SUPREME COURT HEARS ARGUMENT ON RECOVERY OF DEFENSE FEES

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Today, the Supreme Court heard oral argument in the case of *Baker Botts L.L.P., et al. v. Asarco, LLC*. The issue before the Court is whether bankruptcy judges have discretion under section 330(a) of the Bankruptcy Code to award compensation for fees and costs incurred by counsel to defend their fee applications in bankruptcy court. Based largely on a textual analysis of section 330 of the Bankruptcy Code, the Fifth Circuit held that bankruptcy judges do not have such discretion, and established a *per se* rule prohibiting such awards. *ASARCO, L.L.C. v. Jordan Hyden Womble Culbreth & Holzer, P.C. (In re ASARCO, L.L.C.)*, 751 F.3d 291 (5th Cir. 2014). By contrast, the Ninth Circuit held in *In re Smith,* 317 F.3d 918, 929 (9th Cir. 2002) that bankruptcy courts do have discretion to award defense fees in appropriate circumstances. Understandably, the high Court's resolution of this split in authority among the Courts of Appeal is a matter of great interest to all bankruptcy professionals.

Fifth Circuit Decision

On April 30, 2014, the Fifth Circuit Court of Appeals upheld a core fee award of more than $120 million plus a fee enhancement in excess of $4 million to Baker Botts and its co-counsel, Jordan Hyden, for the law firms' work as counsel to the debtor in Asarco's chapter 11 case. During the course of the bankruptcy case, the law firms prosecuted complex fraudulent transfer claims against Asarco's parent company to recover a controlling interest in the debtor's former subsidiary, valued at between $7 and $10 billion, which the parent had directed Asarco to transfer to the parent despite Asarco's financial distress. After confirmation of a reorganization plan that resulted in full payment to unsecured creditors, a lengthy and complex fee dispute ensued between the law firms and the debtor (now once again controlled by the parent) in which the firms incurred an additional $5 million in fees and costs defending their fee applications. After both the bankruptcy court and the district court approved payment of the firms' core fees, fee enhancements and defense fees, the Fifth Circuit reversed with respect to the defense fees,[1] holding such fees are not authorized under section 330 of the Bankruptcy Code. The Court first acknowledged that sections 330(a)(3) and (a)(4) of the Bankruptcy Code authorize an award of

[1] On appeal to the Fifth Circuit, Asarco abandoned its challenges to the core fee award and contested only the fee enhancement and defense fee awards.

professional fees only for services that are likely to benefit a debtor's estate or are necessary to case administration. Yet, the Fifth Circuit concluded that the primary beneficiary of defense fees is the professional seeking them, not the estate or its creditors who bear the cost of such fees, and therefore, defense fees do not satisfy the requirements of the statute. Commentators have suggested that the Court improperly conflated the concepts of benefit and necessity to case administration, and that under a correct reading of the statute, either would suffice – both are not required. The appellate court also determined that section 330(a)(6) – which addresses the amount of compensation to be paid if fees are awarded for preparing a fee application – cannot be read to authorize fees for litigating a fee application. The Court rejected the law firm's efforts to compare fee awards under the Bankruptcy Code to federal fee shifting statutes, where courts have routinely permitted defense costs to defend a core fee award, stating that "[i]n bankruptcy, the equities are quite different." Notwithstanding the parity principles codified in section 330(a)(3)(F) of the Bankruptcy Code, the court was similarly unpersuaded that potential dilution of the hourly rates paid to bankruptcy attorneys provided sufficient justification to deviate from the American Rule that each party must bear its own costs. Noting that "the claim for compatibility is easily made but difficult to analyze," the Court declined to engage in fee-shifting absent specific statutory guidance directing such a result. Finally, in response to arguments that its opinion could be read to allow "tactical or ill-supported objections to fee applications," the Fifth Circuit explained that "[w]here appropriate, the courts should not hesitate to implement the exception to the American Rule that allows fee shifting where an adverse party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons."

Petitioners' Argument and Amici

In their brief, Petitioners argued that the Fifth Circuit erred by failing to consider the broad discretion granted to bankruptcy courts to determine whether fees are reasonable and necessary, by failing to acknowledge that resolution of fee disputes contributes to the administration of a bankruptcy case and by focusing on, and then narrowly defining, benefit to the estate. According to Petitioners, Section 330(a)(3) authorizes an award of reasonable fees subject only to carefully crafted limitations set out in Section 330(a)(4), which prohibits compensation only for services that are duplicative, or were not reasonably likely to benefit the estate ***or*** were not necessary to the administration of the case. Defending against an objection to their fees was necessary to case administration and also benefitted the estate, the Petitioners argued, because the administration of a bankruptcy case cannot be completed and creditors cannot be paid until the bankruptcy court enters an order allowing compensation, which requires both considering a fee application and resolving litigation over any objections. Petitioners argued defense fees also benefit the estate on a general level by ensuring parity with non-bankruptcy counsel and high quality legal representation in bankruptcy cases. According to the Petitioners, the Fifth Circuit misinterpreted Section 330(a)(6) to authorize compensation only for preparing a fee application and not defending a fee objection. They argued that section 330(a)(6) is not an authorizing provision at all, but rather a narrow limitation on the amount of compensation a court can award with respect to one specific type of services only: the preparation of fee applications. That fee defense services are not mentioned in that subsection means only that such services are not subject to the same restriction on payment as fee preparation services. Finally the Petitioners argued that the Fifth Circuit's decision departs from a long line of decisions in fee shifting cases authorizing

defense fees to protect core fee awards against dilution, and that by forcing professionals to bear all defense costs, the decision would encourage meritless objections as a tactic.

