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## Fees-on-Fees Retention Provisions Might Be Circling Back This Way

On Sept. 20, 2017, for the first time post-*ASARCO*,<sup>1</sup> a bankruptcy court approved<sup>2</sup> a “fees-on-fees” retention provision for an estate professional.<sup>3</sup> In so ruling, the *Hungry Horse* court ruled contrary to *Boomerang*<sup>4</sup> — which it stated is the “leading post-*ASARCO*” decision — and offered guidance for drafting fees-on-fees provisions.



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### ASARCO: Section 330(a)(1) Does Not Provide for Fees on Fees

In *ASARCO*, the U.S. Supreme Court previously ruled that attorneys for a debtor in possession (DIP) are not entitled to recover their fees for successfully defending their fee applications — from the DIP's objection — because such a defense did not fall within the American Rule.<sup>5</sup> The Court explained that the American Rule requires that “[e]ach litigant pays his own attorney's fees, win or lose,” and thus prevents parties from recovering their fees “unless a statute or contract provides otherwise.”<sup>6</sup> While it acknowledged the “contract” exception to the American Rule in passing, the Court's discussion focused exclusively on the “statutory” exception given that the law firm in that case did not have a “fees-on-fees” provision in its engagement letter. The Court's conclusion — that the case does not fall within the American Rule because § 330(a)(1) of the Bankruptcy Code “does not explicitly override the American Rule with respect to fee defense litigation” — does not even mention the contract exception.<sup>7</sup>

### Boomerang: Parties Cannot “Contract Around” ASARCO

In *Boomerang*, the U.S. Bankruptcy Court for the District of Delaware applied *ASARCO* and ruled that fees-on-fees provisions are impermissible because “retention agreements are not contractual exceptions to the American Rule.”<sup>8</sup> In the alternative, the *Boomerang* court determined that

fees-on-fees provisions in retention agreements are not “reasonable term[s] and condition[s] of employment” for purposes of § 328(a) of the Bankruptcy Code.<sup>9</sup> According to the court, *dicta* from *ASARCO* “prevents courts from concluding that Section 328 permits defense fees even if they were routinely allowed by the market in bankruptcy or nonbankruptcy contexts prior to the ruling.”<sup>10</sup>

### Hungry Horse: Parties Can “Contract Around” ASARCO

In *Hungry Horse*, the court acknowledged *Boomerang* as the “leading post-*ASARCO*” decision on the permissibility of fees-on-fees provisions,<sup>11</sup> but it nonetheless came to an opposite conclusion. The court framed the issue as being “whether *ASARCO* prevents the Court from approving a fee-defense provision in a retention agreement as a ‘reasonable term and condition’ under § 328(a),” and concluded that it does not.<sup>12</sup>

The court observed that *ASARCO* involves § 330(a)(1) — not § 328(a) — because the bankruptcy court had not already approved a fees-on-fees provision.<sup>13</sup> The court further observed that “[n]othing in the Code says that an employment term must benefit the estate [in order] to be reasonable.”<sup>14</sup> According to *Hungry Horse*, courts should determine whether a provision is a “reasonable term and condition of employment” under § 328(a) based on all of the terms of the contract.<sup>15</sup> The *Hungry Horse* court concluded that a “properly drafted fee-defense provision could be a reasonable term” under § 328(a).<sup>16</sup>

### Hungry Horse: Guidance for Drafting Fees-on-Fees Provisions

In *Hungry Horse*, the court reasoned that such a “properly drafted fee-defense provision” for counsel for the DIP should incorporate the following four concepts:

- Be agreed to by the bankruptcy estate (thus avoiding the problem addressed in *Boomerang*);<sup>17</sup>

1 See *Baker Botts LLP v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

2 Technically, the court did not approve the provision, but it made it pretty clear that it intends to do so given that — as discussed herein — the court included a model fees-on-fees provision.

3 See *In re Hungry Horse LLC*, 574 B.R. 740, 747-48 (Bankr. D.N.M. 2017).

4 See *In re Boomerang Tube Inc.*, 548 B.R. 69, 79 (Bankr. D. Del. 2016).

5 See *ASARCO*, 135 S. Ct. at 2164.

6 *Id.*

7 *Id.* at 2169.

8 See *Boomerang*, 548 B.R. at 74-75.

9 *Id.* at 75.

