]*ASARCO LLC*, 751 F.3d at 302 quoting *In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1255 (5th Cir. 1986).

feasible way out) seems even less likely. It is possible (perhaps even probable) that *Boomerang* will gain traction among other courts. For now, however, it remains a live issue whether bankruptcy professionals, in reliance on the contract exception recognized by *Baker Botts*, can seek indemnification or compensation for defense costs in their retention agreements under § 328(a).