Nine[2] amicus briefs were filed in support of Petitioners or reversal of the Fifth Circuit's ruling. Many of the amici stressed that a *per se* rule prohibiting defense fees would dilute compensation in contravention of the parity policies of the Bankruptcy Code, and would encourage meritless fee disputes. Others focused on the textual arguments advanced by the Petitioners. Two amici advocated in favor of allowing the bankruptcy courts discretion to award defense fees, but only in cases where counsel substantially prevails in the compensation dispute.

Respondent's Arguments and Amicus

In its brief, Asarco contended that fees for defending an objection to a fee application – a concept that it dubbed "fees on fees" - are not authorized under section 330. Focusing specifically on the interplay between sections 330 and 327, Asarco argued that the latter section only authorized employment to "represent or assist the trustee in carrying out the trustee's duties" and that the former section only authorizes reasonable compensation for actual and necessary services under section 327(a). Asarco contended that defense fees do not qualify as representing or assisting the trustee in carrying out his duties and, consequently, are not permitted under § 330. Asarco also argued that because sections 327 and 330 apply to all professionals, reading them to allow an attorney to recover fees for litigating a fee dispute would place other professionals at an unfair disadvantage, because they presumably would be required to bear the cost of engaging outside counsel to defend their fee applications. Asarco further argued that nothing in section 330, including the general authorization to award reasonable compensation, overrides the presumption of the American Rule. Asarco then pointed to specific provisions of § 330 that it contended prohibit an award of defense fees. According to Asarco, defense fees are neither (i) reasonably likely to benefit the debtor's estate; nor (ii) necessary to the administration of the case and therefore must be disallowed under section 330(a)(4). In addition, Respondent argued that section 330(a)(6) of the Bankruptcy Code allows compensation "for the preparation of a fee application [ ] based upon the level of skill reasonably required to prepare the application." According to Asarco, this section confirmed that only fee application preparation is compensable and, the omission of any reference to fee litigation, indicates Congress' intent to exclude such services from section 330. The rule posited by Asarco would, in its view, place bankruptcy attorneys on similar footing as non-bankruptcy attorneys who must typically bear the cost of defending their fees if challenged.

Respondent's arguments were supported by a group of law professors advancing similar arguments. The amici placed additional emphasis on the legislative history behind § 330(a)(6), stating that the provision was added to resolve a split in authority among bankruptcy courts as to whether fees for preparation of fee applications and/or defense of objections were compensable. According to the amici, Congress conclusively resolved the split by expressly authorizing some (albeit limited) compensation for fee preparation while declining to authorize any compensation for fee defense. Thus, the amici posit, *expressio unius est exlcusio alterius* requires an interpretation that excludes fee defense from that subsection. Respondent's amici also argued that

[2] One amicus styled its brief in support of neither party, but argued in favor of allowing defense fees if the core award is substantially upheld.

allowing fees for defense of objections would dilute the recoveries for priority and unsecured creditors, making plan confirmation more difficult.

Argument at the Supreme Court

At argument, the Court appeared divided as to whether fees incurred defending objections to fee applications are compensable. In addressing Petitioners' arguments, Justice Roberts, focused on the American Rule and queried whether an intended departure from that rule would not be expressly spelled out in the Code. Other Justices focused on statutory construction, whether the fee defense could fall within the ambit of case administration, and whether other court appointed professionals might be at a disadvantage if only bankruptcy counsel were authorized to recover their fees for defending objections to fee applications.

The Assistant to the Solicitor General, arguing for the Office of the United States Trustee, urged a rule vesting bankruptcy courts with discretion to award defense fees, but only in the case of a successful defense. Justice Breyer asked whether fee defense falls within the ambit of case administration, and if not, what statutory authority supported an award of such fees. Questions from other Justices explored whether sanctions for frivolous objections could ensure the same result as awarding defense fees, and also if the risk of fee litigation was built into attorney's rates.

Justice Ginsburg asked counsel for Respondent inquired whether fee preparation, objections and ensuing litigation were part of a single process, similar to a complaint, answer and trial. Justice Kagen explored whether defense fees are analogous to enhancement factors considered in determining a reasonable fee award, much like factoring the cost of additional labor or expense into the price for a particular service. Inquiry then moved to comparisons to fee shifting statutes, their similarities to and differences from the Bankruptcy Code. Ultimately, it was not possible to ascertain whether there is a consensus among the Justices on the issue of defense fee awards. A decision is expected by the end of June, 2015.