10 *Id.* at 78.

11 See *Hungry Horse*, 574 B.R. at 744.

12 *Id.* at 747.

13 *Id.*

14 *Id.*

15 *Id.* (comparing what client is giving to what it is getting in return).

16 *Id.* at 748.

- Allow the bankruptcy court to review and approve the reasonableness of any fees sought for a fee defense;
- Provide that the estate will also agree to a similar provision for committee counsel;<sup>18</sup> and
- Provide that no fees will be allowed for unsuccessful fee-defense work.<sup>19</sup>

The court incorporated such concepts and offered a model fees-on-fees provision for counsel for a DIP:

Fee Defense. The Client agrees to pay all reasonable legal fees and expenses incurred by the Firm, and also by any counsel retained by the unsecured creditors' committee (if one is formed in the Client's bankruptcy case) for successfully defending their respective fee applications. The bankruptcy court must approve all of such fees as reasonable. The Client will have no obligation to pay for any fees or expenses the Firm incurs defending fees that are not allowed.<sup>20</sup>

Given the estate-consent issues, such a provision would not work if it were for counsel for the official committee of unsecured creditors. Although the *Hungry Horse* court does not address the issue, estate professionals seeking approval of fees-on-fees provisions under § 328(a) — or any other § 328(a) approval, for that matter — should ensure that the proposed order satisfies their jurisdiction's standards for a § 328(a) approval order.<sup>21</sup> These standards can vary greatly among circuits.<sup>22</sup>

In addition, any carve-out allowing for review under § 330 might have the effect of making the fees-on-fees provision unenforceable.<sup>23</sup> For example, if an investment banker agrees to the Blackstone protocol, which gives the U.S. Trustee (but no other parties) the right to object under § 330 of the Bankruptcy Code,<sup>24</sup> then the fees-on-fees provision might be unenforceable unless such right is limited and does not include “fees on fees.”<sup>25</sup>

## How Persuasive Is *Boomerang*?

Although *Hungry Horse* stated that *Boomerang* is the “leading post-ASARCO” decision, it is not at all clear whether *Boomerang* is persuasive outside of Delaware. While some courts favorably cite *Boomerang* and all of the Delaware

bankruptcy judges appear to follow it,<sup>26</sup> no court outside of Delaware has ever cited *Boomerang* for the proposition that an estate professional retention agreement containing a “fees on fees” provision cannot be approved under § 328(a). As of Nov. 15, 2017, there have been four decisions other than *Hungry Horse* that cite *Boomerang*, and only three involve estate professionals.<sup>27</sup> In all three of these decisions, the court was deciding whether to approve the estate professionals' fee — and not a retention — application.<sup>28</sup>

### Capitol Litho

In the first case, a commercial real estate broker sought reimbursement of its attorneys' fees/expenses based on a court-approved agreement that contains a purported fees-on-fees agreement. However, the order states that the real estate broker is entitled to reimbursement under § 330(a)(1)(B) and does not mention § 328(a).<sup>30</sup> So the decision does not implement § 328(a) and is consistent with *Bletchley Hotel*.<sup>31</sup>

### Community Home Financial

In the second case, the chapter 11 trustee's counsel sought to be compensated on an interim basis for its defense of the trustee fees. The court disallowed such fees given that “*Boomerang* found that ASARCO applied regardless of whether the retained professional defended its own fees or the professional hired outside counsel.”<sup>32</sup>

### Rose

In the third case, the lawyer for a chapter 13 debtor sought compensation for its defense fees based on a purported fees-on-fees provision in a retention agreement between the lawyer and the chapter 13 debtor that was never approved by the court. He based such “requested relief” on “section 330(a) and section 503.”<sup>33</sup> For this reason, the court concluded that it does not need to decide “whether a contractual exception to the American Rule might apply in other contexts.”<sup>34</sup> The *Rose* court makes it very clear that it does not reach the critical issue in *Boomerang*: whether a provision in an estate professional's retention agreement can provide for the payment of “fees on fees” pursuant to a court approval under § 328(a).

## Conclusion

It is difficult to predict whether bankruptcy courts around the nation will follow *Hungry Horse*. Given the fees that will be at stake, however, it is not difficult to predict that the issue of “fees on fees” is not going away anytime soon. **abi**

17 The court is referred to one of the reasons that the *Boomerang* court concluded that the committee counsel's retention agreement was not a contractual exception to the American Rule: The estate did not consent. See *Boomerang*, 548 B.R. at 74-75. However, the court was forthright that the foregoing was *dicta*. *Id.* at n.6 (noting that it would come to same conclusion for “any professional” seeking approval of similar retention order under § 328).

18 The court observed that such a provision is necessary to “level the playing field” because it would otherwise “often be tilted against committee counsel.” See *Hungry Horse*, 574 B.R. at n.3.

19 *Hungry Horse*, 574 B.R. at 748.

20 *Id.*

21 See 3 *Collier on Bankr.* ¶ 328.01 (Alan N. Resnick & Henry J. Sommers eds., 16th ed.) (explaining different standards applied by four different circuit courts to address whether order was approved under § 328(a)).

22 For example, in the Southern District of New York, the standard for whether an order approves a retention agreement under § 328(a) is much less strict than it is in the District of Delaware. Compare *Zolfo, Cooper & Co. v. Sunbeam-Oster Co.*, 50 F.3d 253, 261-62 (3d Cir. 1995) (requiring that orders “expressly and unambiguously state specific terms and conditions (e.g., specific hourly rates or contingency fee arrangements) that are being approved pursuant to the first sentence of section 328(a)”), with *Riker, Danzig, Scherer, Hyland & Peretti v. Official Comm. of Unsecured Creditors (In re Smart World Techs. LLC)*, 552 F.3d 228, 233 (2d Cir. 2009) (adopting “totality-of-the-circumstances” test).

23 See, e.g., *Bletchley Hotel at O'Hare Field LLC v. River Road Hotel Partners LLC*, No. 15 C 8063, 2016 WL 4146480, at \*4 (N.D. Ill. Aug. 4, 2016), appeal dismissed *sub nom.*, *In re River Rd. Hotel Partners LLC*, No. 16-3343, 2017 WL 4003683 (7th Cir. Aug. 10, 2017) (finding that court-approved fees-on-fees retention provision was unenforceable and controlled by ASARCO because approval order expressly stated that reimbursement of financial advisor's out-of-pocket expenses would be “subject to further review and approval by the Court pursuant to section 330”).

24 See *In re Relativity Fashion LLC*, No. 15-11989 (MEW), 2016 WL 8607005, at \*6 (Bankr. S.D.N.Y. Dec. 16, 2016) (explaining Blackstone protocol).

25 See *Bletchley Hotel*, 2016 WL 4146480, at \*4.

26 See, e.g., Letter from Hon. Christopher S. Sontchi to Counsel, *In re Samson Res. Corp.*, No. 15-11934, ECF No. 641 (Bankr. D. Del. Feb. 8, 2016); Letter from Hon. Brendan Linehan Shannon to Counsel, *In re New Gulf Res. LLC*, No. 15-12566, ECF No. 228 (Bankr. D. Del. Feb. 1, 2016).

27 One of the decisions involved the attorneys' fees of an indenture trustee. See *In re Nortel Networks Inc.*, No. 09-10138(KG), 2017 WL 932947, at \*9 (Bankr. D. Del. March 8, 2017) (“Indenture Trustee and its lawyers are therefore awarded their fees for the fee dispute” given that “Indenture is clearly outside the circumstances of ASARCO and *Boomerang*”).

28 See *In re Capitol Litho Printing Corp.*, 573 B.R. 771 (Bankr. D. Ariz. 2017); *In re Cmty. Home Fin. Servs. Inc.*, No. 12-01703-NP01, 2017 WL 1753224 (Bankr. S.D. Miss. May 3, 2017); *In re Rose*, 561 B.R. 70 (Bankr. W.D. Mich. 2016).

30 *Capitol Litho*, 573 B.R. at 776.

31 See *Bletchley Hotel*, 2016 WL 4146480, \*4 (finding that court-approved retention fees-on-fees provision was unenforceable and controlled by ASARCO because approval order expressly stated that reimbursement of financial advisor's out-of-pocket expenses would be “subject to further review and approval by the Court pursuant to section 330”).

32 See *Cmty. Home Fin. Servs. Inc.*, 2017 WL 1753224, at \*19.

33 See *Rose*, 561 B.R. at n.5.

34 *Id.*